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U.S. DEPARTMENT OF THE TREASURY

PRESS RELEASES

federal financing bank NEWS
WASHINGTON, D.C. 20220

Press 566-2041
FFB 566-2468

FOR IMMEDIATE RELEASE May 8, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of November 1988.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $143.3 billion on November 30, 1988, posting a decrease of $2.2 billion from the level on October 31, 1988. This net change was the result of an increase in holdings of agency debt of $104.1 million, and decreases in holdings of agency assets of $68.5 million and in agency-guaranteed debt of $2,244.1 million. FFB made 35 disbursements during November.

The Continuing Appropriations Resolution for 1988 allowed FFB borrowers under foreign military sales (FMS) guarantees to prepay at par their debt with interest rates of 10 percent or higher. Pursuant to this Resolution, FFB received FMS prepayments of $2,180 million in November 1988. FFB suffered an associated loss of $341.8 million.

Attached to this release are tables presenting FFB November loan activity and FFB holdings as of November 30, 1988.

NB-254

FEDERAL FINANCING BANK

NOVEMBER 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 #476	11/8	$ 33,990,000.00	2/09/89	7.887%	
+Note #477	11/17	9,212,000.00	2/21/89	8.354%	
+Note #478	11/29	45,000,000.00	2/27/89	8.393%	
TENNESSEE VALLEY AUTHORITY					
Advance #959	11/7	116,000,000.00	11/15/88	7.817%	
Advance #960	11/9	103,000,000.00	11/21/88	7.971%	
Advance #961	11/15	131,000,000.00	11/23/88	8.162%	
Advance #962	11/21	84,000,000.00	11/28/88	8.333%	
Advance #963	11/23	10,000,000.00	12/01/88	8.402%	
Advance #964	11/23	107,000,000.00	12/02/88	8.402%	
Advance #965	11/28	96,000,000.00	12/05/88	8.428%	
Advance #966	11/30	138,000,000.00	12/07/88	8.393%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Morocco 9	11/2	475,501.64	9/30/93	8.505%	
Morocco 11	11/2	136,849.90	9/08/95	8.665%	
Morocco 13	11/2	1,179,715.49	11/30/93	8.513%	
Morocco 13	11/18	4,929,757.65	11/30/94	9.044%	
Morocco 9	11/21	357,038.73	9/30/93	9.034%	
Greece 16	11/22	20,891,316.32	3/01/12	9.220%	
Greece 17	11/22	2,696,664.06	8/25/11	9.220%	
Greece 16	11/23	874,521.71	3/01/12	9.241%	
Peru 10	11/23	983,384.02	4/10/96	9.166%	
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development					
*Lincoln, NE	11/1	406,000.00	11/01/94	8.482%	8.662% ann.
Lincoln, NE	11/4	30,000.00	10/02/89	8.176%	8.327% ann.
Brownsville, TX	11/4	657,000.00	9/01/89	8.151%	8.281% ann.
Montgomery County, PA	11/4	200,000.00	1/17/89	7.769%	
Newport News, VA	11/17	10,000.00	2/15/89	8.340%	

+rollover
*maturity extension

FEDERAL FINANCING BANK

NOVEMBER 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION					
New Hampshire Electric #270	11/2	$ 659,000.00	1/02/18	8.858%	8.762% qtr.
*United Power #139	11/2	2,900,000.00	12/31/15	8.850%	8.754% qtr.
*Colorado Ute-Electric #96A	11/7	1,133,000.00	12/31/90	8.539%	8.450% qtr.
*Colorado Ute-Electric #203A	11/10	1,090,000.00	12/31/90	8.700%	8.607% qtr.
*Wolverine Power #183A	11/10	3,447,000.00	1/02/90	8.522%	8.433% qtr.
*Cajun Electric #197A	11/14	40,000,000.00	12/31/90	8.734%	8.641% qtr.
Basin Electric #232	11/22	514,000.00	1/03/23	9.222%	9.118% qtr.
N. Dakota Central Elec. #278	11/30	107,000.00	1/03/17	9.244%	9.140% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Long Island Dev. Corp.	11/9	232,000.00	11/01/08	9.037%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-02	11/30	689,681,516.11	2/28/89	8.398%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	November 30, 1988	October 31, 1988	Net Change 11/1/88-11/30/88	FY '89 Net Change 10/1/88-11/30/88
Agency Debt:				
Export-Import Bank	$ 10,957.6	$ 10,957.6	$ -0-	$ -0-
NCUA-Central Liquidity Facility	106.9	120.9	-13.9	-11.2
Tennessee Valley Authority	16,876.0	16,758.0	118.0	-255.0
U.S. Postal Service	5,592.2	5,592.2	-0-	-0-
sub-total*	33,532.7	33,428.7	104.1	-266.2
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	96.3	96.4	-0.1	-0.1
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,071.2	4,139.2	-68.0	-68.0
Small Business Administration	14.7	15.1	-0.4	-0.7
sub-total*	62,757.7	62,826.2	-68.5	-68.8
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	13,452.9	15,658.9	-2,206.0	-2,558.8
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	49.6	50.0	-0.4	-0.4
DHUD-Community Dev. Block Grant	315.3	316.2	-0.9	-2.7
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	2,037.0	-41.7	-41.7
General Services Administration +	386.5	387.5	-0.9	-0.9
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	995.2	-0-	96.4
DON-Ship Lease Financing	1,758.9	1,758.9	-0-	-0-
Rural Electrification Administration	19,220.5	19,221.7	-1.2	15.2
SBA-Small Business Investment Cos.	607.6	614.2	-6.6	-25.1
SBA-State/Local Development Cos.	864.2	866.7	-2.4	-6.7
TVA-Seven States Energy Corp.	2,195.0	2,176.3	18.6	32.6
DOT-Section 511	43.6	46.2	-2.6	-2.6
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	47,030.3	49,274.4	-2,244.1	-2,494.7
grand total*	$ 143,320.8	$ 145,529.3	$ -2,208.5	$ -2,829.7

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

TREASURY NEWS

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

Contact: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
May 8, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 6,803 million of 13-week bills and for $ 6,808 million of 26-week bills, both to be issued on May 11, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 10, 1989			:	26-week bills maturing November 9, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.38%	8.68%	97.882	:	8.37%	8.86%	95.769
High	8.42%	8.72%	97.872	:	8.40%	8.90%	95.753
Average	8.41%	8.71%	97.874	:	8.39%	8.88%	95.758

Tenders at the high discount rate for the 13-week bills were allotted 1%.
Tenders at the high discount rate for the 26-week bills were allotted 41%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 36,875	$ 36,875	:	$ 33,495	$ 33,495
New York	21,787,765	5,286,375	:	21,029,820	5,266,355
Philadelphia	15,915	15,915	:	14,400	13,220
Cleveland	40,800	40,800	:	33,345	33,345
Richmond	49,315	49,315	:	43,210	43,210
Atlanta	30,195	30,115	:	28,580	28,580
Chicago	996,540	297,540	:	1,692,340	635,640
St. Louis	54,620	34,670	:	35,990	27,990
Minneapolis	10,380	10,380	:	14,405	14,405
Kansas City	30,385	30,385	:	41,695	41,695
Dallas	30,430	20,480	:	26,280	16,280
San Francisco	947,560	393,560	:	923,920	181,420
Treasury	556,845	556,845	:	471,980	471,980
TOTALS	$24,587,625	$6,803,255	:	$24,389,460	$6,807,615
Type					
Competitive	$21,004,385	$3,220,015	:	$19,875,010	$2,293,165
Noncompetitive	1,289,265	1,289,265	:	1,042,210	1,042,210
Subtotal, Public	$22,293,650	$4,509,280	:	$20,917,220	$3,335,375
Federal Reserve	2,268,515	2,268,515	:	2,000,000	2,000,000
Foreign Official Institutions	25,460	25,460	:	1,472,240	1,472,240
TOTALS	$24,587,625	$6,803,255	:	$24,389,460	$6,807,615

An additional $4,340 thousand of 13-week bills and an additional $ 260,360 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

NB-255

TREASURY NEWS

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

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For Release Upon Delivery
Expected at 9:30 a.m.
May 9, 1989

STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
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 nondiscrimination and qualification rules applicable to certain employee benefit plans under section 89 of the Internal Revenue Code. As we have testified before other Congressional committees, the Administration believes that section 89 is overly complex and imposes undue compliance burdens on employers. We are pleased that Congress is promptly addressing these problems, and the Treasury Department looks forward to assisting Congress in developing an adequate legislative solution. To facilitate the legislative process, the Treasury Department and the Internal Revenue Service last week announced additional transitional relief provisions that are designed to provide Congress with sufficient opportunity to develop legislation before employers are required to expend substantial further resources to comply with the statute.

In the first part of my testimony, I will describe briefly the provisions of section 89 and the policy rationale underlying those provisions, the transitional relief treatment under the regulations, and certain proposed legislative replacements of section 89. I will then discuss the core issues the Administration believes must be addressed in fashioning any new legislation. Finally, I will conclude by summarizing the Administration's position on the revision of section 89.

Background

A. Statute.

The Internal Revenue Code provides that certain employer-provided benefits are excludable from the gross income of employees. For example, employer-provided health coverage and benefits are excludable under sections 105 and 106, employer-provided group-term life insurance is excludable under section 79 and employer-provided dependent care assistance is excludable under section 129.

Section 89 provides that health coverage and group-term life insurance may be excluded from the income of highly compensated employees only to the extent that the coverage and insurance is provided on a basis that does not discriminate in favor of highly compensated employees within the meaning of certain statutorily imposed nondiscrimination tests. In addition, employers may elect to test their dependent care assistance programs under the nondiscrimination rules of section 89. The rationale for limiting the income exclusions is that the tax expenditures are justified only if nonhighly compensated employees are provided benefits that are comparable to the benefits provided to highly compensated employees. In enacting section 89 and other employee benefit nondiscrimination rules in 1986, Congress was concerned that the prior law nondiscrimination rules did not require sufficient coverage of nonhighly compensated employees as a condition of the exclusions. The President's 1990 budget reports that the revenue loss tax expenditure in 1990 for employer-provided health coverage will be $29.6 billion, for group-term life insurance, $2.2 billion, and for dependent care assistance, $155 million.

Under section 89 an employer may choose to determine whether a plan satisfies the nondiscrimination rules under one of two testing methods. Under the first method, a plan satisfies the rules if it satisfies three eligibility tests and a benefits test. The first eligibility test is that at least 50 percent of the plan participants must be nonhighly compensated. 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 any highly compensated employee. The third eligibility test is that the plan may not contain any provision relating to eligibility that, by its terms or otherwise, discriminates in favor of highly compensated employees. This test is intended to address those instances of discrimination that are not quantifiable, such as whether benefits are, in fact, available to nonhighly compensated employees and whether more favorable eligibility waiting periods are provided to highly compensated employees. The benefits test is satisfied if the average value of all employer-provided health coverage received by nonhighly compensated employees is at least 75 percent of the average value of employer-provided health benefits received by highly compensated employees.

Under the second testing method, a plan satisfies the nondiscrimination rules if it benefits 80 percent of the employer's nonhighly compensated employees and if it does not contain, by its terms or otherwise, any discriminatory provision.

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; or (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 are indexed for inflation.

When testing its plans, an employer generally may exclude those employees 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.

B. Transition Rules Under the Proposed Regulations.

In the proposed regulations promulgated in March of this year, the Treasury Department and the Internal Revenue Service attempted to be very flexible in implementing section 89 so that employers could more easily bring their plans into compliance. The proposed regulations provide several transitional provisions that apply in 1989. First, the 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, 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. Finally, employers may generally ignore facts in existence prior to July 1, 1989 when testing their plans for compliance in 1989. Employers who chose to take advantage of this relief merely annualize the benefits provided after July 1 to determine whether their plans are discriminatory.

On May 1, 1989, Secretary of the Treasury Nicholas F. Brady announced the July 1, 1989 optional beginning date of the 1989

testing year provided in the proposed regulations would be changed to October 1, 1989. On May 5, 1989, the Internal Revenue Service published Notice 89-65 implementing the October 1 testing period commencement and announcing that the July 1, 1989 deadline for providing eligible employees reasonable notice of benefits available under certain plans is postponed until October 1, 1989.

C. Proposed Legislation.

In response to the perceived problems with section 89, several bills have been introduced in the Senate and House of Representatives. S. 654, introduced by Senator Pryor and others on March 17, 1989, would modify section 89 in several ways. First, it would provide that an employer would not be required to test its health plan under section 89 if the plan qualified as a simplified health arrangement, which generally is a plan in which 90 percent of the employees are eligible to participate and the cost to the employees does not exceed certain defined maximums. In addition, the definition of part-time employee would be changed to an employee generally working 25 hours or less, with a phase-in of 30 hours in 1989 and 27.5 in 1990. The treatment of family coverage, employee cost comparability, valuation of benefits, and testing dates would also be modified. Finally, the sanction for failure to meet the qualification requirements would be modified so that only highly compensated employees would be required to include in income the value of coverage.

S. 595, introduced by Senator Domenici and others on March 15, 1989, would delay the application of section 89 until plan years beginning after December 31, 1990 and make section 89 inapplicable to any employer who employs less than 20 employees. In addition, the definition of part-time employee is changed to an employee normally working less than 25 hours. Finally, the bill creates an eligibility safe harbor that allows an employer to satisfy section 89 if all of its nonhighly compensated employees are eligible to participate in a plan as valuable as the most valuable plan available to any highly compensated employee, and changes the 80 percent alternative coverage test to a 65 percent coverage test.

S. 89, introduced by Senator Symms and others on January 25, 1989, would delay the effective date of section 89 for one year. S. 350 introduced by Senator Lott and others would repeal section 89.

H.R. 1864, introduced by Congressman Rostenkowski and others on April 13, 1989, would make several changes to section 89. First, the various section 89 nondiscrimination tests would be replaced with one simplified test, under which a plan containing no discriminatory provision would qualify if it meets two requirements: (1) it provides primarily core health coverage to at least 90 percent of the employer's nonhighly compensated employees at a cost of no more than $10 per week for individual coverage and $25 for family coverage; and (2) the maximum amount

of employer-provided coverage of any highly compensated employee is not more than 133 percent of the affordable employer-provided coverage made available to 90 percent of the employees. Second, part-time employees normally working less than 25 hours would not be required to be covered. Third, leased employees could generally be disregarded if the employees are covered under a core health plan meeting the nondiscrimination tests. Fourth, employees covered by a collective bargaining agreement are tested separately. Fifth, officers with compensation not in excess of $45,000 will not be considered highly compensated. Sixth, the nondiscrimination rules in effect prior to the Tax Reform Act of 1986 are made applicable to group-term life insurance. Finally, the present law sanction for failure to qualify is changed to an excise tax on the employer equal to 34 percent of the cost of coverage.

Issues to be Resolved in Legislation

Several aspects of the operation of section 89 have received particular attention in recent weeks, as the process has begun of replacing section 89 with a workable provision. Some of the most important areas of concern are discussed below. Others may arise as the discussion proceeds. Although the issues involved are difficult, we intend to work with Congress to formulate resolutions of all of these issues as soon as practicable. It is imperative that the final statutory solution that is enacted resolve all of the outstanding issues in a satisfactory manner.

A. Nondiscrimination Rules.

The basic objectives of the nondiscrimination tests are the elimination of plans providing tax-favored health benefits only to highly compensated employees and the promotion of coverage of nonhighly compensated employees. These objectives must be achieved by means of workable tests that can be understood by employers and applied without undue expense in a wide variety of circumstances. In this context, employers are confronted with several overriding problems of statutory design, including particularly (i) the problem of valuation of benefits, (ii) the question of which employees may be excluded, (iii) the treatment of salary reduction contributions, and (iv) the special considerations applicable to small businesses.

1. Valuation. The most fundamental problem in determining compliance with section 89 in its current form has been the necessity of reliance upon valuation of benefits. It has become clear that the problems with valuation simply were not understood in 1986 when section 89 was enacted. Valuation has proved to be not only a very complex task, but an expensive one as well. Thus, to be viable, any legislation replacing section 89 must confront the problems posed by reliance upon valuation of benefits.

At a minimum, employers should be assured, under the statute, that an employer's cost may be viewed as the value of the benefit. In addition, the Treasury Department should have the authority to develop other reasonable valuation methods.

More important, it is crucial to replace the current nondiscrimination tests with a test or tests which are to the fullest extent possible "design based," i.e., tests which the employer may be confident it has passed without undertaking a complex valuation of benefits. In this regard, the efforts of Senator Pryor and Congressman Rostenkowski are important first attempts. In the case of both S. 654 and H.R. 1864, the testing for nondiscrimination would, in part, be generally based on the required availability, at affordable costs, of health insurance coverage to 90 percent of the employees.

Three different types of questions are raised with respect to design-based tests of the types included in S. 654 and H.R. 1864. First is the question of the percentage of nonexcludable employees to whom coverage is required to be offered. Both Senator Pryor and Congressman Rostenkowski have required that, generally, 90 percent of nonexcludable employees be offered coverage. Others have suggested that, in the alternative, the nondiscrimination test be based on the relative proportion of highly compensated and nonhighly compensated employees covered. We believe that such an alternative test is worthy of consideration so long as the implementing provision does not sacrifice the underlying policy goal of broadly available affordable health coverage.

The second problem to be considered with a design-based test is the "cliff effect" such a test often has. For example, an employer providing the option of coverage to a group of employees constituting only slightly less than the required percentage, may, in fact, pay a large portion of the cost of providing health coverage to nonhighly compensated employees. It seems inappropriate to impose on such an employer the full sanction for failure to satisfy the test, when another employer actually providing very little health coverage could very well meet the availability tests.

We believe Congress should consider ways of ameliorating the cliff problem. It is important, however, in addressing this problem not to re-introduce statutory complexity and onerous valuation procedures.

The third question is the extent to which it is necessary that a designed-based test be accompanied by an overriding provision limiting the extent to which the employer-provided benefit of highly compensated employees can exceed that provided to or made available to nonhighly compensated employees. H.R. 1864, for example, limits the employer-provided health benefit available to highly compensated employees to 133 percent of that available as a core health benefit to 90 percent of the employees

under the basic plan. Although we recognize that this test would not require full scale valuation because only the employer-provided benefit of highly compensated employees must be valued, we also believe that the administrability and simplicity of the new provision would be improved if valuation requirements could be limited even further.

2. Employees Taken Into Account. If relatively strict, broadly based eligibility tests are included in any new legislation, consideration should be given to expanding the classes of employees who may be excluded from the tests in certain cases. For example, governmental entities and charitable organizations, as well as for-profit entities, sometimes hire handicapped adults for rehabilitation or job-training purposes, for whom insurance companies often will not provide coverage. If these individuals receive health benefits under Medicaid or other governmental programs, perhaps employers should be permitted to consider such individuals as excluded employees.

In addition, we believe it is appropriate to relax the definition of part-time employee. We note that in this regard that several of the bills have adopted a 25-hour standard to replace the 17-1/2 hour standard of current section 89.

3. Salary Reduction Contributions. The Internal Revenue Code generally provides that salary reduction contributions to a health or group-term life insurance plan are employer contributions. For purposes of determining whether at least 90 percent of nonhighly compensated employees have available a benefit at least equal to 50 percent of the benefit available to any highly compensated employee (the 90/50 percent eligibility test), however, an employer may elect to treat salary reduction contributions as employer contributions only if three conditions are satisfied. First, all employees must be eligible to participate in the plan under the same terms and conditions. Second, the percentage of an employer's nonhighly compensated employees eligible to participate cannot exceed the percentage of an employer's highly compensated employees so eligible. Third, no highly compensated employee eligible to make salary reduction contributions may be eligible to participate in any other employer plan of the same type unless the other plan is available on the same terms and conditions to nonhighly compensated employees. If these three conditions are not satisfied, salary reduction contributions are treated as employee contributions for purposes of the 90/50 eligibility test.

The proposed regulations generally provide that, notwithstanding the rules set forth in the previous paragraph, a highly compensated employee's salary reduction contributions used to purchase core health benefits are treated as employer contributions for the purpose of the 90/50 percent eligibility test only to the extent that such contributions exceed other employer contributions made on the employee's behalf for core health coverage. Similarly, core health coverage attributable to

a nonhighly compensated employee's salary reduction contributions are treated as employee contributions to the extent that such contributions exceed employer contributions (excluding salary reduction contributions) made on the employee's behalf to provide core health coverage.

The Administration believes that any new legislation should consider the effect of restrictive rules regarding the treatment of salary reduction contributions on the willingness of employers to maintain cafeteria plans. If it is determined that there are certain types of health expenses that should not be reimbursed or otherwise paid under a cafeteria plan or other flexible spending arrangement, this problem should be addressed directly.

4. Small Business Considerations. The special circumstances faced by small businesses should be addressed in any legislation enacted to revise section 89. The situations of small businesses may differ in several respects from those of other businesses to which section 89 is applicable. First, the relative burden of the costs of determining compliance may be significantly higher. Second, because some small businesses have only a few employees, a small change in the number of employees in the workforce may have a disproportionate impact under the various tests. Third, insurance companies often treat small businesses in ways different than they treat larger employers.

Although we do not support a complete exemption of small businesses from the nondiscrimination rules, the Administration urges Congress to consider proposals that would enable small businesses to comply more easily with the nondiscrimination rules. If new nondiscrimination rules applicable to health benefits are based on cost of coverage, the Administration suggests that Congress consider permitting small businesses to satisfy the nondiscrimination rules under alternative tests. For this purpose, a small business generally would be defined as a business that cannot purchase health insurance at group rates. The Secretary of the Treasury would have the flexibility of further defining this concept through regulations.

We have offered for 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 percent of its nonhighly compensated employees; and (iii) a majority of the nonexcludable, nonhighly compensated employees eligible to participate in the plan actually do so.

In addition, many small businesses have insurance contracts that do not provide coverage for employees working less than 30 hours per week. The Administration believes that any new legislation requiring employers with such contracts to make available health coverage to employees working less than 30 hours per week should not be effective with respect to such employees until the expiration of the current contract term.

B. Types of Plans Covered by Section 89 Nondiscrimination Rules.

One of the purposes of section 89 was to subject various employee benefits to "uniform" nondiscrimination rules. In practice, this undertaking has turned out to be misconceived.

Thus, the Administration endorses the provision of H.R. 1864 that provides group-term life insurance should be tested for discrimination under a different set of rules than those applied to health benefits. The income exclusion for group-term life insurance is limited by section 79 to the cost of $50,000 of such insurance; complex nondiscrimination rules do not seem appropriate for such a limited tax benefit. Consequently, we support a return to the pre-1986 Act rules applicable to such plans.

C. Qualification Requirements.

Under section 89(k), a plan covered by the statute must meet five so-called "qualification rules": the plan must be in writing; employees' rights must be enforceable; eligible employees must be given notice of their benefits; the plan must be maintained for the exclusive benefit of employees; and the employer must intend that the plan be maintained indefinitely.

1. Covered Plans. Congress should consider applying the qualification requirements only to health plans and, if group-term life insurance is subject to the same nondiscrimination rules as health plans, group-term life insurance. It is questionable whether the tax law's qualification rules are appropriate for all plans currently covered by these rules.

Under prior law, dependent care assistance programs were required to be in writing and reasonable notification of the benefits available under the program was required to be given to eligible employees. These rules are sufficient to protect the interests of employees and the Administration recommends that these provisions be re-enacted rather than subjecting dependent care assistance programs to the qualification requirements of section 89.

Moreover, the qualification requirements appear to be unnecessary for no-additional-cost fringe benefits, employee discounts and employer-provided eating facilities. 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. These fringe benefits are adequately addressed in section 132 and the regulations thereunder.

2. Sanctions for Failure to Meet Qualification Requirements. The current sanction for failure to comply with the qualification requirements of section 89 is the inclusion in

employees' incomes of the values of the benefits received under the plan. H.R. 1864 would replace this sanction with an excise tax on the employer equal to 34 percent of the amount paid or incurred under the plan. The Administration agrees with the sponsors of H.R. 1864 that the sanction for failure to comply with these requirements should be imposed on the employer causing 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 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 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

Although the Administration supports nondiscrimination rules to employer-provided health benefits, the rules of section 89 are, in some cases, too complex and, in other cases, too harsh. There is now a consensus that section 89 must be replaced, and the Treasury Department looks forward to working with this Committee and the Committee on Ways and Means to fashion legislation that addresses the major concerns of employers while serving the basic tax policy objectives of the nondiscrimination rules.

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 IMMEDIATE RELEASE
May 9, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted $9,794 million of $29,713 million of tenders received from the public for the 3-year notes, Series S-1992, auctioned today. The notes will be issued May 15, 1989, and mature May 15, 1992.

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

	Yield	Price
Low	9.11%*	99.717
High	9.12%	99.691
Average	9.12%	99.691

*Excepting 2 tenders totaling $20,000.

Tenders at the high yield were allotted 75%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 48,390	$ 48,390
New York	26,498,540	8,553,385
Philadelphia	31,520	30,520
Cleveland	99,320	92,820
Richmond	156,815	52,815
Atlanta	56,890	51,140
Chicago	1,355,120	333,620
St. Louis	88,070	60,070
Minneapolis	55,145	48,515
Kansas City	126,830	123,830
Dallas	25,985	24,730
San Francisco	1,162,800	367,050
Treasury	7,535	7,535
Totals	$29,712,960	$9,794,420

The $9,794 million of accepted tenders includes $1,157 million of noncompetitive tenders and $8,637 million of competitive tenders from the public.

In addition to the $9,794 million of tenders accepted in the auction process, $1,240 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,526 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

TREASURY NEWS

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

Contact: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
May 9, 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 $13,200 million, to be issued May 18, 1989. This offering will result in a paydown for the Treasury of about $1,900 million, as the maturing bills are outstanding in the amount of $15,093 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 15, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,600 million, representing an additional amount of bills dated February 16, 1989, and to mature August 17, 1989 (CUSIP No. 912794 SU 9), currently outstanding in the amount of $8,065 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,600 million, to be dated May 18, 1989, and to mature November 16, 1989 (CUSIP No. 912794 TE 4).

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

The bills will be issued for cash and in exchange for Treasury bills maturing May 18, 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 $1,916 million as agents for foreign and international monetary authorities, and $4,497 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.

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TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
EXPECTED AT 9 A.M., WEDNESDAY MAY 10

Statement By
The Honorable David C. Mulford
Assistant Secretary of the Treasury
for International Affairs
Before the
Subcommittee on International Economic Policy,
Trade, Oceans and Environment
Committee on Foreign Relations
United States Senate
May 10, 1989

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you today to discuss the Inter-American Development Bank. I am happy to report that after three years of negotiations, agreement has been reached on a proposal to increase the Bank's resources. The agreements reached in the negotiations will help accelerate the transformation and revitalization of the IDB already begun by President Iglesias. We are now seeking your support for legislation to authorize United States participation in the resource increase.

Importance of Latin America

This Administration is acutely aware of the problems in Latin America and of the region's significant commercial, cultural, and strategic ties to the United States. The Administration has acted quickly to come to the aid of beleaguered Latin American nations; by reshaping the debt strategy and now by reaching agreement on a replenishment of the IDB. A strengthened and reorganized Inter-American Development Bank can provide much needed funding and leadership in helping restore sustained growth in the countries of Latin America and the Caribbean.

Latin American countries continue to face serious economic and financial problems. In the 1970's Latin America relied too heavily on external borrowing. Although some countries achieved significant growth in this period, many did not make effective use of the borrowed resources. Without a broad economic base, and with heavily managed economies, these countries were not prepared to adjust to the adverse developments of the early 1980's.

Many Latin American countries now realize they need to adopt appropriate policies that will enable their economies to function efficiently and to produce growth and better lives for

their people. Particularly since 1985, several countries have implemented important structural reforms with the help of the international financial institutions. These countries have privatized government-owned industries, liberalized their trade regimes, reformed tax systems, and pursued market-oriented pricing.

However, much remains to be done to help Latin American economies function efficiently and effectively -- and in the best interest of Latin Americans themselves. The reforms should be implemented consistently: realistic exchange rates must be maintained and public sector deficits must be further reduced. In addition, attention needs to be focussed on other areas, particularly measures to attract new investment and encourage the return of flight capital.

Some countries have made a good beginning. Others must strengthen their efforts or even make a fresh start. The IDB can play a critical role in working with these countries to initiate major policy reforms.

At the beginning of his tenure in March 1988, President Iglesias' committed himself to reforming the IDB to improve the quality and effectiveness of its lending. As part of his effort he has:

- adopted measures to strengthen programming and loan review;

- established a self-financing, early retirement program to encourage needed personnel changes;

- initiated an evaluation of the Bank by the High-Level Review Committee, a group of prominent outside experts which included a number of former Latin American finance ministers; and

- launched task forces on programming, operations, and administration and personnel to examine the IDB's policies, practices, and structure.

Implementation of the recommendations of the High-Level Review Committee and the task forces will further improve the quality of Bank's operations and its overall effectiveness. The recommendations have been accepted by President Iglesias who has pledged to implement them. Once effected, the recommended actions will need to be supported by the Bank's Board of Directors. It is important that the Board members support these changes and truly represent the new policy thinking of leading Latin American governments. It is also important that Latin governments follow through on their commitments to reorganize and change the policies in a replenished IDB.

IDB-7 Agreement

The Seventh Replenishment (IDB-7) Agreement which was reached during the IDB's annual meeting in March, marks the key implementation phase of the IDB's reform efforts. Funds to make the new IDB a more effective contributor to solving Latin America's problems can now be injected into the Bank as the reform efforts move forward. Governors proposed increases of $26.5 billion in the IDB's capital and $200 million in the Fund for Special Operations (FSO). These increases will finance $22.5 billion of lending over the four-year period 1990 to 1993. This will be a significant increase in lending -- about double actual Sixth Replenishment (IDB-6) levels. While up to 65 percent of IDB-7 lending could go to the most advanced Latin American countries, 35 percent will be reserved for the smaller countries of Latin America and the Caribbean. All the concessional FSO lending will go to the poorest countries.

The U.S. share of the capital increase is $9.2 billion of which 2.5 percent or $229.3 million will be paid-in. Our share of the FSO replenishment is $82.3 million. The U.S. would thus be providing 34.7 percent of the capital increase and 41.2 percent of the FSO replenishment. Our payment for paid-in capital subscriptions and FSO contributions under IDB-7 would require $78 million of budget authority annually compared to $131 million under IDB-6.

The IDB-7 replenishment agreement incorporates a number of significant decisions about Bank operations over the next few years that complement the actions already taken to improve the Bank. The IDB-7 agreement proposes:

- adopting a loan approval mechanism that will promote improved loan quality and give greater decision-making authority to non-borrowing countries;

- strengthening the country programming process to ensure that Bank lending will support policy reform and self sustaining growth;

- providing up to 25 percent of IDB-7 lending for sector loans; and

- committing more staff and financial resources to strengthening the technical and institutional capabilities of countries in environmental management and conservation of natural resources.

I would like to elaborate further on the significant elements of the IDB-7 agreement and the complementary task force recommendations:

Loan Approval Mechanism - The intent and design of the new loan approval mechanism is to foster a Board consensus in support of loans and thereby improve loan quality. The mechanism allows for a delay of up to 12 months in the consideration by the Board of Directors of a loan from capital resources (the U.S. has a veto over FSO loans). Within specified limits, the President of the IDB could reduce this delay period to seven months. The delay periods will be used by Bank management to remedy those problems that prompted objections to the loan so that it can be supported by the entire Board of Directors.

Country Programming - A strengthened country programming process is a critical element in improving the quality of IDB lending. The country programming process and the Bank's policy dialogue with each country will result in a coherent and comprehensive framework for Bank operations. As outlined in the replenishment agreement, the IDB will analyze potential investment areas in each country in light of the adequacy of macroeconomic and sectoral policies. Therefore, the Bank's entire lending program, project as well as policy-based loans, will support needed policy reforms. In addition, the task forces recommend ways to reorganize operating departments to implement effective country programming.

Sector Lending - During the IDB-7 period the Bank will begin a program of sector lending. Fast-disbursing, policy-based lending is new to the IDB. They will not undertake broad-based structural adjustment lending but will focus instead on loans aimed at improving the economic efficiency of specific sectors, such as agriculture. For at least the first two years of the replenishment, all sector loans will be cofinanced with the World Bank.

Environment - In addition to committing more resources to environmental management and establishing a senior line unit to strengthen its own environmental assessment capabilities, the task forces recommended that the Bank improve its environmental action through other means as well. These include enhancing Bank relations with non-governmental organizations, improving its dissemination and collection of environmental information and hiring a core group of environmentalists to support technical staff.

Lower-income Beneficiaries - As in its last two replenishments, the Bank will seek in the seventh replenishment to ensure that 50 percent of its lending program benefits lower income groups. This includes sector lending where it is not always possible to precisely ascertain the effect of a loan on various groups. Nevertheless, the Bank will undertake to ensure that low-income persons benefit from sector loans and that potential adverse effects are minimized

IDB and Debt

A strengthened and reformed IDB will be in a position to make its contribution to helping resolve the economic and social problems facing Latin America. As far as the debt problem is concerned, the IDB's role at this point 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.

Next Steps

The member countries of the IDB have charted a course for the Bank over the next five years. It is now time to act to implement the IDB-7 agreement and the recommendations of the IDB's task forces. We will be following this closely as the pace of our subscriptions could be affected by the pace and effectiveness of their implementation.

We must get the new Bank up and operating. This will not be an easy task. It will require that all members work cooperatively and enthusiastically with President Iglesias and Bank management.

For our part we can support the Bank by formally agreeing to the capital increase and the replenishment of the Fund for Special Operations. Neither can go into effect without our agreement which requires prior Congressional authorization. We will submit the necessary legislation to Congress shortly.

We are seeking authorization legislation this year although subscription and contribution payments for IDB-7 are not due until October 1990 (U.S. FY 1991 budget). The primary reason for doing so is to demonstrate the United States commitment to the IDB and our support for the increase in the Bank's resources. In addition, our early agreement to the replenishment will allow other members to begin their approval processes and will facilitate the implementation of the IDB-7 agreement from January 1990.

I would urge you to act promptly to adopt the legislation to authorize United States participation in the increase in the capital of the IDB and the replenishment of the Fund for Special Operations.

TREASURY NEWS

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

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Remarks by Thomas J. Berger
Deputy Assistant Secretary of the U.S. Treasury
for
International Monetary Affairs
before
The Ninth Annual United States Investment Policy Forum
Washington, D.C.
May 9, 1989

Trade, Economic Growth and Third World Debt:

A Potomac River Viewpoint

Introduction

Good morning. As a former investment professional, it is a pleasure for me to address this internationally diverse group of senior investment officers. I would like to talk with you this morning about three critical economic issues that have important implications for the world economy and for the decisions of investment managers.

First, I would like to give you a perspective on the U.S. trade deficit -- where it's been, where it's going and what needs to be done to get it down. Second, I plan to discuss our efforts in the Group of Seven to forge a more effective process of economic policy coordination in order to achieve sustained noninflationary growth and stable financial markets. Finally, I will discuss the debt problems of the developing countries and the new approach to this issue proposed by the Bush Administration.

The U.S. Trade Balance

Throughout much of the post-World War II period, the U.S. ran a surplus in its current account balance. In this decade, however, we have seen a dramatic reversal in our payments position. Regardless of the measure used, it has deteriorated to an unprecedented degree. In 1980, our current account was in

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rough balance, with a $2 billion surplus. By 1987, this modest surplus had swung to a record $154 billion deficit. At the same time, our merchandise trade deficit increased from $25 billion in 1980 to a record $160 billion in 1987.

This deterioration has been across-the-board in terms of products and widespread in terms of geographical regions. Our trade balance worsened in nearly all of the major product categories, while bilateral balances worsened against all of our top trading partners, especially against Japan where our bilateral trade deficit widened from $19 billion in 1982 to nearly $57 billion in 1987.

Special factors have undoubtedly contributed to the deterioration in our trade balance, such as the relative openness of markets. But the worsening of our trade performance has been much too pervasive to be explained solely by protectionist practices in certain countries. What then explains the deterioration in U.S. external accounts during much of the 1980s?

- The combination of a vibrant U.S. economy and relatively sluggish growth abroad was a major factor. Between 1982 and 1985, U.S. demand increased 19 percent in real terms compared with less than 8 percent for the other major industrial countries. To satisfy the strong growth of both U.S. domestic consumption and investment, the U.S. increased imports of goods and services.

- From 1980 to 1985, the value of the U.S. dollar appreciated substantially making our exports less competitive in foreign markets.

- The international debt situation led to reductions in U.S. exports to major developing country markets.

- Asian newly-industrialized economies (NIEs) emerged as major low-cost producers of manufactured goods. (At the same time, some of these economies have resisted opening their markets and allowing their exchange rates to adjust adequately.)

In 1988, the U.S. experienced an improvement in its external accounts that was broadly based across products and regions, just as had been the case in the previous deterioration. The U.S. trade account began to improve in volume terms in late 1986, but did not begin to improve in value terms until 1988. Our current account deficit improved by $19 billion in 1988, going from $154 billion in 1987 to $135 billion. Our merchandise trade deficit improved by some $34 billion, which reflected a robust growth in exports of 28 percent, compared with a 9 percent growth in imports.

This recent improvement reflects a number of factors, many of which stem from the coordination process initiated in

September 1985 at the Plaza Hotel meeting in New York of the Group of Five. The foreign exchange value of the dollar in real terms has reversed its earlier appreciation, and is back on average to its 1980 trade-weighted value. Domestic demand growth in the other industrial countries outpaced U.S. growth in 1987 and 1988, as surplus countries, especially Japan, stimulated their economies. In addition, U.S. exports to the LDC countries partially recovered, while our domestic demand grew more slowly than GNP, softening our demand for imports.

Thus, the evidence indicates that both the deterioration and subsequent improvement in the U.S. balance of payments have been primarily macroeconomic phenomena. Further improvement will, therefore, depend importantly on such macroeconomic factors as: (1) sustained strong growth in Japan and Western Europe; (2) a reduction in the U.S. budget deficit; (3) steps by the NIEs to adjust their exchange rates in line with economic fundamentals; and (4) progress on the LDC debt situation. At the same time, it is important to underscore that the adjustment of trade imbalances will be difficult to achieve if the markets of our trading partners remain closed to foreign goods and unexposed to the therapeutic affects of open competition.

Economic Policy Coordination

Major structural changes in the global economy have intensified the need for close and effective economic policy coordination among the major industrial countries and the G-7 process was developed in response to this need. In particular:

- The globalization of financial markets has reduced substantially the independence that domestic policy-makers believed they would enjoy under flexible exchange rates as wide currency swings involved unacceptable economic costs and increased protectionist pressures.

- The liberalization of international trade and investment and the development of global integrated production facilities have increased substantially the importance of the external sector in all countries.

- Finally, the greater balance in economic size among the major countries requires the effective external adjustment be a shared responsibility of a number of countries. No single nation, be it in surplus or deficit, can be expected to undertake the bulk of the adjustment role.

The coordination process developed since the 1985 Plaza Agreement -- reinforced and strengthened over the last three and one-half years -- reflects these new realities. It seeks to promote a sound world economy and stable international financial system through the adoption of compatible, consistent and mutually supporting policies by the major industrial countries.

It thus provides greater discipline for the international monetary system and increased assurances that emerging problems will be addressed in a timely manner.

Is the process working and achieving the desired results? Notable accomplishments in 1988 included world economic growth that exceeded expectations, inflation which remained in check, external imbalances which were reduced substantially, and generally stable exchange markets. But continued efforts must be made to sustain noninflationary growth, the central objective of the coordination process. The success of these efforts depends on continued progress in controlling inflation and gradually reducing external imbalances.

Countries with large fiscal and trade deficits -- including the United States, Canada, and Italy -- need to make further reductions in budget deficits to complement monetary policies. We believe that we can achieve further reductions in the U.S. budget deficit through the implementation of the recent bipartisan budget framework agreement between the President and the joint Congressional leadership. The major surplus countries need to emphasize economic and structural policies to sustain domestic demand growth without inflation and facilitate external adjustment of their external surpluses. All countries need to be vigilant on inflation, and to resist protectionist pressures.

Finally, part of the coordination process was the establishment of more effective arrangements to deal with exchange market pressures. These arrangements have contributed to greater exchange market stability over the past year. In this context, the Group of Seven agreed at their meeting last month 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.

Proposals for Dealing with Third World Debt

As you may know, President Bush has made the international debt situation a major priority for this Administration. Recently, Treasury Secretary Brady outlined proposals to strengthen the debt strategy that revolve around two central themes: greater emphasis by commercial banks on debt and debt service reduction as a complement to new lending, and special efforts by debtor countries to adopt measures which will encourage new investment and a return of flight capital as important alternative sources of capital for growth. The International Monetary Fund and the World Bank will have continued central roles in addressing debt problems through both their policy advice and their financial support. Special measures to support voluntary transactions which reduce debt and debt service obligations will be an important element of the new approach.

A month ago, the Finance Ministers of the major industrial and developing nations, as well as the leaders of international financial institutions, endorsed these proposals in a series of communiques issued at their spring meetings in Washington. We have been encouraged by this broad support and the speed with which the various participants have turned to the task of implementation.

There is no substitute for sound economic policies in debtor nations. Without proper policies, no amount of debt or debt service reduction will lead to sustained economic growth. The debtor countries should design policies which will boost the confidence of both foreign and domestic investors, thereby encouraging new investment and fostering flight capital repatriation. Macroeconomic reforms will be critical, as well as supply-side policies to free up rigidities, allow the marketplace to work, and boost production. Each country must take the initiative to undertake the necessary reforms, fitted to its individual needs and circumstances.

The IMF and World Bank have provided important policy and technical advice to debtor nations in the development of key macroeconomic and structural reforms to promote growth. Their policy-based loans have also served as a vital catalyst for other sources of external financial support. They need to continue playing a central role in this process. In addition to stronger emphasis on policies to promote foreign direct investment and flight capital repatriation, we believe they should enhance the effectiveness of their own financial support by using some of their resources to support voluntary debt and debt service reduction transactions for countries with significant debt to commercial banks.

We have suggested that the two institutions modify their policy-based lending operations to help finance specific debt reduction transactions by setting aside, for example, 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 Bank should make available limited interest support for transactions involving significant debt or debt service reduction. Finally, we have suggested that they introduce greater flexibility in the timing of their financial disbursements in order to provide visible, meaningful support for the debtor countries' reform efforts. Initial disbursements from the IMF and the World Bank might, therefore, be made before final agreement is reached with commercial banks on specific debt and debt service reduction transactions.

Active participation by the banking community will be critical. Under our proposal, the banks will be able to choose what form their support of debtor reform will take from a

diversified set of choices, including debt reduction, debt service reduction, or various forms of new lending mechanisms.

Certain steps will need to be taken, however. Attention will need to be focused on legal constraints in existing loan agreements between debtors and commercial bank creditors which may impede debt and debt service reduction. Such contractual constraints can be waived for a limited time to stimulate voluntary transactions to reduce debt or debt service burdens. Once these waivers are agreed upon, the 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.

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

Debtor countries are anxious to proceed with debt reduction. Several potential early candidates for debt reduction are Mexico, the Philippines, Morocco, and Venezuela. They are currently pursuing discussions with commercial banks, while negotiating IMF and World Bank support. The relative balance between debt reduction, debt service reduction, and new money will vary for each country, based on its own individual situation.

The Executive Boards of the IMF and World Bank are already exploring mechanisms necessary for their support for debt and debt service reduction transactions. Both debtor countries and commercial banks will be watching the decisions of these institutions carefully in considering their own options.

In terms of other support from creditor governments, official debt rescheduling in the Paris Club and export credit cover will continue for those countries adopting IMF and World Bank programs. The key industrial countries are reviewing regulatory, accounting, and tax regimes, 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 the challenge by announcing a commitment to provide additional financing of $4.5 billion.

Conclusion

In conclusion, I believe we have set a practical agenda for addressing the three critical issues we have been discussing this morning. We are working to reduce trade imbalances through growth rather than protectionism -- resorting to protectionism would be a solution in search of a problem. We are working to achieve a sound world economy and stable financial markets

through the adoption of consistent and mutually supporting policies by the major industrial countries -- this is the heart of the economic policy coordination process. Finally, we are working to strengthen the international debt strategy by proposing new ideas that we believe will promote cooperative efforts on the part of commercial banks, debtor and creditor governments, and the international financial institutions.

Thank you very much.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 10, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 10-YEAR NOTES

The Department of the Treasury has accepted $9,530 million of $21,995 million of tenders received from the public for the 10-year notes, Series B-1999, auctioned today. The notes will be issued May 15, 1989, and mature May 15, 1999.

The interest rate on the notes will be 9-1/8%.1/ The range of accepted competitive bids, and the corresponding prices at the 9-1/8% interest rate are as follows:

	Yield	Price
Low	9.17%*	99.709
High	9.19%	99.581
Average	9.18%	99.645

*Excepting 1 tender of $34,000.
Tenders at the high yield were allotted 58%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 21,821	$ 21,821
New York	19,925,029	8,767,229
Philadelphia	7,991	7,991
Cleveland	20,887	20,887
Richmond	22,460	12,460
Atlanta	11,593	10,593
Chicago	1,018,708	327,188
St. Louis	39,115	19,113
Minneapolis	7,613	7,613
Kansas City	13,604	13,574
Dallas	8,517	8,517
San Francisco	894,912	310,512
Treasury	2,358	2,358
Totals	$21,994,608	$9,529,856

The $9,530 million of accepted tenders includes $467 million of noncompetitive tenders and $9,063 million of competitive tenders from the public.

In addition to the $9,530 million of tenders accepted in the auction process, $300 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $200 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

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

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// TREASURY NEWS

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

TEXT AS PREPARED
FOR RELEASE UPON DELIVERY
EXPECTED AT 10:00 A.M.
MAY 11, 1989

Statement By
The Honorable David C. Mulford
Under Secretary Designate
Department of the Treasury
Before the
Committee on Agriculture
U.S. House of Representatives
May 11, 1989

Strengthening the International Debt Strategy

Mr. Chairman and Members of the Committee:

Two months ago, the Administration concluded a thorough review of the international debt problems of developing nations. As a result of this review, Secretary Brady outlined several proposals to strengthen the international debt strategy. In early April, the Finance Ministers of the major industrial and developing nations, as well as leaders of international financial institutions, endorsed these proposals in a series of communiques issued at their spring meetings in Washington. We were encouraged by this broad support and the speed with which the various participants have turned to the task of implementation.

I welcome this opportunity, Mr. Chairman, to discuss the Administration's efforts to address international debt problems and to help renew growth in debtor nations, which should in turn help foster an expansion in our agricultural export markets.

Proposals to Strengthen the Debt Strategy

The proposals outlined by Secretary Brady reflected the culmination of an extensive review, which confirmed that while significant progress had been achieved since 1982, several critical issues needed to be addressed. Notably, growth in several of the major debtor countries has been inadequate to

support sustained recovery. In some countries, reforms had not been comprehensive and consistently applied. Investor confidence remained weak -- exacerbating capital flight. And commercial bank financial support was not always timely or sufficient.

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.

In unveiling the approach to strengthen the debt strategy, we focussed on key concepts, rather than offering a blueprint, in order to stimulate discussion and involve key players in the development of a detailed plan. Our proposals were structured to accomplish a broad international consensus that will move us towards objectives for the debt strategy that are widely regarded as necessary next steps.

Those steps include the need to strengthen growth in debtor countries, to address the problem of capital flight, to attract new investment, and to sustain commercial bank financial support. Reductions in the stock of debt are also very important for both economic and political reasons.

Strong economic reforms in debtor countries are an essential first step. There is no substitute for sensible economic policies. No amount of debt or debt service reduction will lead to sustained economic growth without such policies. Inappropriate policies and inconsistent implementation have often been at the heart of economic and financial problems in these countries. In the end, policies must promote confidence in both foreign and domestic investors -- for investment is the single key to growth.

Macroeconomic reforms -- in particular sound fiscal, monetary, and exchange rate policies -- remain critical. However, they are not sufficient. Policies designed to free up rigidities, allow the marketplace to work, and boost production are essential to combining adjustment with growth. Thus, debtor countries should pursue policies which liberalize trade, reform labor markets, develop financial markets, and privatize government enterprises. This will allow the private sector to increase employment and efficiency.

Debtor nations must focus particular attention on the adoption of policies which can better assure the return of flight capital; not the ephemeral return that we have witnessed in

certain countries from time to time, but hopefully a sustained return of those assets that have fled abroad over the years. Debtor nations can build investor confidence by reducing or eliminating limitations on remittances through tax reform, and by amending policies to assure real rates of return. Such measures can win back the resources that have deserted archaic investment regimes. This will not happen overnight. The web of government controls, intervention, ownership, and regulations has to change. And these reforms must be sustained. Frequently, we have seen capital return early in an adjustment program, only to move out of the country when the program falters.

Privatization programs can offer many countries a large pool of financial resources. In several heavily indebted countries, parastatals control on the order of two-thirds of domestic production. Privatization programs can be structured to attract both domestic and foreign investors, to reduce the stock of external debt, to raise government revenues, and to cut government expenditures on inefficient operations. All told, privatization is a win-win deal.

To support debtor countries' reform efforts, the international community needs to provide timely financial assistance. A broader range of financial support by commercial banks is the key, in our view. Debt and debt service reduction can be an important component of this support and can be structured in ways to meet the diverse interests of commercial banks.

New lending will also be important for most countries, but the magnitudes of new lending required may be substantially reduced by debt and debt service reduction. New financing could include concerted lending, club loans, trade credits, or project finance.

Several steps must be taken to enhance the potential for debt and debt service reduction by commercial banks. Legal constraints in existing agreements now stand in the way of transactions that can directly benefit the debtor country. Waivers of these provisions for a limited period can help to stimulate greater activity within the market and allow those banks willing to accept various options to do so. We believe that a waiver can be structured to permit multiple debt and debt service reduction transactions during a given period of time. Such a waiver is much less cumbersome than seeking waivers on a transactions-by-transaction basis. Once these waivers are agreed upon, the 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.

In addition, the IMF and World Bank can facilitate agreement on specific transactions. We have proposed that these institutions redirect a portion of their normal policy-based loans to fund

debt reduction transactions such as cash buy-backs or collateralized exchanges. We have also proposed that they provide limited interest support for significant debt and debt service reduction. We believe that IMF and World Bank resources should be used to help reduce debt rather than increasing the future servicing burdens of debtor countries.

In addition to pursuing reductions in their debt burdens, developing countries should seek to develop other ways of meeting their financing needs. As I mentioned above, both new investment and flight capital repatriation are important sources of capital and can be encouraged through sound policies.

Let me say a few words in particular about the role investment can play in a developing economy. In our view, foreign investment offers countries a unique opportunity to gain access to not only capital but also technology, management expertise, and employment for its citizens. In a time of scarce financial resources, countries simply must be more active in seeking to develop the potential for investment.

Debt/equity swaps can be an important vehicle for attracting such investment and in our view should be key elements of any debt reduction program.

Benefits

What are the benefits of this approach for debtor countries and commercial banks?

Those countries which are prepared to adopt significant reforms will have earlier support for their efforts, will be able to demonstrate at home that their debt burden is being reduced, and will enhance their potential to achieve domestic growth, development, and social objectives. Their need for new money from commercial banks will be reduced.

Commercial banks will be able to make realistic adjustments in their portfolios in a way that enhances the quality of their loans. The creditworthiness of their debtor country clients will improve. Debt reduction will be closely linked to debtor reforms to assure that these benefits will be sustained.

Most importantly, this approach will allow the market to function. It provides IMF and World Bank loans to debtor nations as a catalyst for market activity, permitting debtor nations to pledge some of these resources as backing for new debt instruments which reduce the burden of debt and debt service.

Next Steps

It is up to all of the parties involved to make this strategy work. We have seen encouraging signs of progress.

Key debtor countries have begun to seek support from the Fund and Bank for debt reduction as part of their economic reform programs. Countries as diverse as Mexico, Venezuela, Morocco, the Philippines, and Costa Rica are anxious to get this process underway and have initiated discussions with the commercial banking community.

The IMF and World Bank have prepared interim papers on the nature of the support they might provide for debt and debt service reduction transactions. These papers are now under discussion within their Executive Boards. Both debtor countries and commercial banks will be watching the decisions of these institutions carefully in considering their own options.

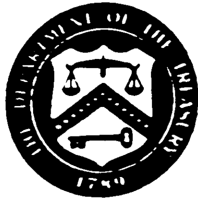
The commercial banks have also begun to discuss among themselves the potential for waivers, techniques for transactions that reduce debt and debt service, and possible ways of differentiating new money from existing loans.

Creditor governments are following developments in each of these areas closely. Official debt rescheduling in the Paris Club and export credit cover will continue for those countries adopting IMF and World Bank programs. The key industrial countries are reviewing regulatory, accounting, and tax regimes, 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 the challenge by announcing a commitment to provide additional financing of $4.5 billion.

Conclusion

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 improve the creditworthiness of developing countries. The achievement of progress in coming months depends critically on the cooperative efforts of commercial banks, debtor and creditor governments, and the international financial institutions. Secretary Brady and the Bush Administration, and G-7 governments are fully committed to making this process work.

TREASURY NEWS



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

May 10, 1989

**Statement by
The Secretary of the Treasury
Nicholas F. Brady**

The results of today's vote in the House Ways and Means Committee is a mistake. If adopted, this action could force us to go back to square one on both the budget and the savings and loan plan. It could mean months of stalemate. This is not the way either to lower interest rates or solve the savings and loan crisis.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 11, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 29-3/4-YEAR BONDS

The Department of the Treasury has accepted $9,535 million of $20,015 million of tenders received from the public for the 8-7/8% 29-3/4-year Bonds of 2019 auctioned today. 1/ The bonds will be issued May 15, 1989, and mature February 15, 2019.

The range of accepted competitive bids was as follows:

	Yield	Price 2/
Low	9.10%	97.653
High	9.12%	97.453
Average	9.11%	97.553

Tenders at the high yield were allotted 51%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 1,128	$ 1,128
New York	18,353,462	8,892,182
Philadelphia	640	640
Cleveland	2,108	2,108
Richmond	12,343	8,893
Atlanta	6,324	6,324
Chicago	1,044,237	441,107
St. Louis	15,070	7,070
Minneapolis	6,043	6,043
Kansas City	6,151	6,151
Dallas	7,246	4,796
San Francisco	560,012	158,362
Treasury	459	449
Totals	$20,015,223	$9,535,253

The $9,535 million of accepted tenders includes $367 million of noncompetitive tenders and $9,168 million of competitive tenders from the public.

In addition to the $9,535 million of tenders accepted in the auction process, $100 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

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

2/ In addition to the auction price, accrued interest of $21.81975 per $1,000 for February 15, 1989, to May 15, 1989, must be paid.

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᠎# TREASURY NEWS

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

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
FRIDAY, MAY 12, 1989

STATEMENT OF
ROBERT R. GLAUBER
NOMINEE FOR UNDER SECRETARY (FINANCE)
UNITED STATES DEPARTMENT OF THE TREASURY
BEFORE THE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

Mr. Chairman, Senator Garn, distinguished members of the Banking 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 also an honor to appear before this Committee.

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, Congressional Committees 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

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

EMBARGOED FOR RELEASE UNTIL DELIVERY
Expected at 10:00 a.m., D.S.T.
May 12, 1989

Statement by the Honorable David C. Mulford
Under Secretary-Designate of the Treasury
before the
Committee on Finance,
Subcommittee on International Trade
United States Senate
May 12, 1989

Mr. Chairman and members of the Subcommittee:

I welcome this opportunity to discuss the issues related to the exchange rate practices of Korea and Taiwan, particularly as the Treasury Department has recently released a report on international economic and exchange rate policy which addresses this matter.

For the last several years we have sought to reduce global trade imbalances in the context of a growing world economy. Our efforts to coordinate economic policies with other major industrial countries have focused on this goal. Indeed, last year economic growth in the G-7 exceeded expectations and there was a significant reduction in global current account imbalances. This strong performance provides a solid basis for continued progress in 1989, although there is some concern that external adjustment is slowing and that further efforts will be required.

We also recognize that others should play an integral role in preserving and ensuring a strong, stable world economy. In particular, the newly industrialized economies of Asia have benefitted from an open, growing international trading system. As such, it is essential for them to also work toward reducing global imbalances by allowing the value of their currencies to reflect the strength of their economies and by dismantling barriers to trade and investment.

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To that end, we have held discussions with the Asian NIEs, beginning in mid-1986. The 1988 Trade Act provided impetus to this process by requiring the Secretary of the Treasury to issue periodic reports on international exchange rate policy and to determine which economies manipulated their exchange rates. In our first report, issued in October, we concluded that Korea and Taiwan were "manipulating" their exchange rates to gain a competitive advantage within the meaning of the legislation. Consequently, as required by the legislation, we have intensified our negotiations with Korea and Taiwan.

In reaching the conclusion, concerning manipulation of exchange rates, we looked at a wide range of factors to determine whether Korea and Taiwan were manipulating their exchange rates. An important factor was the existence in both cases of pervasive capital controls and administrative mechanisms aimed at preventing the exchange rate from reflecting market forces. A second factor was large-scale intervention in the local foreign exchange market by the Central Bank of Taiwan. A third factor was the lack of significant exchange rate appreciation at a time when Korea and Taiwan were running very large external surpluses in both absolute terms and relative to GNP. This relative lack of appreciation was particularly striking when compared with the appreciation of the currencies of other surplus economies.

Our negotiations with Korea and Taiwan have been aimed specifically at ending such currency manipulation. We have also sought other policy changes, including structural reforms to give greater emphasis to domestic demand as a source of growth and the liberalization of financial markets.

These negotiations have led to some encouraging progress. The currencies of both Korea and Taiwan have appreciated further. In addition, they have taken measures to open their markets and, to varying degrees, internationalize their financial systems. Indeed, we believe that due to these factors, a structural decline in their external surpluses may have begun. At the same time we believe that more progress is necessary.

Korea

Appreciation of the Korean won accelerated in 1988, reaching nearly 16 percent, including about 4 percent in the 6 weeks following the release of our October report. Also, unlike in previous years, the won began to strengthen against the currencies of key competitors, such as Japan and Taiwan.

Although we welcome the appreciation of the won in 1988, its adequacy must be judged against its much slower appreciation in 1987 and the size of Korea's external surpluses. In 1988, Korea's global current account surplus grew 44 percent to $14.3 billion.

To put this surplus in perspective, one need only realize that it was equal to 9.1 percent of Korea's GNP. In comparison, Japan's 1988 current account surplus was equal to 2.7 percent of its GNP.

The United States' bilateral trade deficit with Korea began in 1988 to show some limited prospects of improving, growing by only 1 percent, compared with a 34 percent increase in 1987. Encouragingly, this reflected stronger growth of our exports to Korea and decline in the rate of growth of our imports. Nonetheless, at $9.5 billion, our bilateral trade deficit remains unsustainably large.

Preliminary Korean data for the first quarter suggests a potentially significant decline in the trade and current account surpluses, due, in part, to the prior appreciation of the won. This data also indicate that Korea's bilateral surplus with the United States fell by 34 percent to $1.2 billion.

Unfortunately, the response of the Korean authorities 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.

While we are somewhat encouraged by Korea's recent trade developments, we believe that the Korean current account data are too limited and preliminary to demonstrate clearly that a structural, lasting decline in Korea's external surpluses is underway. Indeed, we expect Korean exports to begin to recover in the second quarter, once the current labor disputes have been resolved. As such, further exchange rate appreciation is necessary to sustain and reinforce recent developments. However, due to concerns about the first quarter declines in the surpluses, the Korean authorities have not been willing to provide assurances of adequate continued won appreciation.

Our negotiations with Korea in the coming months will be aimed at obtaining assurances of continued appropriate appreciation. In addition, 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. We will also seek to obtain an understanding on the implementation of a market-based exchange rate system and the dismantling of the current system of comprehensive capital and exchange controls used to manipulate the exchange rate.

Taiwan

A decline in Taiwan's external surpluses is also occurring. Taiwan's global current account surplus decreased by 43 percent in 1988 to $10.2 billion, or 8.5 percent of GNP. According to U.S. customs data, the trade imbalance with Taiwan, which accounts for 95 percent of its global trade surplus, fell last year by 26 percent to $12.7 billion. However, the large U.S. exports of gold to Taiwan accounted for more than half of this reduction. Preliminary Taiwanese data for the first four months of 1989, point to further reductions in Taiwan's trade surplus with the United States, compared to the same period in 1988, if last year's U.S. gold shipments are excluded.

The past appreciation of the New Taiwan (NT) dollar has been an important factor in the reduction of Taiwan's external surpluses. Furthermore, since our October report, the exchange rate has appreciated by 12 percent. Significantly, five percent of this movement has been since the release of our April report. We believe this exchange rate appreciation will reinforce the positive trends in Taiwan's external surpluses.

Taiwan also implemented a new exchange rate system in early April following a round of negotiations. Without this change, the recent currency appreciation would probably not have occurred. This new more market sensitive system could represent an important step toward the establishment of a market-based system to determine the exchange rate. However, it is premature at this point to make a definitive assessment of its impact. The effectiveness of the liberalization will depend on reducing the extent of central bank intervention, removing the remaining controls on capital inflows, and resolving a number of operational problems with the system itself. Consequently, we will monitor carefully its implementation and operation.

Given the recent sharp appreciation of the New Taiwan dollar, the reduction in external surpluses, and the institution of the new exchange rate system, there may not be a need for further appreciation at this time. We will, however, continue to monitor Taiwan's exchange rate and trade developments closely to ensure that momentum toward external adjustment is sustained.

Conclusion

In conclusion, Mr. Chairman, we believe that Korea and Taiwan have an important role to play in reducing external imbalances. The progress we have achieved in our bilateral negotiations with Korea and Taiwan could lead to a sustainable decline in their external imbalances. In the period before our next report in October, we will aim to have these economies continue to correct their policies to avoid an unfair competitive

advantage in trade and, hence, contribute to the global adjustment process.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE

Remarks by
The Secretary of the Treasury
Nicholas F. Brady
At the North Carolina Bankers Association
Pinehurst, North Carolina
May 12, 1989

I am pleased to be here in North Carolina for the annual meeting of the North Carolina Bankers Association. Today I would like to discuss some of the most difficult problems facing our country and the approach President 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.

Although we are still very early 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 ultimately 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.

It was this same open and responsive approach that enabled the Congress and the President to achieve consensus on a budget agreement -- 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.

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 Great 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. The House Banking Committee has completed its work and the bill is now being considered by the House Ways and Means Committee.

On Wednesday, Ways and Means voted to drive a truck through the Gramm-Rudman process in direct violation of the recent budget agreement the President reached with Congress.

The cost of solving the S&L problem is truly staggering -- $40 billion already spent and another $50 billion needed to deal with the remaining insolvent S&Ls.

The President's plan creates a new corporation that will borrow the $50 billion that will be needed. It will use savings and loan industry funds to collateralize the principal and a combination of industry and taxpayer funds to pay the interest. All taxpayer funds will be counted on budget as they are spent.

This structure extracts and locks up the maximum industry contribution. It also maintains the budget discipline of the Gramm-Rudman process.

It appears that the Ways and Means Committee wants to directly appropriate the $50 billion we have requested for the S&L plan and to waive the Gramm-Rudman deficit reduction targets. This would completely, and unnecessarily, make a mockery of Gramm-Rudman. Meeting the Gramm-Rudman deficit reduction targets is very important to the continued vitality of our economy. When I meet with the finance ministers from other leading industrial nations in the so called G-7, they always tell me how they see Gramm-Rudman as the only hope for responsible deficit reduction in the U.S.

The stated motivation for the committee alternative is to save money by having Treasury borrow directly at a slightly lower rate. But if we wreck the Gramm-Rudman process, the markets may lose confidence in our commitment to deficit reduction. That could lead to higher borrowing costs, not only for the S&L plan, but for the rest of the Treasury's financing needs, as well. A sustained increase in interest rates of only one basis point (one one-hundredth of one percent), applied to the half of our national debt that is financed on a short-term basis, would raise the taxpayers' bill for interest by about $140 million per year. This is more than the savings from any alternative plan.

The full Senate and the House Banking Committee have previously approved our plan, and we will continue to fight for it. Our plan preserves Gramm-Rudman, which is our best hope for fiscal sanity. It puts as much industry money as possible into the solution. And it is the least costly financing method.

Now, turning to the plan itself, it is not a bailout for ailing S&Ls. Instead, its purpose is to fulfill the government's ironclad commitment to protect depositors' savings. But the plan involves much more than writing checks to depositors. 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 should 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. Of the remainder, almost half have tangible capital between two and three percent of assets and should easily be able to meet the standard. Only 246 institutions might have difficulty meeting the standard, but ought to be able to merge with stronger ones.

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 eliminate 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 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 25 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 this 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. President Bush has agreed 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 Republicans and Democrats 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 wonder drug, 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 on the job 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 and Democracy in Central America, education and the environment. President Bush has tackled them all and sought the help of Congress on each one. Thank you for your interest in these issues, and for the opportunity to be with you today.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 16, 1989

CONTACT: Office of Financing
202/376-4350

A M E N D E D

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,606 million of 13-week bills and for $6,605 million of 26-week bills, both to be issued on May 18, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 17, 1989			:	26-week bills maturing November 16, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.20%	8.49%	97.927	:	8.15%	8.62%	95.880
High	8.22%	8.51%	97.922	:	8.22%	8.70%	95.844
Average	8.21%	8.50%	97.925	:	8.19%	8.66%	95.860

Tenders at the high discount rate for the 13-week bills were allotted 15%.
Tenders at the high discount rate for the 26-week bills were allotted 11%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 33,615	$ 33,615	:	$ 24,695	$ 24,695
New York	21,849,175	5,458,970	:	18,967,335	5,439,565
Philadelphia	29,515	29,515	:	13,405	13,405
Cleveland	46,045	45,620	:	27,865	27,865
Richmond	46,250	46,250	:	70,190	70,190
Atlanta	38,980	37,790	:	29,570	29,570
Chicago	1,232,800	64,000	:	1,087,270	231,520
St. Louis	45,730	23,730	:	34,380	30,600
Minneapolis	7,620	7,620	:	9,995	9,995
Kansas City	42,285	42,285	:	37,815	37,815
Dallas	22,070	22,070	:	16,680	16,680
San Francisco	1,203,650	199,650	:	1,189,435	202,935
Treasury	594,800	594,800	:	470,080	470,080
TOTALS	$25,192,535	$6,605,915	:	$21,978,715	$6,604,915
Type					
Competitive	$20,788,925	$2,502,305	:	$17,675,170	$2,601,370
* Noncompetitive	1,315,125	1,315,125	:	986,120	986,120
* Subtotal, Public	$22,104,050	$3,817,430	:	$18,661,290	$3,587,490
* Federal Reserve	2,403,610	2,103,610	:	2,200,000	1,900,000
Foreign Official Institutions	684,875	684,875	:	1,117,425	1,117,425
TOTALS	$25,192,535	$6,605,915	:	$21,978,715	$6,604,915

An additional $192,225 thousand of 13-week bills and an additional $299,075 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

* Adjustments were made in these categories due to correction of amounts allotted to Federal Reserve Banks.

: 8.16--95.875 8.17--95.870 8.18--95.865
: 8.20--95.854 8.21--95.849

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 15, 1989

Contact: Peter Hollenbach
(202) 376-4302

TREASURY TO EXPAND REGIONAL DELIVERY SYSTEM FOR SAVINGS BONDS

Savings bond purchasers in communities served by the Cleveland Federal Reserve District will be introduced to a new Regional Delivery System (RDS) for savings bonds on June 1, 1989. RDS is the first significant change to the delivery system since the bond program began nearly 50 years ago.

Investors purchasing U. S. Savings Bonds at financial institutions in western Pennsylvania, eastern Kentucky and the panhandle of West Virginia will complete a bond order form and pay for their bonds. Financial institutions will forward the orders and payments to the regional service center at the Federal Reserve office in Pittsburgh, where the bonds will be issued and mailed. Bonds should be delivered within three weeks of the day they were purchased.

Bonds will earn interest, as they do now, from the first of the month in which payment is made. Purchasers who order bonds as last-minute gifts will be given a special Treasury gift certificate for their use. Because savings bonds will be issued from a regional service center, investors will be able to order the particular denominations that suit their needs. Under the present system, some denominations of bonds are not always available at all financial institutions. Payroll savings plans are not affected by this change to the regional delivery system.

RDS was introduced throughout the state of Ohio in October 1987, as a pilot. Since then, the new system has gained acceptance with more than 600,000 Ohioans investing $314 million in savings bonds. Financial institutions in Ohio reacted favorably to RDS as it allowed them to serve their customers while eliminating the expense of maintaining and accounting for savings bond stock. Tellers are also able to complete the customers' bond purchase transactions more quickly.

Richard L. Gregg, Commissioner, Bureau of the Public Debt said, "Only the way bonds are delivered is being changed and not the features that make bonds attractive to savers. The expansion of RDS from Ohio to western Pennsylvania, eastern Kentucky and the panhandle of West Virginia is the first step in introducing RDS nationwide over the next few years."

Gregg added, "RDS will strengthen the savings bond program by reducing the burden on financial institutions who sell bonds to their customers and by reducing the cost of processing savings bonds transactions. The new system will also set the stage for modernizing our savings bonds systems, which will allow us to better service bond owner inquiries and claims in the future."

Accompanying this release is a list of those counties in Kentucky, Pennsylvania and West Virginia where RDS will be introduced. These counties, along with the state of Ohio, make up the territory served by the Federal Reserve Bank of Cleveland.

NB-269

COUNTY LISTING FOR RDS INTRODUCTION

The counties listed below are served by the Federal Reserve Bank of Cleveland. RDS will be introduced in only these counties of Kentucky, Pennsylvania and West Virginia on June 1, 1989.

Kentucky

Bath
Bell
Boone
Bourbon
Boyd
Bracken
Breathitt
Campbell
Carter
Clark
Clay
Elliott
Estill
Fayette
Fleming
Floyd
Garrard
Grant
Greenup
Harlan
Harrison
Jackson
Jessamine
Johnson
Kenton
Knott
Knox
Laurel
Lawrence
Lee
Leslie
Letcher
Lewis
Lincoln
Madison
Magoffin
Martin
Mason
McCreary
Menifee
Montgomery
Morgan
Nicholas
Owsley
Pendleton
Perry
Pike
Powell
Pulaski
Robertson
Rockcastle
Rowan
Scott
Whitley
Wolfe
Woodford

Pennsylvania

Allegheny
Armstrong
Beaver
Butler
Clarion
Crawford
Erie
Fayette
Forest
Greene
Indiana
Jefferson
Lawrence
Mercer
Somerset
Venango
Warren
Washington
Westmoreland

West Virginia

Brooke
Hancock
Marshall
Ohio
Tyler
Wetzel

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TREASURY NEWS

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

For Release Upon Delivery
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May 16, 1989

STATEMENT OF
JOHN G. WILKINS
ACTING ASSISTANT SECRETARY (TAX POLICY)
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 discuss tax policy issues related to recent trends in mergers, acquisitions, leveraged buyouts, and corporate debt generally. We commend the Committee for the thorough-going nature of its examination of the issues raised by these trends.

We share the Committee's concerns about LBOs, and we continue to monitor carefully the level and trends of such activity. However, as Secretary Brady stated earlier before this Committee, we will not counsel major tax changes to correct a trend which may be about to correct itself. The evidence concerning LBO trends and impact is far from conclusive and further study is clearly warranted. At present, we do not believe that major tax changes limiting interest deductions are justified given other concerns I will discuss today. We also note that the adverse effects described by many critics--particularly economic dislocations--are common to merger and acquisition transactions generally, not just LBOs. In short, further study with a wider focus is appropriate and that study is underway.

In our view, a focal point of these hearings should be the impact of the tax treatment of corporate debt and equity on the competitiveness of U.S. businesses in world markets. That concern requires a tax policy focus considerably broader than the LBO financing issue. LBOs are symptomatic of a fundamental bias of the corporate income tax structure, which encourages debt financing and discourages equity financing of corporate assets.

We are unique among the major industrialized nations that are our principal trading partners because we alone provide no relief for double taxation of corporate equity.

I. INTRODUCTION

In testimony today I will briefly review recent trends in corporate debt financing generally and in LBOs specifically; I will discuss potential impacts of LBOs on competitiveness; I will evaluate the need for tax policy solutions to potential problems; and, last, I will give the Treasury Department's views on the specific proposals listed for comment.

Recent Trends in Corporate Finance

Fueled by press reports of large transactions that substitute debt for corporate equity, many believe that corporate debt is reaching all-time highs. This impression is based upon measures of corporate leverage that do not take into account the large increases in the market value of corporations. These measures, which are based on book values, indicate an increase in leverage over the past few years, with current levels at an historical high. This may be a substantial overstatement. While other measures reflecting market values also show an upward trend in recent years, they remain well below the peak levels in the mid-1970s and in line with the average over the last 20 years.

According to our estimates, the percent of the market value of nonfinancial corporate assets represented by debt was 41 percent in 1988 and had remained between 35 percent and 40 percent from 1980 through 1987, averaging 38 percent. This translates to a debt to equity ratio measured at market values of .7 to 1 in 1988, and an average of .62 to 1 from 1980 through 1987. By contrast, the fraction of nonfinancial corporate assets financed by debt in the decade of the 1970s averaged 40 percent (or a debt to equity ratio of .65 to 1), and fluctuated between 31 percent and 47 percent (or .45 to .89 to 1 for the debt to equity ratio). Clearly, current levels of debt financing are well under the high levels during the 1970s. Moreover, there is as yet no hard evidence that LBOs are permanently increasing the amount of corporate debt in the aggregate.

According to the publication Mergers and Acquisitions, the dollar value of corporate mergers and acquisitions completed in this country since 1981 has increased at the rate of just over 17 percent per year; however, over the last few years, there is evidence of some leveling off. In 1986 the total value of mergers and acquisitions reached $204 billion but by 1988 the level of activity had grown to only $227 billion, a modest 5 percent average annual rate of growth. Furthermore, the preliminary figures for the first quarter of 1989 show activity to be in the range of $195 billion, well below the trend line.

Looking at recent history, the period of high LBO activity, there is no evidence that LBO financing has claimed a rising share of merger and acquisition activity. As a fraction of the total value of all mergers and acquisitions, LBOs have dropped from a 1986 high of 22.7 percent to 21.3 percent in 1987 and to 18.9 percent in 1988. Although the data for the first quarter of 1989, which are still preliminary, suggest a slight rise in the dollar share of LBO activity -- to around 20 percent -- most of this activity results from deals that were planned and in various stages of completion last year. (These figures do not include the $25 billion RJR Nabisco transaction because it was not formally completed until April 1989.) In 1986, when LBO financing peaked as a share of the value of all completed mergers and acquisitions, we estimate that interest payments attributable to LBOs completed that year amounted to no more than 1 percent of all corporate interest deductions. This calculation is apt to err on the high side because the definition of an LBO used here is any private acquisition of a public corporation that used debt as well as equity in the purchase agreement and not just highly leveraged financial arrangements.

Tax Influences

It is clear that the structure of our corporation income tax in which the income from equity capital is often taxed twice or more -- once when income is earned by the corporation and again at the individual tax level when distributions are made in the form of dividends and possibly again when intercorporate distributions are made -- encourages debt over equity financing. This non-neutrality of the corporate income tax with respect to financing decisions is a potential source of inefficiency which, given the structure of our trading partners' tax systems, may be having a detrimental effect on American business as a global competitor.

On balance, it is unlikely that the increase in LBO activity during the 1980s has had a significant impact on revenues. This conclusion is reached only after examining the various ways in which LBOs may affect government revenue. Without passing judgment on a case-by-case basis, it can generally be stated that LBOs that increase efficiency will lead to more long-run tax revenue and that LBOs that decrease efficiency will lead to less long-run tax revenue. Thus, the debate about long-run revenue turns on evaluations of long-run efficiency, which are, of necessity, case specific.

The elements of a typical LBO financing arrangement and the way that they affect tax revenues are as follows:

° Capital gains from the sale of corporate shares by existing owners are prompted by the buyout offer and often reflect a higher price and hence increased capital gain revenues. Tax-exempt owners, such as pension funds, of course, pay no

current capital gains tax from the sale; however, taxable owners pay a capital gains tax sooner than they otherwise would.

° Interest income of debt holders generates additional tax revenue to the extent that LBO debt pays a higher yield than the debt holders would have received on alternative investments. Again, however, revenue is lost to the system to the extent the higher yield is paid to tax-exempt entities.

° Interest deductions from the corporate profits base will generally reduce corporate tax revenues by more than the additional tax from interest income of debt holders because corporate income tax rates now generally exceed individual income tax rates and because tax-exempt and tax-favored entities hold a substantial amount of corporate debt.

° Corporate profits and the corporate income tax on them would rise to the extent that the sum of the parts of the original corporation are more efficiently managed under the post-LBO scenario.

° Capital gains at the corporate level from the subsequent disposition of certain corporate assets typically sold in order to help service the LBO debt will raise corporate level tax revenue by the degree to which the sale of such assets occurs sooner under the post-LBO scenario.

° Dividend income and the associated individual income tax are reduced as corporate earnings are typically devoted to servicing higher levels of LBO debt.

Because the weight given to each of these revenue factors differs with each LBO transaction, it is impossible to generalize as to the overall impact of LBOs on taxes. A revenue analysis would have to be conducted on a case-by-case basis and would have to extend far into the future to capture important long-run effects.

Although many dispute the conclusion that LBOs have been undertaken for tax reasons, it is clear that tax considerations have heavily influenced the structure of LBO transactions. Other factors which may determine whether a transaction will occur (as opposed to how it will be structured) include favorable interest rates, undervaluation by the market of assets and even entire divisions of companies, and possibly over-diversification of certain target corporations.

The Tax Reform Act of 1986 contained a number of provisions that altered the relationship between debt and equity financing. The inversion of the traditional ranking of the top individual and top corporate income tax rate in and of itself probably encourages more debt financing of corporate assets. This is because interest deductions at the 34 percent marginal corporate income tax rate are worth relatively more when the highest

individual income tax rate applicable to returns on distributed equity investments is 28 percent or 33 percent than when the corporate rate was 46 percent and the top individual rate was 50 percent. On the other hand, sharply lower corporate and individual income tax rates since 1986 reduce the overall impact of the tax system on all transactions.

The impact of full taxation of capital gains under the 1986 Act on LBO transactions is also unclear. Full taxation of gains made equity investments less attractive to individual investors but also may have discouraged purchase transactions generally because such transactions trigger immediate capital gains realizations by taxable owners.

Good Debt and Bad Debt

It is both difficult and dangerous to try to distinguish good debt from bad debt, good LBOs from bad LBOs, and good mergers from bad mergers using a tax policy standard.

Observers generally identify "bad" LBOs after the fact by examining the consequences the financing arrangement had on corporate employment, on the amount and use of cash flow, and on other stakeholders such as "the community of corporate neighbors." In contrast, however, if an LBO results in improved efficiency, there may be transitional unemployment as labor and capital move from less efficient activities to more efficient activities. Although this would produce short-run dislocations, which would be a cause of concern, it would be offset by general improvement in the economy in the long run.

From a tax policy point of view, we believe a focus on LBOs per se is too narrow in that LBOs are merely one aspect of the general corporate tax bias against equity capital. Consequently, it is our position that any solution to perceived problems associated with LBOs should not be attempted through the tax code at this time. The tax code is too blunt an instrument and there is a real danger that any cure -- particularly one that further increases the cost of capital to American corporate enterprise -- may be worse than the perceived problem. If changes in the rules are appropriate, they are appropriate in other areas, such as securities and credit rules.

Competitiveness

We are mindful, as is this Committee, of the need to ensure that any tax legislation does not hinder the ability of U.S. corporations to compete in the global marketplace. Congress should weigh carefully whether proposals intended to restrict such activities will, in fact, have unintended adverse effects on American business and the American economy. For example, some options consider various limitations on the amount of interest corporations would be permitted to deduct. This approach could have a severe consequence for competitiveness. According to our

estimates, a 20 percent reduction in the amount of interest that could be deducted by corporations would raise the cost of capital for U.S. corporations by more than 6 percent. In the long run, the nation's capital stock would be reduced by approximately 1 percent, or $350 billion.

In contrast to our classical corporate income tax structure, which applies tax at both the corporate level and at the shareholder level, most other major industrialized countries provide some relief from the burden of the double taxation of dividends. In principle, this relief makes it easier for foreign firms to obtain corporate financing by increasing the after-tax return to investors.

Many countries provide relief by giving the shareholder a tax credit for all or part of the corporate tax paid, in effect treating that part of the corporate tax as if it were merely a withholding of tax on the shareholder. The shareholder adds the credit to taxable income and then credits an equal amount against his or her individual income tax due.

Eight of the 12 European Community member countries use such an approach, as do Canada, Japan, Australia, New Zealand, and Finland. In Germany, Italy, Australia, and New Zealand, double taxation is completely eliminated by allowing the shareholder to receive credit for the full tax paid by the corporation. Several other countries substantially reduce double taxation; for example, in Belgium, France, Ireland, and the United Kingdom, the shareholder credit amounts to at least half the corporate tax. In Japan and Spain, the credit amounts to 10 percent of the dividends received.

A less frequently used alternative method provides relief for the double taxation of dividends at the corporate level by subjecting distributed profits to a lower rate of tax than retained profits. This approach is used by Germany and Japan, which combine this approach with a shareholder-level credit, and by Greece and Norway. In Germany, for example, the corporate rate of 56 percent on retained profits is reduced to 36 percent on distributed profits. The 36 percent rate is then fully credited to the shareholder, eliminating double taxation of distributed dividends. Japan currently taxes retained profits at 40 percent and dividend distributions at 35 percent. In addition, shareholders receive a tax credit for 10 percent of dividends received. However, beginning in 1990, Japan will replace its split rate tax with a single rate of 37.5 percent.

II. OPTIONS MODIFYING THE CURRENT TAX TREATMENT OF CORPORATE INTEREST

Current Law

Under current law, interest on corporate debt is generally deductible by the corporate payor as paid or accrued. In the case of a corporation as in the case of a sole proprietor, interest expense is viewed as a cost of doing business and thus an appropriate deduction in determining net income subject to tax. Consequently, the corporate interest deduction is currently limited in only very special circumstances and for clear-cut policy reasons. These limitations can be divided into three categories: (1) interest on "debt" that is more properly viewed as equity; (2) interest on debt used to finance tax-favored income; and (3) interest on current debt used to finance certain future income. Many of these limitations apply to individuals as well as to corporations.

Debt More Properly Viewed as Equity

Section 279 is a provision that limits the corporate interest deduction for debt that is more properly viewed as equity. It disallows interest deductions on certain indebtedness incurred to acquire another corporation's stock or at least two-thirds of its assets. This disallowance applies only to interest in excess of $5 million and only if: (1) the debt is substantially subordinated and carries an equity participation, such as being convertible or including warrants to purchase stock; and (2) the issuer has a debt/equity ratio that exceeds two to one or has annual earnings that do not exceed three times annual interest costs.

Section 385 is a grant of regulatory authority for the Treasury to determine whether an interest in a corporation is to be treated as stock or debt. The statute lists five factors that may be included in making this determination, including whether there is a written unconditional promise to pay a sum certain on a specified date, whether there is subordination, and the debt to equity ratio of the corporation. Although section 385 was enacted in 1969, to date no satisfactory general rules have been developed under this provision. The Internal Revenue Service has administered this area on a case-by-case basis by examining all the characteristics of a particular instrument in determining whether it is more properly treated as debt or equity for federal income tax purposes.

Debt Financing Tax-Favored Income

Section 265(a)(2) denies an interest deduction on indebtedness incurred or continued to purchase or carry tax-exempt income. Under section 265(a)(2), the deduction is

disallowed only if there is a connection between the indebtedness and the acquisition or holding of the tax-exempt obligation. Section 265(a)(2) is intended to prevent the double benefit of both earning tax-free income and deducting related interest expenses.

Section 246A limits the dividends received deduction if the investment in the stock is directly attributable to indebtedness. The regulatory authority under this section provides for the disallowance of interest deductions in lieu of reducing the dividend received deduction where the obligor is someone other than the corporation receiving the dividend. This provision prevents a double benefit from the interest deduction and the dividends received deduction.

Debt Financing Future Income

For costs incurred in manufacturing or constructing certain tangible property, section 263A requires that interest paid or incurred during the production period be capitalized. Interest is allocable to the production of property not only if it can be traced specifically to production, but also where the taxpayer could have avoided the interest expense if amounts applied to production expenditures could have been used to repay debt. These interest capitalization rules are intended to avoid a mismatching of income and expense, and capitalized interest is, in effect, deductible when the related income from the property is realized. Similarly, section 263(g) requires the deferral of the deduction for interest allocable to personal property that is a part of a straddle until such property is sold and associated gains are realized.

Despite these various limitations, interest paid or accrued by corporations continues for the most part to be deductible. Accrued interest deductible by corporations includes original issue discount. Since mid-1982, taxpayers that issue debt with original issue discount have been required to compute the deduction of original issue discount on a constant yield basis over the life of the debt instrument. In the case of zero coupon instruments, OID thus accrues in steadily increasing amounts over the term of the obligation. In addition, the OID rules require symmetry: Cash basis as well as accrual taxpayers must include OID in income as the interest accrues. This income inclusion, however, is largely an academic requirement since tax-exempt and tax-favored entities (such as insurance companies) are the principal purchasers of deep discount or zero coupon bonds.

Discussion

The tax bias against equity under current law could be greatly reduced either by providing some form of tax relief for equity distributions or by limiting the deductibility of interest expense. These apprcaches, however, raise very different policy issues. Before turning to comments on specific options that

would limit interest deductions, I would like to review some of our general concerns about proposals of this type.

Most important, limiting interest deductions would increase the cost of capital to American corporations and thus hinder their efforts to compete in the global economy. It would have adverse effects on the domestic economy. In addition, limits on the deductibility of interest on acquisition-related debt would favor foreign acquirers to the extent they are able to deduct interest payments in their home countries.

Limiting the deduction for interest paid would also increase significantly the tax liabilities for corporations in industries where a high degree of leverage is customary, such as public utilities, real estate, and finance. In the absence of special rules, this effect would be especially severe on financial institutions, which pay some 65 percent of all corporate interest. In addition, it would adversely affect small firms, start-up firms, and venture capital firms that can borrow only at high rates of interest.

A limitation on corporate interest deductions would discourage use of the corporate form. Any further disadvantage to the use of the corporate form requires particularly careful consideration given the fundamental changes made by the 1986 Tax Reform Act. Before the 1980s, certain tax rules mitigated the impact of the separate tax on equity income. Returns on equity were taxed at the corporate level at rates below individual rates (at times markedly so), and the second level of tax on the distribution of income from corporate equity to shareholders could be deferred by retaining earnings and ultimately minimized through a sale of stock taxed at preferential capital gain rates. The rate inversion introduced by the 1986 Act, and the repeal of the capital gain preference, the dividend exclusion, and the General Utilities doctrine, have reduced or eliminated these compensating factors that formerly ameliorated the impact of the separate tax on corporate equity income.

Restricting the deduction for interest paid would also raise issues with respect to the treatment of interest substitutes. If the deduction of interest were limited, corporations would have additional incentives to lease assets and deduct rental payments rather than borrow to finance a purchase of the assets. A portion of such rental payments would represent implicit interest.

Six of the nine options before this Committee regarding changes in the tax treatment of interest payments deal generally with redressing the current bias against equity financing by limiting interest deductions. With one exception, relating to the current accrual of original issue discount, we would oppose these proposals for the reasons stated above.

The other three options are aimed specifically at deterring LBOs. These proposals reflect the view that changes in the tax law should be made to specifically address LBOs. We do not share that view.

Comments on Specific Options

Deny Interest Deduction and Require Recognition of Gain at the Corporate Level For Hostile Acquisitions (Option B-1)

This proposal would deny the interest deduction for debt incurred in a hostile tender offer, defined as an offer disapproved by a majority of the independent members of the target's board. In a hostile stock acquisition, the proposal would also require recognition of all gain at the corporate level.

It is by no means clear that hostile LBOs, as a general matter, are any less likely to be beneficial than friendly ones. A hostile LBO can just as readily increase efficiency and productivity as a "friendly" transaction. Moreover, tax rules designed to discourage hostile takeovers would clearly serve to entrench management.

The proposal also poses administrative and definitional difficulties. A board of directors' determination that a takeover is or is not acceptable is frequently a highly complex and dynamic process. The effect of this proposal would also be to bring new and extreme pressure to bear on the decisionmaking of independent directors.

None of the perceived problems associated with hostile acquisitions is caused by current tax rules. Accordingly, we would oppose attempts to address any such problems through changes in the tax code at this time.

Deny Interest Deduction for Acquisitions Not in the Public Interest (Option B-2)

Under the proposal, the Federal Trade Commission (FTC) would determine whether a proposed merger would have a substantial adverse effect on employment. If the FTC makes such a finding, the merger would be deemed not to be in the public interest and the corporate deduction for interest on debt used to finance the merger would be disallowed.

This proposal uses the tax code to address non-tax policy concerns, and we would object to it on that basis. Furthermore, it is not clear how the FTC would be able, in any realistic way, to make the findings that would trigger the proposed nondeductibility, either before or after a takeover. The effect of a change of control on employment depends on a variety of factors, many of which cannot be predicted or anticipated. It should

also be noted that the proposed standards for FTC review are biased: They appear to exclude consideration of the benefits derived from shutting-down obsolete or otherwise inefficient operations. For example, a merger that produced short-term unemployment could lead to long-term increases in employment, but would presumably fail the proposed test.

Deny Interest Deductions on High-Yield Debt (Option B-3)

The proposal would deny the deduction for interest payments on so-called "junk bonds" above a specified dollar amount, such as $50 million. It would define a junk bond by reference to one or more of several characteristics, including interest rate, subordination, convertibility and rating.

So-called "junk bonds" can serve an important and legitimate role in the financing of corporate activity. Increasing the cost of their use could restrict access to capital markets for many firms and raise the cost of capital to others. It would hurt issuers of high-risk bonds, including small firms, start-up firms, and venture capital companies that have difficulty raising funds in other ways. If the problem identified is LBOs, a proposal aimed at junk bonds, which are used in some LBOs but not others and which are used for purposes other than LBOs, is not well targeted.

This comment should not be read to imply a lack of concern about risks inherent in high-yield bonds. Existing LBOs and the junk bonds used to supply the debt capital through which they are financed have thrived in a period of extended economic expansion. Under such a favorable economic environment, some investors may not have sufficiently understood the risks of junk bonds in the event of a downturn in the economy. While older studies have found the default rate for junk bonds to be low, a more recent study that tracked junk bonds over time shows default rates to have been substantial, even when the economy was strong. This study does not, however, analyze the costs of defaults nor does it analyze whether investors are adequately compensated for the greater risk inherent in junk bonds by higher returns. Ultimately, however, these are corporate finance, not tax, issues that are best addressed through the securities laws.

Reduce Corporate Interest Deductions to Permit a Dividends Paid Deduction on a Revenue-Neutral Basis (Option B-4)

The proposal would deny the deduction for all corporate interest by a specified percentage. The money so raised would be used to permit a deduction for the same percentage of dividends paid. The percentage would be determined on a revenue-neutral basis.

By limiting the corporate interest deduction, this proposal raises concerns similar to those raised by other such proposals. In addition, corporations with characteristically above-average

debt ratios would be heavily penalized, and corporations that are predominantly equity financed would receive a windfall, as would their shareholders.

Determining revenue-neutral rates at which interest and dividends could be deducted would be very difficult. First, estimating behavioral responses on the part of investors and corporate managers would vastly complicate calculation of a break-even percentage. Second, calculation of the revenue-neutral deduction percentage would depend on our ability to forecast accurately interest rates, debt levels, and dividend payments. The actual amounts for any of these variables could differ widely from the amounts forecasted. As a result, a disallowance ratio that is revenue neutral under current economic conditions would be likely either to raise or to lose revenues under economic conditions prevailing in the future.

In order to maintain revenue neutrality, the deduction percentage would have to be adjusted on a regular basis. The percentages could be adjusted annually, based either on current forecasts or on actual data on dividends and interest payments from a prior year. Imposing such variability on a corporation's cost of capital, however, would likely inhibit long-term planning and investment.

Even without considering behavioral effects, the need to adjust the deduction percentage to maintain revenue neutrality over time can be illustrated by examining historical data. If the revenue-neutral rate had been set in the 1960s, it would have been approximately 49 percent. In the 1970s, it would have been 70 percent, 21 percentage points higher. Between 1980 and 1986, the revenue-neutral rate would have increased again, by an additional 8 percentage points, to 78 percent.

The proposal also raises technical issues, such as the interaction of the dividends paid deduction with the dividends received deduction for corporations, the treatment of tax-exempt and foreign shareholders, and other issues that arise in connection with proposals for dividend relief. Such issues are addressed in the following section in the discussion of dividend relief proposals.

<u>Repeal Deduction for Corporate Interest Expense and Provide Shareholder Credit on Dividends (Option B-5)</u>

This proposal would deny any deduction for corporate interest expense. Shareholders would receive a credit for corporate taxes paid on earnings distributed as dividends.

Rather than equalizing the treatment of debt and equity, this proposal would turn current law on its head by taxing earnings distributed as interest twice -- once when earned by the corporation and once when received by the debtholder -- and earnings distributed as dividends only once (at the corporate level). A

shareholder-level credit with respect to distributed earnings raises issues that will be discussed in the section below relating to equity relief proposals.

The complete repeal of the deduction for corporate interest highlights issues raised by all proposals that limit corporate interest deductions: increasing the cost of capital, favoring the non-corporate sector, increased pressure on distinguishing debt from equity instruments, and the need to identify interest analogs such as rents or royalties. Because this proposal denies all corporate interest deductions, it also exacerbates transition-related problems. The proposal could, for example: (a) dramatically increase corporate tax collections and correspondingly threaten the financial stability of many corporations; (b) cut dividend payments (and personal tax collections) during the interim while corporations restructure by replacing "debt" with "preferred stock"; and (c) precipitate a restructuring of the investment portfolios of tax-exempt organizations. While these and other concerns could be reduced by substantial transition relief, there does not appear to be a tax policy justification for this proposal that is sufficiently compelling to warrant its enactment.

Disallow Corporate Interest Deduction in Excess of a Specified Rate of Interest (Option B-6)

The proposal would deny in whole or in part the deduction for corporate interest paid in excess of some specified percentage above the applicable federal rate (AFR). This partial interest disallowance would not affect the characterization of the instrument as debt.

This approach is apparently based on the assumption that an unusually high interest rate indicates that a purported debt obligation is really "disguised equity." Under this view, a high interest rate indicates a high degree of risk, which is usually associated with equity holdings. It is undeniable, however, that many obligations traditionally viewed as debt also carry substantial risk. Moreover, the sources of risk for equity and low-grade debt are often quite different. For example, the risk of an equity owner includes the risk associated with being last in line (after creditors) in any claim against the corporate assets. On the other hand, even significant risk of senior debt holders, as in the case of a financially troubled company, does not result from the existence of any prior claims.

Finally, proposals such as this one would favor stable and established firms and would be biased against start-up companies, small businesses, venture capital companies, and other inherently risky ventures. Presumably, the rate of deductible interest could be set at a higher rate for such firms, assuming they could be adequately identified, but this would create a bias against still other firms with equal borrowing costs and would raise difficult issues of definition and administration.

Establish a Normative Level of Debt to Equity and Penalize Levels that Exceed this Norm (Option B-7)

The option proposes that, if a corporation's debt to equity ratio exceeds a specified percentage, such as 80 percent, a penalty would be imposed, such as permitting only 50 percent of interest on debt in excess of the ratio to be deducted.

There is no single debt/equity ratio that is appropriate for all corporations. Real estate and financial institutions, for example, have traditionally had high debt/equity ratios; service corporations have not. Even within an industry group, debt/equity ratios vary tremendously depending on conditions in the markets the corporations serve and how capital markets evaluate their managements.

We acknowledge, however, that a high debt/equity ratio is one factor to be taken into account in determining whether a purported debt instrument should be treated as debt for tax purposes. Nonetheless, we think establishing normative debt/equity ratios, and using them in a single-factor test, is highly undesirable.

Replace Corporate Interest Deduction with an Annual Percentage Deduction Based Upon Overall Capitalization (Option B-8)

Under this proposal, the corporate interest deduction would be denied altogether and the resulting revenues would be used to permit, on a revenue-neutral basis, an annual percentage deduction based on a company's overall capitalization. Overall capitalization, however, would be defined for financial corporations in order to permit them to offset interest expense against interest income.

This proposal is apparently based on the view that lenders and shareholders of a corporation are both investors in the corporation and they merely have different claims and rights with respect to the corporation's assets. Under such a view, which is not without its supporters, there is no principled reason for distinguishing the tax treatment of debt and equity. However, many of the issues discussed above in connection with maintaining revenue neutrality within the scope of a particular proposal would apply here as well, including the accuracy of forecasts and the adverse effect on corporate planning. There would also be substantial winners and losers as a result of the conversion to such a dramatically different system, raising significant transition problems.

Limit Deductibility of Accrued but Unpaid Original Issue Discount (OID) (Option B-9)

This proposal would deny the deduction for corporate interest expense on an original issue discount (OID) obligation issued in

a transaction in which debt replaces equity until such time as amounts of interest were in fact paid. It is further suggested that this interest disallowance might apply only to OID obligations held by tax-exempt persons and foreign entities.

In general, there is a sound theoretical basis for allowing a current deduction for accrued, but unpaid, OID. In some cases, however, the assumptions underlying the OID rules do not necessarily apply and it may be inappropriate to accrue currently a deduction for unpaid interest. Thus, for example, the proposed OID regulations do not generally provide for current deduction of contingent interest. Where there is a substantial risk of default, it may be more appropriate to treat the discount as contingent and not to permit a deduction prior to payment. These concerns increase as the term of the bond increases. In addition, in certain cases, administrative concerns may argue against current accrual. These concerns are more likely to arise in longer-term zero coupon bonds and bonds providing for payment in the form of new bonds (so-called payment in kind, or PIK, bonds).

Concerns about current deductibility of OID are particularly strong when the instrument is held by a tax-exempt organization or a foreign person, because the issuer has a current deduction for accrued OID (without an equivalent current cash payment) and the holder has no corresponding income inclusion. In the case of OID, current law already reflects this concern on obligations issued to a related foreign person. No deductions are allowed on such obligations until interest is actually paid.

The proposal also suggests limiting the nondeductibility rule to debt that replaces equity. While debt replacing equity tends to erode the corporate tax base, taxing only such debt suggests that all corporations are free to establish whatever capital structure they choose, but that once they have made their choice they have "pledged" not to change the structure if the change decreases their corporate tax liability. That is, a newly organized corporation would be able to treat its interest deductions more favorably than a corporation wishing to recapitalize. Moreover, defining debt that replaces equity is difficult and complicated.

In sum, we agree that certain applications of the OID rules merit further consideration because of the ability of issuers to exploit the rules. Any change in the treatment of the issuer, however, would require careful consideration of how to treat the debtholder.

III. OPTIONS MODIFYING THE CURRENT TAX TREATMENT OF DIVIDENDS

Current Law

Under current law, corporations are generally treated as taxpaying entities separate from their shareholders. A corporation separately reports, and is directly taxable on, the equity holders' share of income. The after-tax income of a corporation is not taxable to its shareholders until it is distributed to them. Dividends paid by corporations other than S corporations are taxed to individual shareholders as ordinary income. Consequently, corporate taxable income paid as dividends to individuals generally bears two taxes, the corporate income tax and the individual income tax. (S corporations are an exception to this rule. Taxable income of S corporations is allocated and taxed directly to its shareholders.)

Corporate shareholders generally are taxed on at most 30 percent of dividends received from other corporations. Intercorporate dividends among members of affiliated groups (each 80 percent or more owned by a common parent) are not taxable to payee corporations.

Discussion

The disparate tax treatment of debt and equity in the corporate sector creates economic distortions. It distorts decisions regarding a corporation's capitalization and its policies with regard to investment and distribution of earnings in ways that detract from the efficiency of the economy. The double taxation of dividends encourages corporations to finance their operations with debt rather than equity.

Prior to the Tax Reform Act of 1986, corporations with shareholders in relatively high tax brackets were encouraged to retain earnings in order to defer the shareholder-level tax and to transform this income into capital gain. With corporate rates now higher than individual rates, and with the tax rate differential for capital gains now eliminated, equity financing of corporate assets has been made less attractive.

The double taxation of dividends also increases the cost of capital for corporations and thereby discourages capital-intensive means of production in the corporate sector. Similarly, it penalizes goods and services that are more readily produced or provided by the corporate sector and the performance of risk-pooling functions that are most effectively accomplished by corporations. Investors are thus discouraged from using the corporate form even in circumstances where nontax considerations make it desirable.

The LBO phenomenon has focused attention on the bias in our tax system against equity capitalization and has renewed interest in proposals that would provide partial relief from multiple taxation of corporate earnings. A partial dividends paid deduction or partial tax credit to shareholders for dividends paid would represent a meaningful first step toward reducing the tax burden on corporate equity. By making equity securities more competitive with debt, either of these options would reduce the existing incentive for corporations to raise capital through issuing debt.

Most of our major trading partners provide some form of relief from the multiple taxation of corporate earnings. Dividend relief in foreign countries typically is provided by means of a shareholder level credit for part or all of the corporate tax, less frequently by means of a reduced corporate rate on distributed profits or a corporate deduction with respect to dividends paid. Some countries provide full relief from the double tax on dividends. For example, Germany, Italy, Australia, and New Zealand allow shareholders full credit for corporate tax paid. Other countries, including Canada, France, and the United Kingdom, provide partial relief from the double taxation of dividends.

Proposals for relief from the burden of multiple taxation of corporate earnings have substantial merit quite apart from the recent considerations related to LBOs. We recognize, however, that revenue considerations limit Congress's ability to provide such relief at this time. The fact that we cannot currently afford to grant such relief, however, should not obscure its desirability as a matter of sound tax policy.

Comments on Specific Options

Provide a Shareholder Credit for Corporate Tax Paid with Respect to a Percentage of Dividends (Option C-1)

The double taxation of corporate earnings distributed as dividends could be partially relieved by allowing shareholders to claim a credit for corporate tax paid with respect to dividends received from the corporation. Under this approach, the corporate tax may be viewed as a withholding tax for a portion of the individual tax on dividends. The shareholder would "gross-up" dividends by the amount of the credit, include the grossed-up amount in income, and then use the credit to offset tax liability. This approach would directly relieve the same amount of the corporate tax for taxpayers at all income levels. We will discuss this approach more fully below in connection with the dividends paid deduction proposal.

Provide Shareholders with an Exclusion from Income for a Percentage of Dividends Paid (Option C-2)

The double taxation of dividends could be partially relieved by allowing shareholders to exclude from gross income a percentage of dividend income. Prior to its repeal under the Tax Reform Act of 1986, a dividend exclusion was provided for up to $100 in dividends for single individuals and $200 for married individuals who filed joint returns.

A dividend exclusion would provide relief from the individual level tax, although the corporate level tax is generally viewed as creating the additional burden from operating in corporate form. A partial dividend exclusion would provide an increasing amount of relief per dollar of dividends to taxpayers in higher tax brackets and therefore is regressive. Although the lowering and compressing of marginal tax rates under the Tax Reform Act of 1986 has ameliorated this effect, we still find this approach less desirable than either a dividends paid deduction or shareholder credit.

Provide a Dividends Paid Deduction (Option C-3)

This proposal would permit corporations to deduct, in whole or in part, dividends paid. Under the option, the deduction could be reduced to the extent the corporation has foreign and tax-exempt shareholders or a compensating tax on such shareholders could be imposed so that one level of tax would be assured.

If the double taxation of corporate earnings distributed as dividends is relieved partially by providing a deduction or credit for only a percentage of dividends paid to shareholders, the tax treatment of dividends and interest payments would not be equalized; however, the present bias against equity would be lessened.

Because both a dividends paid deduction and a shareholder credit would reduce the incentive to retain earnings, corporations would be likely to pay greater dividends and to seek new capital in financial markets. Corporations would thus be subject to greater discipline in deciding whether to retain, and how to invest, their earnings. The increased level of corporate distributions could enhance the efficiency of investments.

The Reagan Administration's 1985 tax reform package included a proposal that would have allowed domestic corporations a deduction for 10 percent of dividends paid to their shareholders. The House tax reform bill included a similar dividends paid deduction proposal phased in over ten years.

Dividend relief proposals encourage distribution of corporate earnings over retention of such earnings. All of these dividend-

relief proposals, however, would raise difficult issues, including the treatment of tax preferences, foreign shareholders, tax-exempt shareholders, and new versus old equity. These issues are discussed below.

Treatment of tax preferences. Dividend relief proposals raise issues with respect to whether relief should apply to dividends paid out of tax-free or preferentially-taxed corporate income. If the objective of the proposals is to relieve the double taxation of dividends, it could be argued that providing relief to dividends paid from tax-free or tax-preferred income is not justified. However, if the policy underlying the preference is to provide incentives for certain economic activities, then the preferential treatment should arguably be passed through to the individual taxpayer. Under the latter approach, some shareholders would receive relief for taxes which were not actually paid at the corporate level because dividends were paid out of partially or fully tax-exempt income.

The Reagan Administration's proposal to permit a deduction for dividends paid was limited so that the deduction would have been allowed only with respect to dividends attributable to earnings that had already borne the corporate income tax. Dividends eligible for the deduction would have been paid from a qualified dividend account, which would consist of all earnings that had borne the regular corporate tax, less any deductible dividends paid by the corporation. The dividends paid deduction, therefore, would not have been available with respect to corporate distributions from tax-preference income.

The qualified dividend account would have been increased each year by the amount of the corporation's taxable income (computed without regard to the dividends paid deduction). However, the amount added each year would have been reduced by the amount of taxable income that, because of any allowable preferences or credits, did not actually bear the corporate tax. Even in such a system, however, problems could arise regarding dividends paid out of income from prior years, if the tax rate for that year differed from that of the year of payment.

A shareholder credit system would also require rules regarding the treatment of tax-preferred and tax-exempt income.

Foreign shareholders. Another issue is whether relief should be available to foreign shareholders in U.S. corporations. Unless special rules are devised, a dividends paid deduction would permit corporate earnings to pass untaxed to such shareholders. If the objective of the proposal is to provide relief from double taxation, foreign shareholders should be allowed the same relief as residents. It could also be argued, however, that the proposal is not intended to provide unilateral tax relief on income earned by foreign shareholders in U.S. corporations and that any such relief should be provided by the home country. If it were decided that the United States should not grant relief

unilaterally from double taxation, selective relief could be provided through bilateral tax treaties, as other countries with shareholder-credit mechanisms usually do.

The Reagan Administration's proposal for dividend relief would have imposed a compensatory withholding tax on dividends paid to foreign shareholders who are not entitled to the benefits of a bilateral tax treaty. The House version of the 1986 Tax Reform Act would have extended the deduction to a foreign corporation at least half of whose income is from a U.S. business.

Tax-exempt shareholders. The treatment of tax-exempt shareholders creates similarly difficult issues regarding the extent of relief. If relief is provided with respect to tax-exempt shareholders for a portion of dividends paid, either in the form of a deduction to the corporation for dividends paid to tax-exempt stockholders or in the form of a refundable shareholder credit, then the portion of the business income of a taxable entity that is distributed to tax-exempt shareholders would escape taxation entirely. However, if the objective is to tax dividends only at the shareholder level, tax-exempt shareholders should enjoy the same corporate-level relief as other shareholders. If such relief for tax-exempt shareholders is believed to be desirable, it would be provided automatically under the dividends paid deduction approach. Under a shareholder credit approach, such relief could be provided by allowing the gross-up and credit to tax-exempt shareholders (assuming that the credit is refundable).

Such relief for tax-exempt shareholders also could be denied under either approach. For example, the House tax reform proposals contained a provision for a dividends paid deduction that would have denied tax relief to tax-exempt organizations by requiring such organizations to include the deductible portion of dividends paid as unrelated business income. Under a shareholder credit system, tax relief could be denied to tax-exempt shareholders by making the credit nonrefundable.

New versus old equity. Dividend relief would provide a windfall to current shareholders to the extent that such shareholders paid a lower price for corporate stock because of the double tax on dividends. To prevent such windfall gains, dividend relief could be provided only for new equity, but this, too, would create problems. For example, corporations would have an incentive to redeem old shares and to replace them with new shares. Thus, rules would be needed to deny relief for new equity that replaces old equity. Such rules would considerably complicate the tax code.

Both the dividends paid deduction and the shareholder credit can be designed to deal with the special problems discussed above. Although the dividends paid deduction has the advantage of simplicity in that it does not directly affect the computation

of the shareholder's tax liability, it does not provide much flexibility. If it is determined that relief should be denied to certain dividend recipients, such as nonresident shareholders in U.S. corporations, the shareholder-credit approach may be preferable because of its flexibility in this regard.

IV. OPTIONS RELATING TO INVESTMENT BANKING FEES

Current Law

Profits and other income, including advisory fees, earned in connection with leveraged buyouts and other mergers and acquisitions are usually taxed as income or gain under generally applicable rules. A special 50 percent excise tax is imposed, however, on any gain from "greenmail payments," defined as payments received in redemption of stock held for less than two years if the redeeming shareholder has made or threatened a tender offer for the stock of the corporation. The excise tax does not apply if the redemption offer was also made to other shareholders. In addition, an employer may not deduct so-called "golden parachute payments," i.e., payments triggered by changes in the ownership of a corporation or its assets, and the employee must pay a 20 percent excise tax on such payments.

Comments on Specific Options

Impose Nondeductible Excise Tax on LBO-Related Income (Option D-1)

This proposal would impose a nondeductible excise tax on income derived in connection with LBOs and other mergers and acquisitions. The tax would generally be at a 5 percent rate, but there would be an additional 20 percent tax on investment banking fees.

This proposal is apparently based on the view that LBOs are unduly stimulated by high fees earned in connection with such transactions. The proposal would apply, however, regardless of whether the fees earned in connection with a particular LBO were inordinately high or whether the LBO was driven by factors completely apart from the fees.

While the fees earned in connection with LBO transactions are clearly substantial, we believe it is inappropriate to tax such fees in a punitive manner. The appropriate level of fees should be set by the marketplace. If the fees being charged to the parties in these transactions are too large, competition should bring them down.

Impose Nondeductible Excise Tax on Excessive M&A Compensation (Option D-2)

This proposal would impose a substantial nondeductible excise tax on "excessive compensation" derived by individuals from services rendered in connection with merger and acquisition activity. The threshold for excessive compensation would apparently be set at a high level (such as $50 million per year).

This is a slight variation on the preceding proposal, and, in our view, it suffers the same defects. By limiting the application of the tax to income above a threshold such as $50 million, however, the proposal seeks to penalize only those who are most successful. It is difficult to identify a sound tax policy that would justify such a rule.

Impose Nondeductible Excise Tax on Certain Advisory Fees (Option D-3)

This option would impose a nondeductible excise tax on income derived from advisory fees that are based on the success of an offer and on the income of financial advisors who both provide an "independent" appraisal of the target company's assets and also play a role in the tender offer for the company.

This proposal is designed to discourage arrangements that raise serious conflict of interest concerns. We share the concerns that underlie this proposal and believe that serious study should be given to addressing them, either under the federal securities law or state corporation laws. Because these concerns are not tax-related, however, it is inappropriate to address them through the tax code.

V. OPTIONS RELATING TO THE TAX TREATMENT OF FOREIGN PERSONS AND TO ISSUES OF FOREIGN INVESTMENT

Current Law

Foreign investment in the United States takes a variety of forms. Two of the most important forms are loans (either to related or unrelated U.S. persons) and direct equity investment through controlled domestic subsidiaries.

Interest paid or accrued to a foreign corporation or nonresident alien is deductible by the U.S. borrower according to the same rules applicable to domestic transactions, except that the U.S. borrower is not entitled to deduct original issue discount on obligations held by certain related foreign persons until the time of actual payment.

Under the general rule, interest actually paid from U.S. sources to foreign persons is subject to a 30-percent withholding

tax, imposed on the gross amount of the interest payment. There are, however, several major exceptions to this general rule of taxability. First, the United States does not impose any tax on interest paid to foreign corporations or nonresident aliens (other than banks and persons related to the borrower) with respect to registered debt instruments and certain bearer debt instruments issued in accordance with specified procedures. Similarly, U.S. tax is not imposed on interest paid to foreign persons with respect to deposits with banks and certain other financial institutions, or with respect to original issue discount obligations with maturities not exceeding 183 days at the time of issuance. Finally, the 30-percent withholding tax on interest may be reduced or eliminated altogether under the terms of an applicable tax treaty between the United States and the country of residence of the beneficial owner of the interest.

Like interest, dividends actually paid to foreign corporations and nonresident aliens are generally subject to a 30-percent withholding tax imposed on the gross amount of the dividend payment. There are no statutory provisions that reduce or eliminate this withholding tax, but the tax may be reduced by tax treaty.

Capital gains realized by foreign persons on the sale or exchange of debt instruments are generally not subject to U.S. tax. There are exceptions to this rule for gains on certain debt obligations secured by U.S. real property and gains that are effectively connected with a U.S. trade or business. Gains on the disposition of debt obligations are taxable to foreign persons as interest income to the extent attributable to accrued interest or original issue discount (but not market discount), although the tax on such income may be reduced or eliminated by any of the rules previously discussed.

Similarly, gain realized on the exchange of stock in a domestic corporation, whether in liquidation of the corporation or in a normal sale transaction, is generally not included in the gross income of either a nonresident alien shareholder or a foreign corporate shareholder. There are a number of exceptions to this rule, the most important of which relates to ownership of interests in United States real property.

Discussion

In our view, the dominant issue in the foreign options is the extent to which the obligations of the United States under its many existing tax treaties should be respected. Treasury wishes to reiterate its general objection to the override of tax treaties. Treasury objects to override not merely because it violates our international commitments, but also because it is in most cases inconsistent with the United States' long-term economic and political interests.

Our tax treaties are not unilateral concessions to the interests of foreign persons investing in the United States; they represent a careful balance of interests and confer substantial benefits on many U.S. persons investing overseas. The override of existing tax treaties, and even the recurring threat of override, make it difficult for U.S. treaty negotiators to obtain concessions that will benefit U.S. investors, since foreign negotiators feel that the United States may later renege on its own concessions. Moreover, overrides by the United States will inevitably invite retaliation from our trading partners. For these reasons, it is Treasury's strongly held view that, although Congress clearly is empowered to override U.S. treaty obligations, it should do so only in the most exceptional cases and after full and careful consideration of the consequences of such action. Treasury does not believe that any of the five foreign-related options that are the subject of these hearings presents an appropriate occasion for treaty override.

Comments on Specific Options

Tax on Imputed Income of Domestic Corporations to Account for Offshore Interest Expense (Option E-1)

This proposal would apply to a domestic corporation if it is controlled by foreign persons and otherwise would be subject to a limitation on the deduction of interest expense under one of the interest limitation proposals discussed above. Under the proposal, the corporation would be required to include in its U.S. gross income an amount of additional income to account for "tainted" interest expense borne by related foreign corporations outside the United States. The "tainted" interest expense is interest that would be disallowed if it were borne by a domestic corporation.

It is unclear under this proposal how the correct amount of tainted offshore interest expense would be determined. One approach would be to consider only offshore debt that can be "traced" to the domestic corporation (*e.g.*, acquisition debt). A second approach would be to consider the related group's entire worldwide interest expense and allocate to the domestic corporation its proper share, based on the theory of fungibility of money.

There are a number of serious problems with the proposal. First, the proposal may violate the prohibition contained in numerous of our tax treaties against discrimination on the basis of capital ownership.

Second, the determination of whether taxpayers in a foreign jurisdiction have an unfair advantage over U.S. taxpayers cannot be made on the basis of a single criterion such as the deductibility of interest expense. A host of other factors must be considered, including tax rates, the definition of the tax base,

investment incentives, depreciation methods, the treatment of foreign source income, and direct and indirect government subsidies. The problem of focusing on a single criterion is illustrated by the present proposal, which attempts to neutralize the advantage of a foreign acquirer deducting interest paid with respect to debt financing offshore but does nothing about the advantage of a foreign acquirer deducting dividend payments with respect to equity financing offshore (or the advantage for shareholders who receive a credit for taxes paid by the foreign corporation).

Third, the proposal would be difficult to administer and enforce. The proposal assumes, for example, that it is feasible to identify foreign corporations that are related to a domestic corporation. In fact, this can be a very difficult task for the Internal Revenue Service, often requiring the use of harsh statutory or regulatory presumptions. More fundamentally, if administered equitably, the proposal would require domestic corporations to provide the Internal Revenue Service with detailed information concerning the worldwide interest expense of the corporate group and the extent to which such interest expense generates a foreign tax benefit.

Reimpose a Withholding Tax on Portfolio Interest (Option E-2)

This proposal would reimpose a withholding tax on interest paid to foreign persons with respect to certain portfolio debt obligations ("portfolio interest").

Prior to the Tax Reform Act of 1984, a 30-percent withholding tax was imposed on portfolio interest paid to foreign persons, although the tax was sometimes reduced under the provisions of an applicable tax treaty. The tax was eliminated by the 1984 Act, in part because U.S. borrowers were avoiding the tax through the use of foreign finance subsidiaries, and in part because Congress recognized that the tax was blocking efficient access to the rapidly developing Eurobond capital market for U.S. borrowers.

The proposal to reimpose a withholding tax on portfolio interest is objectionable on several grounds. The question of whether to tax portfolio interest was thoroughly debated in 1984, and a decision was made not to tax. Treasury supported that decision in 1984, and we continue to support the decision now. Reimposition of the tax after only five years could significantly disrupt the Eurobond capital market, promote skepticism about the U.S. commitment to particular tax policies in this area, and possibly trigger a withdrawal of substantial amounts of foreign capital from U.S. markets. Moreover, reimposition of the tax would once again erect a barrier against U.S. issuers seeking access to international capital markets. Such a barrier would have no obvious relationship to the debt/equity concerns that are the focus of the current hearings, since access to international markets would be denied to all U.S. issuers, regardless of their degree of leverage or their status as takeover targets. Finally,

for reasons previously stated, Treasury opposes any reimposition of a withholding tax at rates that would apply notwithstanding contrary rates prescribed in existing treaties.

<u>Limit Corporation's Deduction for Interest Paid to Related Tax-Exempt Persons Where Interest Exceeds a Certain Percentage of Income (Option E-3)</u>

This proposal would limit a corporation's interest deduction for interest paid to certain related parties to prevent the sheltering from U.S. tax of more than a designated percentage of the corporation's taxable income (computed without regard to the interest deduction or net operating losses). The limitation might be applied only to interest paid to related parties who are not subject to U.S. tax.

The proposal is similar to a provision passed by the Senate in 1986 but deleted from the final Tax Reform Act in conference. Treasury opposed the provision in 1986 and continues to oppose it in its present form. The proposal should be rejected as inconsistent with this country's tax treaty program. The proposal appears to be targeted primarily at related foreign lenders, since they are the related lenders most likely to be exempt from U.S. tax. Interest paid to such lenders is normally subject to the full U.S. withholding tax (because the portfolio interest exemption does not apply to related party interest); thus, the proposal apparently would apply only where the withholding tax has been eliminated pursuant to one of our tax treaties. The proposal, if so targeted, would clearly violate the nondiscrimination article in the relevant treaty.

<u>Allow U.S. Acquirers to Amortize Target's Goodwill or Review Foreign Acquirers' Advantage from Amortizing Goodwill (Option E-4)</u>

This proposal sets forth two alternatives involving the tax treatment of goodwill in acquisitions. Under the first alternative, taxpayers would be allowed to amortize the goodwill in a target corporation over 40 years if the basis of such goodwill were stepped-up as the result of a taxable acquisition of the target (for example, in an acquisition under section 338). Under the second alternative, U.S. treaty policy would be reviewed to determine whether foreign acquirers are given an advantage over U.S. acquirers relating to the tax treatment of goodwill in acquisitions.

Foreign corporations may have an advantage over U.S. corporations in asset acquisitions because the foreign corporations may be permitted a deduction in their home jurisdictions for the amortization of the cost of goodwill. This is the situation, for example, in Japan, West Germany, and Canada, but not in the United Kingdom. We understand, however, that acquisitions of substantial U.S. business assets (as opposed to stock) by foreign corporations are not common in most

industries, in part because the operation of a U.S. branch instead of a U.S. subsidiary will often result in less favorable treaty benefits and the earlier and more burdensome imposition of tax on U.S. profits not reinvested in the U.S. business. It is important to note that foreign corporations do not appear to have any tax advantage in stock acquisitions of U.S. targets since, even if the foreign acquirer makes an election under section 338 to treat the acquisition as an asset acquisition for tax purposes, the target's goodwill will remain inside U.S. corporate solution. We are not aware of any foreign jurisdiction that permits its corporations to amortize goodwill for tax purposes under these circumstances.

The treatment of goodwill for financial accounting purposes may also disadvantage U.S. corporations relative to their foreign counterparts. Because some countries do not require that goodwill be amortized for financial accounting purposes (for example, the United Kingdom and West Germany, but not Japan or Canada), corporations in those countries may report higher earnings on their financial statements than their U.S. competitors, which are required to amortize goodwill for financial purposes. As a result, such foreign acquirers may have an artificial advantage in the competition for investors. Treatment of goodwill for financial purposes is not, however, a problem that can be addressed through the tax laws.

Completely apart from concerns over foreign competition, there remains the issue of whether we should permit the amortization of purchased goodwill. An argument can be made that the purchase value of goodwill dissipates over time. In other words, the value of goodwill acquired on the acquisition date steadily declines, and additional costs incurred in sustaining the business go toward the development of new or replacement goodwill. Thus, under present law, taxable income is overstated, relative to economic income, by the amount of the current year decline in value of the intangible asset.

Were goodwill to be viewed as a wasting asset, its acquisition cost should be amortized over its useful life. In light of the difficulty in determining the useful life of such an asset, however, it would be appropriate to fix by statute the period over which the cost should be amortized. For financial accounting purposes, the acquisition cost of an asset in the nature of goodwill or going concern value must be amortized over the useful life of such asset, but not to exceed 40 years (Accounting Principles Bulletin 17). Thus, 40 years would be the amortization period for tax purposes that would most likely conform to the financial accounting treatment of goodwill. It is likely that such a provision would result in a large revenue loss.

Tax Foreign Shareholder's Stock Gains on Liquidation or Sale as Dividend (Option E-5)

This proposal would treat the gain realized by a foreign shareholder on the liquidation of a domestic corporation as a dividend, presumably to the extent of the shareholder's ratable share of earnings and profits. The dividend would be subject to withholding, at either the normal 30-percent rate under section 1441 or 1442 or at a lower rate prescribed by an applicable tax treaty. The proposal also suggests that gain realized by a foreign shareholder on the sale or exchange of the stock of a domestic corporation could be treated as a dividend according to similar rules. Although not mentioned in the proposal, gain recognized by foreign shareholders in stock redemptions could presumably also be treated as a dividend to the extent of the shareholder's ratable share of earnings.

The treatment of gain realized by a shareholder on the liquidation of a corporation as a dividend is a logical subject of study for a number of reasons; many of our major trading partners, for example, currently have such a rule and apply it to domestic as well as foreign shareholders. It is possible, however, that such a rule, by increasing the total cost of equity investments in domestic corporations, could actually increase the incentives to use debt financing.

Moreover, there are a number of complex issues that must be resolved before such a tax rule can be enacted. Many of the complexities relate to the potential for avoidance if the historical shareholder sells prior to the liquidation. In addition, our ability to tax the foreign seller's gain as a dividend may be limited by treaty provisions.

VI. OPTIONS MODIFYING THE TAX CONSEQUENCES RELATING TO CERTAIN CORPORATE FINANCING TRANSACTIONS

These options are of such disparate nature that they can be discussed only as separate proposals.

Impose Excise Tax on Acquisitions (Option F-1)

This proposal would impose a nondeductible excise tax of 3 to 5 percent on the value of certain stock and asset acquisitions. The acquisitions that trigger the tax could be limited to acquisitions of more than 50 percent of the stock or substantially all of the assets of a corporation. The proposal could also be limited to hostile acquisitions. The revenues raised by this proposal would be used "to help small business and venture capital situations."

This proposal is in itself a cluster of options. At its broadest it would be a tax on any transfer of stock or assets.

Thus, it seems to be an attempt to raise revenue, and we would oppose it on that basis. In addition, the proposal is not targeted to leveraged acquisitions in that it would seem to apply regardless of whether any debt was used to finance the transaction.

Insofar as the proposal might be limited to hostile acquisitions, we have earlier described our opposition to such proposals. There is no evidence that hostile acquisitions are less likely to be beneficial than friendly acquisitions and the determination of whether an acquisition is "hostile" is fraught with difficulties. These same objections would obviously be applicable here to the extent the proposal is confined to hostile acquisitions.

Reestablishing a Capital Gains Preference for Certain Assets (Option F-2)

This option would provide a 50 percent exclusion for gains from the sale of an asset which is financed through corporate or individual equity (or savings) and held for at least three years.

This proposal resembles the Administration's capital gains proposal in that it seeks to encourage investors to focus on longer term investments by requiring a three-year holding period. However, the proposal is broader than the Administration's capital gains proposal in that it would apparently apply to gains realized on collectibles, and depreciable and depletable property, as well as to gains realized by corporations. The proposal does not provide any special relief for gains of lower income taxpayers, a key feature of the Administration's proposal. On the other hand, the proposal is narrower than the Administration's proposal in that it applies only to property financed through equity or savings. Such a rule would require potentially complex rules to determine whether property is financed by the required sources. While we support long-term capital gains incentives, we believe that this proposal is not as suitably structured as our proposal.

Trigger Gain Recognition when a Corporation Borrows Against Appreciated Assets to Finance Distributions (Option F-3)

Under this proposal, a corporation would recognize gain when it borrows against appreciated assets and distributes the proceeds to its shareholders. The proposal would apply only to the extent the distribution exceeds the amount of the shareholders' contributions to the capital of the corporation plus the accumulated earnings of the corporation. The proposal also includes certain additional rules clarifying its application and implementation.

This complex proposal is apparently intended to shore up the rule of section 311 that treats a corporation as recognizing gain when it distributes appreciated property to shareholders. The

concern appears to be that corporations will avoid the effect of section 311 by borrowing against appreciated assets, without recognizing any gain, and simply distribute the proceeds rather than the appreciated assets.

Assuming this is a correct understanding of the proposal, we would oppose it on several grounds. First, our tax system generally defers recognition of gain until a realization event, such as a sale or other disposition occurs. The proposal, in effect, requires a marking to market of the value of corporate assets, with a tax on the corporation based on that value, even though the corporation retains the full risk of loss should the value of the asset subsequently decline. Current law does not generally treat borrowing as a realization event, even in the case of nonrecourse borrowing in excess of the taxpayer's basis in the asset. We would also note that this proposal is distinguishable from former section 453C, which treated certain indebtedness as payment on installment obligations (thus triggering gain recognition), since in the case of an installment sale the realization event (a sale) has already occurred.

Second, the proposal would apparently trigger gain recognition even where there may in fact be no appreciation in assets that could be distributed (and thus trigger section 311 gain). For example, a service business might have most of its value in goodwill, an asset that it could not distribute in a section 311 distribution. The corporation may also own furniture and fixtures with no appreciation and be able to borrow in excess of the basis and value of the furniture and fixtures because of the goodwill value in the corporation and the corporation's earning power. Alternatively a lender might lend more than the value of the assets in the business based on a shareholder guarantee of the loan. Yet if the corporation borrowed in excess of its basis in these assets and distributed the proceeds to shareholders, the proposal would apparently trigger a tax.

Third, when the provision is triggered, gain is to be allocated to all of the corporation's assets including goodwill. This would presumably be done under a method similar to that required under section 1060, which makes the allocation on the basis of the relative fair market values of all the assets. Thus, an appraisal of the corporation's assets would be required. We are disinclined to add yet another difficult valuation and appraisal requirement to the tax code in the absence of more compelling need.

VII. OPTIONS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs)

Current Law

An Employee Stock Ownership Plan (ESOP) is an employee benefit plan designed primarily for investment in securities of

the employer. ESOPs are generally accorded the same tax advantages as qualified retirement plans. Thus, an employer's contribution to an ESOP is deductible to the employer and not includible in the income of the employee until distributed from the plan to the employee. Income earned on the contribution while held in the plan is not taxable. An ESOP is an individual account plan, which means that each participating employee has an account to which employer contributions in the form of company stock are allocated and the employee is entitled to the value of the account. Thus, the employee, and not the employer, bears the risk of investment gain or loss on stock allocated to his account.

The tax law provides numerous additional advantages to ESOPs and transactions involving ESOPs. First, there is an exception to the prohibited transaction rules generally applicable to qualified plans, permitting an employer to secure loan financing through a leveraged ESOP. In a leveraged ESOP, either the ESOP borrows money from a lender, and the employer guarantees the loan, or, alternatively, the employer borrows from a lender and then makes a mirror loan to the ESOP. In either case, the proceeds of the loan are used to acquire employer securities, either directly from the company or on the open market. The stock acquired serves as collateral for the loan, and is held in a suspense account to be allocated among employees' accounts as the loan is repaid. The employer then makes annual tax-deductible contributions to the ESOP, which are used to pay down the loan. As the loan is repaid, the shares of stock are released from the suspense account and allocated among employees' accounts pursuant to the plan's allocation formula.

Second, section 133 of the Code provides that in the case of an ESOP loan, a bank or other qualified lender may exclude from its income 50 percent of the interest received with respect to the loan.

Third, section 404(k) of the Code provides that an employer may deduct cash dividends paid with respect to employer securities held by an ESOP if the dividends are either (i) paid to the participants (directly or passed through the ESOP), or (ii) applied to make payments on an ESOP loan. Where dividends are used to pay down a loan, the dividend deduction applies to dividends paid with respect to both allocated and unallocated securities. Where dividends paid with respect to allocated securities are used to repay an ESOP loan, a participant who would have otherwise been entitled to the dividends paid with respect to his stock must receive an allocation of additional securities equal in amount to the dividend.

Fourth, under section 1042 of the Code, if an individual sells stock to an ESOP and reinvests the proceeds of the sale in securities of another corporation, the individual does not recognize any gain on the sale. Rather, the individual recognizes the gain, if any, upon subsequent disposition of the

replacement securities. In addition, under section 2057 of the Code, if an estate sells stock to an ESOP, the estate may, under certain circumstances, deduct from the value of the gross estate as much as one-half of the proceeds of the sale.

Other ESOP preferences facilitate loan financing and include exceptions from generally applicable qualified plan rules. The applicable deduction limit for employer contributions to a qualified plan is increased from 15 percent to 25 percent of participants compensation to the extent the contributions are to repay principal on an ESOP loan. Also, substantially greater allocations of benefits to highly compensated employees are permitted under ESOPs than under other qualified plans (up to $60,000 instead of $30,000), and the additional income tax on early withdrawals from qualified plans does not apply to distributions from ESOPs.

Under current law the various tax advantages are available to an ESOP without regard to whether the company maintains any other qualified retirement plan for the employees covered under the ESOP.

Discussion

ESOPs are used both in LBO transactions and to defend against potential takeovers. In an LBO transaction an ESOP may be used to take a company private and create a company that is entirely employee owned, or alternatively, an ESOP may be one of several players in an LBO, as for example where a management group takes a company private and establishes an ESOP as one source of financing. In either case, the various tax benefits for ESOPs may play a significant role in reducing the costs of the transaction.

ESOPs are also frequently established as a defensive tactic to protect against unwanted takeovers or LBOs. This is accomplished by establishing an ESOP that acquires a significant portion of voting stock, thus placing a significant number of voting shares in the hands of employees, who it is presumed (perhaps incorrectly) will vote against a hostile tender offer, thus making it more difficult for a raider to acquire a sufficient number of shares to consummate the transaction.

Comments on Specific Options

Repeal Interest Exclusion on ESOP Loans and Deduction for Dividends on ESOP Stock (Options G-1 and G-2)

These options would repeal or reduce the exclusion for interest received with respect to ESOP loans and repeal the deduction for dividends paid with respect to ESOP securities (except to the extent that corporate dividends are otherwise deductible).

While we are committed to encouraging meaningful employee stock ownership through the ESOP mechanism, the Treasury Department believes that the Committee should consider whether some of the newer tax preferences afforded to ESOPs, including the interest exclusion for ESOP loans, the deduction for dividends paid with respect to ESOP securities, and the nonrecognition of gain on sales of stock to ESOPs, are appropriate. The Treasury Department believes that these new tax benefits afforded to ESOPs may not be justified either by the role of ESOPs as retirement plans or their aggregate effect on corporate performance, and that further study of the appropriateness of these additional tax benefits should be undertaken.

We are concerned that the substantial tax preferences available to ESOPs could lead to abuse. These tax preferences could make them an attractive method of corporate financing, thereby increasing the tax system's bias in favor of debt financing. The interest exclusion results in a significantly lower interest rate on corporate borrowing. Similarly, the deduction for dividends paid with respect to ESOP securities and the ability to use the dividends to repay the debt make establishing a debt-financed ESOP a more attractive means of raising new capital. Under our current estimates, the revenue loss attributable to the interest exclusion alone will be approximately $3 billion over the five-year budget period. Recent increases in ESOP activity suggest that this revenue loss estimate may, in fact, be conservative. While we would oppose any reduction in legitimate incentives for meaningful employee stock ownership, we urge the Committee to be vigilant against the potential for abuse.

Permit ESOPs Only As Supplemental Retirement Plans (Option G-3)

Under this proposal, a company would be permitted to maintain an ESOP that is 100-percent leveraged only where the employer also maintains another, meaningful, qualified retirement plan or, alternatively, the extent of leveraging permissible under an ESOP would be limited.

We do not believe that it would be appropriate to require that an employer maintain some other qualified retirement plan as a precondition to maintaining a leveraged ESOP. We are particularly reluctant, in light of recent congressional concerns about section 89, to embark on the difficult and complex task of defining a "meaningful" retirement plan.

VIII. MISCELLANEOUS

The central concept of this group of proposals is to restrict tax benefits (such as interest deductions) if a merger or acquisition fails to comply with one or more rules that could be

adopted. The rules that are contemplated tend to address fairness, conflict of interest and disclosure issues.

Discussion

While we understand the concerns that underlie these proposals, they do not arise as a result of our tax laws, and we believe the tax laws are not an appropriate means for dealing with them at this time. As a general matter, these concerns are more properly addressed under federal securities and state corporation laws.

IX. CONCLUSION

We at the Treasury intend to continue to monitor LBOs. The conclusions we express today reflect our view that the economic evidence currently available does not justify major steps such as limiting interest deductions. We are particularly concerned that such actions, once taken, may themselves become an impediment to future corporate tax reform to reduce the bias against corporate equity investment.

Fundamental change in the corporate tax system should come only after careful study--and after workable and stable methods of financing such change have been devised. We intend to continue a constuctive dialogue with the Congress to develop proposals which will result in long-run improvements to the corporate tax system.

Mr. Chairman, that concludes my formal statement. I will be happy to answer questions which you and Members of the Committee may wish to ask.

TREASURY NEWS

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

Text As Prepared
May 15, 1989

Remarks by
The Secretary of the Treasury
Nicholas F. Brady
At A Briefing With 130 Of
Senator Dodd's Connecticut Constituents
Dirksen Senate Office Building
Washington, D. C.
May 15, 1989

Good afternoon. It's a pleasure to be here with you today to discuss the President's proposal to end the savings and loan crisis. Senator Dodd has been one of our strongest supporters in this important effort.

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 we commend Chairman Riegle, Senator Dodd and the other Senators who were actively involved in expediting the Senate passage. The House Banking Committee has completed its work and the bill is now being considered by the House Ways and Means Committee.

The cost of solving the S&L problem is truly staggering-- $40 billion already spent and another $50 billion needed to deal with the remaining insolvent S&Ls.

The President's plan creates a new corporation that will borrow the additional $50 billion that will be needed. It will use savings and loan industry funds to collateralize the principal and a combination of industry and taxpayer funds to pay the interest. The private funds which are used to repay the principal and part of the interest naturally will not be counted on budget, but all taxpayer funds used to subsidize interest payments will be counted on budget as they are spent.

This structure extracts and locks up the maximum industry contribution. It provides for a clear accounting of all costs. And it maintains the budget discipline of the Gramm-Rudman process.

Last week, the Ways and Means Committee voted to drive a truck through the Gramm-Rudman process in direct violation of the recent budget agreement the President reached with Congress. The Ways and Means Committee wants to use direct Treasury

borrowing to finance the needed $50 billion and to exempt the additional spending from the Gramm-Rudman deficit reduction targets. This exemption would signal to the world that we are not serious about meeting our deficit reduction responsibilities. When I meet with the finance ministers from other leading industrial nations in the so-called G-7, they tell me how they see Gramm-Rudman as the only hope for deficit reduction in the U.S.

Creating this exemption would establish a bad precedent for similar exemptions any time a large spending need is seen. The President's proposal, on the other hand, would be extremely difficult to duplicate for another purpose. Its very nature requires a substantial, up-front industry contribution that is not likely to be available in other situations.

The stated purpose for the committee alternative is to save money by having Treasury borrow directly at a slightly lower rate. But if we wreck the Gramm-Rudman process, the markets may lose confidence in our commitment to deficit reduction. That could lead to higher borrowing costs, not only for the S&L plan, but for the rest of the Treasury's financing needs, as well. A sustained increase in interest rates of only one basis point (one one-hundredth of one percent), applied to the half of our national debt that is financed on a short-term basis, would raise the taxpayers' bill for interest by about $140 million per year. This is more than the savings from any alternative plan.

When you come right down to it, reduction in interest rates is at the heart of curing both the S&L problem and providing relief for Third World debtors. It is hard to see the logic behind tampering with Gramm-Rudman if we are really serious about lowering interest rates.

The full Senate and the House Banking Committee have previously approved our funding plan, and we will continue to fight for it and fight for it hard. Our plan preserves Gramm-Rudman, which is our best hope for fiscal sanity, perhaps our only hope. It puts as much industry money as possible into the solution. And it is the least costly financing method.

Now, turning to the reform portion of the plan, it is not a bailout for ailing S&Ls. Instead, its purpose is to fulfill the Government's ironclad commitment to protect depositors' savings. But the plan involves much more than writing checks to depositors. It provides significant reforms 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 should demand no less.

National bank capital standards soon will have two minimum requirements: a total capital-to-risk-weighted-assets ratio of eight percent and a tangible-capital-to-total-assets ratio of three percent.

Two thousand savings and loans could meet these standards today. Those two thousand represent four out of every five of the solvent S&Ls in this country. Of the remainder, almost half have tangible capital between two and three percent of assets and should easily be able to meet the standard. Only 246 institutions might have difficulty meeting the standard, but ought to be able to merge with stronger ones.

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 eliminate the conditions which would let it occur again.

The Senate deserves a great deal of credit for moving quickly to adopt the President's S&L reform proposal. It finished action on the legislation a month ago. The House started out the same way, but now the entire process is bogging down. I understand that two committees have been given two more weeks to look at the bill. Delay is costing the taxpayers every day.

Thank you for your interest in this important issue, and thanks again to Senator Dodd for his help and support. Now, I'd be glad to take a couple of questions.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
May 16, 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 $13,200 million, to be issued May 25, 1989. This offering will result in a paydown for the Treasury of about $ 1,700 million, as the maturing bills are outstanding in the amount of $ 14,908 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, May 22, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 6,600 million, representing an additional amount of bills dated February 23, 1989, and to mature August 24, 1989 (CUSIP No. 912794 SV 7), currently outstanding in the amount of $ 7,261 million, the additional and original bills to be freely interchangeable.

183-day bills (to maturity date) for approximately $ 6,600 million, representing an additional amount of bills dated November 25, 1988, and to mature November 24, 1989 (CUSIP No. 912794 SN 5), currently outstanding in the amount of $ 9,139 million, the additional and original bills to be freely interchangeable.

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

The bills will be issued for cash and in exchange for Treasury bills maturing May 25, 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 $ 1,645 million as agents for foreign and international monetary authorities, and $ 4,507 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.

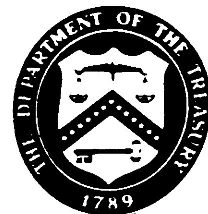
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments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

May 16, 1989

JOHN EDWIN ROBSON
Appointed Deputy Secretary of the Treasury

John Edwin Robson was appointed by President Bush yesterday to be Deputy Secretary of the Treasury. He was confirmed by the United States Senate for this position on May 12, 1989.

As Deputy Secretary, Mr. Robson will act as the chief operating officer of the Treasury. He will participate in all of the Department's key policy deliberations and decisions and play a regular role in relations with Congress. As the number two ranking official of the Department, the Deputy Secretary will assume the duties and powers of the Secretary when the Secretary is absent or unable to serve or when the office of the Secretary is vacant.

Prior to joining the Department, Mr. Robson served as Dean and Professor of Management at Emory University's School of Business and Administration. He was an executive with G.D. Searle & Co. from 1977-1985 and served as President and Chief Executive Officer from 1982-1985.

Mr. Robson is not new to government service, having served three times previously in Presidential Appointments requiring Senate Confirmation. He was Chairman of the Civil Aeronautics Board from 1975-1977; General Counsel and then Under Secretary of the U.S. Department of Transportation from 1967-1969; and a consultant with the Bureau of the Budget from 1966-1967.

Mr. Robson practiced law as a partner with the law firm of Sidley and Austin from 1970-1975; and as an Associate and then Partner with the law firm of Leibman, Williams, Bennett, Baird & Minow from 1958-1966.

Mr. Robson was graduated from Yale University (B.A) and Harvard University School of Law (J.D). He served in the United States Army from 1955-1957. Born in New York City on June 21, 1930 to Edwin O. and Elizabeth S. Robson, he was raised in Illinois. He currently resides in Atlanta, Georgia with his wife, the former Margaret Elizabeth Zuehlke. They have two children, Matthew and Douglas.

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

FOR IMMEDIATE RELEASE
May 16, 1989

CONTACT: Lawrence Batdorf
202/566-2041

New Empirical Analyses of Capital Gains Taxation

The Treasury Department today released three new Office of Tax Analysis staff papers on the taxation of capital gains. The papers provide additional evidence supporting the Treasury Department estimates that the President's capital gains proposal will increase Federal tax receipts.

These empirical papers analyze the effect of changes in capital gains tax rates on taxpayers' capital gains realizations and other income sources. The papers analyze prior tax law changes and find significant short- and long-term responsiveness of taxpayers' realizations to lower capital gains tax rates. Taxpayer responsiveness was more than sufficient to increase total Federal tax revenues.

The papers use three different data sources to analyse the effect of capital gains tax rates on taxpayers' realizations: (1) aggregate time-series data (national data for a 40 year period), (2) pooled cross-section tax return data (four years of individual tax return data), and (3) panel tax return data (individual tax return data following the same taxpayers for a five-year period). In addition, the papers improve on the statistical estimation and models of prior empirical studies.

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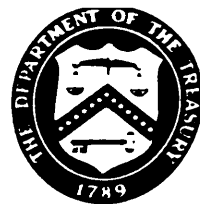
TREASURY NEWS



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

Text as Prepared
For Release Upon Delivery
Expected at 8:00 p.m. DST

Remarks by Thomas J. Berger
Deputy Assistant Secretary for International Monetary Affairs
U.S. Department of the Treasury
before the
Second Harvard Conference on Latin American Debt
John F. Kennedy School of Government
Harvard University
Cambridge, Massachusetts
May 15, 1989

Of Harvard, Machiavelli and New Beginnings: Proposals to Strengthen the International Debt Strategy

Introduction

As a graduate of Harvard College and Harvard Business School, it is a pleasure for me to be back in Cambridge and to participate in the Second Harvard Conference on Latin American Debt. Because this is a Cantabrigian affair, I would like to begin my remarks this evening by sharing with you something I learned during my freshman year in college here in 1970. During that year I took a course offered by the Government Department that required me to read Niccolo Machiavelli's classic book, The Prince. One quotation from this book that I will always remember goes as follows:

> "There is nothing more difficult to take in hand or more perilous to conduct ... than to take the lead in the introduction of a new order of things."

Although Machiavelli could not have known about Secretary Brady's recent initiative regarding international debt when he wrote The Prince in 1532, his words provide certain insights into the process of implementing these proposals. As with any new idea

or "new order of things" there will be doubters who have to be won over and exhausting work to be done. And, there will be numerous perils that will have to be navigated around -- but this is hardly surprising.

Proposals to Strengthen the Debt Strategy

The proposals outlined by Secretary Brady reflected the culmination of an extensive review, which confirmed that while significant progress had been achieved since 1982, several critical issues needed to be addressed. Notably, growth in several of the major debtor countries has been inadequate to support sustained recovery. In some countries, reforms had not been comprehensive and consistently applied. Investor confidence remained weak -- exacerbating capital flight. And commercial bank financial support was not always timely or sufficient.

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 some of the people attending this conference. 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.

In unveiling the approach to strengthen the debt strategy, we focussed on key concepts, rather than offering a blueprint, in order to stimulate discussion and involve key players in the development of a detailed plan. Our proposals were structured to accomplish a broad international consensus that will move us towards objectives for the debt strategy that are widely regarded as necessary next steps.

Those steps include the need to strengthen growth in debtor countries, to address the problem of capital flight, to attract new investment, and to sustain commercial bank financial support. Reductions in the stock of debt are also very important for both economic and political reasons.

Strong economic reforms in debtor countries are an essential first step. There is no substitute for sensible economic policies. No amount of debt or debt service reduction will lead to sustained economic growth without such policies. Inappropriate policies and inconsistent implementation have often been at the heart of economic and financial problems in these countries. In the end, policies must promote confidence in both foreign and domestic investors -- for investment is the single key to growth.

Macroeconomic reforms -- in particular sound fiscal, monetary, and exchange rate policies -- remain critical. However, they are not sufficient. Policies designed to free up rigidities, allow the marketplace to work and boost production are essential to combining adjustment with growth. Thus, debtor countries should pursue policies which liberalize trade, reform labor markets, develop financial markets, and privatize government enterprises. This will allow the private sector to increase employment and efficiency.

Debtor nations must focus particular attention on the adoption of policies which can better assure the return of flight capital; not the ephemeral return that we have witnessed in certain countries from time to time, but hopefully a sustained return of those assets that have fled abroad over the years. Debtor nations can build investor confidence by reducing or eliminating limitations on remittances through tax reform, and by amending policies to assure real rates of return. Such measures can win back the resources that have deserted archaic investment regimes. This will not happen overnight. The web of government controls, intervention, ownership, and regulations has to change. And these reforms must be sustained. Frequently, we have seen capital return early in an adjustment program, only to move out of the country when the program falters.

Privatization programs can offer many countries a large pool of financial resources. In several heavily indebted countries, parastatals control on the order of two-thirds of domestic production. Privatization programs can be structured to attract both domestic and foreign investors, to reduce the stock of external debt, to raise government revenues, and to cut government expenditures on inefficient operations. All told, privatization is a win-win deal.

To support debtor countries' reform efforts, the international community needs to provide timely financial assistance. A broader range of financial support by commercial banks is the key, in our view. Debt and debt service reduction can be an important component of this support and can be structured in ways to meet the diverse interests of commercial banks.

New lending will also be important for most countries, but the magnitudes of new lending required may be substantially reduced by debt and debt service reduction. New financing could include concerted lending, club loans, trade credits, or project finance.

Several steps must be taken to enhance the potential for debt and debt service reduction by commercial banks. Legal constraints in existing agreements now stand in the way of transactions that can directly benefit the debtor country. Waivers of these provisions for a limited period can help to stimulate greater activity within the market and allow those banks willing to accept various options to do so. We believe that a waiver can be

structured to permit multiple debt and debt service reduction transactions during a given period of time. Such a waiver is much less cumbersome than seeking waivers on a transactions-by-transaction basis. Once these waivers are agreed upon, the debtors and creditors should be able to negotiate a range of specific transactions, which might include debt-for-debt swaps, cash buybacks, and interest reduction instruments.

In addition, the IMF and World Bank can facilitate agreement on specific transactions. We have proposed that these institutions redirect a portion of their normal policy-based loans to fund debt reduction transactions such as cash buybacks or collateralized exchanges. We have also proposed that they provide limited interest support for significant debt and debt service reduction. We believe that IMF and World Bank resources should be used to help reduce debt rather than increasing the future servicing burdens of debtor countries.

In addition to pursuing reductions in their debt burdens, developing countries should seek to develop other ways of meeting their financing needs. As I mentioned earlier, both new investment and flight capital repatriation are important sources of capital and can be encouraged through sound policies.

Let me say a few words in particular about the role investment can play in a developing economy. In our view, foreign investment offers countries a unique opportunity to gain access to not only capital but also technology, management expertise, and employment for its citizens. In a time of scarce financial resources, countries simply must be more active in seeking to develop the potential for investment.

Debt/equity swaps can be an important vehicle for attracting such investment and in our view should be key elements of any debt reduction program.

Benefits of the New Approach

What are the benefits of this approach for debtor countries and commercial banks?

Those countries which are prepared to adopt significant reforms will have earlier support for their efforts, will be able to demonstrate at home that their debt burden is being reduced, and will enhance their potential to achieve domestic growth, development, and social objectives. Their need for new money from commercial banks will be reduced.

Commercial banks will be able to make realistic adjustments in their portfolios in a way that enhances the quality of their loans. The creditworthiness of their debtor country clients will improve. Debt reduction will be closely linked to debtor reforms to assure that these benefits will be sustained.

Most importantly, this approach provides an economic incentive for the market to function better. It provides IMF and World Bank loans to debtor nations as a catalyst for market activity, permitting debtor nations to pledge some of these resources as backing for new debt instruments which reduce the burden of debt and debt service.

Next Steps in Implementing the New Approach

It is up to all of the parties involved to make this strategy work, and we have seen encouraging signs of progress.

Key debtor countries have begun to seek support from the Fund and Bank for debt reduction as part of their economic reform programs. Countries as diverse as Mexico, Venezuela, Morocco, the Philippines, and Costa Rica are anxious to get their process underway and have initiated discussions with the commercial banking community.

The IMF and World Bank have prepared interim papers on the nature of the support they might provide for debt and debt service reduction transactions. These papers are now under discussion within their Executive Boards. Both debtor countries and commercial banks will be watching the decisions of these institutions carefully in considering their own options.

The commercial banks have also begun to discuss among themselves the potential for waivers, techniques for transactions that reduce debt and debt service, and possible ways of differentiating new money from existing loans.

Creditor governments are following developments in each of these areas closely. Official debt rescheduling in the Paris Club and export credit cover will continue for those countries adopting IMF and World Bank programs. The key industrial countries are reviewing regulatory, accounting, and tax regimes, 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 the challenge by announcing a commitment to provide additional financing of $4.5 billion.

Conclusion

In closing, I want to emphasize that the Bush Administration's intent in strengthening the international debt strategy is to promote an approach to debt problems that will help revive growth and improve the creditworthiness of developing countries. The achievement of progress in coming months depends critically on the cooperative efforts of commercial banks, debtor and creditor

governments, and the international financial institutions. Secretary Brady and the Bush Administration -- and G-7 governments -- are fully committed to making this process work.

Thank you very much.

TREASURY NEWS

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

Release Upon Delivery
Expected at 10:00 A.M., E.S.T.
May 17, 1989

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

Mr. Chairman and Members of the Committee:

I am pleased to be here today to testify concerning the following tax bills: (1) S. 659, S. 838 and S. 849 (repeal of estate freeze provisions); (2) S. 442 (value added tax); and (3) S. 353 (amendment to educational savings bond provisions).

REPEAL OF ESTATE FREEZE PROVISIONS: S. 659, S. 838 AND S. 849

Background

Section 2036(c) was enacted as part of the Omnibus Budget Reconciliation Act of 1987 and was further amended by the Technical and Miscellaneous Revenue Act of 1988. The statute was intended to eliminate the perceived unfair transfer tax advantages of estate valuation freezes. An estate freeze is a technique whereby the value of certain property is frozen for estate tax purposes. The freeze is accomplished by transferring the future appreciation in a business or other property to a younger generation while the older generation retains a non-appreciating interest in the business or property that provides income or other significant rights with respect to the business or property. Although there are a variety of

transactions and arrangements that can be used to achieve an estate tax freeze, the most typical example is a transfer of common stock of a business by a parent-owner to children coupled with the parent's retention of preferred stock. Prior to the enactment of section 2036(c), no part of the value of the transferred common stock would have been included in the parent's estate.

The legislative history of this provision indicates that Congress was concerned about estate freezes for several reasons. First, it was thought that such arrangements too often permitted wealth to pass outside the transfer tax system. This could result from an initial undervaluation of the transferred appreciation interest or because of subsequent action or inaction by the transferor with respect to the retained frozen interest. For instance, in the typical freeze I described earlier, the older generation's failure to take preferred dividends or to exercise other rights in an arm's-length manner could in effect transfer wealth to the younger generation. In addition, the general effect of an estate freeze transaction was thought to be essentially that of a transfer of an interest in property with retention of the enjoyment of the entire property. Such transfers have long been treated under the estate tax law as incomplete for estate tax purposes.

Section 2036(c) applies if a person who holds a substantial interest in an enterprise in effect transfers property having a disproportionately large share of the potential appreciation in such interest while retaining an interest in the income of, or rights in, the enterprise. The legislative history describes an "enterprise" as including any business or other property which may produce income or gain. A person holds a "substantial interest" in an enterprise if he or she owns, directly or indirectly, 10 percent or more of the voting power or income stream, or both, in the enterprise. An individual is treated as owning an interest in an enterprise which is directly or indirectly owned by any member of such individual's family.

Where the statute applies, the value of the transferred property will be included in the transferor's estate if the transferor continues to hold the retained interest until death or will be treated as the subject of a deemed gift by the transferor at the time the transferor's retained interest in the enterprise terminates or the transferred appreciation property is disposed of outside the transferor's family. In either case, the original transfer will be taken into account so that the general effect of section 2036(c) will be to tax the post-transfer appreciation in the value of the transferred property through the time of such inclusion or deemed gift.

Section 2036(c) generally does not apply where the transferor receives full and adequate consideration for the transfer of the disproportionate appreciation interest. This exception is not available for transfers to family members, but the statute

generally does not apply to the post-transfer appreciation attributable to consideration paid by the younger generation from its own funds for the appreciation interest.

The statute contains several safe harbors for common transactions that were thought not to provide significant opportunities to transfer wealth outside the transfer tax system but that otherwise might be reached by section 2036(c). For example, the retention or receipt by the transferor of debt that meets certain qualifications will not be considered a retained interest that could trigger the statute. Further, the statute would not apply solely because the transferor enters into an agreement for the sale or lease of goods or other property, or the providing of services, if the agreement is an arm's-length agreement for fair market value and does not otherwise involve any change in interests in the enterprise. The statute also contains safe harbors for options to buy or sell property at fair market value as of the time the option is exercised and for grantor retained income trusts that meet certain requirements.

S. 659, S. 838 and S. 849

All three of the Bills under consideration, S. 659 introduced by Senator Symms on March 17, 1989, S. 838 introduced by Senator Heflin on April 19, 1989 and S. 849 introduced by Senator Daschle for himself and Senators Heflin, Boren and Symms on April 18, 1989, would repeal section 2036(c) retroactively in its entirety.

Discussion

Although section 2036(c) was intended to address an area of significant tax avoidance, the statute has been criticized for being both overly broad and uncertain in its application. We understand the views of those who have expressed such concerns, and we share some of those concerns.

However, the repeal of the statute at this time would raise serious revenue concerns. The revenue loss that would result from the repeal of section 2036(c) if such repeal were effective as of the date of its original enactment as is proposed in the bills under consideration would, according to our estimates, be as follows (in millions):

1989	1990	1991	1992	1993	1994	1995
-2	-25	-72	-146	-249	-384	-555

The Treasury Department is willing to consider reasonable suggestions for amendment of section 2036(c) that would not substantially compromise the revenues or the basic tax policy goal of preventing significant bypassing of the transfer tax system through estate freeze techniques. The repeal bills before the Committee today would not satisfy either requirement, and we must therefore oppose them.

VALUE ADDED TAX: S. 442

Background

The Value Added Tax (VAT) is a multistage sales tax that is collected at each stage of the production and distribution process. A firm typically pays a fixed percent of the value it adds to the goods and services it purchases from other firms. For example, if a firm purchases $60 worth of raw materials from other firms and produces a good or service that sells for $100, the firm's value added is $40. If the VAT rate were five percent, the firm's VAT liability would be two dollars. A VAT that extends through the retail level would raise the same amount of revenue as a retail sales tax levied at the same rate. The United States does not have a value added tax, although most states have retail sales taxes.

Under a consumption type VAT, a firm pays VAT on its value added only, not on any purchases from other businesses. Because purchases of capital assets are not subject to the VAT, a consumption type VAT does not distort a firm's decision to employ capital or labor, nor does it distort an individual's decision to consume or save.

Under a subtraction method VAT, a firm's VAT tax liability is computed by subtracting its firm's purchases from other businesses from its sales to arrive at value added, and then applying the VAT rate. Under the credit invoice method, a firm's tax liability is determined by allowing the firm to credit the VAT paid on its purchases against the tax computed on its sales. In order to claim the credit, a firm would be required to furnish an invoice indicating the amount of VAT paid on the goods and services it purchased. The credit invoice method is less susceptible to noncompliance than the subtraction method, because the tendency of sellers to underreport sales and reduce taxes will be offset by the incentive of purchasers to report sales at their full price in order to receive full tax credits.

Under the destination principle, a good or service is considered to be taxed in the country where it is consumed so that imports and domestically-produced goods and services compete on an equal tax footing. In general, the appropriate VAT rate is applied to all imports, and a VAT rate of zero is applied at the export stage. Exporters are given full credit for any VAT paid on inputs purchased to produce a good or service. The method frees the good or service from any VAT imposed in an exporting country and subjects it to the same VAT rate as similar domestically-produced goods in the importing country.

To the extent that a VAT is imposed at a uniform rate across all goods and services, it will not distort an individual's decision about what goods and services to consume. For a variety

of reasons, certain commodities, transactions, and/or firms may receive preferential treatment under a VAT. This may occur through either exemption or zero rating. Briefly, if a commodity or service is zero rated, it is freed of all value added tax. In other words, the good is taxed at a zero rate at every stage.

This may be contrasted with an exemption which frees the sale of a commodity or service from explicit payment of tax. The seller, however, does not receive a credit for VAT paid on his purchases. Explicit exemptions in S. 442 would be given to de minimis activities and for employee services furnished to an employer. Exemptions would also be defined implicitly by narrowly defining taxable transactions, e.g., by excluding sales of intangible property.

The proponents of a VAT argue that the tax is an efficient source of revenues in that it does not distort the present/future consumption choices of individuals, nor the choice among different consumption goods (if a uniform rate is applied). They also argue that any distortion in the labor/leisure choice is small relative to the intertemporal distortions caused by taxes such as the income tax.

Opponents argue that the VAT is a regressive tax, because consumption expenditures as a percentage of income decrease as income increases. Excluding necessities from the VAT, or reducing the VAT rate on necessities, may alleviate some of the regressivity but may substantially erode the VAT tax base and dilute the nondistortionary aspects of the tax. Adjusting transfer payments or providing a refundable income tax credit are often considered as alternatives to excluding or zero rating commodities.

Opponents of the VAT also argue that the VAT will result in a one time increase in the price level (if accommodated by the monetary authority), would distort the labor/leisure choice, and would compete with an important source of state and local revenues. In addition, the implementation of a credit invoice consumption type VAT would involve substantial administrative costs. Volume 3 of the Treasury Department's 1984 Report to the President, Tax Reform for Fairness, Simplicity, and Economic Growth, estimated that the Internal Revenue Service would require 18 months from the date of enactment to fully implement such a tax. It also estimated that the IRS would require an increase in personnel of 20,000 and an increased budget of $700 million annually to enforce a VAT.

S. 442

S. 442 would impose a VAT on the sale of property and the performance of services in the United States with respect to commercial transactions. The VAT would also be imposed on the sale or lease of real property and on the importation of property whether or not it is with respect to a commercial transaction.

The amount of tax would be five percent of the value added to the property sold or the services performed and would be imposed on the seller at each stage of production and distribution, including the retail stage. S. 442 would require that all revenues net of administrative expenses be dedicated to deficit reduction and not used to finance current expenditures.

S. 442 has four important characteristics: 1) It is a consumption type VAT; 2) It uses the credit invoice method to calculate tax liability; 3) It uses the destination principle for border tax adjustments; and 4) It exempts or zero rates certain commodities.

Discussion

The Administration opposes S. 442. The Administration does not believe that tax increases are necessary to reduce the deficit. The value added tax, as its name states clearly, is an additional tax liability that would be paid by the American public. The Administration remains committed to reducing the deficit through reduced expenditures and continued economic growth.

EDUCATION SAVINGS BONDS: S. 353

Background

In the Technical and Miscellaneous Revenue Act of 1988, Congress enacted section 135 which excludes from income interest earned on qualified United States Series EE savings bonds to the extent the bond proceeds (principal and interest) are used to pay qualified higher educational expenses of the taxpayer or the taxpayer's spouse, child or dependent. Qualified Series EE bonds are those issued after December 31, 1989 to an individual who has attained age 24, and who is the sole owner of the bond, or who owns the bond jointly with his or her spouse. Subject to the phase-out rules, if the proceeds of all qualified Series EE bonds redeemed by the taxpayer during the taxable year are used to pay for qualified higher educational expenses, all interest accrued on such bonds is excluded from income. If a taxpayer uses a portion of the bond proceeds for purposes other than qualified higher educational expenses, i.e., if the bond proceeds exceed the student's qualified expenses, the amount of excludible interest is reduced on a pro rata basis.

Educational expenses that qualify for the tax exemption include tuition and fees required for the enrollment or attendance of a student at an eligible educational institution. These expenses are calculated net of scholarships, fellowships,

and other tuition reduction amounts. Eligible educational institutions include most post-secondary institutions, including vocational schools, that meet the standards for participation in federal financial aid programs.

The benefits of this tax exemption are phased out for taxpayers filing joint returns and whose modified adjusted gross incomes are between $60,000 and $90,000 (adjusted for inflation after 1990). Thus, a taxpayer whose modified adjusted gross income exceeds $90,000 when the bonds are redeemed will not benefit from the exclusion. For single taxpayers and heads of households, the phase-out range is $40,000 to $55,000.

S. 353

S. 353 would allow a taxpayer to qualify for the interest exclusion provided by section 135 by paying for the educational expenses of any individual, including a person who is not a spouse or dependent of the taxpayer.

Discussion

The Administration opposes extension of the benefits provided in section 135 to taxpayers who are paying for the education expenses of an individual other than the taxpayer's spouse or dependent.

Section 135 is a modified version of a bill proposed by the previous Administration, entitled the "College Savings Bond Act of 1988." This Administration fully supports that initiative and generally supports the similar provision enacted by Congress in section 135. With the costs of a post-secondary education continuing to outpace inflation, American families need more than ever to save to educate their children. The current provision on education savings bonds provides valuable and needed assistance to low and moderate income American families in financing post-secondary education.

We are concerned that the purposes of the phase-out could be easily circumvented if the interest exclusion, and thus phase-out test, were made applicable to individuals other than the student, the student's spouse or a person who supports the student as a dependent within the meaning of section 151. Under the bill an individual could benefit from the exclusion even though the income of the student or the student's parents exceeds the phase-out limit. For example, high income parents could give tax-free monetary gifts to others (*e.g.*, grandparents) with lower incomes for use in purchasing bonds to be used for the education of the parents' children. Congress enacted section 135 to enable low and moderate income families to save on a tax-free basis for their children's future education. We do not believe that it is appropriate to extend the benefits of this provision beyond that targeted group.

The estimated revenue loss from S. 353 would be as follows (in millions):

1989	1990	1991	1992	1993	1994	1995
0	-4	-19	-40	-60	-79	-96

CONCLUSION

This concludes my prepared remarks. I would be pleased to answer any questions.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE May 17, 1989

Gregory P. Wilson Deputy Assistant Secretary (Financial Institutions Policy) Leaves Treasury

Secretary of the Treasury Nicholas F. Brady announced today that Gregory P. Wilson is leaving the Department to become a banking consultant with McKinsey and Company, Inc.

Mr. Wilson has served as Deputy Assistant Secretary for Financial Institutions Policy since October 1986. In that position he served as a senior advisor to the Secretary, Under Secretary, and other Treasury officials on all issues affecting the financial services industry.

Secretary Brady said, "Mr. Wilson was a key player in the passage of the Administration's 1987 legislation to recapitalize the Federal Savings and Loan Insurance Corporation and in the development of the Treasury's 1988 policy on reform of the Glass-Steagall Act and the President's Financial Institutions Reform, Recovery, and Enforcement Act of 1989. We appreciate his hard work and dedication to public service and wish him success in his future endeavors." Upon Mr. Wilson's departure, Secretary Brady conferred on him the Department's Distinguished Service Award.

Before accepting his appointment as Deputy Assistant Secretary, Mr. Wilson served for three years as the Minority Staff Director to the Committee on Banking, Finance and Urban Affairs of the U.S. House of Representatives, where he worked on a wide variety of domestic and international financial issues. He served in other positions on the Committee since 1977.

Mr. Wilson received his Bachelor of Arts degree, Magna Cum Laude in 1974, from Ohio Wesleyan University, where he was a member of Phi Beta Kappa. He attended the Fletcher School of Law and Diplomacy from 1974 to 1976. A native of Ohio, Mr. Wilson lives in Vienna, Virginia with his wife, Mary, and children, Sarah and Christopher. He is the son of Mr. and Mrs. Paul M. Wilson of Ravenna, Ohio.

NB-277

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
May 17, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION 2-YEAR AND 5-YEAR 2-MONTH NOTES TOTALING $16,250 MILLION

The Treasury will raise about $5,875 million of new cash by issuing $8,750 million of 2-year notes and $7,500 million of 5-year 2-month notes. This offering will also refund $10,372 million of 2-year notes maturing May 31, 1989. The $10,372 million of maturing 2-year notes are those held by the public, including $1,326 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $16,250 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 $1,024 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 each of the new securities are given in the attached highlights of the offerings and in the official offering circulars.

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Attachment

NB-278

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC OF 2-YEAR AND 5-YEAR 2-MONTH NOTES

May 17, 1989

Amount Offered to the Public ...	$8,750 million	$7,500 million
Description of Security:		
Term and type of security	2-year notes	5-year 2-month notes
Series and CUSIP designation ...	Series Z-1991 (CUSIP No. 912827 XP 2)	Series K-1994 (CUSIP No. 912827 XQ 0)
Issue date	May 31, 1989	June 2, 1989
Maturity date	May 31, 1991	August 15, 1994
Interest rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	November 30 and May 31	February 15 and August 15 (first payment on February 15, 1990)
Minimum denomination available .	$5,000	$1,000
Terms of Sale:		
Method of sale	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None	None
Payment Terms:		
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment 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
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Receipt of tenders	Wednesday, May 24, 1989, prior to 1:00 p.m., EDST	Thursday, May 25, 1989, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):		
a) funds immediately available to the Treasury ...	Wednesday, May 31, 1989	Friday, June 2, 1989
b) readily-collectible check ...	Friday, May 26, 1989	Wednesday, May 31, 1989

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 18, 1989

CONTACT: Office of Financing
202/376-4350

AMENDMENT TO TREASURY'S AUCTION OF 5-YEAR 2-MONTH NOTES
ANNOUNCED MAY 17, 1989

The Treasury's announcement of $7,500 million of 5-year 2-month notes to be auctioned May 25, 1989 is amended as follows:

If, under Treasury's usual operating procedures, the auction of 5-year 2-month notes results in the same interest rate as the outstanding 8-3/4% bonds of August 15, 1994, the new notes will be issued with an 8-5/8% or an 8-7/8% coupon. The 8-7/8% coupon will apply if the auction results in a yield in a range of 8.80% through 8.98%.

NB-279

TREASURY NEWS

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

FOR IMMEDIATE RELEASE May 18, 1989

STATEMENT BY
NICHOLAS F. BRADY
SECRETARY OF THE TREASURY

The Ways and Means Committee vote to waive Gramm-Rudman-Hollings sets a precedent that would render its budget discipline meaningless.

Their approach says it puts the financing "on-budget" but then makes it disappear, with no GRH accounting. It just vanishes into thin air.

The President's proposal fully accounts for each dollar of industry money that is spent on the problem in a fully contained funding corporation, and accounts for each taxpayer dollar on budget and within the GRH spending limits.

Finally, the President's proposal would cost taxpayers less, because it preserves GRH budget discipline. The cost of violating GRH would far outweigh any anticipated savings from an "on-budget" approach.

We believe in the GRH budget discipline and will fight to see that its integrity is maintained.

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TREASURY NEWS

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REMARKS OF THE HONORABLE SALVATORE R. MARTOCHE
ASSISTANT SECRETARY (ENFORCEMENT)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE AMERICAN ASSOCIATION OF EXPORTERS AND IMPORTERS
NEW YORK, NEW YORK
MAY 18, 1989

U.S. Customs Policy and Procedures on Commercial Operations: The Treasury Perspective

I am most grateful for the opportunity to be here with you today, and I am especially pleased to be a part of your annual forum on international trade.

For many years, this organization and the Treasury Department have enjoyed an excellent working relationship, and I look forward to our continuing that interaction.

Today, I want to discuss some developments affecting the Customs Service. But first, I want to say a few words about my role in Treasury with respect to Customs rulings and regulatory decisions.

My role is one of policy and oversight, rather than day-to-day management. I do not believe in micro-management, and I will err on the side of allowing a Customs ruling or decision to stand if it is reasonable, defensible, and in accord with overall Treasury policy--even if it is not precisely the decision that I would have made, had I considered it de novo. It is a matter of exercising discretion--from the broader perspective of seeing that general Treasury and Administration policies are carried out.

Because I represent the Treasury Department in this policy role, I bring to my oversight role another perspective, and that is the Treasury and Administration perspective on trade. Simply stated, this Administration is deeply committed to the principles of free trade and open investment. But that policy is a fruitless one if we do not also insist on fair trade.

And for this, the Customs Service performs an essential function in trade enforcement. In Treasury's viewpoint, aggressive enforcement of our trade laws is essential, not only because doing so is critical to our desire to maintain

a "level playing field", but also because such a policy is one of the best ways to stave off pressures for increased protectionism.

As important as it is to identify and attack unfair trade practices and battle the forces of increased protectionism, there are still other hindrances to free and open international commerce. As everyone in this room is all too aware, we must all deal with what might be called transactional barriers to trade. But I think you will agree with me that the prospects of doing away with many of these procedural and paperwork encumbrances have never been brighter than they are today. I want to mention just a few of the reasons why.

Automation

One reason is automation. At Customs, as many of you know, automation is forever changing the way commercial transactions are conducted and processed. For example, Customs tells me that more than 70 percent of all entries are now processed through the Automated Broker Interface (ABI). This is an excellent example of cooperation between government and private industry, and we sincerely appreciate the contribution that the broker community has made to this effort.

On the subject of automation, Customs also tells me that they have received their first error-free message transmission in the new EDIFACT syntax. As some of you no doubt know already, EDIFACT is an internationally-agreed-upon syntax for the transmission of commercial information.

Customs is also testing and refining their Automated Importer Interface, which is an automated format for invoice information. This is another step toward paperless entry. Another initiative, known as Automated Clearing House, will permit electronic funds transfer for paperless payment of duties and fees.

In Customs commercial processing, automation brings benefits not only to the international business community but also to the taxpayer.

For example, Customs estimates that had it not begun its Automated Commercial System in the early 1980s--and instead resorted to the outmoded, manual processing procedures to handle the vastly increased workload since then--their operations today would be much more expensive. In fact, Customs would need more than 7000 extra positions and $154 million, just to meet the same workload demands that it is meeting now.

Automation is just one of the reasons why Customs has been able to increase both the efficiency and the effectiveness of its cargo inspection. Another reason is the continuous effort to refine cargo selectivity criteria, so that resources are directed to the cargo that poses the highest risk.

Effective cargo inspection, of course, is essential not only for trade enforcement but also for our country's war on drugs. I am very proud of Customs' successes in drug enforcement and its contributions to the President's goals, and I will continue to look for ways to enhance our capabilities in this area.

The Implementation of the Harmonized System

To return to the question of transactional barriers to trade, no discussion of reducing these barriers would be complete without mention of the new Harmonized Tariff Schedule.

I know you have heard of the benefits by now, so I won't dwell on the greatly increased predictability the Harmonized System promises for the international business community. But I would like to comment on the implementation.

All things considered, the transition has been remarkable--far less disruptive than one might expect from a change of this magnitude. We expected a number of difficult classification issues, and some have arisen, but this has occurred in far fewer instances than we feared.

You have probably also heard that one of the classification issues is now before the Customs Cooperation Council--the tariff classification of sport-utility vehicles. It will be interesting to see how the international procedures for resolving inconsistent decisions will work in actual practice.

One of the reasons the transition has been so smooth is the painstaking effort by Customs to get vital information about the Harmonized System into the hands of the trade community. For example, Customs to date has issued 30 Harmonized System fact sheets on all aspects of the new tariff--from entry procedures to statistical reporting and the implementation of quotas.

Another smooth transition has been the implementation of the U.S.-Canada Free Trade Agreement. I was very glad to hear that the Canadian customs service recently complimented us by pointing out that problems associated with the transition were fewer than expected.

This is remarkable given the magnitude of the changes that the Agreement made in the rules governing bilateral trade between our two nations, including the adoption of an innovative new procedure for determining origin.

There is another bit of welcome news from Canadian customs. They tell us that U.S. exports of goods now entitled to preferential treatment under the Agreement grew substantially in April--indicating that U.S. exporters are discovering the benefits achieved in the historic agreement and taking advantage of them. That is good news for our trade balance and for our economy.

Earlier, I mentioned what I consider to be two critical goals of the Customs Service--rigorous enforcement of trade laws and reduction of transactional trade barriers.

However, the Customs commercial operations mission is broader than these two goals. We also see that mission as one of improving our overall level of service to the trade community.

Uniformity and the District Rulings Program

A key example is the Customs regulatory initiative to provide uniformity in Customs decisions and in cargo inspection. Some of you may have seen, and perhaps even submitted comments on, the Federal Register notice announcing this initiative. This regulatory change is certainly one of the most noteworthy in recent Customs history.

What I especially like about this program is the strong emphasis it places on the needs of the importer. Consider the District Rulings Program, which offers the convenience of tariff classification rulings issued from District offices--in many cases within 30 days--that are binding at all ports.

The new program also allows for prompt resolution of difficult classification issues: rulings requiring referral to Customs headquarters are to be issued within 120 days. These time limits are ambitious ones, and I'm not claiming that we are up to full speed just yet. But we are strongly committed to the idea, and we are making progress every day.

In my view, we owe it to the importing community to be as prompt, and as consistent, as we possibly can when issuing these rulings. I want the emphasis to be on providing a high level of service. The importing community deserves no less.

The new regulations also address uniformity in other types of decisions, including the examination of merchandise. For example, the regulations provide an importer a means to object, and seek resolution, if three or more like shipments--that is, those involving the same or substantially similar merchandise, the same manufacturer, and the same country of origin--have been treated inconsistently from other shipments of the same or substantially similar commodity.

This might occur when, for instance, the shipments are singled out for intensive examination at a particular port, or even at different ports, and when no discrepancies are found as a result of the examinations.

The new procedure also will apply to decisions other than inspection decisions: it will be available for any decision that would be subject to a protest, where the importer can show inconsistency.

There is one other aspect of the uniformity regulation that I want to mention. It is a critical one, in my opinion, because it embodies a concept of equity and fairness. Customs will delay the effective date of a ruling, for up to 90 days, where an importer has relied to his detriment on a previous Customs position.

- Customs will do this even in the absence of an established and uniform practice--such as cases in which an unpublished ruling letter is issued.

- Customs will consider delaying the effective date even when there was no ruling letter, if the importer can show that the past treatment was sufficiently continuous to justify reasonable reliance.

Many of you know that the courts had previously held that Customs lacked authority to grant such relief, that Customs had no choice but to collect increased duties once a determination was made that particular entries were subject to them.

All of that changed when the Court of Appeals for the Federal Circuit implied, in _dicta_ in the _Corn Growers_ case, that we do in fact have such authority. It is a matter of discretion, but as a matter of policy I am strongly committed to the position we have taken in the regulation, and I will see that it is applied where equitable considerations warrant.

By the way, the regulations to finalize the uniformity and equitable relief provisions are moving through the final review process now. I expect to receive them for approval and signature in the very near future.

Customs User Fees (Merchandise Processing Fee)

I would now like to turn for a moment to a subject in which I know most of you have a strong interest--Customs user fees.

I also know that this is not a favorite subject with many of you. But given the severe budgetary restraints now facing the Federal government, and given the substantial costs of commercial operations, I would have to guess that user fees are here to stay.

So our task in Treasury and Customs is to see that they are administered as fairly as possible and in a way that is not unnecessarily burdensome.

Last year, the current Customs user fee system was found by a GATT panel to be inconsistent with our obligations under the GATT. According to the panel, our merchandise processing fee, which is an ad valorem-based fee, is not "approximately equivalent to the cost of services rendered", as required under Article VIII. The panel also reached some other conclusions. They ruled that:

- o the cost of services provided for entries that are exempt from the fee cannot be subsidized by the fees paid for non-exempt imports; and finally,

- o that certain ancillary costs could not be funded from user fees [air passenger processing costs, international operations, and costs of administering export controls].

The Administration is considering a proposal for a revised user fee system that we hope will bring the United States back into compliance with our GATT obligations. As you may be aware, the Treasury Advisory Committee on Commercial Operations has been helping us evaluate user fee options.

This Committee is comprised of twenty members drawn from industry for their expertise on customs issues. Your organization is very ably represented by your President, Gene Milosh. Also represented are individual importers and exporters, carriers and ports, brokers, trade associations, and the Customs bar.

The Administration is preparing to submit a draft bill to the Congress that will embody some important points raised by the Committee.

- o First, the proposal is for a modified ad valorem system that we hope will have a strong chance for GATT approval. The fee schedule will have a reasonable

ceiling, so that fees charged are not disproportionate to the costs of services provided.

- User fees would be established annually by the Secretary of the Treasury, based on the prior year's experience in balancing revenues collected and the cost of commercial operations.

The new user fee system will be straightforward and easy to administer. As far as automation is concerned, we believe the fee schedule should reflect the difference in the costs of processing manual and automated entries.

Some members of the Advisory Committee and the importing community favor direct dedication of user fee revenues to operations. They also advocate exemption of these funds from potential sequestration under Gramm Rudman Hollings.

I understand fully why these representatives favor a fee on such a basis. I must be candid and admit that I have my doubts whether these wishes can be accommodated in an Administration bill.

Penalties for Export Violations

So far, most of what I have said, other than my earlier reference to the increasing shipments to Canada, has been of greater interest to importers than to exporters. I know that some of you represent entities interested in both, and I want to mention something I have been working on that will come as good news to exporters.

For a while now, I have been concerned that the existing penalty guidelines for violations under the Export Administration Act and the Arms Export Control Act need certain improvements.

The good news I have for you today is that we are about to issue better guidelines. When I say better, I mean that they are, in my opinion, more fair. For one thing, the penalties for many types of technical violations are reduced.

It is my intention to treat as very serious those violations that are truly substantive, such as those resulting from failure to obtain an export license.

On the other hand, there are violations that I consider technical, such as inadvertent failure to present a license to Customs upon exportation--but where a proper license was obtained and its number noted on the Shipper's Export

Declaration. I want to treat these more leniently than in the past, particularly when they are first violations.

Also, exporters that conduct large numbers of licensed transactions will be getting some good news in the new guidelines. At present, the total number of past violations compounds the size of penalties.

Under the new guidelines, I will count only those violations that occurred within the three years prior to the new violation. I think this is more equitable, particularly for companies that export a high volume of controlled shipments.

Also, Customs will make every effort to promote uniformity from port to port in export enforcement--both in administering licensing requirements and in detentions and seizures. In fact, this is a matter we expect to discuss with the Advisory Committee. We do not want our export policies--any more than we want our import policies--to encourage "port shopping."

Conclusion

I want to conclude my remarks today by summarizing the broad principles I want Customs to continue to pursue in its commercial functions.

First, I want sustained, aggressive trade enforcement, particularly in the area of commercial fraud.

Second, I want to encourage continued progress in trade facilitation:

- in reducing transactional barriers and improving automation;
- in cutting out unnecessary paperwork and procedures where feasible; and
- in refining cargo selection criteria.

Third, and most important, I want Customs to move forward with the improvements, planned and underway, that will make its commercial operations programs more responsive to the needs of the trade community.

Thank you very much for your kind attention.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
May 19, 1989

MAY 2
DEPARTMENT

CONTACT: LARRY BATDORF
(202) 566-2041

INDIA AND UNITED STATES INITIAL INCOME TAX CONVENTION

Delegations from India and the United States met in Washington from May 8 through May 15, 1989, and on May 15 initialled a draft Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income. The Indian delegation was headed by G.N. Gupta, Chairman, Central Board of Direct Taxes, and the United States delegation was headed by Mary C. Bennett, Deputy International Tax Counsel, Department of Treasury.

These successful negotiations conclude the latest round of bilateral talks which began in July 1988. The delegations agreed in all respects on the text of a new Convention and Protocol, as well as on exchanges of notes and a memorandum of understanding. Signature of the Convention and supporting documents awaits full and early review by the authorities of both Governments. After signature and completion of other necessary legal formalities, the Convention will enter into force.

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TREASURY NEWS

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FOR IMMEDIATE RELEASE May 18, 1989

TREASURY BUILDING TOUR PROGRAM
LAUNCHED IN TIME FOR SUMMER VISITORS

Washington's oldest office building is now offering tours for the public. Guided tours of the Treasury Building are available on alternate Saturday mornings by advance reservation. The tour program is part of the Treasury Department's celebration of its 200th anniversary as an Executive Branch agency.

The Treasury Building is the third oldest federal building in the Capital City, but it is the oldest built to accommodate members of the federal workforce. Its original T-shaped section dates from 1836 and was designed by the American architect Robert Mills who also designed the Washington Monument.

The one-hour tour features opportunities to view the building's distinctive architectural and decorative features, its large art collection and its historic nineteenth century furnishings, and to learn about the Department's influential role in domestic and international economic affairs. Tours begin at 10 o'clock and at 10:20, accommodate 20 visitors, and are led by Treasury employees trained as docents.

Advance reservations are required at least one week before the tour date. Visitors will be asked to provide their name, birthdate, and social security number when phoning to reserve space. The Treasury Building is located at 15th Street and Pennsylvania Avenue, NW. For additional information and reservations, call 343-9136.

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TREASURY NEWS

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

5310

Monthly Release of U.S. Reserve Assets

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

As indicated in this table, U.S. reserve assets amounted to $50,303 million at the end of April, up from $49,854 million in March.

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					
Mar.	49,854	11,061	9,443	20,298	9,052
Apr.	50,303	11,061	9,379	20,731	9,132

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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May 18, 1989

Roger Bolton
Assistant Secretary of the Treasury
(Public Affairs and Public Liaison)

Roger Bolton was confirmed by the United States Senate as Assistant Secretary of the Treasury for Public Affairs and Public Liaison on May 11 and was sworn into office by Secretary Nicholas F. Brady on May 15. President Bush nominated Mr. Bolton for this position on March 28.

Prior to joining the Treasury Department, Mr. Bolton was Special Assistant to the President for Public Liaison and Director of the Economic Division at the White House in 1988. He was Assistant U.S. Trade Representative for Public Affairs and Private Sector Liaison from 1985 to 1988.

In 1984 and 1985, Mr. Bolton was Deputy Assistant Secretary for Public Affairs at the Department of the Treasury. He was Director of Speechwriting for Reagan-Bush '84; Press Secretary for the Joint Economic Committee of Congress, 1983; and Deputy Director of Government Affairs for the National Transportation Safety Board, 1983.

Mr. Bolton served as Administrative Assistant for Congressman Clarence J. Brown from 1977 to 1983 and as his Press Secretary from 1975 to 1977. From 1972 to 1975 he was a political reporter for The Marion (Ohio) Star.

Mr. Bolton was graduated from The Ohio State University (B.A., 1972). He is the son of Mr. and Mrs. John T. Bolton of Cincinnati, Ohio, and is married to the former Lynne Melillo.

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TREASURY NEWS

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Text as Prepared

REMARKS BY
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY
UNIVERSITY OF MILWAUKEE
WISCONSIN SCHOOL OF BUSINESS ADMINISTRATION
MILWAUKEE, WISCONSIN
MONDAY, MAY 22, 1989

It is an honor to have the opportunity to participate in this lecture series. I commend the University of Wisconsin Business School for its recognition of the importance of bringing together academics and professionals involved in American business. The United States needs more programs like this because the challenges we face today can only be met by the joint efforts of the best minds in business and education in this country.

I would like to address some of those challenges today. We are fast approaching the last decade of this century. As we enter the 1990s, we must give careful thought to where we want our economy to be in the year 2000--and beyond--because what we do in the next 10 years will determine where we will be in the 21st century.

The key issue is how are we to sustain and strengthen our position as a leading economic power in the international arena. We have many strengths from which to approach this challenge: strengths which propelled us into the role of dominant economic power of the post war era, strengths that were born of American traditions of independent thinking and innovation, of daring vision and the drive to make that vision reality. Our society has been characterized by a work ethic that carries a commitment to quality, by the discipline to only produce our best. Our heritage--that of a nation created by immigrants who settled a vast continent--has given us the will to build an economy and society on solid foundations, to build industry and financial institutions to last over the decades. Traditionally, the whole American workforce--from the boardrooms to the factory floors--shared a pride in their work unequaled in the world. That commitment to planning and building for the future as well as for the present is one of our proudest and most valuable legacies.

However, in recent years we have neglected our traditional strengths and have seen other nations move forward to challenge our position in the world economy. It may be that we were so

successful in leading the world economy in the post-war era that we allowed ourselves to become complacent. Perhaps we began to assume that what had come to us by the fruits of our labors was instead a birthright due us as Americans. It has taken our nation some time to come to terms with the new international realities, but we are doing so.

Our approach to the challenges of the 1990s and beyond should be to draw upon our traditional strengths and rejuvenate and restore them to their proper place of prominence in our economy. We can benefit from looking at the path pursued by Japan, our chief competitor in many areas.

Japan's industry has developed the ability to seize upon technological developments and turn innovative ideas into production models. Effective, efficient quality production is made possible by the committed, highly-skilled and motivated workforce. Japanese dedication to hard work is well-known. But more important to their continued success is their business leaders' commitment to building and maintaining Japanese industry's leading role in the international arena over time, whether it be by ensuring that their technological base is state of the art or by educating their workforce to meet the changing requirements of modern industry.

Thus the Japanese share with us a tradition of pride and commitment to excellence and success in the economic arena. Our task is to revitalize our pursuit of excellence in the 1990's. To maintain our competitiveness where it is strong, and to rebuild it where it has faltered, demands a combination of government and private sector initiatives.

For its part, the government must pursue macroeconomic policies that create the conditions that will enable American business to compete fairly in the international markets. There are three areas in which the government clearly must play a role. The first is coordinating economic policies with our major trading partners. The lack of consistent, compatible policies among the G-7 countries early in the decade resulted in divergent economic performance and a sharp appreciation of the dollar. These led to large trade imbalances. Through the development of the economic policy coordination process, we have produced increased and more balanced world growth, low inflation, and exchange rates that have made our producers competitive again in world markets. As a result, the U.S. trade deficit fell by $34 billion last year, to about $127 billion. The downward trend is continuing this year. The deficit for the first three months of 1989 was nearly twenty percent below that for the same period last year; and exports averaged more than six percent higher. This is encouraging news indeed. We need to and will continue to build on this progress.

Extensive multinational negotiations are essential to fulfilling our second major responsibility--abolishing barriers to free trade. Our key tool is the ongoing multilateral negotiations under the General Agreement on Tariffs and Trade, known as GATT. In the latest series of these negotiations, known as the Uruguay Round, we are working to strengthen GATT and expand its coverage. In particular, we are striving to bring under the tough GATT rules: trade in services, agriculture, foreign investment and intellectual property, which includes patent and copyright protection. As you well know, this is an extremely difficult undertaking. Although much remains to be done, with the successful completion of the mid-term review in April, the Uruguay Round is on track for a successful conclusion at the end of next year. In addition, we will continue to fully enforce tough action against unfair trade practices when necessary. In accordance with the 1988 Trade Act the U.S. government must identify countries with significant foreign trade barriers or distortions by May 28 of this year. We plan to meet that deadline.

The third major macroeconomic responsibility of the government is to reduce the cost of capital to corporations. This is essential to fostering the long-term planning on which our future economic success depends. The high cost of capital make short-term investments more appealing. By definition, it makes the short-term reward the principal focus of investment.

The first step the government must take in bringing down the cost of capital is to reduce the federal deficit. As everyone in this room knows, the large federal deficit's effect on interest rates has increased the cost of capital in this country and consequently discourages business from making many long-term investments. The Bush Administration is absolutely committed to reducing the deficit by meeting the deficit level targets established by the Gramm-Rudman legislation. We have already taken a first, very important step by achieving an agreement with the bipartisan leadership of Congress on the fiscal 1990 budget--an agreement which meets the Gramm-Rudman target and reduces the deficit to just below 100 billion dollars without raising taxes. The President has met his commitment to "no new taxes," but more than that, he has demonstrated the open-minded, responsive leadership essential to a successful, multi-year process to eliminate the deficit by 1993.

As such, this bipartisan agreement represents a promise by both sides to put aside their differences in the interest of fiscal sanity. This agreement demonstrates to the American people and to the financial markets--both domestic and international--that the U.S. Government is willing, and able, to exercise fiscal responsibility and act in the long-term economic interests of our nation.

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, and tomorrow, interest rates will come down. In fact, we have seen a decrease of a half a percent in the last month.

The government can also lower the cost of capital by providing a tax and regulatory environment with the fewest possible disincentives to capital formation and economic growth. To this end, the Bush Administration has proposed a cut in the capital gains tax. If enacted, our proposed tax rate differential for capital gains will lower the cost of capital, thereby encouraging investment. The Bush Administration is also on the record as advocating an end to the double taxation of dividends. If the U.S. tax code gave equal treatment to equity and debt, we would see the cost of capital come down. The government also needs to pursue policies which encourage Americans to increase the amount of money that they save. As long as the U.S. savings rate remains so far below those of our major competitors, the cost of our capital will remain an impediment to equal competition in international trade.

Clearly, through its capacity to effect the cost of capital the government has a crucial role to play. However, as I said at the beginning of my remarks, solving the problem of U.S. competitiveness must be a joint effort. By the very nature of our free market economy, business must take responsibility for its performance. I believe there are some fundamental adjustments that need to be made to our way of doing business if we are to remain competitive into the next century. I speak here not as the Secretary of the Treasury, but as a businessman of 34 years experience who has seen many changes in those years in the way we do business. And perhaps even more importantly, many changes in our attitude about business. Some of those changes have led us away from the strong American traditions that made us so successful in the past.

When I graduated from business school in the early 1950's, it was expected that you joined a firm and built a career with that firm. There was in those days the idea that business was a profession that you learned from the ground up, that there were professional standards that you had to meet. You became a professional by learning and developing over time the skills and judgement born of experience. The career incentives in those days were long-term; reward for professional endeavors was not expected in the first year or two, but later when you had achieved an expertise and maturity in your profession.

Clearly, the pace of American business has changed since those days, particularly in the last decade. And as a result,

the pace of building a career has accelerated in the past decade. Most successful business school students today graduate with the expectation that they will begin their professional careers with top salaries and the promise of ever-increasing financial rewards. I by no means begrudge those starting out today the lucrative opportunities available to them. I was just as eager to do well when I started out. What concerns me is that our best young business professionals are beginning their careers and having their attitudes and approach to business shaped by the current, frenetic environment, which is not conducive to fostering the kind of long-range planning and activity that is essential to the future well-being of our economy. I am concerned that by the attention and emphasis placed on personal gain and the financial transactions that generate the highest immediate return, we are losing sight of the long-term goals of our economic endeavors.

For example, today the cutting edge of my profession, investment banking, is the leveraged buyout. Hardly a week goes by that we do not hear about some dramatic takeover fight which reaps fabulous profits. There is a great deal of debate about whether or not leveraged buyouts are good. Congress is currently considering legislation that would remove some of the tax incentives for LBOs. The view of the Treasury Department is that the jury is still out on LBOs; we believe it is too soon to determine their full effect on American industry. Proponents of LBOs argue that they are good because they compel reduction and streamlining of corporate structures. They argue that removing corporate bureaucracy makes American firms more efficient and competitive. No one would argue in favor of corporate bureaucracy, but if it were really a key contributing cause of inability to compete internationally, then Japan--which has substantial corporate bureaucracies of its own--would not hold the standing it does in the international marketplace.

What concerns me the most about LBOs and similar currently popular transactions is the way they distort our perspective about what is fundamentally important in business today. Their focus is on paying out profits to pay down debt rather than building a competitive position for the future. Their emphasis on immediate profits, without a long-term commitment to the firms involved, is not in the best interests of a country attempting to sustain and strengthen our productive capacity for the next century. It worries me that many of the best minds in American business are concentrating on financial engineering rather than laying plans for corporate strategies into the future.

The verdict is still out on LBOs, but regardless of the merits of specific transactions, the lesson we should draw from this type of activity is that we should make it a national objective to shift the emphasis from the flashy short-term deal to a more careful long-term approach to business and financial

decisions. The importance of this must be understood and taught at all levels--in the business schools, in the entry-level training courses for young executives and in the corporate boardrooms.

As I sound this cautionary note, let me be clear that I believe my contemporaries as well as the rising generation need take notice. Our preoccupation with the immediate and the short-term never could have occurred without the advice and consent of my generation. Ultimately, we bear the responsibility for the business environment today. And by the example we set in the next decade--most probably our last decade of professional life--we will bear responsibility for the American approach to business into the 21st century.

Just as we led American business through the post-war economic boom, we must be the leaders in the effort to rejuvenate and draw on our traditional dedication to quality and innovation, to hard work and team effort, and most of all, to a shared pride, to build industries and financial institutions that will ensure America's place in the world economy for decades to come.

This effort will be neither simple nor easy. In some instances solutions are not readily apparent. We need to direct our efforts to finding the means to achieve our goals. In closing, let me suggest where part of the solution will be found. It is the role that education plays in our economic endeavors. Just as education has been the root to success for individuals in this country, it is the root to success for our nation as a whole. The education I refer to encompasses the broadest possible definition of the word--from basic skills and industrial retraining programs to support for the most advanced scientific research being conducted in the laboratories of our leading universities. We must put our money where our ideas are. We must be willing to invest in research and development; we must be willing to educate and retrain our workforce to make it competitive internationally. For example, it is a sad fact that 25 percent of all high school students drop out. We must ask ourselves: How are we going to beat the competition when a quarter of our starting team is only qualified to be second string. Education is crucial to our efforts. We must recognize that the varied aspects of education are links of a chain which runs through our economic system. If we are to be successful in remaining truly competitive we must be successful in promoting the full spectrum of educational achievement.

We must make our traditional strengths our guiding principles. We must make our commitment to them, rather than to the trendy, and I believe illusory, high flying, hot house notions of today. Working toward the year 2000 must truly be a cooperative effort, in which everyone recognizes the importance

of working and planning to ensure that through our efforts today the United States will be a preeminent economic power in the 21st century.

TREASURY NEWS

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

Contact: Office of Financing
202/376-4350

JN 5310

FOR IMMEDIATE RELEASE
May 22, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,607 million of 13-week bills and for $6,610 million of 26-week bills, both to be issued on May 25, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 24, 1989			26-week bills maturing November 24, 1989		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	8.29% a/	8.59%	97.904	8.30%	8.79%	95.781
High	8.33%	8.63%	97.894	8.34%	8.83%	95.761
Average	8.32%	8.62%	97.897	8.33%	8.82%	95.766

a/ Excepting 1 tender of $850,000.

Tenders at the high discount rate for the 13-week bills were allotted 74%.
Tenders at the high discount rate for the 26-week bills were allotted 16%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 31,785	$ 31,785	$ 25,605	$ 25,605
New York	19,175,270	5,313,770	19,648,465	5,714,265
Philadelphia	24,280	24,280	13,875	13,035
Cleveland	40,460	40,450	35,525	35,525
Richmond	41,440	41,440	38,365	38,365
Atlanta	30,040	30,040	26,880	26,880
Chicago	1,090,945	231,645	968,935	47,135
St. Louis	18,660	18,660	19,630	19,630
Minneapolis	7,095	7,095	8,725	8,725
Kansas City	34,505	34,505	34,810	34,810
Dallas	25,880	25,880	20,965	20,965
San Francisco	859,830	290,330	860,960	175,280
Treasury	517,130	517,130	450,000	450,000
TOTALS	$21,897,320	$6,607,010	$22,152,740	$6,610,220
Type				
Competitive	$18,162,385	$3,172,075	$17,817,875	$2,575,355
Noncompetitive	1,171,250	1,171,250	922,365	922,365
Subtotal, Public	$19,333,635	$4,343,325	$18,740,240	$3,497,720
Federal Reserve	2,306,785	2,006,785	2,200,000	1,900,000
Foreign Official Institutions	256,900	256,900	1,212,500	1,212,500
TOTALS	$21,897,320	$6,607,010	$22,152,740	$6,610,220

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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

For Release Upon Delivery
Expected at 11 a.m.
May 23, 1989

STATEMENT OF
JOHN G. WILKINS
ACTING ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to present the views of the Treasury Department with respect to the low-income housing tax credit, including its efficacy in increasing and improving the stock of low-income housing, the desirability of extending the credit beyond its currently scheduled expiration at the end of the 1989 calendar year, and the legislation the Chairman recently introduced to modify the credit.

We strongly support the objective of the credit. However, the Administration does not at this time support an extension of the current credit or a modified credit beyond 1989 due to budgetary constraints.

In my testimony today I will briefly discuss the existing low-income housing tax credit, and I will comment on H.R. 2319 (the "Low-Income Housing Credit Act of 1989"), legislation recently introduced by the Chairman. Finally, I will discuss the budgetary impact of extending the credit -- either in its present form or as amended by H.R. 2319 -- beyond its currently scheduled expiration at the end of the 1989 calendar year.

I. CURRENT LAW

The primary tax benefits for low-income housing prior to the Tax Reform Act of 1986 ("1986 Act") were the following: accelerated depreciation at 200 percent declining balance over 15 years, recapture of accelerated depreciation of low-income housing phased out after 100 months, expensing of construction period interest and taxes, and 5-year amortization of certain rehabili-

tation expenditures. These accelerated deductions resulted in large tax reductions for owners of low-income housing projects.

Although certain tax-exempt bond financing also was nominally directed at low-income rental housing, the income limits were well above the poverty line and only 20 percent of tenants had to meet the income restrictions. According to a 1986 General Accounting Office study, that resulted in most bond-assisted projects benefiting moderate- and high-income households.

Under current law, the low-income housing tax credit is allowed for certain expenditures with respect to qualified low-income residential rental housing, but only to the extent that expenditures are for low-income units. Expenditures eligible for the credit include some or all of the taxpayer's depreciable adjusted basis with respect to the costs of new construction and certain rehabilitations, as well as the costs of acquisition of existing buildings not placed in service within the last 10 years and not subject to a 15-year "compliance period" described below.

The credit for any low-income building generally is limited to the credit authority allocated to that building by a designated State or local agency. State and local agencies may authorize credits each year subject to an annual credit volume limitation of $1.25 per resident, 10 percent of which must be set aside for projects syndicated by qualified tax-exempt organizations. State and local agencies may not carry unused credit authority from one year to the next and may make allocations only through the 1989 calendar year. In 1989, the total State credit allocation authority is approximately $325 million. A credit allocation is not required, however, if the building is substantially financed with the proceeds of tax-exempt multifamily housing bonds subject to the State's private activity bond volume limitation of $75 per capita.

Although the low-income housing credit generally is scheduled to expire for property placed in service after December 31, 1989, certain property placed in service by 1991 may continue to qualify for the credit. This is because the Technical and Miscellaneous Revenue Act of 1988 permits a building to be placed in service within 2 years from the year in which the credit authority is received, provided that (1) the building is part of a project in which the taxpayer's basis at the end of the allocation year is more than 10 percent of the reasonably expected basis for the project, and (2) the building involves either new construction or substantial rehabilitation.

The credit is claimed by owners of qualified low-income buildings in equal annual installments, generally over a 10-year period beginning with the year in which the building is placed in service. The annual installments generally provide a discounted present value equal to 70 percent of the expenditures eligible for the credit. A smaller annual installment, sufficient to maintain a discounted present value equal to 30 percent of

eligible expenditures over the 10-year credit period, is available for certain acquisition costs of existing buildings and for most federally subsidized new buildings. For these purposes, substantial rehabilitation expenditures are treated as a "separate new building," and "federal subsidies" are defined to include tax-exempt financing and below-market federal loans.

The credit generally is available only with respect to housing units serving low-income tenants. In addition, projects must satisfy one of two minimum income criteria: (1) at least 40 percent of the units in a project must have restricted rents and be occupied by households having no more than 60 percent of area median gross income, adjusted for family size; or (2) at least 20 percent of the units in a project must have restricted rent and be occupied by households having no more than 50 percent of area median gross income adjusted for family size. Gross rents on qualifying low-income units generally must not exceed 30 percent of the income limitations, also adjusted for family size. However, certain exceptions, such as a reduction in the percentage of units set aside for low-income tenants, are provided where taxpayers elect to satisfy a stricter requirement and significantly restrict rents on low-income units relative to other residential units in the building (the "deep-rent skewing" set-aside).

While the credit is claimed over a 10-year period, buildings must comply with the low-income housing requirements for a period of 15 years. If, during this compliance period, a building fails to comply with the applicable requirements, or the taxpayer disposes of the building, the taxpayer will normally have to recapture the credit. Noncompliance or disposition within the first 11 years could result in recapture of one-third of the credit amount, while recapture thereafter would be less.

Although credits generated by passive activity generally are limited to tax liability attributable to passive activity income, investors receiving the low-income housing credit are deemed to be active participants and, thus, the low-income housing credit may offset additional tax liability on up to $25,000 of nonpassive income. This additional amount phases out ratably as an investor's adjusted gross income increases from $200,000 to $250,000, instead of phasing out over the general $100,000 to $150,000 income range. Similarly, although the at-risk rules apply to the low-income housing credit, the rules for "qualified non-recourse financing" are substantially relaxed.

II. DISCUSSION

The purpose of the low-income housing tax credit is to increase the stock of low-income housing in the United States. Indeed, the Treasury Department believes that the low-income housing tax credit represents a significant improvement over the tax benefits for low-income housing that existed before the 1986 Act. Congress enacted the low-income housing tax credit as part

of the 1986 Act because the several tax preferences to encourage low-income housing under prior law were considered to be inefficient and not coordinated. The preferences were ineffective in providing affordable housing for low-income individuals and the amount of tax subsidy was not directly related to the number of low-income households served. There were no incentives for recipients of tax subsidies to provide more than the minimum amount of low-income units. Nor were there any direct incentives to limit rents.

According to preliminary data compiled by the National Council of State Housing Authorities ("NCSHA"), it is apparent that credit utilization has increased in each year of the program. Allocated credits as a percentage of all credits available under the overall credit cap have increased to 67 percent in 1988 from 19 percent in 1987. NCSHA projects that this allocation percentage will increase to 93 percent in 1989.

This increase in allocation percentages not only reflects increased awareness of the program by developers, but also 1988 amendments to the Tax Code liberalizing allocation rules to permit allocations for projects where only 10 percent of the anticipated project costs have been incurred. This implies that for many projects, credit allocation precedes the placement into service of housing units by as much as 2 years. The potential exists, therefore, for credit allocation to exceed final credit utilization if planned units are not placed into service. In 1988, almost 48 percent of the credits allocated were "carried over" for utilization in later years.

Based upon incomplete NCSHA data for 1988, credits were allocated to projects expected to provide more than 85,000 low-income housing units at an average credit per unit of over $25,000 over a 10-year period. Approximately 90 percent of all units in projects receiving credit allocations are anticipated to be occupied by low-income residents.

The Treasury Department is committed to ensuring that tax benefits are used in a cost-effective manner. Thus, while we do not support an extension of the credit for budgetary reasons, we also have five other areas of concern regarding the effectiveness of the credit to increase the low-income housing stock.

First, the low-income housing stock may be increased by targeting the credit to new construction and substantial rehabilitation. Preliminary data for 1988 suggest that approximately 20 percent of the credit-assisted housing units represent acquisitions of existing housing stock. Providing a credit for construction and rehabilitation clearly increases the low-income housing stock as opposed to simply providing an incentive for the transfer of ownership.

Second, as Treasury has previously testified, the low-income housing credit provides no incentive for maintenance. If units

receiving the credit are rented at below-market rental rates, landlords could allow the projects to deteriorate substantially without losing tenants. This would lead to an erosion of the low-income housing stock in the long run. An incentive for the maintenance of low-income units could be provided by reducing the credit percentage available when the building is originally placed in service from 70 percent and allowing a landlord subsequent credits for documented expenditures for maintenance of up to some specified percent of the original cost.

Third, imposing more restrictive ceilings on the income requirements for low-income units may lead to a greater increase in the stock of low-income housing. While there is limited empirical evidence, a study of Federal housing incentives in the 1960s and 1970s found that about 35 percent of government-subsidized low-income housing units were not offset by reductions in market-supplied housing, and thus represented a net increase in the supply of housing. The study found that subsidies for moderate-income housing resulted in no statistically significant long-run increase in housing supply. Preliminary NCSHA data for 1987 indicate that most tenants in low-income credit buildings are in the highest category -- incomes of 60 percent or less of area median income. This suggests that the more a program focuses benefits on the lower end of the income distribution, the more apt it will result in an increase in the stock of low-income housing and not just a substitution of one housing unit for another.

Fourth, the low-income housing credit may not lead to housing of a quality or in a location that is best for low-income individuals. For example, low-income housing property may not be located near jobs or public transportation that low-income individuals would value. This suggests that the low-income housing credit may not be the most efficient means of subsidizing low-income housing. Rental housing vouchers may be more efficient, because they allow low-income individuals to live in buildings whose characteristics they value the most. The voucher program is subject to periodic review by Congress and the Department of Housing and Urban Development, an agency that has more expertise in the housing area than does the Internal Revenue Service.

Fifth, the cost of providing the credit may increase substantially over time since all low-income housing credits are not subject to the credit allocation. For example, investors can avoid the cap on low-income housing credit allocations by using the 30 percent credit in conjunction with tax-exempt bond financing. If, as expected, the demand for low-income housing credits causes credit caps to be reached, investors may choose the 30 percent credit combined with tax-exempt bond financing to circumvent the cap. Imposing a specific cap on the use of the 30 percent credit in combination with tax-exempt bond financing would limit the potential cost.

III. H.R. 2319

H.R. 2319 proposes to extend the credit permanently while modifying certain provisions. The bill retains the basic outline of the current credit, by permitting a 10-year tax credit for the construction, rehabilitation, and acquisition costs of rent-restricted housing provided to low-income families. Within that basic framework, however, the bill would make a number of significant changes.

In order to encourage owners to keep units in low-income housing use, the bill limits the ability of owners benefiting from the credit to convert or transfer low-income housing for nonlow-income use. As a condition of being allocated the credit, owners would be required to execute with the State housing credit agency an extended low-income housing "commitment" to maintain a specified percentage of the project as low-income housing for an "extended use period" of 30 years. This commitment would be recorded and binding upon the owner's successors. If the owner desired to convert or transfer low-income units for other use after the compliance period, the owner generally would be required first to give the agency a 1-year period to locate a buyer willing to pay an amount no less than the low-income portion of the sum of (1) the outstanding debt balance, plus (2) "adjusted investor equity" (the original gross equity invested in the project, increased annually by the CPI, not to exceed 5 percent annually), plus (3) additional capital contributions, less (4) cash distributions. The specific provisions of this commitment, mechanisms for its operation and enforcement, and effects of noncompliance are all unclear. Moreover, extending the low-income housing commitment is likely to make low-income housing substantially less attractive from an investment standpoint and consequently could reduce the low-income housing stock in the long run.

Because the credit is a limited resource, and because demand for it in 1989 appears to be approaching the full extent of its availability (a trend that would continue were the credit extended beyond 1989), the bill establishes several requirements to encourage more efficient utilization. First, credit allocating agencies would be required to establish allocation plans, essentially creating "ranking" systems for awarding credits. Second, credits would not be allocated beyond the extent necessary to ensure each project's financial feasibility (considering the sources and uses of funds and total financing contemplated for the project, as well as anticipated tax benefits). Third, no credits would be available for acquisitions not involving "substantial rehabilitations" defined as expenditures exceeding $3,000 per low-income unit. These provisions of the bill would improve the effectiveness of the credit.

The bill also includes a variety of additional provisions that improve the feasibility of managing and operating low-income

housing projects, increase the availability of the credit, and remove other limitations on the use of the credit. Most of these are useful clarifications but some may have limited value. For example, the bill would permit taxpayers to treat their adjusted gross income as fixed at the outset of a low-income housing investment for purposes of the $25,000 exception to passive loss limitations. Such a provision would permit otherwise ineligible high-income taxpayers to shelter nonpassive income. Given the apparently high use of the credit, this deviation from a general tax rule would appear to be unnecessary.

IV. CONCLUSION

The Administration does not support an extension of the low-income housing credit at this time due to its budgetary constraints. Although the Administration supports the objectives of the low-income housing credit, we must carefully weigh competing needs and existing programs in light of the budget deficit. The Administration's budget includes substantial direct expenditures for low-income housing.

Mr. Chairman, that concludes my formal statement. I will be happy to answer questions you and Members of the Subcommittee may wish to ask.

REVENUE IMPACT OF ALTERNATIVE PERIODS OF
EXTENSION FOR THE LOW-INCOME HOUSING CREDIT

	Fiscal Year					
	1990	1991	1992	1993	1994	1990-94
	(In billions of dollars)					
One-Year Extension	-0.1	-0.2	-0.3	-0.3	-0.3	-1.2
Two-Year Extension	-0.1	-0.2	-0.5	-0.6	-0.7	-2.1
Three-Year Extension	-0.1	-0.2	-0.5	-0.8	-0.9	-2.6
Four-Year Extension	-0.1	-0.2	-0.5	-0.9	-1.1	-2.8
Five-Year Extension 1/	-0.1	-0.2	-0.5	-0.9	-1.2	-2.9

Department of the Treasury
Office of Tax Analysis

May 23, 1989

1/ Over the 1990-1994 budget period, the revenue impact of a permanent extension is equivalent to that of a five-year extension.

TREASURY NEWS

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FOR IMMEDIATE RELEASE

Speech
by the
Honorable Robert R. Glauber
Under Secretary of the Treasury for Finance
before the
Financial Services Council
May 23, 1989
Washington, D.C.

Good morning.

I am very pleased to be here with you today to discuss the U. S. Treasury's viewpoints with respect to the need for change in the structure of our nation's financial institutions and markets.

Professional students of this subject have long been aware of the existence of certain shortcomings in our nation's financial marketplace -- problems that in recent years have become a part of the daily diet of the news-consuming public.

Hardly a day now passes without some reference to the difficulties of the thrift industry and its required restructuring; bank failures in the late 1980s that reached record levels; the Farm Credit System's ongoing recovery from near insolvency; certain Third World debtor nations desperately seeking relief; or, finally, the unbridled pursuit of personal gain by a few that has seriously tainted the reputations of Wall Street and LaSalle Street.

To discuss all of these issues would clearly require more time than available to me today. Accordingly, I will focus my remarks more narrowly on an issue of most immediate concern to you, that is, the proper structuring and range of activities to be permitted to financial intermediaries.

But before I do, let me emphasize that the Treasury's top priority in financial restructuring is passage of the thrift industry legislation now before Congress. In this respect, I thank all of you who have strongly supported the Administration's efforts to resolve the thrift crisis, and I hope you continue to do so until enactment of the legislation.

As you know, a critical element of the Administration's thrift plan is its approach to financing, where private funds from the S&L industry are off-budget and Treasury funds are on-budget. There are those who wish to put all $50 billion on-budget but waive the resultant breach of Gramm-Rudman. The reason is clear -- to eviscerate the main pillar of budget discipline and then nominate other "worthy" causes for similar

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treatment. The Administration will strongly oppose this effort. And let us not forget that the cost of delay in funding resolution of the thrift crisis is increasing at more than $10 million a day.

Now, let us take a look at where we need to go in the future.

The Costs of Inefficient Financial Structuring

Conceptually speaking, financial intermediaries are essentially portfolio managers. In effect, they invest their assets in an array of financial products and activities according to their rate of return, their degree of acceptable risk, their competitive advantage, the structure and cost of their funding, and so on. For financial intermediaries to accommodate market dynamics, to remain profitable in the face of changes in these variables, their portfolios must be actively managed. Management must therefore have the discretionary ability to diversify investments and funding sources as dictated by a changing environment. Clearly, if all financial services firms were able to adjust in this way effectively, there would be no issue of financial institutions restructuring and reform. But this is not the case.

Indeed, the central problem facing the U.S. financial services industry today is that long-standing regulation has prevented the greatest number of financial institutions from structuring their portfolios in the most efficient and profitable way possible relative to their competitors, in both national and international markets.

As a case in point, studies have shown that underwriting and dealing in securities could substantially reduce risk to banking organizations for two reasons. First, securities underwriting is no more risky -- and probably less risky -- than commercial lending. Is a one hour underwriting exposure riskier than a 30-year loan? Second, overall earnings variability is reduced when securities underwriting is combined with commercial lending. Furthermore, by attracting new capital, enhancing the value of the franchise, and stemming the erosion of assets, banks will be in a stronger position to meet the challenges of the future.

1. Insured Depository Institutions

To date the barriers to diversification have been most notable, and most costly, with respect to the nation's federally insured depository institutions. In the wake of the widespread bank failures following the Great Depression, government policy favored increased regulation of the nation's depository

institutions. A system of federal deposit insurance was established; closer federal oversight was institutionalized; specialization of asset and liability portfolios was imposed; and geographic diversification was strictly limited. Rather than diminish over time, the regulation of insured depositories expanded, so that by the early 1970's managements had effectively lost discretionary authority over essential aspects of their institutions, including products, pricing, organizational form, operating standards, and location.

It was the inability of federally insured depositories to adjust to market dynamics commencing in the late 1960's, and extending through today, that made it progressively more obvious that reform was required. But it is equally clear that the model of the thrift industry in the early 1980's -- with its lack of private, up-front capital and ill-supervised reform -- is not the model to be followed as we move forward. Although the legacy of that "experiment" will be with us for some time to come, a "silver lining" must be the lessons learned for the critically needed, and broader reforms, we must now pursue.

2. <u>Benefits to Consumers</u>

More effective financial restructuring will also redound to the benefit of consumers. For consumers, whether states, institutions, or individuals, are the direct or eventual beneficiaries of our reform efforts -- to offer them the broadest range of quality services at the most reasonable cost, consistent with preserving the U.S. financial system. For example, in the securities area, municipalities have been denied a broader choice of municipal revenue bond underwriters, corporations have not been able to have banks issue their commercial paper, and individuals were limited as to providers of mutual funds. Businesses and consumers can only benefit from the conveniences of "one stop shopping", while service providers gain from the economies of scale and earnings stability associated with a broad product mix.

3. <u>International Considerations</u>

The new and present reality of global financial markets also demands significant change in the financial landscape of the United States. American financial intermediaries need the freedom to become effective competitors on a sustained basis in this global marketplace. Permitting the common management of a broad array of financial services and products will allow our domestic institutions to meet the foreign competition both here and abroad. This can only help U.S. firms stem the loss of customers to less regulated foreign firms, and, in so doing, help prevent the erosion of the primacy of U.S. capital markets.

For purposes of illustration, look at foreign banking structures. In France, West Germany, and the United Kingdom, a

banking organization can engage, directly or indirectly, in underwriting and dealing in securities and other full service investment banking activities; engage in unlimited insurance activities through subsidiaries; engage, directly or indirectly, in brokering, developing and managing real estate; and invest in industrial companies (and vice-versa). The other European countries are variations on this theme -- a theme which may come to dominate international finance as EC '92 approaches.

For our part, we have witnessed the disappearance of U.S. banking organizations from the world's "top 10" list over the course of two decades, dropping from seven banks on the list in 1970, to three in 1980, and none currently. The U.S. also under-performed other major industrial countries in terms of the growth of banks' assets relative to the growth of nominal GNPs over the same approximate period of time. Other forces were also at work, including the change in exchange rates and the more concentrated structure of banking abroad compared to the U.S. But the effect of the restrictive range of activities permitted U.S. banks is undeniable.

The message from all of this is loud and clear: sooner or later we must restructure, and in a way that promotes our international competitive posture without undermining the safety and soundness of our financial system.

Guidelines for Financial Reform

Financial intermediaries in the future should be able to offer a wide range of financial products and services, moving away from the excessive segmentation of institutions that is a relic of the past. And it should be increasingly accomplished through a streamlined operational structure, functional regulation, and systemic safeguards.

1. Streamlined Operational Structure

As all of you know, the prior Administration proposed that financial reform be accomplished by permitting holding companies to establish subsidiaries to engage in non-traditional activities, rather than by allowing banks to engage in such activities directly. It was felt that this would:

-- better insulate the insured depository, and the deposit insurance fund, from the perceived risks;

-- reduce concerns that the lower-cost funds of the depository might be used to "subsidize" competition with non-bank firms; and

-- advance the goal of functional regulation, while making it easier to define and enforce firewalls.

This approach could well streamline institutional corporate structures and allow for the broadening of old powers and the addition of new ones with minimal dislocation.

2. Functional Regulation

Progressive financial restructuring needs to be matched by prudent and equitable regulation. Functional regulation avoids the pitfalls that might arise if different service providers engage in similar activities under dissimilar regulatory regimes. Similar activities, wherever located in a financial organization, should be made subject to similar controls and standards.

3. Safeguards and System Stability

Prudence also requires that insured depositories be insulated from the higher-risk activities of broad-based financial services firms. This can be accomplished through the establishment of appropriate safeguards, for example, along the lines of those included in last year's Senate legislation (S. 1886). Such safeguards, endorsed by all the regulators, included a strong firewall between the bank and its securities affiliate, greater disclosure and supervision by the appropriate regulatory agencies, and stronger penalty and enforcement provisions. But it is equally important that our quest for safety through firewalls not be allowed to effectively "suffocate" the vitality of the "new" financial institutions we need to create. The overreaching of last year's House of Representatives' versions of financial reform illustrate this form of Pyrrhic victory.

There may be some types of activities that require tighter firewalls or may be simply off-limits for insured depositories. But I believe that allowing financial intermediaries to offer a wide array of products and services subject to appropriate safeguards is consistent with safety and soundness and the protection of depositors and taxpayers. And risk-based capital standards will put private capital on call first. Indeed, we have absolutely no desire to extend federal guarantees -- and expose taxpayers -- unnecessarily. However, the advent in the U.S. of broad-based financial services providers is likely to enhance, not jeopardize, the safety and soundness of the financial system. This is so because these organizations would gain the opportunity to compete effectively, to diversify portfolio risk, and to evolve with the marketplace.

Conclusions

This need for reform is, of course, not unique to banking organizations (or Glass-Steagall) but affects the broad range of

financial intermediaries facing the competitive requirements of the international marketplace.

Of course such an improved structure will only be as useful as the resultant performance of the institutions affected. Purveyors of financial services are aware more than ever before that the marketplace champions achievement. I would encourage you all to continue your ongoing review of the contributions different operational sectors of your business make to overall performance, so you can fine tune your efforts even further. Washington alone is not the answer.

Be assured that Treasury has no intention of rushing forth to support financial reform legislation unless it meets the requirements and challenges I have outlined. But Treasury must also know directly what sectors of the financial services industry favor legislative reform. Last year's fragile coalition was hard enough to assemble, and there are certainly those who would prefer not to see the Senate's financial modernization bill put forward again. Nevertheless, these issues will not disappear, for they represent an evolutionary outgrowth of the marketplace's requirements for financial services. They also offer an opportunity to reassert the prominence of American financial institutions in the world at large. Strong momentum has been generated. I truly hope it can continue.

Thank you for your kind attention.

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
May 23, 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 $12,800 million, to be issued June 1, 1989. This offering will result in a paydown for the Treasury of about $2,000 million, as the maturing bills are outstanding in the amount of $14,809 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Tuesday, May 30, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated September 1, 1988, and to mature August 31, 1989 (CUSIP No. 912794 SK 1), currently outstanding in the amount of $16,692 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,400 million, to be dated June 1, 1989, and to mature November 30, 1989 (CUSIP No. 912794 TF 1).

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

The bills will be issued for cash and in exchange for Treasury bills maturing June 1, 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 $2,353 million as agents for foreign and international monetary authorities, and $4,298 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.

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
Expected at 10 A.M. EDT

Statement By
The Honorable David C. Mulford
Under Secretary of the Treasury
for International Affairs
Before the
Subcommittee on International
Development, Finance, Trade and Monetary Policy
Committee on Banking, Finance and Urban Affairs
United States House of Representatives
May 24, 1989

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you today to discuss United States' participation in the increase in resources of the Inter-American Development Bank and in the Enhanced Structural Adjustment Facility of the International Monetary Fund.

INTER-AMERICAN DEVELOPMENT BANK (IDB)

I am happy to report that after three years of negotiations, agreement has been reached on a proposal to increase the resources of the Inter-American Development Bank. The agreements reached in the negotiations will help accelerate the transformation and revitalization of the IDB already begun by President Iglesias. We are now seeking your support for legislation to authorize United States participation in the resource increase.

Importance of Latin America

This Administration is acutely aware of the problems in Latin America and of the region's significant commercial, cultural, and strategic ties to the United States. The Administration has acted quickly to come to the aid of beleaguered Latin American nations, by reshaping the debt strategy, and now by reaching agreement on a replenishment of the IDB. A strengthened and reorganized Inter-American Development Bank can provide much needed funding and leadership in helping restore sustained growth in the countries of Latin America and the Caribbean.

Latin American countries continue to face serious economic and financial problems. In the 1970's Latin America relied too heavily on external borrowing. Although some countries achieved significant growth in this period, many did not make effective use of the borrowed resources. Without a broad economic base, and with heavily managed economies, these countries were not prepared to adjust to the adverse developments of the early 1980's.

Many Latin American countries now realize they need to adopt appropriate policies that will enable their economies to function efficiently and to produce growth and better lives for their people. Particularly since 1985, several countries have implemented important structural reforms with the help of the international financial institutions. These countries have privatized government-owned industries, liberalized their trade regimes, reformed tax systems, and pursued market-oriented pricing.

However, much remains to be done to help Latin American economies function efficiently and effectively -- and in the best interest of Latin Americans themselves. The reforms should be implemented consistently: realistic exchange rates must be maintained and public sector deficits must be further reduced. In addition, attention needs to be focussed on other areas, particularly measures to attract new investment and encourage the return of flight capital.

Some countries have made a good beginning. Others must strengthen their efforts or even make a fresh start. The IDB can play a critical role in working with these countries to initiate major policy reforms.

<u>Reforming the IDB</u>

At the beginning of his tenure in March 1988, President Iglesias' committed himself to reforming the IDB to improve the quality and effectiveness of its lending. As part of this effort he has:

- adopted measures to strengthen programming and loan review;
- established a self-financing, early retirement program to encourage needed personnel changes;
- initiated an evaluation of the Bank by the High-Level Review Committee, a group of prominent outside experts which included a number of former Latin American finance ministers; and
- launched task forces on programming, operations, and administration and personnel to examine the IDB's policies, practices, and structure.

Implementation of the recommendations of the High-Level Review Committee and the task forces will further improve the quality of Bank's operations and its overall effectiveness. The recommendations have been accepted by President Iglesias who has

pledged to implement them. Once effected, the recommended actions will need to be supported by the Bank's Board of Directors. It is important that the Board members support these changes and truly represent the new policy thinking of leading Latin American governments. It is also important that Latin governments follow through on their commitments to reorganize and change the policies in a replenished IDB.

IDB-7 Agreement

The Seventh Replenishment (IDB-7) Agreement reached during the IDB's annual meeting in March, marks the key implementation phase of the IDB's reform efforts. Funds to make the new IDB a more effective contributor to solving Latin America's problems can now be injected into the Bank as the reform efforts move forward. Governors proposed increases of $26.5 billion in the IDB's capital and $200 million in the Fund for Special Operations (FSO). These increases will finance $22.5 billion of lending over the four-year period 1990 to 1993. This will be a significant increase in lending -- about double actual Sixth Replenishment (IDB-6) levels. While up to 65 percent of IDB-7 lending could go to the most advanced Latin American countries, 35 percent will be reserved for the smaller countries of Latin America and the Caribbean. All the concessional FSO lending will go to the poorest countries.

The U.S. share of the capital increase is $9.2 billion of which 2.5 percent or $229.3 million will be paid-in. Our share of the FSO replenishment is $82.3 million. The U.S. would thus be providing 34.7 percent of the capital increase and 41.2 percent of the FSO replenishment. Our payment for paid-in capital subscriptions and FSO contributions under IDB-7 would require $78 million of budget authority annually compared to $131 million under IDB-6.

The IDB-7 replenishment agreement incorporates a number of significant decisions about Bank operations over the next few years that complement the actions already taken to improve the Bank. The IDB-7 agreement proposes:

- adopting a loan approval mechanism that will promote improved loan quality and give greater decision-making authority to non-borrowing countries;
- strengthening the country programming process to ensure that Bank lending will support policy reform and self sustaining growth;
- providing up to 25 percent of IDB-7 lending for sector loans; and

committing more staff and financial resources to strengthening the technical and institutional capabilities of countries in environmental management and conservation of natural resources.

I would like to elaborate further on the significant elements of the IDB-7 agreement and the complementary task force recommendations:

Loan Approval Mechanism - The intent and design of the new loan approval mechanism is to foster a Board consensus in support of loans and thereby improve loan quality. The mechanism allows for a delay of up to 12 months in the consideration by the Board of Directors of a loan from capital resources (the U.S. has a veto over FSO loans). Within specified limits, the President of the IDB could reduce this delay period to seven months. The delay periods will be used by Bank management to remedy those problems that prompted objections to the loan so that it can be supported by the entire Board of Directors.

Country Programming - A strengthened country programming process is a critical element in improving the quality of IDB lending. The country programming process and the Bank's policy dialogue with each country will result in a coherent and comprehensive framework for Bank operations. As outlined in the replenishment agreement, the IDB will analyze potential investment areas in each country in light of the adequacy of macroeconomic and sectoral policies. Therefore, the Bank's entire lending program, project as well as policy-based loans, will support needed policy reforms. The task forces have recommend ways to reorganize operating departments to implement effective country programming.

Sector Lending - During the IDB-7 period the Bank will begin a program of sector lending. Fast-disbursing, policy-based lending is new to the IDB. They will not undertake broad-based structural adjustment lending but will focus instead on loans aimed at improving the economic efficiency of specific sectors, such as agriculture. For at least the first two years of the replenishment, all sector loans will be cofinanced with the World Bank.

Environment - In addition to committing more resources to environmental management and establishing a senior line unit to strengthen its own environmental assessment capabilities, the task forces recommended that the Bank improve its environmental action through other means as well. These include enhancing Bank relations with non-governmental organizations, improving its dissemination and collection of environmental information and hiring a core group of environmentalists to support technical staff.

Lower-income Beneficiaries - As in its last two replenishments, the Bank will seek in the seventh replenishment to ensure that 50 percent of its lending program benefits lower income groups. This includes sector lending where it is not always possible to precisely ascertain the effect of a loan on various groups. Nevertheless, the Bank will undertake to ensure that low-income persons benefit from sector loans and that potential adverse effects are minimized.

IDB and Debt

A strengthened and reformed IDB will be in a position to make its contribution to helping resolve the economic and social problems facing Latin America. As far as the debt problem is concerned, the IDB's role at this point 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.

Next Steps

The member countries of the IDB have charted a course for the Bank over the next five years. It is now time to act to implement the IDB-7 agreement and the recommendations of the IDB's task forces. We will be following this closely as the pace of our subscriptions could be affected by the pace and effectiveness of their implementation.

We must get the new Bank up and operating. This will not be an easy task. It will require that all members work cooperatively and enthusiastically with President Iglesias and Bank management.

For our part we can support the Bank by formally agreeing to the capital increase and the replenishment of the Fund for Special Operations. Neither can go into effect without our agreement which requires prior Congressional authorization.

We are seeking authorization legislation this year although subscription and contribution payments for IDB-7 are not due until October 1990 (U.S. FY 1991 budget). The primary reason for doing so is to demonstrate the United States commitment to the IDB and our support for the increase in the Bank's resources. In addition, our early agreement to the replenishment will allow other members to begin their approval processes and will facilitate the implementation of the IDB-7 agreement from January 1990.

I would urge you to act promptly to adopt the legislation to authorize United States participation in the increase in the capital of the IDB and the replenishment of the Fund for Special Operations.

ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF)

For the world's poorest countries, the Administration is seeking authorization to contribute $150 million to the Interest Subsidy Account of the IMF's Enhanced Structural Adjustment Facility (ESAF).

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.

Let me underscore that the purpose of the ESAF is to promote the adoption by low-income countries of the comprehensive macroeconomic and structural economic reforms necessary for sustained growth on the concessional financing terms consistent with the longer term economic needs of these countries and their ability to meet repayment obligations. Some mistakenly argue that the purpose of the ESAF is to allow the IMF to clear its arrears. However, only a handful of low-income countries have arrears to the Fund and the vast bulk of ESAF resources will be used in the other poorest countries. Moreover, even the few low-income countries receiving ESAF monies as part of efforts to normalize relations with the international financial community will be required to adopt comprehensive structural reform programs.

The ESAF, in conjunction with other IMF efforts, should also make a substantial contribution towards alleviating poverty. Poverty and the effects of IMF programs on the most needy are

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.

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 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, 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.

taken into account in developing IMF programs. Countries are encouraged to include in their programs measures to mitigate the effects of poverty on the most needy segments of the population. The United States in particular has encouraged the Fund and member countries to enhance the information base to assess poverty and improve understanding of the effects of IMF policies on low-income groups, so as to find ways to alleviate poverty without impeding adjustment.

The ESAF is catalyzing significant additional resources for the low income countries through its association with the Policy Framework Paper (PFP) process. 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 PFP process represents an historic step forward in strengthening collaboration between the IMF and World Bank in the low-income countries, a step which in our judgment should be built upon to intensify collaboration for all members. Intensified collaboration between the IMF and World Bank has become increasingly imperative in recent years as widespread recognition has emerged that the macroeconomic and structural reforms necessary for establishing a foundation for sustained growth require the expertise of both institutions. Recently, IMF Managing Director Michael Camdessus and World Bank President Barber Conable have developed arrangements to strengthen collaboration between the two institutions. The United States welcomes this agreement and it is our sincere hope that these arrangements will strengthen the ability of the Fund and Bank to fulfill their central roles in the global economy and in the debt strategy.

In support of the PFP process, the World Bank agreed to earmark $3 to $3.5 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.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 23, 1989

LIBR
MAY 2

CONTACT: LARRY BATDORF
(202) 566-2041

RECIPROCAL TAX EXEMPTIONS OF SHIPPING AND AIRCRAFT INCOME

The Treasury Department today announced further agreements with India and St. Vincent and the Grenadines for the reciprocal tax exemption of income from international shipping and aviation and with Peru for the reciprocal tax exemption of income from international shipping. The exchanges of notes are in accordance with section 872 and 883 of the Internal Revenue Code. The exemptions apply for taxable years beginning on or after January 1, 1987.

Copies of the notes with Peru and St. Vincent and the Grenadines are available from the Office of Public Affairs, room 2315, Department of the Treasury, Washington, D.C. 20220. The notes with India will be released when they arrive in Washington and have been processed by the Department of State.

The income exempted from tax in the notes with India is income from the international operation of ships and aircraft, including income from the leasing of ships and aircraft on a full basis. It also includes income from the leasing on a bareboat basis of ships and aircraft used in international transport, income from the leasing of containers and related equipment used in international transport, and gain on the disposition of ships and aircraft provided in each case that the income or gain is incidental to international operating income.

Revenue ruling 89-42 summarizes reciprocal tax exemptions of income from international shipping and/or aviation with other countries.

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TREASURY NEWS

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

May 23, 1989

MAY 2

DAVID C. MULFORD
Under Secretary for International Affairs
U.S. Department of the Treasury

DAVID C. MULFORD was sworn in as Under Secretary (International Affairs) of the Treasury on May 23, 1989.

Since 1984, Dr. Mulford has been an Assistant Secretary (International Affairs) of the Treasury. As Under Secretary for International Affairs, he will continue in his lead role for international economic policy formulation and implementation. In particular, he will be responsible for exchange market policies and will remain the U.S. G-7 Deputy with responsibility for coordinating economic policies with other industrial nations. In addition, he will maintain his key concentration on the international debt strategy and will continue to focus on economic relations with the newly industrializing economies, trade and investment matters and preparations for the annual Economic Summit.

Prior to serving at Treasury, Dr. Mulford spent 20 years in the international investment banking business. He served as Senior Advisor at the Saudi Arabian Monetary Agency in Riyadh, Saudi Arabia, as well as a Director of Merrill Lynch, Pierce, Fenner & Smith (1974-1984); and Director of White, Weld, & Co., Inc. (1966-1974). Dr. Mulford was a White House Fellow during 1965-66 and served as Special Assistant to the Secretary of the Treasury.

Dr. Mulford earned his doctorate from Oxford University in 1965 and his Master's degree from Boston University in 1962, specializing in African Studies, and also attended the University of Cape Town. He graduated from Lawrence University with a B.A. (Cum Laude) in Economics in 1959. During his academic career, Dr. Mulford held several fellowships and wrote two books, both published by Oxford University Press.

He was born and raised in Rockford, Illinois. He is married, has two children, and resides in Alexandria, Virginia.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE May 23, 1989

J. French Hill
Appointed Deputy Assistant Secretary
For Corporate Finance

Secretary of the Treasury Nicholas F. Brady announced the appointment of J. French Hill to serve as Deputy Assistant Secretary for Corporate Finance, effective May 15, 1989. Mr. Hill will serve as the principal advisor to the Assistant Secretary for Domestic Finance on corporate economic and financial issues.

Since October 1984, Mr. Hill was with Mason Best Company of Dallas, Texas, and named a director in 1988. He was involved in mergers and acquisitions and in corporate finance for the company's clients and affiliates. Previously he had served on then Senator John Tower's staff and on a subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs from 1983 to 1984. During the period 1979 to 1982, Mr. Hill was a banking officer at InterFirst Bank-Dallas and the senior financial analyst in the Corporate Planning and Investment Group of the Bank's holding company.

In 1981, during a leave of absence from InterFirst, Mr. Hill played a major role in creating PULSE, the Southwest's largest shared automated teller machine network. He was responsible for its planning, marketing, and financial coordination during the start-up phase. Mr. Hill has also been a frequent lecturer on mortgage finance and was a contributor to the Heritage Foundation's Mandate for Leadership II (1984). He is also a director of a number of business and philanthropic organizations, including the Texas Lyceum Association and the Dallas Museum of Natural History and Aquarium Association.

Mr. Hill, a native of Arkansas, is a graduate of Vanderbilt University in economics (magna cum laude). He is married to the former Martha McKenzie of Dallas.

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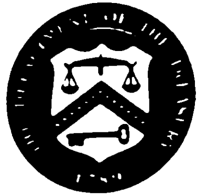

Department of the Treasury • Washington, D.C. • Telephone 566-204

May 24, 1989

HOLLIS S. MCLOUGHLIN
Assistant Secretary of the Treasury (Policy Management)
and Counselor to the Secretary

On May 23, 1989 Hollis Samuel McLoughlin was sworn-in as Assistant Secretary of the Treasury (Policy Management). He was confirmed by the United States Senate for this position on May 10, 1989 and appointed by President Bush on May 22, 1989. Mr. McLoughlin will also serve as Counselor to the Secretary.

As Assistant Secretary (Policy Management) and Counselor to the Secretary, Mr. McLoughlin will serve as the Senior Advisor to the Secretary and overseer of the Executive Secretariat. He will identify and manage policies covering the full range of the Department's activities and will coordinate departmental policies with the White House and other executive branch departments.

Prior to joining the Department, Mr. McLoughlin was Managing Director of the Taggart Group. Previously, he was an Executive of Purolator Courier Corporation, most recently as Senior Vice President (1983-1987); Chief of Staff for then U.S. Senator Nicholas F. Brady (1982) and Administrative Assistant to former Congresswoman Millicent Fenwick (1974-1979). His prior business experience was as an Account Executive with Benton and Bowles (1980-1982); and Assosciate with William Sword & Co. (1979-1980).

Mr. McLoughlin received his B.A. in 1972 from Harvard College. He was born July 4, 1950 to John Thomas and Harriette Hollis McLoughlin of Princeton, New Jersey. He resides in Summit, New Jersey with his wife, Caroline Bickel McLoughlin and their daughter, Caroline.

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// TREASURY NEWS

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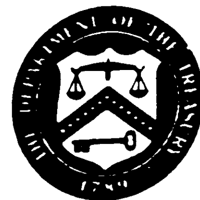

May 24, 1989

Charles H. Dallara
Assistant Secretary of the Treasury
for International Affairs

Charles H. Dallara was appointed by President Bush on May 22 to the position of Assistant Secretary of the Treasury for International Affairs. He was confirmed by the Senate to this position on May 10, 1989. Dr. Dallara's responsibilities will cover a wide range of international economic issues. These include exchange rate policies, the international debt strategy, relations with the newly industrializing economies, trade and investment issues, and U.S. Government policy in the international financial institutions.

Since 1988, Dr. Dallara has been serving as Assistant Secretary of the Treasury for Policy Development and as Senior Advisor for Policy to the Secretary of the Treasury. Since 1984, Dr. Dallara has also been the United States Executive Director at the International Monetary Fund (IMF). From 1985 to 1988, he served concurrently as Senior Deputy Assistant Secretary of the Treasury for International Economic Policy. From 1982 to 1983, he was the Alternate Executive Director at the IMF, and prior to this held a variety of other positions at the Treasury.

Dr. Dallara received his Ph.D., M.A., and M.A.L.D. from the Fletcher School of Law & Diplomacy, Tufts University, and B.A. in economics from the University of South Carolina. He also served as an officer in the U.S. Navy from 1970-74.

Dr. Dallara was born on August 25, 1948, in Spartanburg, South Carolina, to Harry P. and Margaret Dallara. He is married to Carolyn Gault Dallara, has two children, Stephen and Emily, and resides in Falls Church, Virginia.

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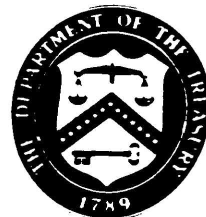
TREASURY NEWS



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

FOR IMMEDIATE RELEASE
May 24, 1989

CONTACT: LARRY BATDORF
(202) 566-2041

LINDBLAD TRAVEL PLEADS GUILTY TO VIETNAM EMBARGO VIOLATIONS

The Treasury Department today announced that on May 15, 1989, in the U.S. District Court for the District of Connecticut, Lindblad Travel, Inc. (LTI), a Westport, CT travel agency, pleaded guilty to a criminal information charging the company with unlawfully arranging, promoting, and facilitating a group tour and travel to Vietnam and Cambodia, in violation of the Foreign Assets Control Regulations (FACR) and the Trading with the Enemy Act (TWEA).

Lars-Eric Lindblad, president and CEO of LTI, told U.S. District Judge T.F. Gilroy Daly that he personally made the decision to book customers on a tour of Vietnam and Cambodia scheduled to leave the United States on October 16, 1988, knowing that the company did not have Treasury Department permission and that he would be violating the law.

One of the customers booking the tour was an undercover agent of the Customs Service. LTI canceled the October 16 tour after Customs agents, armed with a search warrant, seized evidence of the violation from the company.

The Treasury Department's Office of Foreign Assets Control (FAC) administers and enforces the FACR, which imposes a comprehensive economic embargo against Vietnam, Cambodia, and North Korea and prohibits (with certain exceptions) all trade and financial transactions by persons subject to U.S. jurisdiction with these countries and their nationals. The FACR specifically prohibit U.S. persons from arranging, promoting, or facilitating tours or travel to or within Vietnam, Cambodia and North Korea without an FAC license. Travel by individuals to and within these countries is not unlawful, and individuals' travel-related transactions are authorized by the FACR.

The plea agreement, entered into May 15 by LTI and the Department of Justice, follows a cooperative investigation by FAC and the Customs Service working in conjunction with the U.S. Attorney's Office. Under the plea agreement's terms,

LTI agreed to forfeit $25,000 to the United States, the amount it was to pay to the government of Vietnam for tourist services. In addition, LTI faces criminal penalties of up to $500,000 under TWEA. LTI refunded to its customers the approximately $46,000 they paid to book the tour. LTI will also refund to the Treasury Department the $4,410 fee paid by the undercover agent and pay the court a $200 special assessment.

As part of the agreement, the government will not prosecute Mr. Lindblad or any other officers or employees of the corporation individually for their participation in the offense. Each one who knowingly participated in the violation was exposed to the maximum penalty of 10 years' imprisonment and a $50,000 fine. The case was continued until June 14 for sentencing.

The stipulation of facts also describes how Mr. Lindblad was quoted in newspaper and radio press reports as saying that, despite the government's failure to grant the company a license, he intended to "promote a little civil disobedience" and conduct the tours to Vietnam anyway. After the plea agreement was signed, the U.S. Attorney responded to such quotes by stating that "disagreement with a law is no excuse for breaking it."

Salvatore R. Martoche, Assistant Secretary of the Treasury for Enforcement, said, "The guilty plea by Lindblad Travel represents a major victory in the Treasury Department's on-going efforts to enforce vigorously the prohibitions against promoting, arranging, and facilitating travel tours to Vietnam and Cambodia." Mr. Martoche also said, "This case should send a strong message that violations of the Vietnam and Cambodian sanctions program will not be tolerated. The outcome is the result of a joint effort and close cooperation between the Customs and FAC. The two Treasury agencies will continue to work closely with the Department of Justice to pursue a vigorous enforcement program against violations of these and other embargoes."

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

JH 5310

FOR IMMEDIATE RELEASE May 24, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of December 1988.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $142.8 billion on December 31, 1988, posting a decrease of $471.2 million from the level on November 30, 1988. This net change was the result of an increase in holdings of agency debt of $455.5 million, and decreases in holdings of agency assets of $0.3 million and in agency-guaranteed debt of $926.4 million. FFB made 50 disbursements during December.

The Continuing Appropriations Resolution for 1988 allowed FFB borrowers under foreign military sales (FMS) guarantees to prepay at par debt with interest rates of 10 percent or higher. Pursuant to this Resolution, FFB received FMS prepayments of $927.3 million in December 1988. FFB suffered an associated loss of $174.4 million.

Attached to this release are tables presenting FFB December loan activity and FFB holdings as of December 31, 1988.

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FEDERAL FINANCING BANK

DECEMBER 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note #75	12/1	$ 281,000,000.00	12/01/98	9.188%	9.085% qtr.
Note #76	12/1	70,000,000.00	12/01/98	9.099%	8.998% qtr.
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
Note #479	12/8	7,600,000.00	3/08/89	8.393%	
TENNESSEE VALLEY AUTHORITY					
Advance #967	12/2	60,000,000.00	12/12/88	8.243%	
Advance #968	12/5	133,000,000.00	12/12/88	8.470%	
Advance #969	12/7	146,000,000.00	12/16/88	8.351%	
Advance #970	12/12	211,000,000.00	12/19/88	8.270%	
Advance #971	12/16	25,000,000.00	12/21/88	8.602%	
Advance #972	12/16	106,000,000.00	12/23/88	8.602%	
Advance #973	12/19	197,000,000.00	12/30/88	8.565%	
Advance #974	12/23	6,000,000.00	12/27/88	8.454%	
Advance #975	12/23	67,000,000.00	12/30/88	8.454%	
Advance #976	12/30	200,000,000.00	1/03/89	8.539%	
Advance #977	12/30	112,000,000.00	1/06/89	8.539%	
Advance #978	12/31	118,000,000.00	1/06/89	8.500%	
U. S. POSTAL SERVICE					
Note #15	12/8	300,000,000.00	6/02/97	9.081%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 17	12/5	671,772.00	8/25/11	9.301%	
Morocco 13	12/5	414,934.69	11/30/94	9.264%	
Greece 16	12/6	86,113.00	3/01/12	9.258%	
Greece 17	12/6	4,343,037.45	8/25/11	9.258%	
Greece 17	12/15	1,350,929.45	8/25/11	9.221%	
Morocco 9	12/15	11,087.27	9/30/93	9.319%	
Greece 16	12/23	3,107.00	3/01/12	9.098%	
Greece 17	12/23	2,292,668.92	8/25/11	9.101%	

+rollover

FEDERAL FINANCING BANK

DECEMBER 1988 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development					
Newport News, VA	12/5	$ 218,000.00	2/15/89	8.470%	
Binghamton, NY	12/9	7,300,000.00	9/15/89	8.963%	9.102% ann.
Newport News, VA	12/21	59,000.00	2/15/89	8.594%	
Lincoln, NE	12/29	160,000.00	10/02/89	9.154%	9.363% ann.
RURAL ELECTRIFICATION ADMINISTRATION					
Tex-La Electric #329	12/2	4,992,000.00	12/31/90	8.985%	8.886% qtr.
*Basin Electric #137	12/5	15,498,094.56	12/05/90	9.246%	9.142% qtr.
*Wolverine Power #190	12/7	148,000.00	12/31/15	9.073%	8.972% qtr.
Oglethorpe Power #320	12/8	9,751,000.00	12/31/19	9.106%	9.005% qtr.
*Wolverine Power #182A	12/9	2,958,000.00	1/02/90	9.028%	8.928% qtr.
*Wolverine Power #183A	12/9	3,713,000.00	1/02/90	9.028%	8.928% qtr.
S. Mississippi Elec. #330	12/12	524,000.00	12/31/19	9.135%	9.033% qtr.
*Wabash Valley Power #104	12/12	6,991,000.00	1/03/17	9.123%	9.021% qtr.
*Wabash Valley Power #206	12/12	230,000.00	1/03/17	9.123%	9.021% qtr.
Associated Electric #328	12/15	3,825,000.00	12/31/90	9.321%	9.215% qtr.
Old Dominion Electric #267	12/15	3,358,000.00	12/31/90	9.320%	9.214% qtr.
Oglethorpe Power #335	12/15	4,792,000.00	12/31/90	9.322%	9.216% qtr.
*Colorado Ute-Electric #96A	12/19	1,361,000.00	12/31/90	9.304%	9.198% qtr.
*Colorado Ute-Electric #203A	12/19	7,229,000.00	12/31/90	9.304%	9.198% qtr.
*Cooperative Power Assoc. #156A	12/19	8,110,000.00	12/31/90	9.303%	9.197% qtr.
Central Iowa Power #295	12/20	2,130,000.00	1/02/18	9.210%	9.106% qtr.
*Wabash Valley Power #252	12/22	500,000.00	1/03/17	9.126%	9.024% qtr.
*Wabash Valley Power #206	12/29	111,000.00	1/03/17	9.215%	9.111% qtr.
New Hampshire Electric #270	12/30	626,000.00	1/02/18	9.193%	9.090% qtr.
*Wolverine Power #182A	12/30	4,869,000.00	1/02/90	9.202%	9.099% qtr.
*Wolverine Power #183A	12/30	5,452,000.00	1/02/90	9.202%	9.099% qtr.
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-03	12/30	826,561,318.50	3/31/89	8.682%	

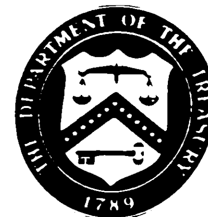
*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	December 31, 1988	November 30, 1988	Net Change 12/1/88-12/31/88	FY '89 Net Change 10/1/88-12/31/88
Agency Debt:				
Export-Import Bank	$ 11,027.2	$ 10,957.6	$ 69.5	$ 69.5
NCUA-Central Liquidity Facility	113.9	106.9	6.9	-4.3
Tennessee Valley Authority	16,955.0	16,876.0	79.0	-176.0
U.S. Postal Service	5,892.2	5,592.2	300.0	300.0
sub-total*	33,988.2	33,532.7	455.5	189.2
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	96.3	96.3	-0-	-0.1
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,071.2	4,071.2	-0-	-68.0
Small Business Administration	14.4	14.7	-0.3	-1.0
sub-total*	62,757.4	62,757.7	-0.3	-69.1
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	12,489.3	13,452.9	-963.6	-3,522.4
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	49.6	49.6	-0-	-0.4
DHUD-Community Dev. Block Grant	321.0	315.3	5.7	2.9
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	383.0	386.5	-3.5	-4.4
DOI-Guam Power Authority	32.1	32.1	-0-	-0-
DOI-Virgin Islands	26.1	26.6	-0.5	-0.5
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,758.9	1,758.9	-0-	-0-
Rural Electrification Administration	19,245.9	19,220.5	25.4	40.6
SBA-Small Business Investment Cos.	604.1	607.6	-3.5	-28.6
SBA-State/Local Development Cos.	859.3	864.2	-5.0	-11.6
TVA-Seven States Energy Corp.	2,213.8	2,195.0	18.9	51.4
DOT-Section 511	43.3	43.6	-0.3	-2.9
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	46,104.0	47,030.3	-926.4	-3,421.1
grand total*	$ 142,849.6	$ 143,320.8	$ -471.2	$ -3,300.9

*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 IMMEDIATE RELEASE
May 24, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $8,769 million of $27,778 million of tenders received from the public for the 2-year notes, Series Z-1991, auctioned today. The notes will be issued May 31, 1989, and mature May 31, 1991.

The interest rate on the notes will be 8-3/4%. The range of accepted competitive bids, and the corresponding prices at the 8-3/4% rate are as follows:

	Yield	Price
Low	8.83%	99.856
High	8.85%	99.820
Average	8.84%	99.838

Tenders at the high yield were allotted 19%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 48,840	$ 47,060
New York	24,333,410	7,360,895
Philadelphia	47,455	47,455
Cleveland	82,210	74,110
Richmond	98,525	47,715
Atlanta	41,635	39,605
Chicago	1,750,240	530,970
St. Louis	116,125	73,495
Minneapolis	36,355	35,355
Kansas City	111,015	109,015
Dallas	27,805	27,805
San Francisco	896,740	188,650
Treasury	187,315	187,315
Totals	$27,777,670	$8,769,445

The $8,769 million of accepted tenders includes $1,239 million of noncompetitive tenders and $7,530 million of competitive tenders from the public.

In addition to the $8,769 million of tenders accepted in the auction process, $1,330 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,024 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
May 25, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 5-YEAR 2-MONTH NOTES

The Department of the Treasury has accepted $7,507 million of $20,752 million of tenders received from the public for the 5-year 2-month notes, Series K-1994, auctioned today. The notes will be issued June 2, 1989, and mature August 15, 1994.

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

	Yield	Price
Low	8.70%	99.619
High	8.72%	99.537
Average	8.72%	99.537

Tenders at the high yield were allotted 98%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

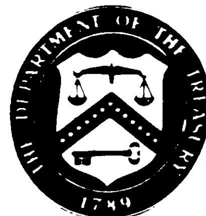
Location	Received	Accepted
Boston	$ 26,786	$ 26,786
New York	18,739,831	6,630,822
Philadelphia	14,451	14,451
Cleveland	37,681	37,641
Richmond	26,815	26,580
Atlanta	20,768	20,738
Chicago	899,898	328,558
St. Louis	53,080	27,040
Minneapolis	18,302	17,302
Kansas City	40,043	39,543
Dallas	15,008	12,993
San Francisco	856,354	321,349
Treasury	2,700	2,700
Totals	$20,751,717	$7,506,503

The $7,507 million of accepted tenders includes $562 million of noncompetitive tenders and $6,945 million of competitive tenders from the public.

In addition to the $7,507 million of tenders accepted in the auction process, $300 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities.

NB-300

TREASURY NEWS



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

5710

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 12:00 NOON
May 26, 1989

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $8,500 million of 364-day Treasury bills to be dated June 8, 1989, and to mature June 7, 1990 (CUSIP No. 912794 UH 5). This issue will result in a paydown for the Treasury of about $300 million, as the maturing 52-week bill is outstanding in the amount of $ 8,801 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, June 1, 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 June 8, 1989. In addition to the maturing 52-week bills, there are $15,189 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 $1,473 million as agents for foreign and international monetary authorities, and $7,863 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 $27 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.

10/87

TREASURY NEWS

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

May 30, 1989

John C. Dugan
Appointed Deputy Assistant Secretary
for Financial Institutions Policy

Secretary of the Treasury Nicholas F. Brady today announced the appointment of John C. Dugan to serve as Deputy Assistant Secretary for Financial Institutions Policy, effective May 27, 1989. Mr. Dugan will serve as principal adviser to the Assistant Secretary for Domestic Finance on all issues affecting financial institutions, including the savings and loan crisis, securities market reforms, and issues affecting competition among financial services companies.

Before joining Treasury, Mr. Dugan had been the minority (Republican) General Counsel to the Senate Committee on Banking, Housing, and Urban Affairs since 1987, where he worked closely on the 1989 savings and loan bill and the bill to repeal the Glass-Steagall Act. Previously, he had worked as a Banking Committee counsel and had been an associate with the Washington law firm Miller & Chevalier, Chartered.

Mr. Dugan received his J.D. cum laude from Harvard Law School in 1981, and his Bachelor of Arts from the University of Michigan in 1977, where he graduated with high distinction.

He is a native Washingtonian who now resides here with his wife, Elizabeth Stark Dugan.

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NB-302

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

FOR IMMEDIATE RELEASE May 30, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of January 1989.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $142.4 billion on January 31, 1989, posting a decrease of $402.5 million from the level on December 31, 1988. This net change was the result of an increase in holdings of agency debt of $65.4 million, and decreases in holdings of agency assets of $0.3 million and in agency-guaranteed debt of $467.7 million. FFB made 70 disbursements during January.

The Continuing Appropriations Resolution for 1988 allowed FFB borrowers under foreign military sales (FMS) guarantees to prepay at par debt with interest rates of 10 percent or higher. Pursuant to this Resolution, FFB received FMS prepayments of $315.5 million in January 1989. FFB suffered an associated loss of $23.1 million.

Attached to this release are tables presenting FFB January loan activity and FFB holdings as of January 31, 1989.

NB-303

FEDERAL FINANCING BANK

JANUARY 1989 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 #480	1/5	$ 1,000,000.00	4/05/89	8.668%	
+Note #481	1/10	14,450,000.00	4/11/89	8.722%	
+Note #482	1/11	2,000,000.00	4/11/89	8.721%	
TENNESSEE VALLEY AUTHORITY					
Advance #979	1/2	18,000,000.00	1/09/89	8.500%	
Advance #980	1/3	151,000,000.00	1/09/89	8.500%	
Advance #981	1/6	225,000,000.00	1/12/89	8.687%	
Advance #982	1/9	187,000,000.00	1/16/89	8.702%	
Advance #983	1/12	24,000,000.00	1/17/89	8.657%	
Advance #984	1/12	168,000,000.00	1/18/89	8.657%	
Advance #985	1/12	21,000,000.00	1/19/89	8.657%	
Advance #986	1/16	13,000,000.00	1/20/89	8.616%	
Advance #987	1/16	191,000,000.00	1/23/89	8.616%	
Advance #988	1/19	12,000,000.00	1/25/89	8.678%	
Advance #989	1/19	136,000,000.00	1/27/89	8.678%	
Advance #990	1/23	159,000,000.00	1/30/89	8.649%	
Advance #991	1/27	63,000,000.00	2/01/89	8.763%	
Advance #992	1/27	54,000,000.00	2/03/89	8.763%	
Advance #993	1/30	193,000,000.00	2/06/89	8.744%	
Advance #994	1/31	186,000,000.00	2/08/89	8.689%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 16	1/11	92,087.00	3/1/12	9.216%	
Greece 17	1/11	2,692,098.00	2/27/12	9.220%	
Greece 17	1/11	624,505.20	2/27/12	9.217%	
Morocco 13	1/11	1,173,496.62	11/30/94	9.422%	
Greece 17	1/13	508,202.40	2/27/12	9.137%	
Greece 16	1/23	257,306.00	3/1/12	9.042%	
Greece 17	1/23	1,368,781.89	2/27/12	9.042%	
Philippines 11	1/23	26,099.38	9/12/90	9.209%	
Greece 17	1/24	151,866.00	2/27/12	9.019%	
Greece 17	1/25	2,292,657.32	2/27/12	8.941%	
Greece 17	1/26	151,866.00	2/27/12	8.986%	
Philippines 9	1/26	102,315.23	5/15/91	9.231%	

+rollover

FEDERAL FINANCING BANK

JANUARY 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development					
Montgomery County, PA	1/13	$ 2,600,379.01	1/17/89	8.676%	
*Montgomery County, PA	1/17	5,000,000.00	5/15/96	9.206%	9.418% ann.
Rochester, NY	1/23	160,000.00	8/31/04	9.140%	9.349% ann.
Newport News, VA	1/27	158,815.00	2/15/89	8.763%	
RURAL ELECTRIFICATION ADMINISTRATION					
*Basin Electric #137	1/3	9,558,294.15	1/3/91	9.268%	9.163% qtr.
*Colorado Ute-Electric #78A	1/3	340,177.76	4/1/91	9.279%	9.174% qtr.
*Colorado Ute-Electric #78A	1/3	8,391,688.88	4/1/91	9.279%	9.174% qtr.
*Colorado Ute-Electric #78A	1/3	3,180,088.88	4/1/91	9.279%	9.174% qtr.
*Colorado Ute-Electric #78A	1/3	2,327,733.36	4/1/91	9.279%	9.174% qtr.
*Colorado Ute-Electric #297	1/3	1,666,097.59	4/1/91	9.280%	9.175% qtr.
*Colorado Ute-Electric #276	1/3	1,090,050.51	4/1/91	9.280%	9.175% qtr.
*Colorado Ute-Electric #297	1/3	9,749,326.86	4/1/91	9.280%	9.175% qtr.
*Cooperative Power Assoc. #70A	1/3	1,600,000.00	4/1/91	9.277%	9.172% qtr.
*Contel of Kansas #201	1/3	4,020,000.00	1/3/17	9.170%	9.067% qtr.
*N. Dakota Central Elec. #278	1/3	261,333.36	4/1/91	9.278%	9.173% qtr.
*New Hampshire Electric #270	1/3	1,834,000.00	1/2/18	9.165%	9.062% qtr.
*New Hampshire Electric #270	1/3	3,019,000.00	1/2/18	9.165%	9.062% qtr.
*New Hampshire Electric #270	1/3	643,000.00	1/2/18	9.165%	9.062% qtr.
*New Hampshire Electric #270	1/3	461,000.00	1/2/18	9.165%	9.062% qtr.
*New Hampshire Electric #270	1/3	132,000.00	1/2/18	9.165%	9.062% qtr.
*New Hampshire Electric #270	1/3	602,000.00	1/2/18	9.165%	9.062% qtr.
*New Hampshire Electric #270	1/3	738,000.00	1/2/18	9.165%	9.062% qtr.
*United Power Assoc. #86A	1/3	449,074.08	4/1/91	9.277%	9.172% qtr.
*United Power Assoc. #129A	1/3	1,251,074.40	4/1/91	9.278%	9.173% qtr.
*Wabash Valley Power #104	1/3	9,328,000.00	1/3/17	9.170%	9.067% qtr.
*Wabash Valley Power #206	1/3	432,000.00	1/3/17	9.170%	9.067% qtr.
*Washington Electric #269	1/3	402,016.75	4/1/91	9.277%	9.172% qtr.
Oglethorpe Power #320	1/5	18,927,000.00	4/1/91	9.377%	9.270% qtr.
*Wolverine Power #182A	1/11	2,203,000.00	1/2/90	9.273%	9.168% qtr.
*Wolverine Power #183A	1/11	2,813,000.00	1/2/90	9.273%	9.168% qtr.
*Wabash Valley Power #104	1/12	8,872,000.00	1/2/18	9.237%	9.133% qtr.
*Wabash Valley Power #206	1/12	623,000.00	1/2/18	9.237%	9.133% qtr.
Soyland Power Coop. #293A	1/17	3,365,000.00	1/2/18	9.117%	9.015% qtr.
*Colorado Ute-Electric #96A	1/26	230,000.00	4/1/91	9.226%	9.122% qtr.
*United Power Assoc. #145	1/26	4,302,000.00	1/28/91	9.225%	9.121% qtr.
*United Power Assoc. #159	1/26	1,798,000.00	1/28/91	9.225%	9.121% qtr.
*Colorado Ute-Electric #168A	1/30	32,119.00	4/1/91	9.197%	9.094% qtr.
*Colorado Ute-Electric #203A	1/30	1,154,000.00	4/1/91	9.198%	9.095% qtr.
*Dairyland Power #54	1/30	1,465,000.00	1/3/17	8.967%	8.869% qtr.

*maturity extension

FEDERAL FINANCING BANK

JANUARY 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-04	1/31	$ 691,552,659.29	4/28/89	8.747%	

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	January 31, 1989	December 31, 1988	Net Change 1/1/89-1/31/89	FY '89 Net Change 10/1/88-1/31/89
Agency Debt:				
Export-Import Bank	$ 11,027.2	$ 11,027.2	$ -0-	$ 69.5
NCUA-Central Liquidity Facility	113.3	113.9	-0.6	-4.9
Tennessee Valley Authority	17,021.0	16,955.0	66.0	-110.0
U.S. Postal Service	5,892.2	5,892.2	-0-	300.0
sub-total*	34,053.6	33,988.2	65.4	254.6
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	96.3	96.3	-0-	-0.1
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,071.2	4,071.2	-0-	-68.0
Small Business Administration	14.1	14.4	-0.3	-1.2
sub-total*	62,757.2	62,757.4	-0.3	-69.3
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	12,097.6	12,489.3	-391.7	-3,914.1
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	49.6	49.6	-0-	-0.4
DHUD-Community Dev. Block Grant	320.2	321.0	-0.9	2.1
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	383.0	383.0	-0-	-4.4
DOI-Guam Power Authority	32.1	32.1	-0-	-0-
DOI-Virgin Islands	26.1	26.1	-0-	-0.5
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,720.5	1,758.9	-38.3	-38.3
Rural Electrification Administration	19,224.6	19,245.9	-21.3	19.3
SBA-Small Business Investment Cos.	600.9	604.1	-3.2	-31.7
SBA-State/Local Development Cos.	853.0	859.3	-6.3	-17.9
TVA-Seven States Energy Corp.	2,207.8	2,213.8	-6.0	45.4
DOT-Section 511	43.3	43.3	-0-	-2.9
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	45,636.3	46,104.0	-467.7	-3,888.8
grand total*	$ 142,447.1	$ 142,849.6	$ -402.5	$ -3,703.4

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

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
May 30, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,407 million of 13-week bills and for $6,403 million of 26-week bills, both to be issued on June 1, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing August 31, 1989			:	26-week bills maturing November 30, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.47%	8.78%	97.859	:	8.33%	8.82%	95.789
High	8.52%	8.83%	97.846	:	8.37%	8.86%	95.769
Average	8.50%	8.81%	97.851	:	8.36%	8.85%	95.774

Tenders at the high discount rate for the 13-week bills were allotted 79%.
Tenders at the high discount rate for the 26-week bills were allotted 59%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 35,420	$ 35,420	:	$ 25,495	$ 25,495
New York	19,686,660	5,318,660	:	19,450,980	5,514,850
Philadelphia	18,355	18,355	:	16,245	16,245
Cleveland	30,585	30,585	:	31,215	31,215
Richmond	40,220	40,220	:	32,780	32,780
Atlanta	37,380	37,380	:	32,165	32,165
Chicago	931,650	106,650	:	840,280	86,180
St. Louis	42,415	26,365	:	27,080	22,260
Minneapolis	4,880	4,880	:	6,120	6,120
Kansas City	46,705	46,705	:	47,520	47,520
Dallas	34,130	29,130	:	25,215	15,215
San Francisco	902,135	189,425	:	849,195	125,695
Treasury	523,405	523,405	:	447,755	447,755
TOTALS	$22,333,940	$6,407,180	:	$21,832,045	$6,403,495
Type					
Competitive	$18,918,245	$3,291,485	:	$17,148,130	$2,019,580
Noncompetitive	1,145,995	1,145,995	:	925,915	925,915
Subtotal, Public	$20,064,240	$4,437,480	:	$18,074,045	$2,945,495
Federal Reserve	2,198,200	1,898,200	:	2,100,000	1,800,000
Foreign Official Institutions	71,500	71,500	:	1,658,000	1,658,000
TOTALS	$22,333,940	$6,407,180	:	$21,832,045	$6,403,495

1/ Equivalent coupon-issue yield.

NB-304

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
May 30, 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 $12,800 million, to be issued June 8, 1989. This offering will result in a paydown for the Treasury of about $2,400 million, as the maturing bills are outstanding in the amount of $15,189 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, June 5, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated March 9, 1989, and to mature September 7, 1989 (CUSIP No. 912794 SW 5), currently outstanding in the amount of $7,614 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,400 million, to be dated June 8, 1989, and to mature December 7, 1989 (CUSIP No. 912794 TG 9).

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

The bills will be issued for cash and in exchange for Treasury bills maturing June 8, 1989. In addition to the maturing 13-week and 26-week bills, there are $8,801 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 $1,446 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,473 million as agents for foreign and international monetary authorities, and $7,863 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.

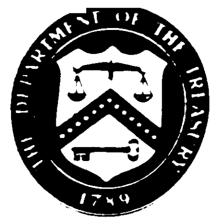
Public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in 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

FOR IMMEDIATE RELEASE May 26, 1989

Statement by
Secretary of the Treasury Nicholas F. Brady
on the International Debt Strategy

I welcome the actions taken by the IMF this week as a major step forward in implementing the strengthened international debt strategy. The decision to set aside a portion of IMF loans for debt reduction transactions and to provide additional resources for interest support puts into place a key element in efforts to achieve significant debt and debt service reduction. The IMF's new emphasis on measures to improve the savings and investment climate and to promote flight capital repatriation in IMF programs will enhance the Fund's ability to play an effective role in the strategy.

The IMF Executive Board approval this week of loans for Mexico, the Philippines and Costa Rica incorporated the new elements of the strategy. I hope that this will help lay the basis for prompt agreement between these countries and commercial banks.

The various actions taken by the IMF this week should serve as an important catalyst for further progress in strengthening the debt strategy, and promoting sustained growth on debtor countries.

oOo

NB-306

TREASURY NEWS

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

Remarks by
The Secretary of the Treasury
Nicholas F. Brady
on Reforming Economic Structures
at the OECD Ministerial
Paris, France
May 31, 1989

Chairman Sigurdsson, Secretary General Paye, Distinguished Colleagues:

We have agreed this morning that meeting our basic objectives -- strengthening the external adjustment process and resisting inflation pressures -- requires an appropriate macroeconomic policy mix. But we also recognize that to be fully successful over the longer term, traditional policy tools must be complemented by structural reforms.

The United States has been a strong and consistent advocate of policies to reduce the rigidities and distortions that, in varying degrees, affect all of our economies. These rigidities clearly diminish the effectiveness of fiscal and monetary policies, reduce the potential for sustained, non-inflationary growth, and impede external adjustment.

The OECD Secretariat has done a great deal of useful work in identifying these problems. It is particularly to be commended for formulating specific recommendations for reforms in individual countries. We also welcome the Secretariat's efforts to develop indicators to gauge structural rigidities and assess progress toward their elimination.

Over the past few years some progress has been made. Nevertheless, the pace of reform has been disappointing in many respects. For most countries there is ample room for major additional steps on tax reform, deregulation, industrial and agricultural subsidy reductions and elimination of labor market rigidities. An ambitious effort in these areas is an essential component of a comprehensive, forward-looking policy approach.

In addition, there are also areas where progress must be made multilaterally -- our agreement on the use of tied aid and standard export credits being a good example. Even here, however, more should be done to increase discipline over the competitive use of such credits. We hope the OECD will intensify its efforts on this score, as well as give new impetus to work on eliminating standard export credit subsidies.

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Similarly, we must seize the opportunity presented by the Uruguay Round to strengthen and improve the credibility of the GATT, and to expand GATT disciplines to reflect new global economic realities. In particular, we must follow through promptly on our agreed intention to reduce agricultural sector distortions substantially.

We are all well aware of the near-term obstacles to structural change, particularly at a political level. But we also recognize that the longer-term rewards will more than compensate. Our challenge now is to move ahead with the difficult steps to implement real reforms. If we are serious about positioning our economies for a vibrant, successful future, it is a challenge we must accept.

Thank you.

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

Remarks by
The Secretary of the Treasury
Nicholas F. Brady
on Sustaining Growth and Reducing Imbalances
at the OECD Ministerial
Paris, France
May 31, 1989

Chairman Sigurdsson, Secretary General Paye, Distinguished Colleagues:

The key issue for this morning's discussion -- strengthening the conditions for sustained growth -- is an issue many of us wrestle with every day. But while we can't claim to have found an ideal recipe for success, developments since the last Ministerial surely suggest that we've been correct about some of the ingredients.

While our six-year economic expansion has not been totally problem free, in 1988 the OECD economies turned in an impressive performance. Real growth exceeded expectations, and its international composition improved; key current and trade account imbalances were reduced; trade flows expanded dramatically; and inflation, while somewhat higher on average, remained modest and under control.

Our basic challenge is to sustain and build on our successes, while effectively dealing with the global imbalances that confront us. Certainly this will require efforts on many fronts, both individually and collectively. But the indispensible component, the bottom line if you will, is maintaining the solid, balanced growth that is essential to achieve our shared objectives: reducing unsustainably large external imbalances; improving living standards by creating new jobs and business opportunities; providing adequate support for developing nations to strengthen their economies; and remaining vigilant against inflation.

On this last point we need to maintain a healthy balance. We should not endorse restrictive policies in those countries where inflation is not a real problem, thereby risking a premature end to an expansion that has served us all so well.

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The industrial countries have agreed that reducing the large existing trade and current account imbalances is a matter of priority. There is a consensus that allowing these imbalances to persist too long increases protectionist threats to the global trading system and raises the risk of sharp and damaging financial market swings.

Through cooperative efforts substantial progress was made last year in reducing some key trade and current account imbalances. The U.S. trade deficit, for example, was cut by $34 billion. But recent trends in the largest surplus countries raise important questions about the continuation of the adjustment process.

Japan's trade surplus declined modestly last year but has increased for three consecutive quarters. Germany's trade surplus continues to grow, and contributes importantly to the major imbalances that have developed within Europe. Progress has been made in reducing the large surpluses of some of the Newly Industrialized Economies of Asia, but there is room for considerably more adjustment in all surplus countries.

Countries with large fiscal and external deficits must reduce budget deficits substantially. For our part, the U.S. Administration and Congress are fully committed to implementing the recent bipartisan agreement designed to meet the target of a $100 billion budget deficit in fiscal year 1990. But let us not lose sight of the fact that substantial deficit reduction progress has already been made in the United States. This year's reductions will bring the federal deficit to 2.7 percent of GNP, and the overall government deficit to only 1.5 percent of GNP--both near or below the OECD average.

But many in the United States feel we are being urged to act in a vacuum. U.S. policy alone does not drive international economic developments, and international policy prescriptions for current problems cannot end with U.S. fiscal action.

Sustaining growth and reducing external imbalances--also--requires that steps be taken by the surplus countries. Action by Germany and Japan is particularly important, and the smaller OECD countries can also make a useful contribution. The Newly Industrialized Economies of Asia too have an essential part to play as part of their larger obligation to assume a more constructive role in the global economy.

Surplus countries should ensure that growth is led by domestic demand. With their strong fiscal positions, large external surpluses, and low underlying rates of inflation, Japan and Germany in particular are well placed to make substantial contributions to the adjustment process.

A cooperative approach to these issues is at the heart of the G-7 policy coordination process to which we remain fully committed. Exchange rates have played an important role in this process and must play a continuing role in promoting adjustment. In this context, the dollar's recent rise against other major currencies is a matter of concern. If the dollar's recent rise is sustainted for a prolonged period, or extended, it could undermine our adjustment efforts.

As we meet here today there is broad agreement on our basic objectives for the coming year: to ensure smooth, balanced, and non-inflationary growth; to make further progress in reducing external imbalances; and to promote a healthy and growing international trade system. These objectives are within our grasp and can be achieved if together we share a sense of common policy priorities.

Thank you.

TREASURY NEWS

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

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For Release Upon Delivery
Expected at 9:30 a.m.
June 1, 1989

STATEMENT OF
JOHN G. WILKINS
ACTING ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to be here today to present the views of the Department of the Treasury regarding revenues to be collected under the Medicare Catastrophic Coverage Act (the "Act"). My statement today is limited to explaining the estimates of the income-related supplemental premium revenues that are the responsibility of the Treasury Department's Office of Tax Policy.

Benefit Financing under the Act

Program benefits are financed under the Act by both flat fees and income-related supplemental premiums. The structure of the Act that gives rise to these receipts is as follows:

Catastrophic.

-- Flat monthly fee. In general, Medicare Part B enrollees are required to pay an additional flat fee of $4.00 per month (equivalent to $48.00 per year) in 1989, $4.90 per month (equivalent to $58.80 per year) in 1990, $5.46 per month (equivalent to $65.52 per year) in 1991, $6.75 per month (equivalent to $81.00 per year) in 1992, and $7.18 per month (equivalent to $86.16 per year) in 1993.

-- Income-related supplemental premium. In addition, Medicare-eligible individuals who pay Federal income tax are required to pay an income-related supplemental premium. The premium rate is $22.50 per $150 of

adjusted Federal income tax liability in 1989. The premium rate per $150 of adjusted liability will be $27.14 in 1990, $30.17 in 1991, $30.55 in 1992, and $29.55 in 1993. (These figures may vary in the case of certain individuals, such as individuals who receive Government pensions.)

Prescription Drugs.

-- Flat monthly fee. In general, Medicare Part B enrollees are required to pay an additional flat fee beginning in 1991 of $1.94 per month (equivalent to $23.28 per year) in 1991, $2.45 per month (equivalent to $29.40 per year) in 1992, and $3.02 per month (equivalent to $36.24 per year) in 1993.

-- Income-related supplemental premium. In addition, Medicare-eligible individuals who pay Federal income tax are required to pay an income-related supplemental premium. The premium rate is $10.36 per $150 of adjusted Federal income tax liability in 1990. The premium rate per $150 of adjusted liability will be $8.83 in 1991, $9.95 in 1992, and $12.45 in 1993. (These figures may vary in the case of certain individuals, such as individuals who receive Government pensions.)

Overall Income-Related Supplemental Premium Limitations.

-- In general, a maximum annual income-related supplemental premium is established by an overall ceiling per enrollee of $800 in 1989, $850 in 1990, $900 in 1991, $950 in 1992, and $1,050 in 1993.

-- In general, individuals with income tax liabilities under $150 are not required to pay income-related supplemental premiums.

Administration Estimates

In June 1988, at the time of enactment of the Medicare Catastrophic Coverage Act, the Administration estimated that receipts from the Act would total $37.4 billion over a 5-year period, fiscal years 1989-1993. These receipt collections include both the flat premiums and the income-related supplemental premiums for the basic catastrophic part of the program as well as for the drug part. Flat premiums were estimated by the Department of Health and Human Services and income-related supplemental premiums were estimated by the Department of the Treasury. Treasury's year-by-year estimates of income-related supplemental premium payments are shown on Table 1.

Coupled with the Department of Health and Human Services' estimates of spending on new benefits under the Act, the $37.4

billion of receipts through fiscal year 1993 -- including $24.0 billion in income-related supplemental premiums -- gave rise to an Administration estimate of a $2.1 billion fund balance at the end of fiscal year 1993. That may be compared with the $4.2 billion fund balance estimated by the Congressional Budget Office at that time, which estimate was the official estimate for congressional consideration. The Administration and Congress were in agreement that a surplus was important to avoid under-funding in order to protect the beneficiaries of the program.

Estimates of income-related supplemental premium payments under the Act were revised by the Treasury for the President's Budget for fiscal year 1990. The revised estimates reflect Administration expectations that receipts from the Act will now total $41.7 billion for this same 1989-1993 5-year period, a $4.3 billion increase over the original estimate. These revised estimates include $28.3 billion of income-related supplemental premiums, also shown on Table 1.

Coupled with the Department of Health and Human Services' current projection of spending on benefits under the Act, our current estimate gives rise to a $6.2 billion fund balance at the end of fiscal year 1993. This is a fund balance increase of about $4.1 billion over the original Administration estimate and about $2 billion over the original congressional estimate.

Reasons for Revision

The revision in the Administration's estimate between June 1988 and January 1989 occurs entirely in the income-related supplemental premiums. The estimate of the flat premiums remains unchanged at $13.4 billion. Our estimate of the income-related supplemental premiums was increased from $24.0 billion to $28.3 billion; however, almost all of this revision is attributable to a revised estimate of the speed with which the premiums will be collected and very little is attributable to a change in the liability of affected taxpayers. This is illustrated by the fact that the January 1989 calendar year liability estimates shown on the lower half of Table 1 are almost identical to the estimates of calendar liabilities prepared in June 1988. The very small differences -- no larger than $200 million in any year -- are associated with changes in the underlying macroeconomic forecast and other technical factors.

The original June 1988 estimate assumed that a relatively small fraction of the additional premium would be paid in the form of quarterly estimated taxes and, to a lesser extent, in the form of withheld income taxes. The January 1989 estimate reflects a reappraisal of the use of quarterly estimated taxes and withheld taxes by elderly taxpayers who would make additional payments under the Act's income-related supplemental premium provision. This change in the assumed form of payment results in

a speedup of collections and accounts for virtually the entire increase in receipts over the 5-year period.

Computer analysis of tax returns filed by those who may be required to pay income-related supplemental premiums shows that more than three-fourths currently pay quarterly estimated tax payments or have income tax withheld from pension or wage income. About 85 percent of income tax payments made by the elderly population occur in the form of estimated and withheld payments.

We believe it is reasonable, therefore, to assume that in order to avoid penalties somewhere between 80 and 90 percent of the income-related supplemental premium payments will be reflected in "current" tax payments, that is, quarterly estimates or withheld taxes, and that only the remaining 10 to 20 percent will be reflected in larger final payments or smaller refunds.

This payment pattern, however, does not apply to the first 2 years of the program. The law specifically waives the estimated tax requirement with respect to income-related supplemental premiums due for 1989. Thus, in that year we assume that only about 15 percent of the income-related supplemental premiums will be reflected in current tax payments. For 1990, we estimate that the fraction of income-related supplemental premiums that will be reflected in estimated or withheld payments will increase only to about two-thirds because many taxpayers will benefit in that year from the general safe harbor rule that estimated payments need not exceed 100 percent of the prior year's liability.

Treasury completed this analysis after revenue estimates were made at the time of the conference report. In June 1988, our estimates were consistent with about three-fourths of the premium payments showing up in yearend settlements.

Differences from CBO Estimates

A comparison of the current Treasury revenue estimate of the income-related supplemental premium payments under the Act with the current Congressional Budget Office estimate shows that Treasury anticipates collections over the 5-year budget period, fiscal years 1989-1993, to be $2.4 billion greater than does CBO. These estimates are shown on Table 2. However, a comparison of Treasury and CBO estimates of calendar year liabilities associated with income-related supplemental premiums (lower half of Table 2) shows that Administration and congressional liability estimates are quite similar. In two of the five years, 1989 and 1990, there is virtually no difference and in only one year, 1993, is the difference between the two offices' estimates as great as $500 million, a difference of about 7 percent.

This demonstrates that the existing difference between Treasury's estimate of $28.3 billion in income-related supplemental premiums and CBO's estimate of $25.9 billion is attributable to different assumptions concerning the payment of premiums

and not to fundamental differences in the amount of premium liability. For reasons I have explained, we believe that our current estimates accurately reflect the requirements of the estimated tax system and incorporate a more complete understanding of taxpayer behavior.

Conclusion

The Reagan Administration supported the Medicare Catastrophic Coverage Act of 1988 when it was enacted and the Bush Administration remains committed to its implementation. The Department of the Treasury has reviewed the data and model used to estimate the receipts under the Act and finds no reason to change the estimates made last winter.

Although our current income-related supplemental premium liability estimates are not substantially different from those made by CBO, the Administration's estimate of actual revenue collections under the Act are $2.4 billion greater than those made by CBO. The Administration's $6.2 billion estimate of the overall fund balance at the end of 1993 is not sufficiently large in our judgment, however, to warrant altering the structure of the program's funding mechanism. Treasury would not consider it prudent to alter the premium structure until we have sufficient experience to validate estimates of revenues and spending made by the Administration and by CBO. There is general agreement that a cushion is required to assure that promised benefits will in fact be available. Given the uncertainty inherent in making projections in the absence of significant actual experience and in view of Secretary Sullivan's concern that the drug fund may be substantially underfunded, we believe that changing the level of funding now would not be consistent with protecting the rights of beneficiaries.

Mr. Chairman, that concludes my formal statement. I will be happy to answer questions that you and Members of the Committee may wish to ask.

Table 1

Medicare Catastrophic Coverage Act
Supplemental Premium Receipts and Liability
Comparison of Treasury June 1988 Estimates
and Treasury 1990 Budget Estimates

	Year					Total
	1989	1990	1991	1992	1993	(1989–93)
			($ billions)			
Fiscal year						
June 1988	0.4	4.5	5.9	6.3	6.9	24.0
1990 Budget	0.6	6.5	7.1	6.9	7.3	28.3
Difference	0.2	2.1	1.2	0.6	0.3	4.3
Calendar year						
June 1988	3.9	5.7	6.2	6.8	7.4	30.0
1990 Budget	4.1	5.9	6.4	6.9	7.4	30.7
Difference	0.2	0.2	0.2	0.1	0.0	0.7

Department of the Treasury
Office of Tax Analysis

June 1, 1989

Table 2

Medicare Catastrophic Coverage Act
Supplemental Premium Receipts and Liability
Comparison of Treasury 1990 Budget Estimates
and CBO 1990 Budget Estimates

	Year					Total
	1989	1990	1991	1992	1993	(1989-93)
			($ billions)			
Fiscal year						
Treasury	0.6	6.5	7.1	6.9	7.3	28.3
CBO	0.4	5.4	6.1	6.7	7.3	25.9
Difference	0.1	1.1	1.0	0.2	-0.1	2.4
Calendar year						
Treasury	4.1	5.9	6.4	6.9	7.4	30.7
CBO	4.1	5.9	6.5	7.1	7.9	31.5
Difference	0.0	0.0	-0.1	-0.2	-0.5	-0.8

Department of the Treasury
Office of Tax Analysis

June 1, 1989

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DEPARTMENT ...

Remarks by
The Secretary of the Treasury
Nicholas F. Brady
on
Debt and Development
at the
OECD Ministerial Meeting
Paris, France
June 1, 1989

Chairman Sigurdsson, Secretary-General Paye, and Distinguished Colleagues:

This morning's agenda topic on debt and development is vitally important to all of us, since we are faced with the formidable challenge of helping to revive growth and renew hope in the developing countries. As you know, we have proposed steps to strengthen the debt strategy and to provide financial support for debtor countries' efforts to reform their economies and achieve lasting growth. This strengthened strategy revolves around two central themes: the need to give greater emphasis to debt and debt service reduction to complement new lending, and the need for debtor countries to implement sound economic policies designed to encourage investment and flight capital repatriation.

Implementing this approach requires concrete steps. Each party has a critical role to play.

For the debtor countries, the essential first step is to adopt sound macroeconomic and structural policies; sustained economic growth will not materialize without such policies. Policies must promote confidence in both foreign and domestic investors -- for investment is the key to growth -- and stimulate a sustained and durable return of flight capital. Attention should also be directed to policies that free up rigidities and allow the marketplace to work.

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These policies should be accompanied by timely financial support, particularly from the commercial banks through debt and debt service reduction transactions and new money arrangements. In this regard, we welcome the adoption by the Executive Boards of the IMF and World Bank of guidelines governing their support for debt and debt service reduction. Individual countries are already moving forward under these guidelines, and commercial banks are tabling their proposals for debt and debt service reduction.

Creditor governments have been providing substantial support for debtor countries, and should continue to do so. In particular, they must assure that official debt rescheduling in the Paris Club and export credit cover will continue for those countries adopting IMF and World Bank programs. Let me commend Japan for stepping forward and announcing a commitment to provide additional financing of $4.5 billion. In addition, the G-7 countries have been reviewing their regulatory, accounting, and tax regimes, with a view to reducing any impediments to debt and debt service reduction.

Much has been accomplished on the official side in a very short period of time. It is now time for the commercial banks and the debtor nations to take advantage of this situation and complete their negotiations.

We recognize that this new approach has created a period of uncertainty. But let us not forget that this is a complex process involving many debtor and creditor countries, the international financial institutions, and technical banking, regulatory, accounting and tax issues unique to each country. In any complicated process, uncertainty is an inevitable step on the road to change and progress.

Yes, we have raised expectations. But we have also raised hopes. Let us work together, build on the progress we have made, and ensure these hopes are realized.

Thank you.

TREASURY NEWS

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FOR RELEASE UPON DELIVERY
Expected at 2:00 P.M., EDT
June 1, 1989

STATEMENT BY FRANK G. VUKMANIC
DIRECTOR, OFFICE OF
MULTILATERAL DEVELOPMENT BANKS
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON
SUPERFUND, OCEAN, AND WATER PROTECTION
OF THE COMMITTEE ON
ENVIRONMENT AND PUBLIC WORKS
UNITED STATES SENATE
JUNE 1, 1989

Mr. Chairman. I am pleased to participate in this afternoon's hearings and to present the Department of the Treasury's views on the reauthorization of appropriations for the Office of Environmental Quality and S.1045, a measure that seeks to promote development of environmental assessments in international financial institutions. I would like to comment first on the draft amendment to clarify National Environmental Policy, extending NEPA procedures to extra-territorial actions of the U.S. Government, and then on S.1045.

Draft Amendment to Clarify National Environmental Policy

We would oppose legislation extending NEPA to international actions of the U.S. Government. We believe this approach is unworkable in the international context and especially in the international financial institutions. We have already expressed our concern about extending NEPA procedures to U.S. votes in the multilateral development banks. We are also concerned that the legislation would affect the International Monetary Fund. This organization emphasizes broad macroeconomic policy issues -- fiscal, monetary, and exchange rate measures -- that relate to balance of payments adjustment and economic restructuring. These measures do not appear to have direct effects on specific environmental issues. Efforts to deal with those environmental issues in the context of IMF programs could hamper the Fund's systematic responsibilities without having a significantly positive impact on the environment.

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<u>S.1045 - National Environmental Policy on International Financing Act of 1989</u>

Let me now turn to Treasury's views on S.1045. We are supportive of the objectives of this legislation, which is to promote environmental reform in the multilateral development banks. Indeed, we have taken the lead internationally to

encourage environmental impact assessment in the MDBs and early dissemination of environmental information on specific projects and programs.

On March 1, Secretary Brady sent a letter to President Conable "strongly recommending that the Bank consider ways that environmental information on specific projects may be made publicly available on a regular basis well in advance of Board review." I would like to provide a copy of that letter for the record because we believe that such public participation is essential to the environmental impact assessment process.

At the April 4 meeting of the Development Committee of the World Bank and IMF, Secretary Brady called for stronger attention to environmental reform in the MDBs. He asked specifically for internal environmental impact assessment procedures and procedures for providing environmental information about individual loans to non-governmental organizations and community groups. In response to the Secretary's statement, environmental issues were highlighted in the communique of that Development Committee meeting. Agreement was also reached that the subject should be included in the agenda of the September meeting.

The Treasury Department has encouraged greater attention to environmental impact assessment in statements given at the annual meetings of the regional development banks this spring. At the Asian Development Bank's Annual meeting, Assistant Secretary Dallara said he was hopeful that the process for assessing the environmental impact of projects and programs will become increasingly effective. At the Annual Meeting of the African Development Bank, Acting Deputy Assistant Secretary Fall said that establishment of environmental impact assessment procedures would be a critical factor in beginning to address that continent's enormous environmental problems.

Environmental impact assessment and early access to information are key conditions that the United States is now seeking to incorporate into the IDA-IX replenishment agreement. At the negotiations that took place in London last month, Assistant Secretary Dallara highlighted the importance we attach to these issues and called for a paper on them, to be discussed at the July or September replenishment meeting.

At the ministerial meeting of the Organization for Economic Cooperation and Development now in progress in Paris, Secretary Brady is pressing the organization to encourage the multilateral development banks to adopt environmental impact assessment procedures and to increase public access to environmental information about specific projects and programs. We are also calling for greater emphasis on energy efficiency and conservation and programs to promote alternatives to chloro-fluoro-carbons. We plan to take the same approach at the meeting of heads of state or government that is to be held in France in July.

The extent of this international initiative reflects the importance we attach to environmental issues, particularly environmental impact assessment and early disclosure of information. We believe these latter elements are the essential components of environmental reform in the multilateral development banks and in borrowing countries. However, we also want to emphasize that a key to success in this endeavor in the MDBs is the support of other member countries, both developed and developing. Unless we can succeed in developing broad-based member support we will not convince the MDBs and ultimately the borrowing countries to adopt effective EIA procedures or move to share relevant information with non-governmental organizations and other interested parties.

Last year the Treasury strongly opposed legislation similar to S.1045 because it incorporated provisions which unilaterally imposed U.S. environmental standards on the MDBs, an action which we believe is counterproductive. We want to compliment the drafters of S.1045. We believe this legislation goes a long way to eliminate some of the problems associated with last year's bill. In fact, this bill incorporates, in section 4, some of the changes we had suggested.

However, we are concerned about the basic thrust of the legislation, i.e., it calls for the identification and promulgation of criteria by the United States to apply to the loans of the multilateral institutions. Section 2 requires U.S. Executive Directors to request that the banks prepare detailed statements on their environmental impact assessments, using criteria developed unilaterally by the U.S. Council on Environmental Quality. The directors then must gauge the banks' statements against these CEQ-developed criteria. Any shortcomings in the assessments, as determined with reference to these U.S. generated criteria, would be reported to the public. We believe that asking for detailed statements and evaluation of the banks' work by U.S. criteria would be misconstrued as unilateral interference and set back our efforts to promote a

multilateral consensus on environmental reform. We are convinced that we cannot achieve our goals in the banks without the support of other member countries.

The bill also contains some ambiguities with respect to the duties of the U.S. Executive Directors. It is not clear whether it is U.S. Executive Directors or the banks who are responsible for dissemination of information to the public under the EIA process. It is also unclear to what extent directors would have to seek relevant information beyond that which is provided by the banks. Will the directors have to make public confidential information provided by the banks? Will the directors' procedures be subject to judicial review and will private citizens be able to seek injunctions against U.S. actions for non-compliance with the environmental criteria? As it is written, this bill could impose onerous fact-finding, public relations, and reporting duties on the Executive Directors.

I would like to stress that Treasury shares the Committee's goals in this legislation. Therefore, we would like to propose a change which we believe addresses our mutual concerns while avoiding the problem of unilateral U.S. action. We propose replacing sections 106(b) and 106(c) of the bill with a provision to authorize the Secretary of the Treasury to initiate international discussions to develop criteria and procedures for conducting environmental impact assessments in the multilateral development banks. The goal of the discussions would be to develop in concert with other member countries in the banks internationally accepted criteria and procedures which could be adopted by the banks to guide their internal operations. We believe that this approach would address squarely the committee's concern about improving project design and appraisal with respect to environmental issues. Moreover, we would encourage the banks' making available to the public environmental information on specific projects and programs in advance of Board consideration. A year after the enactment of the legislation, the Secretary could report to the Congress on the development of these international criteria. Section 106(a) would have to be modified to reflect this new initiative.

I have one additional comment to make. Section 106(a), as it stands, would include in its coverage the International Monetary Fund. We strongly oppose this inclusion. As I indicated earlier, this type of legislation would hamper the Fund's primary work without advancing our efforts on environmental reform.

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Remarks by
Secretary of the Treasury
Nicholas F. Brady
on
Current International Policy Issues
at the
Anglo-American Press Association Breakfast
Paris, France
June 1, 1989

The 1989 OECD Ministerial caps a year of impressive economic performance by the major industrial countries. The past year demonstrates that the coordination of economic policies is a practical and effective means of promoting a sound world economy.

Growth last year exceeded expectations, and prospects for continuing the current expansion into its seventh year and beyond are excellent. Inflation remains moderate and contained. And trade imbalances have begun to be reduced in some countries, although there is a clear need for significant further adjustment.

Building on this success requires strengthened cooperation by the major industrial countries. We must be vigilant and guard against a resurgence of inflationary pressures. However, actions by the monetary authorities during the past year have succeeded in containing potential inflationary pressures. Now, we must be careful that we do not overreact and bring about a premature end to an economic expansion that has served us so well.

Recent trade data suggest that the overall adjustment of external imbalances is slowing, although first quarter figures for the United States were encouraging. Still, the level of deficits and surpluses is unacceptable. In this context, the dollar's recent rise, if sustained or extended, would undermine adjustment efforts. The United States has cooperated and will continue to cooperate with its trading partners in dealing with exchange market pressures.

Our ability to reduce external imbalances to sustainable levels requires concerted actions by all OECD members. In this regard, the United States is keenly aware of its responsibility to reduce the federal budget deficit.

The Administration and Congress are fully committed to achieving further progress by implementing the recent bipartisan

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budget agreement and meeting the $100 billion deficit target in fiscal 1990. And we will continue to reduce the deficit in later years. At the same time, we must not lose sight of the substantial deficit reduction that has already occurred. The federal budget deficit is now 2.9 percent of GNP, compared to a peak of 6.3 percent in 1983. This places the United States below the OECD average.

Sustaining growth and reducing external imbalances cannot be achieved by the U.S. alone. Surplus countries, especially Japan and Germany, must do their part. Their strong fiscal positions, large external surpluses, and low inflation rates enable them to make further substantial contributions to this global effort.

TRADE POLICY

As you know, there have been some recent important developments in U.S. trade policy. Since Ambassador Hills has spoken on the Section 301 issue, I'll focus my remarks on the President's decision to initiate entirely separate bilateral negotiations with the Japanese.

We have been concerned for some time that structural rigidities in the United States and Japan have impeded the adjustment of our large trade imbalances. We believe these rigidities strongly affect each country's trade position, offsetting to some extent the impact of exchange rate and trade policy changes in recent years. Examples include retail and wholesale distribution systems, industrial organization, and saving and investment patterns.

Last week the President directed the Treasury and other agencies to propose results-oriented negotiations with the Japanese government designed to reduce these structural impediments. These talks would take place outside the context of Section 301 and would concentrate on areas not covered in product-specific trade negotiations or in broad macroeconomic discussions. These will continue to be handled within established fora.

The new structural talks would permit our two governments to address issues that cut across traditional trade and macroeconomic areas. This effort is intended to complement our broader multilateral goal: a world-wide reduction of barriers to the free flow of goods, services, and investment.

DEBT STRATEGY

As you know, we have recently proposed steps to strengthen the debt strategy. Our proposals revolve around two central themes: One is the need for debtor countries to implement sound economic policies, especially more open investment policies. The

second is the need to support voluntary, market-based transactions between commercial banks and debtors that reduce debt and debt service.

In recent weeks we have seen encouraging progress: First, the IMF and World Bank have taken steps to support the new strategy. Second, a number of debtor nations have negotiated programs with the IMF. And finally, active discussions are now under way between several debtor nations and commercial banks.

We recognize that this new approach has created some uncertainties. But uncertainty is an inevitable part of change and progress. Yes, we've raised expectations. But so have we raised hope.

Thank you, and now I'd be delighted to take your questions.

TREASURY NEWS

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Contact: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
June 1, 1989

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $8,536 million of 52-week bills to be issued June 8, 1989, and to mature June 7, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	8.18%	8.85%	91.729
High -	8.19%	8.86%	91.719
Average -	8.18%	8.85%	91.729

Tenders at the high discount rate were allotted 55%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 18,090	$ 18,090
New York	26,140,690	7,805,390
Philadelphia	14,195	14,195
Cleveland	27,890	27,890
Richmond	25,475	25,475
Atlanta	20,160	20,160
Chicago	911,725	162,475
St. Louis	18,275	14,825
Minneapolis	9,925	9,925
Kansas City	35,510	35,510
Dallas	12,815	12,815
San Francisco	850,215	132,715
Treasury	256,725	256,415
TOTALS	$28,341,690	$8,535,880
Type		
Competitive	$24,631,540	$4,825,730
Noncompetitive	683,250	683,250
Subtotal, Public	$25,314,790	$5,508,980
Federal Reserve	3,000,000	3,000,000
Foreign Official Institutions	26,900	26,900
TOTALS	$28,341,690	$8,535,880

An additional $23,100 thousand of the bills will be issued to foreign official institutions for new cash.

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Remarks by
Secretary of the Treasury
Nicholas F. Brady
to the Press at the Conclusion
of the 1989 OECD Ministerial
Paris, France
June 1, 1989

Good evening.

I'd like to spend a few minutes reviewing some of the key developments at this year's OECD Ministerial meeting, and then we'll take your questions.

We've had nearly two days of productive discussions on a wide range of important issues. These include macroeconomic trends in the industrial countries; policy priorities to achieve sustained growth and further reduction of trade and current account imbalances; the strengthened debt strategy; and trade issues.

As the final communique makes clear, there was basic agreement on the fundamental issues, setting the stage for a successful and productive Economic Summit meeting of the major industrial countries in July.

Economic Trends and Policy Priorities

On the macroeconomic front, OECD expansion is now into its seventh consecutive year, and moderate growth is expected to continue. Inflation is being contained, and progress has been made in reducing external imbalances.

Our policy priorities are:

(1) to foster the well-balanced growth in the industrial countries that is essential to promoting continued global trade and current account adjustment;

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(2) to create new opportunities for investment and job creation; and

(3) to provide a supportive environment for implementing the debt strategy.

The communique reflects these basic priorities.

Achieving our objectives requires coordinated action, particularly by the largest countries. For our part, we are committed to further reductions in the federal budget deficit. Japan and Germany recognize the need to pursue strong growth in order to promote reductions of their large external surpluses.

We are pleased with the emphasis given in the communique to the need for structural reforms. Tax reform, deregulation and subsidy cuts are essential for balanced long-term growth.

The Debt Strategy

We are also pleased with the Ministerial's endorsement of the strengthened debt strategy, with its new emphasis on debt and debt service reduction and policies to promote investment and flight capital repatriation.

In recent weeks substantial progress has been made in implementing the proposals we advanced just three months ago. The IMF has agreed on a number of important changes in Fund policies to enable it to support the strategy. And we are particularly pleased that just last night the World Bank joined the IMF by agreeing to the necessary policy changes that will enable it to play a crucial role in our renewed strategy.

These steps have given the process new momentum. We now look for the debtor countries and the banks to use these arrangements as a catalyst for agreement on specific financing packages.

Trade Issues

As you know, trade issues were another important theme at the Ministerial. We are pleased with the outcome in this area, particularly with the ministerial's strong endorsement of agricultural reform and a successful completion of the Uruguay Round. Ambassador Hills will be glad to answer your questions on this.

Environment

The Ministerial also gave considerable emphasis to environmental issues, which will also be a major theme at the upcoming Economic Summit. Under Secretary McCormack would be pleased to address this issue.

Thank you, and now Ambassador Hills, Chairman Boskin, Under Secretary McCormack and I would be delighted to take your questions.

TREASURY NEWS

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

Remarks by
Secretary of the Treasury
Nicholas F. Brady
on
Current International Policy Issues
at the
Anglo-American Press Association Breakfast
Paris, France
June 1, 1989

JUN

(Introduction by John Flint, (Reader's Digest) President of the Anglo-American Press Association.)
Ladies and gentlemen, good morning. We have the pleasure today of having with us Nicholas F. Brady, the Secretary of the Treasury, whom I would like to thank for having taken the time from a very busy schedule to come and be with us this morning. This is the fifth time that we have had the Secretary of the Treasury address our Association at the occasion of the annual OECD Ministerial meeting. I hope, obviously, that it's a tradition that is going to be continued in the future.

As most of you probably know, Mr. Brady, before being appointed Secretary of the Treasury last September, served briefly in the Senate and also served on a number of important commissions during the Reagan Administration, including the Commission on Executive, Legislative, and Judicial Salaries; the Commission on Strategic Forces, the Commission on Central America, on Security and Economic Assistance, and, also, the Commission on Defense Management. He has of course, also, had a distinguished career in banking which extended for more than three decades during which time he rose to be a Chairman of the Board of Dillon Reed and Company in New York.

Mr. Secretary, I would like to welcome you. I'd like to point out the Secretary will have a few preliminary remarks to make and then we can go into questions which will be, as usual, on the record. I would like to ask you to identify yourselves and

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your organization when you ask questions. We'll try to give priority to the members of the Association in asking questions. There will be a microphone for those of you who want to ask questions later. Mr. Secretary.

(Secretary Brady)
I would like to make a few prepared remarks, not that they are in the form of revelation, but to give everybody a chance to think for a minute.

The 1989 OECD Ministerial caps a year of impressive economic performance by the major industrial countries. The past year demonstrates that the coordination of economic policies is a practical and effective means of promoting a sound world economy.

Growth last year exceeded expectations, and prospects for continuing the current expansion into its seventh year and beyond are excellent. Inflation remains moderate and contained. Trade imbalances have begun to be reduced in some countries although there is a clear need for significant further adjustment.

Building on this success requires strengthened cooperation by the major industrial countries. Of course, we must be vigilant and guard against a resurgence of inflationary pressures. However, actions by the monetary authorities during the past year have succeeded in containing potential inflationary pressures as we can see it now. However, we must be careful that we do not overreact and bring about a premature end to an economic expansion that has served us so well.

Recent trade data suggest that the overall adjustment of external imbalances is slowing, although first quarter figures for the United States were very encouraging. Still, the level of deficits and surpluses is unacceptable. In this context, the dollar's recent rise, if sustained or extended, would undermine adjustment efforts. But in this regard the United States has cooperated and will continue to cooperate with its trading partners in dealing with exchange market pressures.

Our ability to reduce external imbalances to sustainable levels requires concerted action by all OECD members. For our part, the United States is keenly aware of its responsibility to reduce the federal deficit in our own country.

The Administration and Congress are fully committed to -- achieving further progress by implementing the recent bipartisan budget agreement and meeting the 100 billion dollar deficit target in fiscal 1990. And we will continue to reduce

the deficit in the out years. At the same time we must not lose sight of the substantial deficit reduction that has already occurred. The federal budget deficit is now at 2.9 percent of GNP, compared to a peak of 6.3 percent in 1983. This places the United States below the OECD average.

Sustaining growth and reducing external imbalances cannot be achieved by the U.S. alone. Surplus countries, especially Japan and Germany, must do their part. Their strong fiscal positions, large external surpluses, and low inflation rates enable them to make further substantial contributions to this global effort.

As you know, there have been some recent important developments in U.S. trade policy. Since Ambassador Hills has spoken on the Section 301 issue, I'll focus my remarks on the President's decision to initiate entirely separate bilateral negotiations with the Japanese.

We have been concerned for some time that structural rigidities, not only in the United States but obviously in Japan, have impeded the adjustment of our large trade imbalances. We believe these rigidities strongly affect each country's trade position, offsetting to some extent the impact of exchhange rate and trade policy changes in recent years. Examples include retail and wholesale distribution systems, industrial organization, and saving and investment patterns.

Last week the President directed the Treasury and other agencies to propose results-oriented negotiations with the Japanese government designed to reduce these structural impediments. These talks would take place outside the context of Section 301, and would concentrate on areas not covered in product-specific trade negotiations or in broad macroeconomic discussions. These will continue to be handled within established fora.

The new structural talks would permit our two governments to address issues that cut across traditional trade and macroeconomic areas. This effort is intended to complement our broader multilateral goal: a world-wide reduction of barriers to the free flow of goods, services, and investment.

Just a word on the debt strategy. As you know, we have recently proposed steps to strengthen the debt strategy. Our proposals revolve around two central themes: one is the need for debtor countries to implement sound economic policies, especially more open investment policies. The second is the need to support voluntary, market-based transactions between commercial banks and debtors that reduce debt and debt service.

In recent weeks we have seen encouraging progress: First, the IMF and the World Bank have taken steps to support the new debt strategy. Second, a number of debtor nations have negotiated programs with the IMF. And, finally, active discussions are now under way between several debtor nations and their commercial banks.

We recognize that this new approach has created some uncertainties. But uncertainty is an inevitable part of change and progress. It's been said we've raised expectations. But so have we raised hope.

I want to thank you for being with us this morning and I'd be delighted to answer any questions you might have.

Q. You said at one point that you wanted to strengthen cooperation and coordination of economic policies. Can you give us an idea of how you plan to do that?

A. Well, continue with the process. The G-7 has been so important to the policy coordination process. Meetings like the OECD that we've been having this week add to the ability of nations to agree on policies and procedures that will keep the world economy going. It's had seven years of expansion. That's important, and the meetings we have add to the ability to keep that kind of expansion going.

Q. The riots are continuing in Argentina. But in the general public at any rate the perception is spreading that its debts... debts are the new plague. What is it that the United States can do by itself or in coordination in order to help countries that face this extreme situation?

A. Well, we are trying to do just exactly that. The debt strategy which was announced in March took a process that everybody in the press and elsewhere described as fatigued and moribund and introduced some new life into it. With regard to the discussions that are going on right now between commercial banks and debtor nations, although we don't have agreement, what we have is energy and momentum. The two sides may be at this moment too far apart, but what we're seeing both debtors and creditors coming forward with plans and trying to get together on a debt reduction process. I think it's extremely important that the world financial community is now dedicated to the proposition of debt reduction. It seems to us when we collected the ideas which are part of the debt strategy announced in March, that it was a totally different direction that we were embarking on. Previous attempts at trying to settle the debt problem involved taking countries which were

already overburdened with debt, engaging in negotiations which added to the debt burden and then thinking that that was progress. We tried to turn the problem on its head and say, "Well, what is progress?" And the thought was, well, progress is trying to get total stock of debt down. So we think that the course that we're now on is aimed at trying to do exactly what you've suggested, which is make the debt problem more manageable, and by more manageable we mean reduce it in size.

Q. May I follow up please. But you talked a moment ago of providing some kind of progress on debt reduction. Is there no way that you can address the political situation more exactly, that you can give these people who are really quite hungry some sense of things will get better which they don't have?

A. Well, I don't agree with the assumption underlying your question. I think that when we've come up with a new strategy that does reduce the amount of debt, then that's something that the creditor nations can provide in the way of hope. And the fact that three or four countries are now negotiating to do just exactly that and doing so willingly indicates to me that we're on the right track. It isn't going to solve every problem of the needy but it's to me a way of lighting one candle instead of cursing the darkness.

Q. The problem now is after the International Monetary Fund and the World Bank which makes loans. The problem is that you said with government quarantees some cost must be expected. What is your opinion about this, what is the government will in fact to reduce this kind of debt? I understand that the Europeans are looking at this closely.

A. Let me see if I've got the question. That the IMF and the World Bank have come forward with their outlines of support that they're going to give and your question is what amount in addition to that are governments going to give?

Q. What kind of guaranties about what kind of guaranties the creditor governments will give to the banks in order to loan new money to the debt?

A. Well, at this moment in time, the official help that is being provided is from the IMF and the World Bank. Of course, the Japanese have agreed to put a substantial amount of money into the process, and I believe they are going to be more definitive about that in the next week. But with regard to creditor governments there is no provision at this point in time for any additional guarantees from that source.

Q. Mr. Secretary, the Saudis have indicated that they are

going to ask to allow oil prices to be floated at the upcoming OPEC meeting. What's your reaction to that and what would you hope to see from the OPEC meeting?

A. Well, I think any time we have a free market in a commodity that's as important to the world as oil, that's a good thing. I don't think I'm more able than anybody else to predict what that's going to mean. But the fact that we have a market that will be a free and open market I think is a good thing, particularly for the consuming nations.

Q. Could you give any indication what other things you might hope to see from the OPEC meeting coming up?

A. I don't have any more information than what you've just alluded to.

Q. Mr. Secretary, not too long ago the Administration's been hitting pretty hard on the European Community as well as Japan on structural rigidities and non-tariff barriers. Now that some decisions have been made on Japan what has happened to Europe and the Community? What is the Administration's view that the Europeans need to deregulate? Has that issue just dropped out of sight?

A. Well, I don't think it's dropped out of sight. Section 301 is a law in our country that had to be complied with. The President with the lead from Ambassador Hills has complied with that law. The discussions with the EC and other countries around the world will continue as before. I don't see too much difference.

Q. Well just as a follow-up if I may. Carla Hills was talking about using a crowbar or a handshake not too long ago when she was referring to specific sectors like telecommunications. Again, my question is why has the Administration stopped talking about it?

A. Well, I don't think we've stopped talking about it necessarily. I can't comment on Mrs. Hills' statement. That stands on its own. But we haven't stopped talking about it. What we've been doing in the last week is making sure that everybody understood where 301 was and where the structural initiatives were, and that was the subject of discussion before everybody. It doesn't mean that we were stopping on anything we were doing before that. But all of the interest in the trade problem seems to have centered around that particular part of the framework. So I can't add too much more than that.

Q. You've been trying to in the last few days to sell 301 as complementary to the multilateral trade commitments set up under the GATT. But if I understand what the Japanese and the British and a few other people said yesterday, they don't consider that message as getting across and they don't consider it complementary at all. What is your reaction?

A. Well, I don't want to get into a quarrel with any particular country about what 301 means. Mrs. Hills has been a very adequate spokesman on that subject. It is a law in our country that has been complied with. From my observation of private discussions with countries involved they understand exactly what the law was. My feeling is that business will go on as usual. It's going to take some time, but particularly with respect to the discussions around the structural initiative which are outside 301, I think that progress will be made. I don't see anything on the horizon that's going to stop everything in its tracks.

Q. Mr. Secretary, you said at one point in your statement that you favor more concerted international action on certain things and at another point you said that the dollar was too high. Does that mean then that you favor concerted international action now to bring the dollar down and if so what?

A. Well as I've said a number of times the life cycle of treasury secretaries who comment on the level of the dollar is about two months, and I like the job. However, I think that what we did say was that if the rise of the dollar was continued or extended, it would not be a help to the coordination process. We stand by that. Our discussions with other members of the G-7 on policy coordination matters and procedures that enter into these discussions is healthy and well and alive in every respect.

Q. As a follow up to that Mr. Secretary, given the continuing rise in the dollar and the fact that you are concerned about it, as are your G-7 colleagues, do you think there is a strong case now for the Federal Reserve to begin easing its monetary policy?

A. Well, that's another area that treasury secretaries had better keep out of. As the President says, that's the best fight in town in Washington: the discrepancy between the Federal Reserve and Executive Branch. Certainly, the level of interest rates not only in the United States but other G-7 countries are part of the problem, but it's only part of the problem or part of the solution if you want to look at it that way. So, all of those things go into the answer, and they will be considered.

Q. Regarding the dollar, you said that if the dollar's current level is sustained that would undermine the adjustment process. If you do not want to suggest what might be done within the Administration in the United States, and you seem to be telling Germany and Japan, well you probably should not raise interest rates, and not much is being done on the American budget deficit, are you in effect saying we're happy with the level the dollar is because we're not going to do much about it?

A. Well, first of all, I don't agree with you that not much is being done on the deficit. After some eighty or ninety hours of negotiations, the Congress came up with a budget resolution which reached the Gramm-Rudman goal of 100 billion dollars, which was the goal for 1990, and did so without raising taxes and maintaining the President's commitment not to raise taxes. So, although probably correctly, that resolution has been described as neither bold nor heroic, it does do one very important thing. It does reconcile differences between Republicans and Democrats, between the Executive and Legislative Branch, and it seems to be what the American people expect out of their government. It's not that they won't have differences but that they are able to deal with those differences and move on. And if I had to pick one factor that was responsible for an increase in the bond market in the United States and the increase in the stock market, it's the demonstration that the Bush Administration, working with a Congress of an opposition party, can get on with the business of government. And it seems to me that the juxtaposition of that ability as opposed to some of the other troubles that are going on around the world is a pretty clear indication that things in the United States are at least settled and moving and business is being done. And I think that's important. So I can't agree with the fact that nothing has happened. I think that something very important has happened.

Q. Mr. Secretary, last week in Senegal President Mitterrand announced forgiveness of something like ten percent of the debt in 33 African countries. Do you consider this kind of forgiveness to be applauded or do you consider it a major expense in the debt reduction process?

A. No. I think that any particular country ought to be able to do whatever they think they can do within their own resources and their own budget constraints. So we've said right along that the debt strategy that the United States put forward, which I want to keep saying over and over again is a collection of ideas, some of which are born in the United States and some of which are born elsewhere, is in my mind all

inclusive. And when you change direction in the way the world approaches problems, from one that was described as fatigued, debt weary, moribund, and you turn that to a process where there is momentum and energy, and I say hope, then you've done something very important, in my opinion. And actions such as the one you've described can very well be part of it. I don't know that it's going to be the mainstay of the process but it's an important part.

Q. Mr. Secretary, I have a question I'd like to put. In terms of whatever the level of the dollar might be -- what desirable level there might be -- do you think that the present mechanism for keeping the dollar at that level is adequate, that is the means at the disposal of the central banks and the governments?

A. I really do. Because when we get to moments or intersections like we've had in the last two or three months, the members of the G-7 who are involved in this process have consultations and of course they focus on the kind of question that you've just raised. And to the extent that the process slows down they may say, well, it slowed down some but we've got to do something about it. If anything, I would say, the bonds which are drawn around that process could even be closer. So in my opinion, the process is working. I think we're always going to have moments in time when the process looks a little creaky. But I am very, very encouraged by the fact that at those moments in time members involved get together, and we have a policy coordination process. There are some questions about it right now, but what are we going to do about it? I see cooperation at this moment in time -- a time that you say is slightly more difficult -- but I see the cooperation at this time being very helpful and all the parties to the process being interested, recognizing the problems and trying to do something about it.

Q. Mr. Secretary, do you consider the Louvre Agreement as continuing -- as still alive for us?

A. Yes, sure. The Louvre Agreement is part of the process and part of the fabric of the way that the G-7 process has worked and is a useful part of the process and I would consider it still very much a part of the way we think about things.

Q. More of a Washington question, now with the resignation of Mr. Wright and Mr. Coelho do you think that we've gotten to the point in the American political process where we're asking too much of people, where it is a question about getting people into government service or not?

A. Well, I think it's a very hard thing on individuals. I'm

not commenting on either Mr. Wright or Mr. Coelho, but from watching the assembling of the Bush Administration, I'd say the amount of particular requirements that an individual has to go through are mounting. And there are legal requirements. You have to hire lawyers, you have to hire accountants, and it raises the standards of government to a level which may very well be called for but which is exceedingly hard to comply with. I think the basic principle that you should expect the highest form of ethics from people who come to government is a very good one. But the process becomes difficult when you actually try to put that into practice, and you're asking people without necessarily a great deal of wealth and wherewithal to handle the process, to hire accountants, to hire lawyers, to be so exact and clear about every part of their existence, that it's a very hard thing to do. And of course what happens is that all these things get looked at some three or four years later in hindsight. I think the goal is a good one. I think that as we always do in the American process, we'll work it out. But at this particular moment in time I know from the job of trying to attract people to the Treasury that we've lost some very good people because they were unwilling to subject themselves and their families to the kind of extra expense and potential liability that these laws require. So it has its blessings and it has its distractions.

Thank you very much.

TREASURY NEWS

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FOR IMMEDIATE RELEASE June 1, 1989

Statement by
Secretary of the Treasury Nicholas F. Brady
on the World Bank's Action on International Debt Reduction

I welcome the action by the World Bank establishing its policies for supporting international debt reduction efforts. The World Bank will set aside a portion of its policy-based loans for debt reduction transactions and provide additional resources for interest support. The World Bank also agreed that Bank program objectives should include measures to encourage direct foreign investment and capital repatriation.

Following a similar decision last week by the IMF, these actions by the World Bank essentially complete the steps by the official community to put in place mechanisms to facilitate debt and debt service reductions negotiated between debtor countries and their private creditors.

This approach offers a realistic opportunity to promote sustained growth in debtor countries while strengthening the debt strategy.

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TREASURY NEWS

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Remarks by
Secretary of the Treasury
Nicholas F. Brady
before the
International Monetary Conference
Madrid, Spain
June 5, 1989

Good morning. In March the United States proposed a major change in the approach to the problems of the heavily indebted developing countries. The international community reacted constructively to these proposals and now, less than three months later, has transformed these ideas into an operational framework.

This has given us a fresh opportunity to address the debt problems of developing nations -- problems that confront all of us. Neither the Atlantic Ocean nor the Pacific provides a buffer for our economies against the impact of slow growth and high debt in these countries. Everyone here shares a common interest in their quest to sustain economic growth, expand export markets, reduce debt burdens, and foster democracy.

Developing nations hold a large share of the world's economic potential. And the major debtor countries represent a significant portion of this group. Their large populations and abundant resources make them natural centers of hope for the future. But to unlock their potential and to enable them to take their proper place in the world economy, debtor countries must reform their economies and reduce their burden of external debt. Their efforts are worthy of our active support.

But I do not intend to give a civics lecture to this distinguished audience. We are all practical people who share an interest in solving this global problem. And certainly the United States cannot bring about a resolution of debt problems by itself. The reasons are obvious: the U.S. accounts for less than 20 percent of the capital and voting power in both the IMF and the World Bank. U.S. banks hold only about 25 percent of the commercial bank debt of the major debtor countries. European, Japanese, and Canadian banks also have large exposure. No nation's commercial banks are protected islands. The overnight inter-bank settlement system provides graphic evidence of the links binding our financial markets together. These shared risks imply common leadership responsibilities.

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Recognizing this, our proposals to strengthen the debt strategy incorporated the ideas of many others in the international community and reflected the need for a cooperative approach among nations and institutions. Some were critical of the initiative, first because of its lack of specifics; and second because it was said that it raised expectations and created new uncertainties. It is true that our proposals were based on general concepts, but concepts that reflected a consensus that existed in world opinion. We also recognized the complexities of the process and wished to provide an opportunity for additional contributions and refinements by others.

However, we were clear on the fundamental point: that reducing the debt burden of debtor countries is essential to the ultimate resolution of this problem. It is a simple truth that the cure for too much debt is not the addition of more debt.

The meaning of the proposals was immediately clear. There was a sense that we must face reality. No doubt expectations rose, and these will have to be tempered by the realities of negotiation. But most importantly, a process that was weary and moribund has been revitalized. Hope and momentum are far better allies for tackling a difficult task than inertia and fatigue. As to the creation of uncertainties, this is the temporary price of progress.

Now debate has given way to action, and concepts have been turned into solutions. Let me be specific:

- First, the IMF and the World Bank have put into place the resources and mechanisms for supporting debt and debt service reduction transactions between debtor countries and the commercial banks. The G-10 creditor countries on Friday strongly endorsed these measures.

- Second, Mexico, the Philippines and Costa Rica have already received IMF Board approval for strong economic programs which provide support for debt reduction. These countries have also initiated discussions with the commercial banking community.

- Third, during the past two weeks, the Paris Club has agreed to reschedule outstanding loans as well as interest obligations of these countries.

- And fourth, Japan has agreed to provide an additional $4.5 billion in support of the strengthened debt strategy, and specific commitments are now under discussion for Mexico and the Philippines.

The key elements of official support for debt and debt service reduction are on the table. Now it is time for the commercial banks and the debtor nations to seize the opportunity that has been provided.

Fundamentally, we are faced with two alternatives. Move forward with the new strategy which recognizes present realities or fall back on the old approach.

The old approach did provide important progress for a number of years. But countries found it more and more difficult to sustain the necessary economic reforms in the face of continued growth in debt and debt service burdens. Commercial banks were increasingly reluctant to make new money commitments. Poor economic performance and uncertainty about external financial support undermined investor confidence and stimulated capital flight. This approach, if continued, stands to produce losses of revenue and capital for all banks that go well beyond anything implied in our proposal.

The new strategy, on the other hand, serves the banks' long-term interests. It allows for diversity -- debt reduction, debt service reduction or new money. Banks that participate in debt reduction will hold new claims that are significantly enhanced. In addition, the quality of all outstanding claims will be improved by the debt reduction process. Furthermore, debt reduction will occur only within the context of sound economic programs which will improve the capacity to repay. These programs, supported by the IMF and the World Bank, will also emphasize measures to encourage new foreign investment, flight capital repatriation, and debt/equity swaps. In sum, bank claims will be somewhat lower, but they will be better claims -- and they will be better serviced. This is in stark contrast with the alternative.

I have spent most of my life, as have you, as a member of the financial community. And in my view the approach to developing nation debt that we have put forward is government policy that makes good business sense.

It is to your business judgement that I appeal today in asking that you move ahead. I ask you to compare the risks of inaction with the benefits of concluding transactions that meet the tests of realism and reasonableness.

The debtor countries will need to make the same calculations -- that is, to be realistic in their expectations as to the size and terms of debt reduction transactions and to recognize that reasonableness requires meaningful compromise by both parties.

To be sure, the new strategy will involve tough decisions by debtor countries and commercial banks. But it is important that we distinguish between real and perceived dangers. I am reminded of a small piece of American frontier history which illustrates my point.

In 1869, Major John Wesley Powell led the first expedition down the Colorado River, which flows through the Grand Canyon. At one point on the river -- now called Separation Rapids -- the party reached a moment of critical decision. They had faced many days of difficult rapids, and three of his crew had doubts about continuing, preferring instead to climb out of the Canyon. Major Powell's diary of August 28, 1869, read as follows:

> We come to a place which seems worse than any yet: to run it would be sure destruction. After supper Captain Howland asked to talk with me. He, his brother, and William Dunn have determined to go no further. All night I pace up and down. Is it wise to go on? At last daylight comes: breakfast is solemn as a funeral. Two rifles and a shotgun are given to the men who are going out.... Some tears are shed: each party thinks the other is taking the dangerous course. The three men watch us off. We are scarcely a minute in running the rapids. We have passed many places that were worse.

The next day, August 29th, Major Powell and his remaining crew rowed safely out of the Canyon into quiet waters. The other three men met a different fate, which is now recorded on a plaque at Separation Rapids. It reads:

> Here on August 28, 1869, Seneca Howland, O.G. Howland and William H. Dunn separated from the original Powell party, climbed to the North Rim, and were killed by the Indians.

All courageous men, facing difficult choices. Shooting the treacherous rapids, or scaling the Canyon wall. This story tells us something about danger, real and perceived. It suggests to us that the best course is to tackle our problems head on. I believe our new approach does just that. Realistic expectations and international cooperation are required. The world has asked for decisive action. We must provide it.

Thank you.

federal financing bank NEWS
WASHINGTON, D.C. 20220
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FOR IMMEDIATE RELEASE June 5, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of February 1989.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $142.1 billion on February 28, 1989, posting a decrease of $323.8 million from the level on January 31, 1989. This net change was the result of an increase in holdings of agency debt of $17.4 million, and decreases in holdings of agency assets of $0.5 million and in agency-guaranteed debt of $340.7 million. FFB made 42 disbursements during February.

The Continuing Appropriations Resolution for 1988 allowed FFB borrowers under foreign military sales (FMS) guarantees to prepay at par debt with interest rates of 10 percent or higher. Pursuant to this Resolution, FFB received FMS prepayments of $361.6 million in February 1989. FFB suffered an associated loss of $27.3 million.

Attached to this release are tables presenting FFB February loan activity and FFB holdings as of February 28, 1989.

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FEDERAL FINANCING BANK

FEBRUARY 1989 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 #483	2/9	$ 33,010,000.00	5/11/89	8.964%	
+Note #484	2/21	8,600,000.00	5/22/89	8.915%	
+Note #485	2/27	45,000,000.00	5/26/89	9.086%	
TENNESSEE VALLEY AUTHORITY					
Advance #995	2/3	37,000,000.00	2/08/89	8.803%	
Advance #996	2/6	212,000,000.00	2/13/89	8.903%	
Advance #997	2/8	241,000,000.00	2/16/89	8.964%	
Advance #998	2/13	8,000,000.00	2/17/89	8.977%	
Advance #999	2/13	221,000,000.00	2/21/89	8.977%	
Advance #1000	2/16	29,000,000.00	2/22/89	8.922%	
Advance #1001	2/16	177,000,000.00	2/23/89	8.922%	
Advance #1002	2/21	182,000,000.00	2/27/89	8.901%	
Advance #1003	2/23	146,000,000.00	3/10/89	8.964%	
Advance #1004	2/27	201,000,000.00	3/06/89	9.082%	
Advance #1005	2/28	668,000,000.00	3/10/89	9.112%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 16	2/1	2,141,868.00	9/4/12	9.022%	
Philippines 11	2/1	79,484.55	9/12/90	9.226%	
Greece 15	2/3	17,662.50	6/15/12	8.986%	
Greece 16	2/3	2,373,537.00	9/4/12	8.984%	
Greece 17	2/3	1,494,325.84	2/27/12	8.988%	
Greece 17	2/13	234,408.00	2/27/12	9.195%	
Greece 16	2/16	1,510,220.00	9/4/12	9.228%	
Greece 16	2/23	2,916,562.52	3/1/13	9.277%	
Greece 17	2/23	74,128.00	2/27/12	9.281%	
Philippines 11	2/23	112,874.14	9/12/90	9.549%	

+rollover

FEDERAL FINANCING BANK

FEBRUARY 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development					
Guaynabo, PR	2/9	$ 2,800,000.00	8/30/89	9.120%	9.159% ann.
RURAL ELECTRIFICATION ADMINISTRATION					
New Hampshire Electric #270	2/6	69,000.00	1/2/18	9.017%	8.918% qtr.
Tri-State Generation #250	2/6	8,349,000.00	1/2/24	8.991%	8.892% qtr.
Oglethorpe Power #320	2/8	6,728,000.00	4/1/91	9.317%	9.211% qtr.
*Wabash Valley Power #104	2/13	3,175,000.00	1/2/18	9.213%	9.109% qtr.
*Wabash Valley Power #206	2/13	602,000.00	1/2/18	9.213%	9.109% qtr.
*Basin Electric #232	2/17	1,550,000.00	2/28/91	9.499%	9.389% qtr.
*Dairyland Power #54	2/21	1,154,000.00	1/3/17	9.233%	9.129% qtr.
*United Power #159	2/21	500,000.00	2/21/91	9.496%	9.386% qtr.
*United Power #212	2/21	1,959,000.00	2/21/91	9.496%	9.386% qtr.
*United Power #222	2/21	300,000.00	2/21/91	9.496%	9.386% qtr.
Central Iowa Power #295	2/23	1,380,000.00	1/2/18	9.301%	9.195% qtr.
Brazos Electric Power #230	2/24	2,060,000.00	1/2/24	9.322%	9.216% qtr.
Brazos Electric Power #332	2/24	1,378,000.00	12/31/19	9.344%	9.237% qtr.
*Colorado Ute-Electric #203A	2/27	1,675,000.00	4/1/91	9.770%	9.654% qtr.
*N. W. Electric Power #176	2/27	650,000.00	1/3/22	9.344%	9.237% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Hudson Dev. Corp.	2/8	90,000.00	2/1/04	9.132%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-05	2/28	708,628,110.38	5/31/89	9.105%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	February 28, 1989	January 31, 1989	Net Change 2/1/89-2/28/89	FY '89 Net Change 10/1/88-2/28/89
Agency Debt:				
Export-Import Bank	$ 11,027.2	$ 11,027.2	$ -0-	$ 69.5
NCUA-Central Liquidity Facility	111.7	113.3	-1.6	-6.5
Tennessee Valley Authority	17,040.0	17,021.0	19.0	-91.0
U.S. Postal Service	5,892.2	5,892.2	-0-	300.0
sub-total*	34,071.0	34,053.6	17.4	272.1
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	96.3	96.3	-0-	-0.1
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,071.2	4,071.2	-0-	-68.0
Small Business Administration	13.6	14.1	-0.5	-1.7
sub-total*	62,756.7	62,757.2	-0.5	-69.8
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	11,731.7	12,097.6	-365.8	-4,280.0
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	49.6	49.6	-0-	-0.4
DHUD-Community Dev. Block Grant	314.8	320.2	-5.3	-3.2
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	383.0	383.0	-0-	-4.4
DOI-Guam Power Authority	32.1	32.1	-0-	-0-
DOI-Virgin Islands	26.1	26.1	-0-	-0.5
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,720.5	1,720.5	-0-	-38.3
Rural Electrification Administration	19,244.6	19,224.6	20.0	39.3
SBA-Small Business Investment Cos.	596.1	600.9	-4.8	-36.5
SBA-State/Local Development Cos.	849.6	853.0	-3.4	-21.3
TVA-Seven States Energy Corp.	2,226.7	2,207.8	18.9	64.4
DOT-Section 511	43.1	43.3	-0.2	-3.1
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	45,295.6	45,636.3	-340.7	-4,229.4
grand total*	$ 142,123.3	$ 142,447.1	$ -323.8	$ -4,027.2

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

TREASURY NEWS

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

Contact: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE

June 5, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,411 million of 13-week bills and for $6,405 million of 26-week bills, both to be issued on June 8, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing September 7, 1989			26-week bills maturing December 7, 1989		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	8.15%	8.44%	97.940	7.97%	8.42%	95.971
High	8.17%	8.46%	97.935	8.00%	8.45%	95.956
Average	8.17%	8.46%	97.935	7.99%	8.44%	95.961

Tenders at the high discount rate for the 13-week bills were allotted 27%.
Tenders at the high discount rate for the 26-week bills were allotted 55%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 37,295	$ 37,295	$ 30,600	$ 30,600
New York	27,984,065	5,499,185	20,162,565	5,545,385
Philadelphia	16,455	16,455	15,565	15,565
Cleveland	38,890	38,890	39,735	39,735
Richmond	42,325	42,325	48,875	34,875
Atlanta	36,175	36,175	25,500	25,500
Chicago	1,047,440	46,300	730,015	68,710
St. Louis	45,505	25,495	32,270	24,270
Minneapolis	6,450	6,450	10,190	10,190
Kansas City	30,265	30,265	41,055	41,055
Dallas	25,595	25,595	16,255	16,255
San Francisco	1,115,510	62,510	885,945	93,695
Treasury	544,290	544,290	459,105	459,105
TOTALS	$30,970,260	$6,411,230	$22,497,675	$6,404,940
Type				
Competitive	$27,183,130	$2,924,100	$17,916,840	$2,124,105
Noncompetitive	1,249,080	1,249,080	1,000,855	1,000,855
Subtotal, Public	$28,432,210	$4,173,180	$18,917,695	$3,124,960
Federal Reserve	2,462,730	2,162,730	2,400,000	2,100,000
Foreign Official Institutions	75,320	75,320	1,179,980	1,179,980
TOTALS	$30,970,260	$6,411,230	$22,497,675	$6,404,940

An additional $5,080 thousand of 13-week bills and an additional $132,620 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

NB-319

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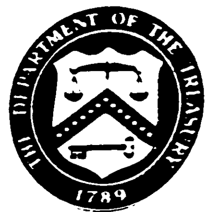
TREASURY NEWS



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

For Release Upon Delivery
Expected at 1:00 p.m., EST
June 6, 1989

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

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to appear before you today to present the views of the Treasury Department concerning the reform of the civil tax penalty system. The consensus for penalty reform which brings us here today is the result of the participation and contributions by many people, both inside and outside the government. Earlier this year, the Internal Revenue Service published a major study recommending many of the reforms we will discuss today. Private groups such as the American Bar Association, the American Institute of Certified Public Accountants, and the Tax Executives Institute have prepared thoughtful and helpful comments. But these efforts would not have been fruitful without the significant efforts of this subcommittee and congressional staff to turn ideas and concepts into concrete legislative proposals. In recognition of the hard work of so many, it is a genuine privilege to comment on H.R. 2528, the Improved Penalty Administration and Compliance Tax Bill, which was recently introduced with bipartisan sponsorship.

We welcome this attention to one of the most important aspects of our system of tax administration. To the extent that the efforts of this subcommittee result in legislation that eliminates unnecessary complexity and improves the fairness and effectiveness of the civil tax penalty system, all taxpayers and the tax system will benefit.

NB-320

General Comments

Over the past two years, the shortcomings of the current penalty system have received increasing attention. Both this subcommittee and the Senate Finance Subcommittee on Oversight have held hearings illuminating the problems with the current system.

Those hearings revealed three major complaints about the penalty system. First, witnesses complained that the system is too complex both in terms of the number of civil tax penalties and in terms of the intricacy of some of the provisions. Second, the system is not well integrated. Taxpayers have been faced with the imposition of multiple penalties for the same item. And third, penalty levels were perceived as too high, particularly for less serious conduct. Together, these perceptions raised concerns about the basic fairness of the civil tax penalty system.

These concerns and others have led the Treasury Department and the Internal Revenue Service to give considerable thought to the characteristics of a good civil tax penalty system. While it has not always been possible to achieve complete agreement in every detail, we believe there is now substantial agreement on the following basic propositions:

First, the primary objective of the civil tax penalty system should be to promote voluntary compliance. The effectiveness of penalties should be judged by how well they promote this important goal. This goal is achieved in two ways: by acting directly to deter the noncompliant and by reassuring the compliant that there are adverse consequences for those who do not comply.

Second, penalties should be fair. This goal is achieved by treating similarly situated taxpayers similarly and by having the severity of the penalty be proportional to the culpability of the noncompliant taxpayer.

Third, penalties should be integrated. This goal is achieved by structuring the penalty system so that noncompliant behavior attracts an appropriately severe sanction while avoiding the imposition of multiple sanctions for what is essentially the same occurrence.

Fourth, penalties should be as simple and as understandable as possible while maintaining effectiveness. This goal is achieved by making the penalties both comprehensible to the taxpayer and administrable by the Service.

We have reviewed H.R. 2528, and I would like to spend the remainder of my time discussing this bill. In general, we believe that this bill, if enacted, would greatly simplify and

coordinate the operation of the penalty system and would, as a by-product, improve both the quality of information provided to the Service and overall taxpayer compliance with the tax system.

I will give our comments in the same order in which the amendments to the Internal Revenue Code appear in the bill. Thus, I will first discuss the document and information return penalties, then the accuracy related penalties and the preparer, promoter and protester penalties, and finally the failure to file or pay penalties.

Document and Information Reporting Penalties

Current Law

Information reporting with respect to the income and deduction items of other taxpayers has played an increasingly important role in recent efforts to improve compliance. The Service currently receives approximately 1 billion information returns and statements each year. This information constitutes an important part of the Service's data base for auditing tax returns and measuring compliance with the tax system. As the Service's functions become increasingly automated in the future, the need for accurate and timely information reporting will only increase.

Information reporting may be divided into four main categories: payor to Service reporting, payor to payee reporting, payee to payor reporting, and miscellaneous information reporting. Under current law, there are dozens of different penalties to enforce these reporting requirements. Although the obligations placed on the reporting person are generally similar, due to the ad hoc manner in which the reporting requirements and accompanying penalties have been enacted, there are numerous similar reporting requirements which impose similar but not necessarily identical penalties.

In general, any person who fails to file an information return with the Service on or before the prescribed filing date (February 28 for most information returns) is subject to a $50 penalty for each failure, with a maximum penalty of $100,000 per calendar year. See section 6721(a). Any person who fails to provide a copy of an information return (a "payee statement") to a payee on or before the prescribed due date (January 31 for most payee statements) is generally also subject to a penalty of $50 for each failure, with a maximum penalty of $100,000 per calendar year. See section 6722(a). This provision is, however, difficult to enforce. If a person fails to include all of the information required to be shown on an information return or a payee statement or includes incorrect information, then a penalty of $5 may be imposed with respect to each such failure, with a maximum penalty of $20,000 per calendar year. See section 6723(a). In the case of intentional failures to comply with the

information return requirements, the penalty is $100 per return with no maximum penalty. Sections 6721(b) and 6722(b). No penalty is imposed if the failure is due to reasonable cause and not to willful neglect. Section 6724(a).

In the case of interest and dividend information returns and statements, there is no maximum penalty and a penalty may only be waived upon a showing that the reporting person exercised due diligence. Section 6724(c).

A penalty may also be imposed for each failure to include a correct taxpayer identification number ("TIN") on a return or statement and for each failure to furnish a correct TIN to another person. The amount of the penalty that may be imposed is either $5 or $50 for each failure, depending on the nature of the failure. *See* section 6676.

Persons who file large numbers of information returns are required to file such returns on magnetic media (*i.e.*, magnetic tapes and disks). Section 6011(e). Filing on magnetic media is generally required only if the number of information returns filed exceeds 250, except for information returns relating to payments of interest, dividends, and patronage dividends where the threshold is 50 returns. Section 6011(e)(2); Treas. Reg. § 301.6011-2(c)(1)(i).

Provisions of H.R. 2528

Failure to file correct information returns. Section 101 of the bill modifies the information reporting penalties in order to encourage persons to file correct information returns and statements even though such returns are filed or corrected after the prescribed filing date.

Under the bill, any person who fails to file a correct information return or statement with the Service on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, a correct information return is filed. If a person files a correct return after the prescribed filing date but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty is $15 per return, with a maximum penalty of $75,000 per calendar year. If a person files a correct information return after the date that is 30 days after the prescribed filing date but on or before August 1, the amount of the penalty is $30 per return, with a maximum penalty of $150,000 per calendar year. If a correct return is not filed on or before August 1, the amount of the penalty is $50 per return, with a maximum penalty of $250,000 per calendar year.

The bill also provides a *de minimis* exception that applies to incorrect information returns that are corrected on or before August 1. Under the exception, if an information return is originally filed without all of the correct required information and the return is corrected on or before August 1, then the

original return is treated as having been filed with all of the correct required information. The number of information returns that may qualify for this exception for any calendar year is limited to the greater of 10 returns or 0.5 percent of the total number of returns that are required to be filed by the person during the calendar year.

The bill maintains the current rules that failures due to intentional disregard of the filing requirements are subject to a penalty of $100 per return or, if greater, 10 percent (5 percent for certain returns) of the amount required to be shown on the return, with no maximum penalty.

Failure to furnish correct payee statements. Under section 101 of the bill, any person who fails to furnish a correct statement to a payee on or before the prescribed date is subject to a penalty of $50 per statement, with a maximum penalty of $100,000 per calendar year. If the failure to furnish a correct payee statement is due to intentional disregard of the filing requirements, the penalty is $100 per statement or, if greater, 10 percent (5 percent for certain payee statements) of the amount required to be shown on the statement, with no maximum penalty.

Failure to comply with other information reporting requirements. Under section 101 of the bill, any person who fails to comply with other specified information reporting requirements is subject to a penalty of $50 for each failure, with a maximum penalty of $100,000 per calendar year. The information reporting requirements specified for this purpose include any requirement to include a correct TIN on a return or statement and any requirement to furnish a correct TIN to another person.

Abatement. Section 101 of the bill provides that no penalty is imposed if a failure to comply with the information reporting requirements is due to reasonable cause and not to willful neglect. The bill thus repeals the special due diligence requirements that apply to reporting the payment of interest and dividends and makes those requirements subject to the same waiver criteria as the other information reporting penalties.

Magnetic media. Section 102 of the bill repeals the provision of present law that requires persons filing more than 50 information returns relating to payments of interest, dividends, and patronage dividends to file such returns on magnetic media and provides that the Service may not require the filing of less than 250 information returns to be on magnetic media.

General Accounting Office Studies. Sections 103 and 104 of the bill require the General Accounting Office to study whether the Service should be permitted to disclose names and TINs to payors for purposes of clearing up discrepancies on information returns, and whether service bureaus which transmit information

returns to the Service should be subject to registration or other regulation.

Discussion

The provisions of sections 101 and 102 of the bill go far toward alleviating the two principal problems with existing information reporting penalties. First, because these penalties are currently imposed at a flat per item rate, there is little incentive for a person who has missed a filing date or has filed incorrect information to take prompt corrective action. And second, the numerous penalties each contain slightly different requirements, even though the underlying reporting requirements are essentially the same.

By making the information return penalties time sensitive, the bill provides an incentive to correct failures to file on time or to file accurately. However, the bill would not make the payee statement penalties time sensitive. Because the timely and accurate furnishing of payee statements is essential if taxpayers are to timely file their returns, we believe that these penalties should also be made time sensitive. On the other hand, because the utility of such information is greatly diminished if not received by taxpayers in sufficient time to file their tax returns, simply copying the bill's rules for information returns is not practical. We therefore believe that the payee statement penalties should be reduced to $10 per statement if a failure to provide a payee statement is corrected within 30 days after the prescribed due date.

In addition, with respect to the information return penalties, we believe that the first step of the penalty--$15 for failures corrected within 30 days--may be too harsh. Consideration should be given to lowering this penalty to $10 per return.

Although the bill standardizes the information reporting penalties, it does so in an uneven fashion with respect to one important group: small businesses. Because the total dollar caps on the penalties would be raised for all information returns (other than interest and dividends), small business which file a large number of information returns and payee statements may still have very large penalties imposed. On the other hand, because approximately 80 percent of all persons filing information returns file less than 10 returns per year, the de minimis rule may have the unintended effect of relieving many filers from the obligation to file accurate information returns.

We believe that consideration should be given to two changes to improve this uneven effect on small businesses. First, consideration should be given to providing lower caps for small businesses. With respect to the information return penalties, we recommend caps of $25,000, $50,000, and $100,000 for the three steps in the penalty. We will be pleased to work with the

subcommittee to develop a fair and administrable definition of businesses eligible for this lower limit.

Second, the de minimis rule should provide that it only applies to 0.5 percent of returns filed in a calendar year. For filers who file fewer than 200 information returns and would not benefit from the de minimis rule, we would suggest that the legislative history provide that a waiver of the penalty is appropriate where the filer has diligently attempted to file accurate information returns and has promptly corrected errors when discovered. It should also be clarified that failure to correct an information return within a reasonable time after a request by the Service for correction is an intentional disregard of the filing requirements and is subject to penalty.

There is also some confusion about what, if any, statute of limitations applies with respect to information returns and payee statements. We recommend adoption of a 6 year statute of limitations.

We note that the bill would repeal the statutory due diligence requirements with respect to information reporting for payments of interest and dividends. Although we believe that this is an important step in improving the simplicity of the information reporting penalties, many information providers have made a substantial investment in compliance with the existing rules. Thus, we recommend that the legislative history clarify that the current regulatory due diligence standards should continue to apply as a safe harbor for determining whether the reporting person has exercised reasonable care.

The standardization of the magnetic media reporting requirements is an important step towards simplifying the burdens placed on filers of information returns. We further recommend adoption of the Service task force's recommendation that the penalty for failure to file on magnetic media be based on the numbers of returns filed on paper in excess of the prescribed maximum.

We are, however, disappointed that the subcommittee has not seen fit to allow the Service to disclose names and TINs to filers when the Service's matching procedures indicate a discrepancy between its records and the filer's submission. Because many such errors involve custodianships, change of name upon marriage, and the like, such disclosure would significantly facilitate resolution of such errors. We want to stress that such disclosure should be limited to names and TINs and should not involve confidential tax return information or addresses. Nevertheless, given the significant question of taxpayer privacy involved, we will be pleased to cooperate with the proposed study.

Accuracy Related Penalties

Current law

Negligence and fraud penalties. If any part of an underpayment of tax required to be shown on a return is due to negligence (or disregard of rules or regulations), a penalty may be imposed equal to 5 percent of the total amount of the underpayment. Section 6653(a). A portion of an underpayment of tax that is attributable to a failure to include on an income tax return an amount shown on an information return is subject to the negligence penalty absent clear and convincing evidence to the contrary. Section 6653(g). If any part of an underpayment of tax required to be shown on a return is due to fraud, a penalty may be imposed equal to 75 percent of the portion of the underpayment that is attributable to fraud. Section 6653(b).

Substantial understatement penalty. If the correct income tax liability of a taxpayer for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations), then a substantial understatement exists and a penalty may be imposed in an amount equal to 25 percent of the underpayment of tax attributable to the understatement. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or a statement attached to the return. Special rules apply to tax shelters. Section 6661.

Valuation penalties. If an individual, closely held corporation, or personal service corporation underpays income tax for any taxable year by $1,000 or more as a result of a valuation overstatement, then a penalty may be imposed with respect to the amount of the underpayment that is attributable to the valuation overstatement. A valuation overstatement exists if the value or adjusted basis of any property claimed on a return is 150 percent or more of the correct value or adjusted basis. As the percentage by which the valuation claimed exceeds the correct valuation increases, the amount of the penalty that may be imposed increases from 10 to 20 to 30 percent of the underpayment attributable to the valuation overstatement. Section 6659. Similar penalties may be imposed with respect to an underpayment of income tax that is attributable to an overstatement of pension liabilities, and to an underpayment of estate or gift tax that is attributable to a valuation understatement. Sections 6659A and 6660.

Provisions of H.R. 2528

Section 201 of the bill reorganizes the accuracy penalties into a new structure that eliminates the current overlapping application of these penalties.

Accuracy-related penalty. The accuracy-related penalty, which is imposed at a rate of 20 percent, applies to the portion of any underpayment that is attributable to (1) negligence or disregard of rules or regulations; (2) any substantial understatement of income tax; (3) any substantial valuation overstatement; (4) any substantial overstatement of pension liabilities; and (5) any substantial estate or gift tax valuation understatement.

If an underpayment of tax is attributable to negligence (or disregard of rules and regulations), the accuracy-related penalty applies only to the portion of the underpayment that is attributable to negligence rather than, as under current law, to the entire underpayment of tax. See, e.g., Asphalt Products Co., Inc., 482 U.S. 117 (1987). In addition, the bill repeals the presumption under which an underpayment is treated as attributable to negligence if the underpayment is due to a failure to include on an income tax return an amount shown on an information return.

In addition to coordinating the penalties in order to prevent multiple impositions, the bill makes four changes to the substantial understatement penalty. First, the rate is lowered to 20 percent. Second, the list of authorities upon which taxpayers may rely is intended to be expanded to include certain nonprecedential authorities. Third, the bill requires the Service to publish an annual list of positions for which it believes there is not substantial authority. And fourth, the bill requires the waiver of the penalty if the taxpayer's position was shown to be due to reasonable cause and the taxpayer acted in good faith.

The penalty that applies to the portion of an underpayment that is attributable to a substantial valuation overstatement is the same as the valuation overstatement penalty provided under current law with five principal modifications. First, the bill extends the penalty to all taxpayers. Second, a substantial valuation overstatement exists if the value or adjusted basis of any property claimed on a return is 200 percent or more of the correct value or adjusted basis. Third, the penalty is to apply only if the amount of the underpayment attributable to a valuation overstatement exceeds $5,000 ($10,000 in the case of most corporations). Fourth, the amount of the penalty is 20 percent of the amount of the underpayment if the value or adjusted basis claimed is 200 percent or more but less than 400 percent of the correct value or adjusted basis. And fifth, the bill provides that this penalty is doubled (to 40 percent) if the

value or adjusted basis claimed is 400 percent or more of the correct value or adjusted basis. The bill provides similar modifications to the penalty for overstatements of pension liabilities and the penalty for estate or gift tax valuation understatements.

Fraud penalty. The fraud penalty, which is imposed at a rate of 75 percent, applies to the portion of any underpayment that is attributable to fraud. This penalty is essentially unchanged from prior law.

Abatement and special rules. The bill provides that no penalty is to be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith. The bill also provides that an accuracy-related or fraud penalty applies only if a return has been filed. (Under present law, a negligence or fraud penalty, in addition to the failure to file penalty, may be imposed in the case of a failure to file a return.) Finally, the bill repeals the higher interest rate that applies to substantial underpayments that are attributable to tax-motivated transactions (section 6621(c)).

Discussion

The bill's provisions modifying the accuracy penalties make a number of important improvements to the current system which the Administration strongly supports:

- The penalties would be now coordinated so that only one penalty could be imposed on an item which resulted in an underpayment of tax.

- The current negligence penalty would be targeted to the portion of the underpayment of tax that is due to negligence. This would not only make the penalty consistent with other penalties, but would avoid penalizing taxpayers on the portion of an underpayment that is due to a legitimate disagreement with the Service's treatment of an item or to uncertainty in the tax law.

- The substantial understatement penalty would be improved by broadening the definition of authority.

- The bill would repeal three unnecessary penalties which have added significant complexity to the tax system: the higher interest rate that applies to substantial underpayments that are attributable to tax-motivated transactions (section 6621(c)) and the presumptive negligence penalties (sections 6653(f) and (g)).

While we will suggest several modifications which would, we believe, improve this portion of the bill, I want to stress our

strong support for the truly significant fundamental reforms which the bill represents.

We cannot overemphasize the point that the purpose of the penalty system is not to collect penalties but to encourage taxpayers to report and pay the correct amount of tax. To a great extent, these goals can be accomplished by encouraging taxpayers to disclose aggressive positions or positions where the law is unclear. We therefore recommend that consideration be given to all of the circumstances where disclosure of a questionable item should be sufficient to prevent the imposition of the accuracy-related penalty. In particular, we question whether the accuracy-related penalty should be imposed on the basis of negligence in situations where the taxpayer has made a specific disclosure of the item in question (as opposed to merely completing the appropriate entry on the tax return as provided in Rev. Proc. 89-11).

However, in order to prevent the nonimposition of penalties in egregious cases, disclosure should not provide an "out" if the disclosed return position is frivolous. For example, the accuracy-related penalty should apply to a taxpayer even if he or she discloses that tax is not being paid because United States currency is not legal tender or that medical expense deductions are being claimed for a pet dog. Similarly, the fact that the taxpayer discloses that he or she is claiming a deduction for which there is no substantiation should not prevent the imposition of the accuracy-related penalty on the basis of negligence.

A provision should be added to the substantial understatement penalty to provide that the disclosure of a position will not be effective to avoid the penalty unless there is an affirmative indication on the return that a disclosure under this section has been made. It is anticipated that this requirement would be met by the Service putting a check-off box on tax returns. This rule would be coordinated with the positions that are considered by the Service not to need special disclosures by providing in the instructions to the appropriate forms that the box need not be checked with respect to such positions. <u>See</u> Rev. Proc. 89-11.

The special tax shelter rules contained in the substantial understatement penalty (section 6661(b)(2)(C)) should be repealed. Such rules inhibit rather than encourage disclosures by denying a taxpayer the certainty that disclosure will avoid the penalty.

The annual list setting forth positions with respect to which the Service believes there is no substantial authority is, we believe, a step in the direction of diminishing the confusion regarding what is "substantial authority." It must, however, be made clear that no inference is to be drawn that there is substantial authority for items that are not on the list. Such a list does not, however, deal adequately with another important

problem. Where a taxpayer has substantial authority for an item, but it is clear that, if discovered, the Service would contest the item, there is currently no penalty if the item is not disclosed. We therefore believe that the Service should be empowered to publish a list of items for which disclosure is mandatory if the penalty is to be avoided, regardless of whether substantial authority exists. Conversely, we would strongly oppose any attempt to provide that such a list of items to be disclosed is exclusive.

Preparer, Promoter, and Protester Penalties

Current law

Sanctions and costs awarded by courts. If it appears to the Tax Court that proceedings before it have been instituted or maintained primarily for delay, the taxpayer's position is frivolous, or the taxpayer has unreasonably failed to pursue administrative remedies, the Court may award damages not to exceed $5,000 to the United States. Section 6673.

Return preparer penalties. An income tax return preparer is subject to a penalty of $100 if any part of an understatement of tax on a return or claim for refund is due to the preparer's negligent or intentional disregard of rules or regulations. In addition, an income tax return preparer is subject to a penalty of $500 if any part of an understatement of tax on a return or claim for refund is due to the return preparer's willful attempt in any manner to understate tax. Section 6694. An income tax return preparer is also subject to a penalty of $25 for each failure to furnish a copy of a return or claim for refund to the taxpayer, sign the return or claim for refund, or furnish his or her TIN. Section 6695.

Penalty for promoting abusive tax shelters. Any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, is subject to a penalty if in connection with such activity the person makes a false or fraudulent statement or a gross valuation overstatement. The amount of the penalty equals the greater of $1,000 or 20 percent of the gross income derived, or to be derived, by the person from the activity. Section 6700. It is unclear under present law whether the term "activity" refers to each sale of an interest in a tax shelter or whether the term activity refers to the overall activity of promoting an abusive tax shelter.

Penalty for aiding and abetting the understatement of tax liability. Any person who aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document under the tax laws which the person knows will be used in connection with any material matter arising

under the tax laws, and the person knows that such portion will (if so used) result in an understatement of the tax liability of another person is subject to a penalty equal to $1,000 for each return or other document ($10,000 in the case of returns and documents relating to the tax of a corporation). Section 6701.

Frivolous income tax return penalty. Any individual who files a frivolous income tax return is subject to a penalty of $500. Section 6702. Taxpayers may contest this penalty by paying 15 percent ($75) and filing a claim for refund. Section 6703.

Disclosure of information by return preparers. Sections 6713 and 7216 impose penalties on return preparers for the unauthorized disclosure of information relating to a tax return.

Provisions of H.R. 2528

Sanctions and costs awarded by courts. Section 301 of the bill authorizes the Tax Court to impose a penalty not to exceed $25,000 if a taxpayer institutes or maintains a proceeding primarily for delay, takes a position that is frivolous, or unreasonably fails to pursue available administrative remedies. The bill also authorizes the Tax Court to require any attorney or other person permitted to practice before the Court to pay excess costs, expenses, and attorney's fees that are incurred because the attorney or other person unreasonably and vexatiously multiplied any proceeding before the Court. In addition, the bill provides for collection by the Service of monetary sanctions and costs awarded by courts other than the Tax Court and clarifies the authority of courts of appeal to impose sanctions.

Return preparer penalties. Section 302 of the bill revises the current law penalties that apply in the case of an understatement of tax that is caused by an income tax preparer. First, the bill provides that if any part of an understatement of tax on a return or claim for refund is attributable to a position for which there was not a realistic possibility of being sustained on its merits and the preparer knew (or reasonably should have known) of such position, then that return preparer is subject to a penalty of $250. In addition, if any part of an understatement of tax on a return or claim for refund is attributable to a willful attempt by an income tax return preparer to understate the tax liability of another person or to any reckless or intentional disregard of the income tax law by an income tax return preparer, then the income tax return preparer is subject to a penalty of $1,000.

Under section 303 of the bill, the return preparer penalties that apply to each failure to furnish a copy of a return or claim for refund to the taxpayer, sign the return or claim for refund, and furnish his or her TIN are increased to $50 per failure and the total amount of penalties that may be imposed for any type of failure for any calendar year is limited to $25,000.

Penalty for promoting abusive tax shelters. Under section 304 of the bill, the amount of the penalty imposed for promoting abusive tax shelters equals the lesser of $1,000 or 100 percent of the gross receipts derived or to be derived by the person from such activity. In calculating the amount of the penalty, the organization of an entity, plan or arrangement and the sale of each separate interest constitutes a separate activity.

Penalty for aiding and abetting the understatement of tax liability. Section 305 of the bill amends the penalty for aiding and abetting the understatement of tax liability by imposing the penalty in cases where the person aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document if the person knows or has reason to believe that the return or other document will be used in connection with any material matter arising under the tax laws, and the person knows that if the portion of the return or other document is so used, an understatement of the tax liability of another person would result. In addition, the bill provides that a penalty for promoting abusive tax shelters is not to be imposed on any person with respect to any document if an aiding and abetting penalty is imposed on such person with respect to such document.

Frivolous income tax return penalty. Section 306 of the bill increases the penalty for filing frivolous income tax returns from $500 per return to $1,000 per return. This section would also amend section 6703 to require the full payment of this penalty prior to the commencement of any proceeding to contest an assertion of the penalty.

Disclosure of information by preparers. Section 309 of the bill would provide that, under regulations, the sanctions for the unauthorized disclosures of information by a return preparer would not apply to the use of such information for quality or peer reviews.

Discussion

Given the Tax Court's view that an increase in the section 6673 penalty is needed, we do not oppose section 301 of the bill, despite our view that this bill should generally not be a vehicle for increases in penalties. We also do not oppose the provisions concerning proceedings in other courts, although we do generally endorse Assistant Attorney General Peterson's recommendations for improvements in those provisions.

We agree that the standard of practice for return preparers should be raised. The bill's provision has the advantage of setting a standard that is substantially the same as the current ethical guidelines for attorneys and accountants. However, we question the need to raise the level of these penalties and note that the Service's task force recommended no such increase. In

addition, we recommend that the words "reckless or" be stricken from proposed section 6694(b), thereby limiting the more severe sanction to willful or intentional conduct. As a technical point, proposed section 6695(b)(2) should refer to "rules or regulations" rather than to "the provisions of this title".

In addition, we believe the abusive tax shelter and the aiding and abetting penalties should, as a matter of equity, have an explicit statute of limitations. We recommend adoption of a 6 year statute of limitations. We also share the administrative concerns expressed by others today regarding the revision to section 6700 in so far as it would make the amount of "gross receipts derived" an issue in each such proceeding.

With respect to the frivolous return penalty, we believe that the penalty is effective at the current rate of $500 and do not believe that it should be raised to $1,000. We do, however, support the bill's repeal of the ability of taxpayers to contest this penalty in district court by paying only 15 percent of the amount of the penalty. We also support the repeal of the section 7407 bonding provision.

Finally, we are concerned about the amendment to the regulatory authority under section 7216(b). Although we agree that disclosure by a tax return preparer, within well defined limits to assure confidentiality, should be permitted for peer and quality review, we believe that it should be made clear that this disclosure exception relates only to return information within the files of the preparer and would not require disclosures by the Service (other than pursuant to existing waiver provisions).

Failure to File or Pay Penalties

Current law

Failure to file. A taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to 5 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 5 months or 25 percent. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax. No penalty is imposed if the taxpayer is due a refund. Section 6651.

Failure to make timely deposits of tax. If any person who is required to deposit taxes with a government depository fails to deposit such taxes on or before the prescribed date, a penalty may be imposed equal to 10 percent of the amount of the underpayment, unless it is shown that such failure is due to reasonable cause and not willful neglect. The amount of the underpayment for this purpose is the excess of the amount of the

tax required to be deposited over the amount of the tax, if any, deposited on or before the prescribed date. Section 6656.

Provisions of H.R. 2528

Failure to file. The bill modifies current law by providing that the fraud and negligence (accuracy-related) penalties are not to apply in the case of a negligent or fraudulent failure to file a return. Instead, section 401 of the bill provides that in the case of a fraudulent or intentional failure to file a return, the failure to file penalty is to be increased to 15 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 5 months or 75 percent.

Failure to make timely deposits of tax. Section 402 of the bill also modifies the penalty for the failure to make timely deposits of tax in order to encourage depositors to correct their failures. Under the bill, a depositor is subject to a penalty equal to 2 percent of the amount of the underpayment if the failure is corrected on or before the date that is 5 days after the prescribed due date. This penalty is increased to 5 percent if the failure is corrected after 5 days but before 15 days after the prescribed due date. If the failure is not corrected after 15 days after the prescribed due date, the penalty is 10 percent. The bill also repeals the current 25 percent penalty on overstated deposit claims.

Discussion

We support the coordination mechanism contained in the bill with respect to fraudulent or intentional failures to file returns. However, as with the current fraud penalty, the Service should bear the burden of proof with respect to this portion of the failure to file penalty.

We believe that the current rule that there is no penalty or other charge for the late filing of a return with a refund due should be changed. Collecting correct information about a taxpayer's tax liability is an important function of the Service. Where a return is not filed, the Service cannot determine whether or how much tax is owed and must attempt to contact the taxpayer and get him or her to file a return on the assumption that there is a balance due. We therefore believe that, in the case of the failure to file a refund return, a modest late filing charge should be imposed on the taxpayer if the return is not filed within 4 months of the due date (which is the amount of time typically granted by the Service in an automatic extension of the time to file a return).

Finally, we would like to express our concerns regarding section 402 of the bill. As you know, this specific proposal was not recommended during the hearings and was only briefly discussed during the "round table" meetings. The federal tax deposit system is vital to the integrity of the pay-as-you-go

system and amendments to its operation deserve careful study. We agree that the current penalty does not provide a sufficient incentive for employers to quickly cure late deposits and believe that this bill should, if possible, contain a provision designed to correct this. We regret that we have not had sufficient time to study all of the ramifications of this provision. In particular, we are concerned that the 2 percent first step may be too low and that a three step system may create significant administrative difficulties. We would like to study this proposal (and other proposals) further before taking a specific position on amending this penalty.

Revenue Estimates

The Treasury Department is currently working on a revenue estimate for H.R. 2528. We regret that we do not have a final estimate ready in time for this hearing; however, our preliminary estimates indicate that it should be possible for H.R. 2528, with certain adjustments affecting only one or two of its provisions, to be essentially revenue neutral. Although we believe that the reforms made by this bill are important, in these times of fiscal restraint, care must be taken in this (as in other tax legislation) to avoid significant unintended revenue loss. After we have finalized our revenue estimates, we will endeavor to work with the subcommittee to make whatever adjustments in the bill are necessary to achieve our goal of revenue neutrality.

Conclusion

In conclusion, I would like to repeat that I believe that H.R. 2528 would, if enacted, constitute an important reform of the civil tax penalty system and would go far toward simplifying and improving this area of tax administration. The subcommittee is to be commended for this significant effort which has been achieved with bipartisan support. While we have recommended changes which we believe will improve the bill, we strongly support the basic structure of the reforms set forth in H.R. 2528. We stand ready to work with the subcommittee.

This concludes my prepared remarks. I would be happy to respond to any questions.

// TREASURY NEWS

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STATEMENT OF THOMAS S. NEUBIG
DIRECTOR AND CHIEF ECONOMIST
OFFICE OF TAX ANALYSIS
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to present the views of the Administration with respect to the targeted jobs tax credit (TJTC) and the rehabilitation tax credit. The Administration's Fiscal Year 1990 Budget does not include an extension of the expiring TJTC nor any modification of the rehabilitation credit. Accordingly, we oppose any extension of the TJTC or modification of the rehabilitation credit.

The Administration supports the objective of providing increased job opportunities for hard-to-employ individuals. The Jobs Training Partnership Act (JTPA), the new Job Opportunities and Basic Skills Training Program (JOBS) for persons on welfare, the Jobs Corps, and several other targeted training programs currently provide assistance to most of the individuals eligible for the TJTC. We believe these programs are superior vehicles for increasing employment of these groups. In contrast, we believe the TJTC has been far less effective in increasing targeted employment. In this budget environment, only the most effective programs can be continued.

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Although the Administration supports the continued availability of the rehabilitation tax credit, both budgetary constraints and concerns about renewed tax shelter activity prevent the Administration from supporting proposals to expand the credit's use or availability.

My testimony today will briefly discuss the existing targeted jobs tax credit and rehabilitation tax credit, and several considerations associated with improving the effectiveness of these credits.

TARGETED JOBS TAX CREDIT

Background and Current Law

Section 51 of the Internal Revenue Code allows employers a tax credit for employing eligible individuals belonging to one of nine target groups. The amount of the allowable credit is generally equal to 40 percent of the first $6,000 of wages paid to a member of a targeted group in the first year of employment. An employer's deduction for wages paid is reduced by the amount of the credit. A targeted group member must be employed at least 90 days (14 days in the case of summer youth employees) before an employer qualifies to receive the TJTC. The credit is unavailable for wages paid to an individual who begins work after December 31, 1989.

The nine eligible targeted groups are the following: (1) economically disadvantaged youths (ages 18-22); (2) economically disadvantaged summer youth (ages 16-17); (3) economically disadvantaged youths participating in cooperative education programs; (4) economically disadvantaged Vietnam-era veterans; (5) economically disadvantaged ex-convicts; (6) certain handicapped workers; (7) certain work incentive employees (AFDC recipients and WIN program registrants); (8) Supplemental Security Income recipients; and (9) general assistance recipients. For purposes of the TJTC, a worker is economically disadvantaged if the worker's family income is below 70 percent of the lower living standard income level.

To claim the credit for an employee, an employer must receive a written certification that the employee is a targeted group member. Certifications of eligibility for employees are generally provided by state employment security agencies. The employer must have received or filed a written request for a certification on or before the date a targeted worker begins work. If the employer has received a written preliminary determination (voucher) that the employee is a member of a targeted group, the employer may file a written certification request within five calendar days after the targeted worker begins work.

Since its enactment in 1978, the TJTC has been extended five times with various modifications. In 1986, the credit expired for part of the year before being retroactively extended. The most recent changes were made by the Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act"), which extended the TJTC one additional year for targeted workers hired in calendar 1989. The 1988 Act changed the eligibility of economically disadvantaged youth from persons between the ages of 18 and 24, to persons between the ages of 18 and 22. The 1988 Act also reduced the rate of credit for disadvantaged summer youth to 40 percent of the first $3,000 of wages.

The number of employed individuals the state employment security agencies have certified as being eligible for the credit reached a peak of 640,000 in 1985. Certifications in 1988 totaled 498,589, reflecting the lower credit rate and tighter eligibility criteria in the 1986 legislation. Table 1 shows the certifications by targeted group in calendar year 1988.

Recent tax return data on the TJTC is shown in Table 2. Due to normal lags in processing and transcribing corporate tax return data, 1986 returns are the latest year for which data with detailed information is available. In 1985, $660 million of TJTC credits were earned with $602 million reported on corporate tax returns and $58 million on individual tax returns. In 1986, approximately $342 million TJTC credits were earned ($299 million by corporations and $43 million by individuals). The decline in credits between 1985 and 1986 can be explained by the credit's expiration for much of 1986. In fact, many of the 1986 credits were earned on 1986 wages paid to workers hired in 1985.

The TJTC in 1985, the year with the highest number of certifications, was claimed by only 33,400 corporations, or only one percent of all corporations. Firms in the wholesale and retail trade industry claimed 48 percent of TJTC credits, firms in manufacturing 32 percent, and firms in the service industry 12 percent. Manufacturing firms were the most likely to claim the credit, yet only 3.4 percent of manufacturing corporations claimed the credit.

The TJTC program if extended for one year, as currently administered, would cost an additional $200 million over the Fiscal Year 1990-94 period ($43 million in FY 1990, $79 million in FY 1991, and $83 million in FY 1992-94). Table 3 shows the revenue impact of alternative periods of extensions of the TJTC program. Administrative costs would be in addition to the revenue loss from the tax credits.

Discussion

The TJTC was intended to increase employment opportunities for targeted workers by reducing the wage costs of employing these workers. The credit achieves its desired effect only when

it results in the hiring of targeted individuals who otherwise would not have been hired, and when their employment results in a net increase in the long-run employment of such workers.

Studies commissioned by the Labor Department[1] in 1986 and the National Commission for Employment Policy[2] (NCEP) in 1988 have found that workers certified as eligible for the TJTC do not have significantly different long-range earnings and employment histories than similar workers in "control" groups who were not certified for the TJTC. Both studies were serious scientific attempts to quantify the employment benefits of the TJTC through analysis of state unemployment compensation wage data on workers followed over several years. While the first study found some evidence of small positive employment effects for some groups (up to 4 weeks of employment for certified nonwhite male youth) and negative impacts for others (certified veterans had 1.5 quarters less employment on average), the study qualified these results by acknowledging that they could have been due to other differences between the certified and noncertified groups. The NCEP study which examined the employment histories of certified and control groups using several years of wage data provided by the states of Missouri and Maryland also was unable to establish that the TJTC caused certified workers to have better employment patterns over long periods of time. If targeted group members do not show measurable improvement in future employment patterns, the credit's efficacy for those hired with the credit is minimal.

When an employer claims a credit with respect to workers who would have been hired without the credit, the credit does not serve its intended effect and is merely a windfall for the employer. The two studies found that many companies retroactively request a determination of an employee's eligibility for the credit after the hiring decision is made, thus obtaining the credit for workers that would have been hired in the absence of the credit.

A net increase in targeted employment may not result even when the TJTC is directly responsible for the hiring of a targeted worker. That is, if newly hired certified targeted employees replace employees who are no longer eligible for the the credit or are hired in place of uncertified targeted workers, targeted employment will not increase on a net basis. Moreover,

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[1] Impact Study of the Implementation and Use of the Targeted Jobs Tax Credit Program, Overview and Summary, Macro Systems, Inc. and the National Center for Research in Vocational Education (July, 1986).

[2] The Targeted Jobs Tax Credit in Maryland and Missouri: 1982-1987, National Commission for Employment Policy, Research Report No. 88-18 (November, 1988).

we believe that it is likely that any increase in the hiring of targeted workers as a result of the credit is achieved at the expense of other low-skilled individuals who are not qualified or not certified for the credit but have job skills similar to workers in the target groups.

Given the ineffectiveness of the TJTC, it is important to note the other Federal programs that currently provide assistance to many of those eligible for the TJTC. Under the Job Training Partnership Act, grants are made to the states to prepare low-income and unskilled youths and adults for entry into the labor force. Among those who are eligible to receive benefits from the JTPA program are older workers and handicapped persons. The Job Corps provides remedial training and job skills training for disadvantaged youth. The new JOBS program for persons on welfare provides education, job training, and child care assistance for welfare recipients. Other training programs are targeted to veterans, native Americans, and migrant and seasonal farm workers.

The Treasury Department has a responsibility to ensure that tax benefits are used in a cost-effective manner. Accordingly, we oppose extension of the TJTC. If Congress chooses to extend the credit, however, we do have two areas of concern regarding the effectiveness of the credit that Congress should consider.

First, many TJTC credits earned by employers are for hiring workers that would have been hired in the absence of the credit. This is particularly true in today's tight labor market characterized by low unemployment rates, currently 5.2 percent nationwide. Regional unemployment rates for targeted workers are also quite low in several areas of the country, attributable both to the tight national labor market situation and to demographic declines in the number of target group members, including economically disadvantaged youth. Accordingly, we believe that the effectiveness of the TJTC could be improved by targeting the credit to specific locations with relatively high unemployment.

Second, as the 1988 NCEP study has indicated, many certifications performed after the hiring date for TJTC eligibles are retroactive certifications for workers who would have been hired without the credit. This problem could be addressed by strengthening the TJTC vouchering system, under which targeted workers receive vouchers from designated state agencies. The TJTC vouchers indicate the workers' eligibility for the credit to potential employers. Eligibility for the credit could be restricted to employees who had valid vouchers prior to their date of hire.

To insure employers an adequate supply of vouchered workers, authority to issue vouchers could be expanded to include the State and local programs which now administer the Jobs Training Partnership Act, the JOBS program, and the general welfare and

public housing programs. The eligibility requirements for these programs include a determination of family income sufficient to identify economically disadvantaged individuals. TJTC vouchers could be issued to the individuals served by these agencies as part of their normal administrative work of verifying eligibility for participation in the programs they administer. These agencies could also refer persons with vouchers to employers seeking targeted workers.

The use of vouchers in applicants' job search and increased employment referrals from vouchering agencies could replace the current ineffective system of retroactive certifications. Eliminating retroactive certifications and extending the vouchering to other agencies that currently make income eligibility determinations would also reduce the cost of administering this labor market program.

Conclusion

The Administration does not support an extension of the targeted jobs tax credit due to budgetary constraints and the ineffectiveness of the current credit. Although the Administration supports the objective of assisting hard-to-employ individuals to qualify for employment, we must carefully weigh competing needs and existing programs in light of the budget deficit. The Administration's budget includes direct expenditures for training of TJTC-eligible individuals, which are more effective than the existing credit.

REHABILITATION TAX CREDIT

Background and Current Law

Section 38 of the Internal Revenue Code provides for a credit against tax in the case of qualified rehabilitation expenditures with respect to qualified rehabilitated buildings. The current credit reflects Congressional concerns about the extra costs associated with the rehabilitation, maintenance and modernization of older and historic structures. The social and aesthetic values of rehabilitating and preserving older and historic structures are not necessarily taken into account in investors' profit projections.

Originally enacted in 1978, the rehabilitation tax credit was expanded in 1981, then scaled back in 1986. As currently structured, the amount of the credit is equal to 20 percent of the basis for qualifying expenditures with respect to certified historic structures, and 10 percent of the basis for qualifying expenditures with respect to nonresidential buildings first placed in service before 1936. Property used predominantly to furnish lodging is eligible for the credit only if a certified historic structure.

Rehabilitation expenditures must be incurred in connection with a "substantial rehabilitation," and must be recovered using straight-line depreciation. The increase in the tax basis of a building that would result from qualified rehabilitation expenditures is reduced by the amount of the allowable credit. Moreover, the rehabilitation tax credit is subject to recapture in the event of disposition or other recapture event within five years after the property is placed in service.

An individual may use the rehabilitation credit generated from a passive activity to offset tax liability on his active income up to a deduction equivalent of $25,000. The ability to offset active income phases out ratably as a taxpayer's adjusted gross income increases from $200,000 to $250,000. These rules represent an exception to the passive activity rules, which generally restrict the ability of credits generated by passive activities to shelter tax liability from such active income sources as wages, salaries, and investments.

Discussion

The preservation of historic structures has been an explicit national goal since the National Historic Preservation Act of 1966. Congress perceived that there was a public benefit associated with providing an incentive for the rehabilitation of structures that were significant in American history and culture.

The Federal incentive for the rehabilitation of old and historic buildings is provided through an income tax credit, rather than a direct expenditure program. Provision of this incentive through the tax code results in its interaction with general income tax provisions designed to ensure the perception of a fair and equitable tax system. A major element of the Tax Reform Act of 1986 (the "1986 Act") was the adoption of rules relating to tax shelter and other passive activities that prevent taxpayers from using deductions and credits to shelter unrelated income. Any proposed modifications to the rehabilitation tax credit must be evaluated in terms of their effect on the reopening of new tax shelters and on the perceived fairness of the tax system.

Projects utilizing the rehabilitation tax credit prior to 1987 commonly were structured as syndicated tax shelters targeted to high income investors. The passive activity rules were directed specifically at that type of tax shelter activity and represent a critical shield against tax shelters. Losses or credits from activities in which investors do not materially participate can not be used to offset other income, but must be deferred until disposition of the property or until the investor has taxable income from passive activities. The passive activity rules, however, do allow annually up to $25,000 of deductions (or their credit equivalent) for active investors in real estate with

adjusted gross incomes below $100,000 (phasing out at $150,000). This exception was allowed for moderate income taxpayers who may invest in real estate for financial security, rather than tax shelter, reasons and who might otherwise face cash flow problems.

Specific exceptions to the general passive activity rules were made for the rehabilitation credit. These exceptions enhance its value to more investors in recognition of its social objectives, while at the same time ensuring that the rehabilitation credit is not subject to tax shelter manipulation. Investors earning the rehabilitation tax credit are deemed to be active investors, regardless of their level of involvement in the property. Further, taxpayers with adjusted gross incomes between $100,000 and $200,000 (phasing out at $250,000) are eligible to claim the $7,000 annual exception for the rehabilitation credit. If the passive activity restrictions were further excepted for the rehabilitation credit, the potential for undesirable marketing of tax shelters would be renewed.

Some data are now available to begin assessing the effects of the 1986 Act changes on rehabilitation expenditures for old and historic structures. Interior Department data indicate that the use of the credit for the rehabilitation of historic structures has decreased since 1985. The number of projects approved by the Interior Department for use with the credit decreased by 65 percent, from 3,100 in FY 1985 to 1,100 in FY 1988, and the dollar investment associated with these projects decreased by 64 percent, from $2.4 billion in FY 1985 to $0.9 billion in FY 1988 (See Table 4).

Recent IRS data also indicate that there has been a decrease in the use of the rehabilitation credit by individuals since enactment of the Tax Reform Act of 1986. The value of the credit earned by individuals decreased from $1.05 billion in 1985 to $708 million in 1986, and preliminary data indicate that the value of the credit was $229 million in 1987 (See Table 5). The tax return data also indicate that in each of these years approximately one-third of the value of the credit was claimed by individuals with adjusted gross incomes of over $200,000.

Although the decrease in the number and value of rehabilitations of older and historic structures with the credit is clear, the causes of the decline are less clear. The 1986 Act reduced the incentive value of the credit and the eligible non-historic structures. The credit rate for historic structures was reduced from 25 percent to 20 percent. In addition, the 1986 Act required full basis reduction by the amount of the credit. In combination, the 1986 Act reduced the value of the historic rehabilitation credit by 31 percent from 29 percent (25 percent credit plus 4 percent credit-equivalent basis reduction) to 20 percent of rehabilitation expenditures. The 1986 Act also

reduced the value of the nonhistoric rehabilitation credit to 10 percent and restricted eligibility to structures originally placed in service before 1936.

In addition, changes in the tax treatment of all real estate affected the incentives for the rehabilitation of old and historic structures. Accelerated depreciation was slowed down for structures. Lower marginal tax rates reduced the value of nominal interest deductions. Higher capital gains tax rates increased the lock-in effect on existing owners. And the passive activity limitations and the alternative minimum tax reduced the value of tax incentives for high-income individuals to generate tax shelter benefits or large tax preferences.

Additional data and analysis is required to determine how much of the decline is attributable to the specific changes in the rehabilitation credit, to the changes in the general tax treatment of real estate, to a temporary restructuring of how the rehabilitation credit is utilized by private investors, or to general economic factors unrelated to the Internal Revenue Code. In addition, an assessment is needed to determine whether the decline in rehabilitations has resulted in a loss of public benefits in excess of the additional revenue losses that would have occurred.

There may be room for improving the effectiveness of the rehabilitation credit, particularly as it applies to nonhistoric buildings, by targeting it more precisely to those structures providing the greatest public benefit. The credit currently may provide incentives for the rehabilitation or preservation of structures that are of a character or are in a location offering no significant public benefit. The credit for the rehabilitation of nonhistoric structures is independent of any standard of public benefit, other than the fact that the structure is old. There are some older buildings that provide private benefits to their owners with little, if any, obvious public benefit. In contrast, the credit for the preservation of historic structures depends on an Interior Department determination that the structures are historically significant and that projects conform to the Interior Secretary's standards for rehabilitation. Similarly, the low-income housing tax credit is targeted to units reserved for low-income families, subject to state volume caps and approval by state housing authorities.

Conclusion

The Administration would not support any expansion of the rehabilitation tax credit or any weakening in tax reform's restrictions on tax shelters. Although the level of rehabilitation activity subsidized by the credit has declined, further analysis is needed to identify the reasons for the decline, and an assessment is needed to determine whether the decline

represents a loss of significant public benefits. In its review of the credit, Congress may wish to consider whether Federal incentives should be better targeted for the rehabilitation of nonhistoric structures to ensure that they provide a public benefit greater than the revenue cost.

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

TABLE 1

TARGETED JOBS TAX CREDIT CERTIFICATIONS ISSUED BY THE DEPARTMENT OF LABOR IN 1988 BY TARGETED GROUP

Targeted Groups	Calendar 1988 Certifications	Percent of Certifications
Economically Disadvantaged Youth Age 18 - 24 [1]	282,640	56.7
Economically Disadvantaged Summer Youth	17,769	3.6
Economically Disadvantaged Vietnam Veterans	16,366	3.3
Economically Disadvantaged Ex-Convicts	22,404	4.5
Vocational Rehabilitation Referrals	36,619	7.3
General Assistance Recipients	18,244	3.7
AFDC Recipients/WIN Registrants	97,276	19.5
Supplemental Security Income Recipients	5,994	1.2
Economically Disadvantaged Cooperative Education [2]	1,277	0.3
Total	498,589	100.0

Department of the Treasury
Office of Tax Analysis

June 6, 1989

Source: Department of Labor.

[1] For targeted workers in this class hired after December 31, 1988, The Technical and Miscellaneous Revenue Act of 1988 restricted TJTC eligibility to persons aged 18 through 22.

[2] The Education Department is responsible for certifying eligible cooperative education students, but maintains no records of certifications for this target group. The numbers shown are for DOL "economic determinations" required for certification. The number of certifications cannot exceed the number of "economic determinations."

TABLE 2

TJTC CREDITS EARNED IN 1985 BY INDUSTRIAL CLASSIFICATION

Industry	TJTC Credits Earned in 1985 ($ millions)	Percent of Total Credits	Percent of Corporations Claiming the Credit in 1985
Agriculture	$ 3	0.6%	0.6%
Mining	6	1.1	0.3
Construction	11	1.9	0.7
Manufacturing	194	32.2	3.4
Transportation	10	1.6	0.6
Communications	3	0.4	0.6
Utilities	5	0.8	0.6
Trade	284	47.1	1.5
Financial	19	3.1	0.2
Services	67	11.2	0.5
Total	602	100.0%	1.0%

Department of the Treasury
Office of Tax Analysis

June 6, 1989

Source: IRS Statistics of Income.

[1]According to IRS data collected by the Statistics of Income (SOI) program, individuals earned $58 million of TJTC credits in 1985. Data on the industrial breakdown of credits earned by individuals is unavailable.

TABLE 3

REVENUE IMPACT OF ALTERNATIVE PERIODS OF EXTENSION
OF THE TARGETED JOBS TAX CREDIT

	Fiscal Years				
	1990	1991	1992	1993	1994
	($ Millions)				
One-Year Extension	-43	-79	-52	-20	-11
Two-Year Extension	-43	-124	-132	-72	-32
Three-Year Extension	-43	-124	-180	-157	-87
Permanent Extension	-48	-139	-206	-257	-318

Department of the Treasury
Office of Tax Analysis

June 6, 1989

TABLE 4

NUMBER OF HISTORIC PRESERVATION TAX CREDIT PROJECTS
APPROVED AND AMOUNT INVESTED, 1978-1988

Fiscal Year	Number of Projects Approved	Amount Invested ($ millions)
1978	512	140
1979	635	300
1980	614	346
1981	1,375	738
1982	1,802	1,128
1983	2,572	2,165
1984	3,214	2,123
1985	3,117	2,416
1986	2,964	1,661
1987	1,931	1,084
1988	1,092	866
Total, FY 1978-88	19,828	12,967

Department of the Treasury
Office of Tax Analysis

June 6, 1989

Source: U.S. Department of the Interior, "Tax Incentives for Rehabilitating Historic Buildings: Fiscal Year 1988 Analysis," November 1988.

TABLE 5

AMOUNT OF REHABILITATION TAX CREDITS EARNED
BY YEAR AND CLASS OF PROPERTY, 1981-1987
($ Millions)

Property	Taxable Years						
	1981	1982	1983	1984	1985	1986	1987p
				Individuals			
Historic	2	159	300	392	633	479	165
40 Year	2	168	236	213	395	215	42
30 Year	*	13	17	10	22	14	7
Pre-1936	-	-	-	-	-	*	15
Subtotal	4	341	553	615	1,051	708	229
				Corporations			
Historic	2	37	60	59	107	84	NA
40 Year	11	131	122	175	277	112	NA
30 Year	2	27	32	21	35	25	NA
Pre-1936	-	-	-	-	-	1	NA
Subtotal	14	196	214	255	419	222	NA
				Total			
Historic	3	197	360	451	740	563	NA
40 Year	14	299	358	388	672	327	NA
30 Year	2	41	49	32	58	39	NA
Pre-1936	-	-	-	-	-	1	NA
Total	19	537	766	870	1,470	929	NA

Department of the Treasury
Office of Tax Analysis

June 6, 1989

Source: IRS Statistics of Income.

Note: Detail may not add to totals due to rounding.

* Less than $500,000

N/A = Not available.

P = Preliminary

TREASURY NEWS

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

June 6, 1989

Mary Catherine Sophos
Appointed Deputy Assistant Secretary
for Legislative Affairs

Secretary of the Treasury Nicholas F. Brady today announced the appointment of Mary Catherine Sophos to serve as Deputy Assistant Secretary for Legislative Affairs. Ms. Sophos will serve as principal adviser to the Assistant Secretary for Legislative Affairs on all issues related to the Department's legislative initiatives and on the relations of the Department with Members of Congress and the staffs of Congressional Committees.

Before joining Treasury, Ms. Sophos had been Director of Government Relations with McCamish, Martin, Brown & Loeffler, a Texas-based law firm. Prior to that she had been Assistant Minority Counsel and Budget Analyst for the Committee on Ways and Means of the U. S. House of Representatives. Previously, Ms. Sophos had been Budget Associate Staff and Legislative Director to Congressman Tom Loeffler; Legislative Assistant to the Director of the Office of Management and Budget; and a Legislative Representative at the National Food Processors Association.

Ms. Sophos received a B.S. in Political Studies (1976) from Pitzer College, The Claremont Colleges, Claremont, California. She resides in Washington, D.C.

NB-322

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

ROOM 5310
JUN 8 9 21 AM '89
DEPARTMENT OF THE TREASURY

FOR IMMEDIATE RELEASE

June 6, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of March 1989.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $141.9 billion on March 31, 1989, posting a decrease of $259 million from the level on February 28, 1989. This net change was the result of an increase in holdings of agency debt of $572.2 million, and decreases in holdings of agency assets of $652.9 million and in agency-guaranteed debt of $178.4 million. FFB made 48 disbursements during March.

Attached to this release are tables presenting FFB March loan activity and FFB holdings as of March 31, 1989.

NB-323

FEDERAL FINANCING BANK

MARCH 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note #77	3/1	$ 247,000,000.00	3/1/99	9.449%	9.340% qtr.
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #486	3/8	7,330,000.00	6/6/89	9.059%	
U. S. POSTAL SERVICE					
Note #16	3/27	600,000,000.00	3/27/90	9.826%	
TENNESSEE VALLEY AUTHORITY					
Advance #1006	3/6	138,000,000.00	3/13/89	9.061%	
Advance #1007	3/10	815,000,000.00	3/16/89	9.100%	
Advance #1008	3/13	162,000,000.00	3/20/89	9.178%	
Advance #1009	3/16	36,000,000.00	3/21/89	9.112%	
Advance #1010	3/16	29,000,000.00	3/22/89	9.112%	
Advance #1011	3/16	36,000,000.00	3/23/89	9.112%	
Advance #1012	3/20	147,000,000.00	3/27/89	9.294%	
Advance #1013	3/27	127,000,000.00	4/03/89	9.495%	
Advance #1014	3/31	130,000,000.00	4/06/89	9.407%	
Advance #1015	3/31	57,000,000.00	4/10/89	9.407%	
Power Bond 1989-A	3/16	700,000,000.00	8/16/04	9.377%	
AGENCY ASSETS					
RURAL ELECTRIFICATION ADMINISTRATION - Certificates of Beneficial Ownership					
Certificate #29	3/31	4,800,000.00	9/30/89	9.729%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 17	3/2	218,101.50	2/27/12	9.355%	
Philippines 11	3/2	11,757.66	9/12/90	9.627%	
Philippines 9	3/3	116,162.63	5/15/91	9.626%	
Greece 16	3/7	1,220,228.05	3/1/13	9.251%	

+rollover

FEDERAL FINANCING BANK

MARCH 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
Foreign Military Sales (continued)					
Greece 17	3/7	$ 2,292,657.42	2/27/12	9.258%	
Philippines 11	3/7	5,470.00	9/12/90	9.533%	
Morocco 12	3/10	381,703.52	3/21/95	9.439%	
Morocco 13	3/10	89,145.57	5/31/95	9.435%	
Philippines 11	3/10	8,726.75	9/12/90	9.568%	
Turkey 18	3/10	757,530.74	3/12/14	9.223%	
Greece 16	3/16	322,417.40	3/1/13	9.285%	
Morocco 13	3/17	66,970.00	5/31/95	9.510%	
Morocco 9	3/20	164,000.00	3/31/94	9.780%	
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT					
Community Development					
Lincoln, NE	3/10	140,000.00	10/2/89	9.329%	9.380% ann.
Lincoln, NE	3/10	160,000.00	10/2/89	9.329%	9.380% ann.
RURAL ELECTRIFICATION ADMINISTRATION					
Oglethorpe Power #320	3/2	5,801,000.00	4/1/91	9.668%	9.554% qtr.
New Hampshire Electric #270	3/3	360,000.00	1/2/18	9.316%	9.210% qtr.
*Cajun Electric #197A	3/13	40,000,000.00	4/1/91	9.779%	9.662% qtr.
*Wabash Valley Power #104	3/13	5,872,000.00	1/2/18	9.344%	9.237% qtr.
*Wabash Valley Power #206	3/13	567,000.00	1/2/18	9.344%	9.237% qtr.
*Cooperative Power Assoc. #156A	3/16	1,950,000.00	4/1/91	9.743%	9.627% qtr.
New Hampshire Electric #270	3/29	304,000.00	1/2/18	9.397%	9.289% qtr.
*Colorado Ute-Electric #276	3/31	522,979.76	4/1/91	9.909%	9.789% qtr.
*Colorado Ute-Electric #276	3/31	1,439,393.92	4/1/91	9.909%	9.789% qtr.
*Colorado Ute-Electric #297	3/31	3,499,873.20	4/1/91	9.909%	9.789% qtr.
*Colorado Ute-Electric #297	3/31	4,708,780.48	4/1/91	9.909%	9.789% qtr.
*Cooperative Power Assoc. #130A	3/31	6,272,727.30	4/1/91	9.908%	9.788% qtr.
*New Hampshire Electric #270	3/31	1,997,000.00	1/2/18	9.333%	9.227% qtr.
*New Hampshire Electric #270	3/31	453,000.00	1/2/18	9.333%	9.227% qtr.
*New Hampshire Electric #270	3/31	723,000.00	1/2/18	9.333%	9.227% qtr.
*New Hampshire Electric #270	3/31	2,851,000.00	1/2/18	9.333%	9.227% qtr.
*New Hampshire Electric #270	3/31	247,000.00	1/2/18	9.333%	9.227% qtr.
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-06	3/31	847,760,024.45	6/30/89	9.425%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	March 31, 1989	February 28, 1989	Net Change 3/1/89-3/31/89	FY '89 Net Change 10/1/88-3/31/89
Agency Debt:				
Export-Import Bank	$ 11,000.6	$ 11,027.2	$ -26.5	$ 43.0
NCUA-Central Liquidity Facility	111.4	111.7	-0.3	-6.8
Tennessee Valley Authority	17,039.0	17,040.0	-1.0	-92.0
U.S. Postal Service	6,492.2	5,892.2	600.0	900.0
sub-total*	34,643.2	34,071.0	572.2	844.3
Agency Assets:				
Farmers Home Administration	57,841.0	58,496.0	-655.0	-655.0
DHHS-Health Maintenance Org.	79.5	79.5	-0-	-0-
DHHS-Medical Facilities	93.8	96.3	-2.5	-2.6
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,076.0	4,071.2	4.8	-63.2
Small Business Administration	13.4	13.6	-0.2	-2.0
sub-total*	62,103.8	62,756.7	-652.9	-722.7
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	11,646.7	11,731.7	-85.0	-4,365.0
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	-0-	49.6	-49.6	-50.0
DHUD-Community Dev. Block Grant	314.0	314.8	-0.8	-4.0
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	383.0	383.0	-0-	-4.4
DOI-Guam Power Authority	31.5	32.1	-0.6	-0.6
DOI-Virgin Islands	26.1	26.1	-0-	-0.5
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,720.5	1,720.5	-0-	-38.3
Rural Electrification Administration	19,195.3	19,244.6	-49.3	-10.0
SBA-Small Business Investment Cos.	587.9	596.1	-8.2	-44.7
SBA-State/Local Development Cos.	846.0	849.6	-3.6	-24.9
TVA-Seven States Energy Corp.	2,247.9	2,226.7	21.2	85.6
DOT-Section 511	40.6	43.1	-2.5	-5.6
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	45,117.2	45,295.6	-178.4	-4,407.8
grand total*	$ 141,864.2	$ 142,123.3	$ -259.0	$ -4,286.3

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

TREASURY NEWS

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

5510

FOR RELEASE AT 3:00 PM
June 6, 1989

Contact: Peter Hollenbach
(202) 376-4302

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

The Department of the Treasury announced activity figures for the month of May 1989, of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS).

Dollar Amounts in Thousands

Principal Outstanding (Eligible Securities)	$346,648,320
Held in Unstripped Form	$263,938,710
Held in Stripped Form	$82,709,610
Reconstituted in May	$8,133,020

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, MAY 31, 1989
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Reconstituted This Month[1]
		Total	Portion Held in Unstripped Form	Portion Held in Stripped Form	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,589,754	$1,068,800	$17,600
11-1/4% Note A-1995	2/15/95	6,933,861	6,176,261	757,600	26,880
11-1/4% Note B-1995	5/15/95	7,127,086	5,406,926	1,720,160	64,640
10-1/2% Note C-1995	8/15/95	7,955,901	7,005,901	950,000	-0-
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	8,411,319	8,105,719	305,600	4,800
7-3/8% Note C-1996	5/15/96	20,085,643	19,882,443	203,200	54,400
7-1/4% Note D-1996	11/15/96	20,258,810	20,025,210	233,600	36,000
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	9,719,628	9,719,628	-0-	-0-
9-1/8% Note B-1999	5/15/99	10,047,058	10,047,058	-0-	-0-
11-5/8% Bond 2004	11/15/04	8,301,806	2,788,206	5,513,600	68,800
12% Bond 2005	5/15/05	4,260,758	1,734,908	2,525,850	9,300
10-3/4% Bond 2005	8/15/05	9,269,713	6,393,713	2,876,000	43,600
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	1,363,984	4,641,600	-0-
11-1/4% Bond 2015	2/15/15	12,667,799	2,910,839	9,756,960	120,000
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	2,811,859	4,088,000	440,000
9-1/4% Bond 2016	2/15/16	7,266,854	5,318,854	1,948,000	188,000
7-1/4% Bond 2016	5/15/16	18,823,551	14,079,551	4,744,000	2,122,400
7-1/2% Bond 2016	11/15/16	18,864,448	9,871,968	8,992,480	1,449,200
8-3/4% Bond 2017	5/15/17	18,194,169	7,752,249	10,441,920	692,000
8-7/8% Bond 2017	8/15/17	14,016,858	9,207,258	4,809,600	507,200
9-1/8% Bond 2018	5/15/18	8,708,639	5,046,239	3,662,400	571,200
9% Bond 2018	11/15/18	9,032,870	4,281,270	4,751,600	1,285,000
8-7/8% Bond 2019	2/15/19	19,250,792	16,805,992	2,444,800	432,000
Total		346,648,320	263,938,710	82,709,610	8,133,020

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form.

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 566-204

FOR RELEASE AT 4:00 P.M.
June 6, 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 $12,800 million, to be issued June 15, 1989. This offering will result in a paydown for the Treasury of about $2,350 million, as the maturing bills are outstanding in the amount of $15,147 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, June 12, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated March 16, 1989, and to mature September 14, 1989 (CUSIP No. 912794 SX 3), currently outstanding in the amount of $7,725 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,400 million, to be dated June 15, 1989, and to mature December 14, 1989 (CUSIP No. 912794 TH 7).

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

The bills will be issued for cash and in exchange for Treasury bills maturing June 15, 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 $1,420 million as agents for foreign and international monetary authorities, and $4,550 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).

NB-325

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.

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UNCLAS SECTION 01 OF 06 PARIS 18450
USIS/USOECD
USIA FOR EU:BSHINKMAN AND THOMSON; P/G:MCCLELLAN;
P/PFO; P/PFW
STATE FOR E, EB, EUR
TREASURY FOR S, U, A, P, I, IT, IM, IMI
STATE PASS ALSO TO CEA
STATE PASS ALSO TO USTR
WHITE HOUSE PASS TO NSC

<SUBJECT>
SUBJECT: FINAL U.S. PRESS CONFERENCE AT THE CONCLUSION
OF THE 1989 OECD MINISTERIAL ON 06/01/89

---- REMARKS BY
---- SECRETARY OF THE TREASURY
---- NICHOLAS F. BRADY
---- TO THE PRESS AT THE CONCLUSION
---- OF THE 1989 OECD MINISTERIAL

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---- PARIS, FRANCE
---- JUNE 1, 1989

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(MODERATOR)
I WOULD LIKE TO INTRODUCE SECRETARY OF THE TREASURY NICHOLAS BRADY, OUR TRADE NEGOTIATOR AMBASSADOR CARLA HILLS, CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS DR. MICHAEL BOSKIN, AND UNDERSECRETARY OF STATE RICHARD MCCORMACK. SECRETARY BRADY WILL HAVE AN OPENING STATEMENT, AFTER WHICH HE AND THE DELEGATION WILL TAKE YOUR QUESTIONS.

-

(SECRETARY BRADY)
THANK YOU. I'D LIKE TO SPEND A VERY FEW MINUTES REVIEWING SOME OF THE KEY DEVELOPMENTS AT THIS YEAR'S OECD MINISTERIAL MEETING, AND THEN WE'LL BE GLAD TO TAKE YOUR QUESTIONS.

-

WE HAD NEARLY TWO DAYS OF PRODUCTIVE DISCUSSIONS ON A WIDE RANGE OF IMPORTANT ISSUES. THESE INCLUDE MACROECONOMIC TRENDS IN THE INDUSTRIAL COUNTRIES; POLICY PRIORITIES TO ACHIEVE SUSTAINED GROWTH AND FURTHER REDUCTION OF TRADE AND CURRENT ACCOUNT IMBALANCES; THE STRENGTHENED DEBT STRATEGY; AND, OF COURSE, TRADE ISSUES.

-

AS THE FINAL COMMUNIQUE MAKES CLEAR, THERE WAS BASIC AGREEMENT ON THE FUNDAMENTAL ISSUES, SETTING THE STAGE FOR A SUCCESSFUL AND PRODUCTIVE ECONOMIC SUMMIT MEETING OF THE MAJOR INDUSTRIAL COUNTRIES IN JULY.

-

ECONOMIC TRENDS AND POLICY PRIORITIES

-

ON THE MACROECONOMIC FRONT, OECD EXPANSION IS NOW INTO ITS SEVENTH YEAR, AND MODERATE GROWTH IS EXPECTED TO CONTINUE. INFLATION IS BEING CONTAINED, AND PROGRESS HAS BEEN MADE IN REDUCING EXTERNAL IMBALANCES.

-

OUR POLICY PRIORITIES ARE:

-

-- (1) TO FOSTER THE WELL-BALANCED GROWTH IN THE INDUSTRIAL COUNTRIES THAT IS ESSENTIAL TO PROMOTING CONTINUED GLOBAL TRADE AND CURRENT ACCOUNT ADJUSTMENT;

-

-- (2) TO CREATE NEW OPPORTUNITIES FOR INVESTMENT AND JOB CREATION; AND

-

-- (3) TO PROVIDE A SUPPORTIVE ENVIRONMENT FOR IMPLEMENTING THE DEBT STRATEGY.

-

THE COMMUNIQUE REFLECTS THESE BASIC PRIORITIES.

-

ACHIEVING OUR OBJECTIVES REQUIRES COORDINATED ACTION, PARTICULARLY BY THE LARGEST COUNTRIES. FOR OUR PART, WE ARE COMMITTED TO FURTHER REDUCTIONS IN THE FEDERAL BUDGET DEFICIT. JAPAN AND GERMANY RECOGNIZE THE NEED TO PURSUE STRONG GROWTH IN ORDER TO PROMOTE REDUCTIONS OF THEIR LARGE EXTERNAL SURPLUSES.

-

WE ARE PLEASED WITH THE EMPHASIS GIVEN IN THE COMMUNIQUE TO THE NEED FOR STRUCTURAL REFORMS. TAX REFORM, DEREGULATION AND SUBSIDY CUTS ARE ESSENTIAL FOR BALANCED LONG-TERM GROWTH.

-

THE DEBT STRATEGY

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P/PFO; P/PFW
STATE FOR E, EB, EUR
TREASURY FOR S, U, A, P, I, IT, IM, IMI
STATE PASS ALSO TO CEA
STATE PASS ALSO TO USTR
WHITE HOUSE PASS TO NSC

<SUBJECT>
SUBJECT: FINAL U.S. PRESS CONFERENCE AT THE CONCLUSION

-
WE ARE ALSO PLEASED WITH THE MINISTERIAL'S ENDORSEMENT
OF THE STRENGTHENED DEBT STRATEGY, WITH ITS NEW

EMPHASIS ON DEBT AND DEBT SERVICE REDUCTION AND
POLICIES TO PROMOTE INVESTMENT AND FLIGHT CAPITAL
REPATRIATION.
-
IN RECENT WEEKS SUBSTANTIAL PROGRESS HAS BEEN MADE IN
IMPLEMENTING THE PROPOSALS THAT WE MADE THREE MONTHS
AGO. THE IMF HAS AGREED ON A NUMBER OF IMPORTANT
CHANGES IN FUND POLICY TO ENABLE IT TO SUPPORT THE
STRATEGY. AND WE ARE PARTICULARLY PLEASED THAT JUST
LAST NIGHT THE WORLD BANK JOINED THE IMF BY AGREEING TO
THE NECESSARY POLICY CHANGES THAT WILL ENABLE IT TO
PLAY A CRUCIAL ROLE IN THE RENEWED STRATEGY.
-
THESE STEPS HAVE GIVEN THE PROCESS A NEW MOMENTUM. WE
NOW LOOK FOR THE DEBTOR COUNTRIES AND THE BANKS TO USE
THESE ARRANGEMENTS AS A CATALYST FOR AGREEMENT ON
SPECIFIC FINANCING PACKAGES.
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TRADE ISSUES
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AS YOU KNOW, TRADE ISSUES WERE ANOTHER IMPORTANT THEME AT THE MINISTERIAL. WE ARE PLEASED WITH THE OUTCOME IN THIS AREA, PARTICULARLY WITH THE MINISTERIAL'S STRONG ENDORSEMENT OF AGRICULTURAL REFORM AND A SUCCESSFUL COMPLETION OF THE URUGUAY ROUND. AMBASSADOR HILLS WILL BE GLAD TO ANSWER YOUR QUESTIONS ON TRADE MATTERS.

-

WITH RESPECT TO THE ENVIRONMENT, THE MINISTERIAL ALSO GAVE CONSIDERABLE EMPHASIS TO ENVIRONMENTAL ISSUES, WHICH WILL ALSO BE A MAJOR THEME AT THE UPCOMING ECONOMIC SUMMIT. UNDERSECRETARY MCCORMACK WOULD BE PLEASED TO ADDRESS THIS ISSUE.

-

THANK YOU, AND NOW AMBASSADOR HILLS, CHAIRMAN BOSKIN, UNDERSECRETARY MCCORMACK AND I WOULD BE GLAD TO ANSWER ANY QUESTIONS YOU MIGHT HAVE.

-

Q. COULD YOU PLEASE SAY, AMBASSADOR HILLS, WHAT CONCRETE MEASURES, IF ANY, THE UNITED STATES MIGHT TAKE TO AMEND SUPER 301 AND THE OTHER FEATURES OF YOUR TRADE LEGISLATION OR THE RECENT ACTION BASED ON THAT AS A RESULT OF THE PRESSURE THAT YOU'VE COME UNDER HERE AND THE COMMUNIQUE WHICH YOU'VE SIGNED?

-

(AMBASSADOR HILLS)
THERE IS NOTHING IN THE 301 STATUTE THAT RUNS CONTRARY AT THE CURRENT TIME WITH EITHER THE COMMUNIQUE OR THE SPIRIT OF THIS ASSEMBLY. OUR TRADE STRATEGY, I HAVE STATED OFTEN, IS CLEAR. IT IS TO OPEN MARKETS AND EXPAND TRADE. AND NO COUNTRY COULD BE MORE DEVOTED TO MULTILATERALISM THAN THE UNITED STATES. WE HAVE LISTED OUR PRIORITIES THAT ARE CONSISTENT WITH THE URUGUAY ROUND AND WE HAVE EVERY HOPE THAT IN DISCUSSIONS WITH OUR TRADE PARTNERS WE WILL BE ABLE TO FURTHER THE GOALS OF THE URUGUAY ROUND.

-

Q. IN THE PREVIOUS PRESS CONFERENCE, THE OECD SECRETARY GENERAL SAID THAT HE THOUGHT THERE WAS A NEED TO REALIGN THE EXCHANGE RATES OF THE OECD AND, IN PARTICULAR, THREE BIG CURRENCY BLOCS: THE DEUTSCH MARK, THE YEN , AND THE DOLLAR. I WONDER IF YOU HAVE ANY COMMENT ON THAT SECRETARY BRADY?

-

(SECRETARY BRADY)

A. WHAT WE'VE SAID IS THE UPWARD RISE IN THE DOLLAR PRESENTS A PROBLEM FOR POLICY COORDINATION. AT THE SAME TIME THIS IS JUST ONE PART OF THE PROCESS AND THERE ARE OTHER PARTS TO IT THAT ARE SIMILARLY IMPORTANT.
-
Q. THIS IS FOR UNDERSECRETARY MCCORMACK. WITH THE BIG EMPHASIS THAT OECD HAS PLACED ON THE ENVIRONMENT, ARE WE LIKELY TO SEE CHANGES IN U.S. ENVIRONMENTAL POLICIES? WILL THE ENVIRONMENT BECOME A BIGGER PORTION OF THE U.S. OVERALL GOVERNMENT POLICY OR WILL IT STILL BE LEFT TO THE STATES TO SET A LOT OF THEIR OWN INDIVIDUAL POLICIES?
-
(UNDERSECRETARY MCCORMACK)
A. PRESIDENT BUSH HAS MADE VERY CLEAR THAT HE
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RUEHSS/OECD COLLECTIVE IMMEDIATE
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UNCLAS SECTION 03 OF 06 PARIS 18450
USIS/USOECD
USIA FOR EU:BSHINKMAN AND THOMSON; P/G:MCCLELLAN;
P/PFO; P/PFW
STATE FOR E, EB, EUR
TREASURY FOR S, U, A, P, I, IT, IM, IMI
STATE PASS ALSO TO CEA
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WHITE HOUSE PASS TO NSC

<SUBJECT>
SUBJECT: FINAL U.S. PRESS CONFERENCE AT THE CONCLUSION
CONSIDERS THE ENVIRONMENT ONE OF HIS TOP PRIORITIES.
HE HAS CALLED FOR A MEETING OF THE RESPONSE STRATEGIES
WORKING GROUP ON GLOBAL CLIMATE CHANGE WILL TAKE PLACE
THIS OCTOBER IN WASHINGTON. IT IS OBVIOUSLY GOING TO

BE ONE OF THE MAJOR SUBJECTS OF THE SUMMIT. HE HAS
SUPPORTED CONSTRUCTIVE SOLUTIONS TO THE OZONE DEPLETION
PROBLEM. HE IS VERY CONCERNED ABOUT THE ENVIRONMENT
AND IT IS REALLY VERY MUCH UP IN U.S. PRIORITIES.
-
Q. I UNDERSTAND WHAT YOU ARE SAYING BUT, AT THE SAME
TIME, WE SEE IN THE PRESS THAT HE'S BEEN RELUCTANT TO
GO ALONG WITH SOME OF THE MAJOR DECISIONS THAT HAVE
BEEN MADE INTERNATIONALLY TO SAY O.K., WE'RE GOING TO
UPGRADE STEPPING OUT CFC'S OR, SIGNING ON AND SAYING,
YES, WE ARE GOING TO DO SOMETHING SPECIFIC. HE HAS
HEDGED THE QUESTION SEVERAL TIMES WHEN HE HAS BEEN
ASKED TO SPECIFICALLY PUT HIS NAME ON SOMETHING. AND
THEN GOING ALONG THAT WE CAN SAY, YES, WE'RE GOING TO
DO ALL OF THESE THINGS BUT IN TERMS OF THE BASIC U.S.
APPROACH TO THEM, WE'RE CAPITALISTIC, VERY INDUSTRIAL.
INDIVIDUAL INDUSTRIES HAVE THEIR OWN RIGHTS AND THINGS
LIKE THAT. HOW WILL THE U.S STEP UP OR MOVE INTO
ENFORCING MORE ENVIRONMENTAL AWARENESS WITHIN THE
INDUSTRIES WHERE THEY ARE SPECIFICALLY INDEPENDENT,
NON-GOVERNMENT RUN AS MANY OF THE EUROPEAN INDUSTRIES
ARE?
-
(UNDERSECRETARY MCCORMACK)
A. WELL YOU HAVE ASKED MANY, MANY QUESTIONS IN THAT
BRIEF INTERJECTION THERE. BUT JUST LET ME SAY THAT
RIGHT NOW WITHIN THE WHITE HOUSE THERE ARE THREE MAJOR
POLICY REVIEW OPERATIONS THAT ARE DEVOTED TO REVIEWING

WHAT WE CAN DO TO ADDRESS ENVIRONMENTAL CONCERNS, LOOKING AT OPTIONS ON ACID RAIN, LOOKING AT OPTIONS ON GLOBAL CLIMATE, LOOKING AT OPTIONS ON ENERGY POLICY. MR. BOSKIN CAN ADD ADDITIONAL DETAILS ON WHAT WE'RE DOING BECAUSE HE'S ATTENDING THE SAME MEETINGS THAT I AM.

-

(CHAIRMAN BOSKIN)
A. LET ME JUST SAY THAT, FIRST OF ALL, THE PRESIDENT HAS COMMITTED HIMSELF TO A FULL PHASE-OUT OF CFC PRODUCTION PENDING THE AVAILABILITY OF SAFE SUBSTITUTES. SO I THINK YOUR FACTS WERE NOT ACCURATE ON THAT ONE, NUMBER ONE. NUMBER TWO, THERE IS A DETAILED LOOK AT THE CABINET-LEVEL AT WHAT MIGHT BE TERMED THE CLEAN AIR ACT DEALING WITH ACID RAIN, AIR TOXICS, AND NON-ATTAINMENT. AND THERE ARE A VARIETY OF OPTIONS THAT HAVE BEEN ANALYZED, THAT ARE GOING THROUGHT THE INTER-AGENCY PROCESS, AND THE PRESIDENT HAS BEEN ACTIVELY INVOLVED IN THAT. AND IT IS VERY CLEAR THAT THERE WILL BE AN EMERGING POLICY ON THIS BUT IT IS PREMATURE TO ANNOUNCE IT OBVIOUSLY AT THIS TIME. SO I THINK YOU CAN REST ASSURED THE PRESIDENT WILL DELIVER ON HIS PROMISE TO BE AN ENVIRONMENTAL PRESIDENT. AND, I THINK THAT WE WILL HAVE POLICIES IN PLACE AND LEGISLATION PRODUCED IN THE COMING WEEKS AND MONTHS.

-

Q. AMBASSADOR HILLS, CHAIRMAN SIGURDSSON SAID THAT HE THOUGHT IN IMPLEMENTING THE 301 LEGISLATION THE U.S. WOULD PROCEED IN THE SPIRIT OF THE MULTILATERAL TRADING SYSTEM, AND IN THE SPIRIT OF GATT. BUT HE SAID THAT HE COULD NOT GIVE A SPECIFIC EXAMPLE HIMSELF OF HOW THAT SPIRIT WOULD BE MANIFESTED. HE SUGGESTED PERHAPS THE AMERICAN SIDE COULD. SO COULD YOU TELL US PLEASE?

-

(AMBASSADOR HILLS)
A. YOU NOTICED THAT WHEN WE ANNOUNCED OUR PRIORITIES, WE ANNOUNCED GOALS THAT HAVE ALREADY BEEN IDENTIFIED IN GATT. OUR PRACTICES FOCUS ON IMPORT RESTRICTIONS AND IMPORT LICENCING, ON PROBLEMS DEALING WITH PROCUREMENT, ON STANDARDS AND DISCRIMINATION WITH RESPECT TO TECHNICAL STANDARDS, ON BARS AGAINST SERVICES, AND BANS AGAINST INVESTMENT. IF WE ARE SUCCESSFUL IN PERSUADING OUR TRADING PARTNERS TO LIBERALIZE IN THOSE AREAS, I SUGGEST TO YOU THAT THAT WILL GO A CONSIDERABLE

DISTANCE IN FURTHERING THE GOALS OF THE URUGUAY ROUND
AND HENCE AUGMENT THE GATT.
-
Q. BUT THE MECHANISM THAT YOU ARE PURSUING TO FOLLOW
WOULD CALL FOR RETALIATION WITHIN A GIVEN NUMBER OF
MONTHS OR A SPECIFIC TIME. IS THAT ALSO IN ACCORDANCE
WITH THE GATT PROCEDURES?
-
(AMBASSADOR HILLS)
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#8450

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<SUBJECT>
SUBJECT: FINAL U.S. PRESS CONFERENCE AT THE CONCLUSION

A. MR. ROWEN, YOU ASSUME THAT OUR NEGOTIATIONS WILL FAIL WHEREAS I DO NOT.

-

Q. NO, I AM NOT ASSUMING ANYTHING. I AM JUST RECALLING YOU WHAT THE ELEMENTS OF THE LAW ARE THAT YOU ARE ATTEMPTING TO FOLLOW THROUGH.

-

(AMBASSADOR HILLS)
A. FORGIVE ME, BUT THE LAW DOES NOT MANDATE RETALIATION. IT PROVIDES DISCRETIONARY RETALIATION BUT IT IS QUITE BROAD AND WE HAVE NEITHER STATED THAT WE WOULD RETALIATE NOR IS THAT OUR GOAL AS WE COMMENCE OUR QUEST FOR LIBERALIZATION.

-

Q. WELL, IS THEN THE SPIRIT THAT HAS BEEN REFERRED TO HERE TODAY, DOES THAT MEAN THAT YOU WILL ATTEMPT TO AVOID RETALIATION?

-

(AMBASSADOR HILLS)
A. IT MEANS THAT WE WILL ATTEMPT TO OPEN MARKETS AND EXPAND TRADE IN A MULTILATERAL SENSE AND HOW WE GO ABOUT IT, THE STRATEGY WE USE, PROBABLY IS NOT BEST GONE INTO DETAIL HERE.

-

Q. AMBASSADOR HILLS, IN YOU FIRST RESPONSE YOU SAID, AND I QUOTE, "AT THE MOMENT", THE UNITED STATES IMPLEMENTATION, INVOCATION OF SUPER 301 WAS CONSISTENT WITH THE SPIRIT OF THIS MEETING AND OF THE MULTILATERAL TRADING SYSTEM. BY USING THE PHRASE "AT THE MOMENT", ARE YOU IMPLYING THAT THERE MIGHT BE SOME OTHER MOMENT, PERHAPS 18 MONTHS FROM NOW, WHEN THE UNITED STATES MIGHT DO SOMETHING NOT IN THE SPIRIT OF THIS MEETING AND OF THE GATT?

-

(AMBASSADOR HILLS)
A. NO.

-

Q. AMBASSADOR HILLS, ON THAT SAME TOPIC, YOU SAY WE HAVE NEVER STATED WE WILL RETALIATE NOR IS THAT OUR

GOAL. ARE YOU WILLING TO STATE HERE THAT YOU WOULD NOT RETALIATE, THAT YOU WOULD NOT RETALIATE ON A UNILATERAL BASIS?

-

(AMBASSADOR HILLS)
A. NO.

-

Q. I'M NOT SURE WHO THIS WOULD BE TO, I THINK SECRETARY BRADY. ONE OF THE THINGS NOTED IN THE COMMUNIQUE IS THAT THE PROCESS OF REDUCING THE CURRENT ACCOUNT IMBALANCE HAS SLOWED OR STALLED AND THE COMMUNIQUE CALLS FOR A STRENGTHENING OF EFFORTS TO ADDRESS THOSE IMBALANCES. WHAT ARE THE FIRST SEVERAL THINGS THAT YOU WOULD DO TO STRENGTHEN THE EFFORTS TO REDUCE THE CURRENT ACCOUNT DEFICITS?

-

(SECRETARY BRADY)
A. WELL, TIM, THE G-7, PARTICULARLY AT MOMENTS LIKE THIS WHEN THE G-7 PROCESS AND POLICY COORDINATION BECOMES MORE DIFFICULT, THE AMOUNT OF TIME THAT MINISTERS SPEND TALKING ABOUT IT INCREASES. AND THE THINGS THAT HAVE BEEN PUT FORWARD HERE TODAY AND THE ONES THAT WE TALK ABOUT ALL THE TIME, SUCH AS REDUCING SURPLUSES IN SURPLUS COUNTRIES, PARTICULARLY JAPAN AND GERMANY, AND WORK IN THE UNITED STATES ON OUR OWN FEDERAL DEFICIT, CONTINUES. I WOULD SAY THAT WITH REGARD TO OUR OWN COUNTRY WHICH WE CAN SPEAK ABOUT FIRST-HAND, THE BUDGET RESOLUTION, JUST ARRIVED AT A MONTH OR SO AGO, WHILE NEITHER BOLD NOR HEROIC, IS A VERY IMPORTANT FIRST STEP. IT IS IMPORTANT BECAUSE IT INDICATES THAT THE DEMOCRATS AND THE REPUBLICANS, THE EXECUTIVE AND THE LEGISLATIVE BRANCH, CAN SETTLE DIFFERENCES. IT ISN'T THE ANSWER TO ALL THE PROBLEMS TO BE SURE, BUT IT IS VERY IMPORTANT IN THE UNITED STATES TO SHOW THAT WE CAN HAVE MOVEMENT ON ISSUES THAT HAVE BEEN THE SUBJECT OF DIFFERENCES. SO, IT IS THAT KIND OF THING THAT IS IMPORTANT AND WE'LL WORK ON IT. WE TALK ABOUT IT.

-

Q. MY QUESTION IS FOR AMBASSADOR HILLS. JAPAN AND QUITE A FEW OF THE OTHER COUNTRIES HERE JOINED TOGETHER IN THEIR CONDEMNATION OF THE U. S.'S USE OF SUPER 301. DO YOU EXPECT THAT JAPAN AND OR OTHER COUNTRIES WILL FILE FORMAL COMPLAINTS WITH THE GATT AND, IF SO, HOW WOULD THE U.S. RESPOND TO THAT?

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A. ALL WE HAVE DONE SO FAR IS TO POST A NOTICE OF WHAT
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STATE PASS ALSO TO CEA
STATE PASS ALSO TO USTR
WHITE HOUSE PASS TO NSC

<SUBJECT>
SUBJECT: FINAL U.S. PRESS CONFERENCE AT THE CONCLUSION
WE BELIEVE TO BE IMPORTANT TRADE PRIORITIES, ALL OF
WHICH HAVE BEEN IDENTIFIED BY OUR TRADING PARTNERS IN

* * * * * * * * * * * * * * * * * * * *
UNCLASSIFIED

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THE MULTILATERAL FORUM IN GENEVA. WE HAVE NOT DONE ANYTHING THAT WOULD BE SUBJECT TO AN ACTION AT GATT.

WE HAVE SIMPLY IDENTIFIED WHERE WE THINK THE SYSTEM NEEDS TO BE LIBERALIZED. WE'RE WORKING VERY HARD, WE BELIEVE, AS A RESPONSIBLE LEADER IN THE URUGUAY ROUND. IF WE WERE A SMALLER NATION, WE COULD SIT BY PERHAPS AND WATCH. BUT WE ARE THE STRONGEST NATION IN THE WORLD AND WE HAVE HISTORICALLY TAKEN A LEADERSHIP ROLE. I BELIEVE WE GET MUCH CREDIT FOR THE LOWERING OF TARIFFS IN THE LAST 40 YEARS AT GATT BECAUSE OF THE SIZE OF OUR MARKET AND THE ENERGY WITH WHICH WE ADDRESSED THAT SUBJECT. WE'RE TRYING AGAIN TO TAKE A LEADERSHIP ROLE, AND WHEN WE TALK WITH A TRADING PARTNER THAT CONSISTS OF THE SECOND LARGEST MARKET IN THE WORLD WITH RESPECT TO BARRIERS THAT ARE UP TO ALL OF OUR TRADING PARTNERS, IF WE ARE SUCCESSFUL IN OUR TALKS, WE WILL DO MUCH TO ADVANCE THE MULTILATERAL SYSTEM. I WILL REMIND YOU THAT WHEN WE HAVE USED 301 BEFORE WE HAVE SOME MEASURABLE AMOUNT OF SUCCESS. AND IT HAS NOT BEEN SUCCESS ONLY FOR THE UNITED STATES. TO THE CONTRARY, WE HAVE HAD SUCCESS IN A MOST-FAVORED-NATION MANNER. SO WHEN WE USED 301 TO OPEN THE BEEF MARKET IN JAPAN, IN FACT I BELIEVE THE AUSTRALIANS HAVE GAINED AS MUCH, IF NOT MORE THAN THE CATTLEMEN IN OUR MID-WEST. AND WHEN WE OPENED THE CITRUS MARKET IN JAPAN, I BELIEVE THE MEDITERRANEAN NATIONS ENJOYED THAT OPENING EVER AS MUCH AS THE FLORIDIANS OR THE CALIFORNIANS. SO WHAT WE ARE DOING TODAY IN IDENTIFYING OUR TRADE PRIORITIES IS WHAT WE HAVE DONE IN THE PAST, AND IT IS FOR THE BENEFIT OF THE MULTILATERAL TRADING SYSTEM.

-

Q. DO YOU INTERPRET OR UNDERSTAND PARAGRAPH 26 OF THE COMMUNIQUE -- SPECIFICALLY ITS REFERENCE TO NEW INTERPRETATIONS OF CERTAIN TRADE CONCEPTS, SUCH AS UNFAIR TRADE PRACTICES, ON PAGE 9? YOU PROBABLY KNOW IT BY HEART. DO YOU INTERPRET THAT AS IMPLIED CRITICISM OF RECENT U. S. TRADE ACTIONS? I DON'T THINK IT CAN ONLY DRAW A YES OR NO ANSWER. IT'S NOT INTENDED TO DRAW A YES OR NO.

-

(AMBASSADOR HILLS)
A. DO I CORRECTLY READ YOUR SENTENCE WHICH GOES, "NEW INTERPRETATIONS OF CERTAIN TRADE CONCEPTS SUCH AS

'RECIPROCITY' AND 'UNFAIR TRADE PRACTICES' AS WELL AS NEW APPROACHES IMPLYING A DEGREE OF BALANCED BILATERAL TRADE ARE BEING INCREASINGLY ADVOCATED IN SOME QUARTERS?"

-

QUESTIONER: YES.

-

(AMBASSADOR HILLS)
A. I DO NOT READ THAT SENTENCE TO BE CRITICAL OF THE TRADE STRATEGY OF THE UNITED STATES, WHICH IS TO OPEN MARKETS AND EXPAND TRADE. AND WE HAVE NEVER ADVOCATED RECIPROCITY AND INSTEAD HAVE ARGUED AGAINST IT IN OTHER SYSTEMS.

-

Q. IF I COULD FOLLOW UP. PERHAPS NOT IN CONFLICT WITH TRADE POLICY, BUT IN CONFLICT WITH RECENT TRADE ACTIONS. I TOOK SPECIFIC NOTE OF THE USE OF THE TERM UNFAIR TRADE PRACTICES.

-

A. WELL, THE PRESS HAS IDENTIFIED THE PRACTICES THAT WE HAVE NAMED AS UNFAIR BUT I HAVE NOT. I HAVE ALLUDED TO THE PRACTICES THAT WE HAVE IDENTIFIED AS BARRIERS TO TRADE THAT ARE PRIORITIES OF OUR TRADE LIBERALIZATION STRATEGY.

-

Q. IF WE TAKE THE FOLLOWING SENTENCE, MRS. HILLS, WHERE MINISTERS FIRMLY REJECT THE TENDENCY TOWARDS UNILATERALISM, BILATERALISM, ETC. WHICH THREATENS THE MULTILATERAL SYSTEM AND UNDERMINE THE URUGUAY ROUND NEGOTIATIONS. NOW YOU HAVE STATED THAT YOU ARE STRONGLY IN FAVOR OF BOTH THE MULTILATERAL SYSTEM AND THE URUGUAY ROUND NEGOTIATIONS. HOWEVER, THE IDENTIFICATION OF THESE BARRIERS LEADING TO A DEADLINE, WHICH YOU DO NOT DENY, WOULD LEAD TO UNILATERAL RETALIATION BY THE UNITED STATES WHICH YOU JUST POINTED OUT IN RESPONSE TO MR. MURRAY'S QUESTION. DO YOU INTERPRET THIS SECOND SENTENCE WHICH I'VE JUST ALLUDED TO AS HAVING ANY RELATIONSHIP WHATSOEVER TO THE RECENT ACTIONS OF THE UNITED STATES?

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P/PFO; P/PFW
STATE FOR E, EB, EUR
TREASURY FOR S, U, A, P, I, IT, IM, IMI
STATE PASS ALSO TO CEA
STATE PASS ALSO TO USTR
WHITE HOUSE PASS TO NSC

<SUBJECT>
SUBJECT: FINAL U.S. PRESS CONFERENCE AT THE CONCLUSION
(AMBASSADOR HILLS)

A. NOT IN MY MIND. THIS ALLUDES TO UNILATERALISM
WHICH THREATENS THE MULTILATERAL SYSTEM AND I CAN ONLY
ASSURE YOU THAT IS NOT OUR INTENT TO DO ANYTHING TO
THREATEN THE MULTILATERAL SYSTEM, A UNILATERALISM THAT
THREATENS THE URUGUAY ROUND NEGOTIATIONS. AND I THINK
THAT YOU WILL FIND NO COUNTRY THAT LEADS MOPE IN THE
URUGUAY ROUND THAN DOES THE UNITED STATES. SO THE

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ANSWER TO YOUR QUESTION, THE SHORT ANSWER, IS NO.
-
Q. CAN I ASK SECRETARY BRADY OR CHAIRMAN BOSKIN IF THEY HAVE ANY REACTION WHATSOEVER ON THE FACT THAT THE BUNDESBANK DID NOT TAKE ANY ACTION ON ITS INTEREST RATES THIS AFTERNOON?
-
(SECRETARY BRADY)
A. NO.
-
(CHAIRMAN BOSKIN)
A. NOR I.
-
LADIES AND GENTLEMEN, THIS CONCLUDES THE AMERICAN PRESS CONFERENCE.
KENNEDY
BT
#3450

<MSG> MSG000234367665

<ANNOTATION>
MULFORD, DALLARA, BOLTON,

TREASURY NEWS

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

LM 5370

For Release Upon Delivery
Expected at 10 a.m.
June 8, 1989

STATEMENT OF
JOHN G. WILKINS
ACTING ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the Department of the Treasury's views on H.R. 1761, a bill introduced by Chairman Rostenkowski to simplify the alternative minimum tax ("AMT") applicable to corporations. Treasury recognizes the significant complexities posed by certain aspects of the corporate AMT, particularly for taxable years beginning after 1989. We agree with Chairman Rostenkowski that simplification of the corporate AMT is appropriate and desirable. We are concerned, however, that certain depreciation transition features of the bill in its current form may result in a significant revenue loss.

I would like to stress at the outset that this testimony reflects our preliminary assessment of H.R. 1761. The issues raised by this legislation are important ones and, as such, need to be thoroughly reviewed before moving forward. We look forward to working with you to achieve appropriate simplification of the corporate AMT.

Section 702 of the Tax Reform Act of 1986 (the "1986 Act") directed the Secretary of the Treasury to conduct a study of "the operation and effect" of the book income and adjusted current earnings ("ACE") provisions of the corporate AMT. Our final report will be submitted shortly. Much of my testimony before you today reflects the analysis and conclusions to be provided in the report.

My statement today is divided into three parts. First, I briefly describe the history of the minimum tax up to the adoption of the current provisions as part of the 1986 Act and the basic policies on which the minimum tax is premised. I then discuss the provisions of current law, including the adjustments

for book income and adjusted current earnings. Finally, I analyze the changes that would be made by H.R. 1761 and their effects on federal revenues.

I. BACKGROUND AND POLICIES

The corporate minimum tax as originally enacted in the Tax Reform Act of 1969 was a 10-percent additional, or add-on, tax on the amount by which the aggregate of specifically identified tax preferences exceeded the sum of a $30,000 exemption and a deduction for regular taxes. The items treated as tax preferences included: (i) accelerated cost recovery in excess of straight-line depreciation; (ii) percentage depletion in excess of basis; (iii) a portion of net capital gains; and (iv) excess bad debt reserves of financial institutions. The Tax Reform Act of 1976 strengthened the corporate minimum tax by: (i) increasing the minimum tax rate from 10 percent to 15 percent; and (ii) replacing the $30,000 exemption and deduction for regular taxes with an exemption equal to the greater of $10,000 or regular taxes.

To address increasing concerns about the equity of the tax system with its numerous corporate tax preferences, Congress enacted in the Tax Equity and Fiscal Responsibility Act of 1982 a direct 15 percent cutback in certain corporate tax preferences. Although these cutbacks, found in Code section 291, operated independently of the minimum tax, adjustments were made to the minimum tax to prevent the combination of that tax and the cutback provisions from unduly reducing the benefits from a preference. In light of large budget deficits, the Deficit Reduction Act of 1984 increased the direct cutback of certain corporate tax preferences from 15 percent to 20 percent and again made corresponding adjustments to the corporate minimum tax.

The corporate minimum tax from its inception in the Tax Reform Act of 1969 has attempted to ensure that corporations pay some minimum amount of tax on their economic income. Congress has regarded such a measure as necessary because many corporations could otherwise avoid paying tax on substantial economic income by pyramiding exclusions, deductions, and credits.

The judgment that a minimum tax is necessary reflects an ambivalence about the desirability and effectiveness of the tax preferences subject to the tax. For example, percentage depletion and accelerated methods of depreciation have traditionally been allowed in part to subsidize the cost of productive depreciable assets and mineral production activities. Some were troubled, however, by the fact that corporations engaged in activities, such as real estate or natural resource production, that benefited from tax preferences were taxed at relatively lower rates on economic income than taxpayers receiving the bulk of their income from nonpreferred activities. The ability of high-income taxpayers to pay little or no tax

undermines respect for the entire tax system and, thus, for the incentive provisions themselves.

Much of the debate leading up to the 1986 Act focused on real and perceived inequities in the tax system. The proposals in the Treasury Department's 1984 tax reform recommendations to President Reagan sought to redesign the income tax base to closely approximate economic income and thereby eliminate the need for the corporate minimum tax. Former President Reagan's 1985 tax reform proposals, however, retained certain incentive provisions, but recognized that "the prospect of high-income corporations paying little or no tax threatens public confidence in the tax system." Consequently, the proposals he submitted to Congress also included a minimum tax designed to limit the number of high-income, low-tax returns.

Prior to the 1986 Act, it became apparent that the original corporate add-on minimum tax did not adequately achieve the primary objective of the minimum tax. The add-on tax was imposed on preferences used by corporations even when the taxpayer was taxed at a high effective rate under the regular tax. President Reagan's 1985 tax reform proposals suggested that an "alternative" minimum tax, imposed only to the extent a taxpayer's regular effective tax rate falls below a minimum acceptable level, is better designed to achieve the purpose of a minimum tax. Moreover, the proposals noted that "an alternative minimum tax limited to the tax preferences applicable to corporations under [pre-1986 Act] law would be insufficient to prevent many corporations from eliminating their regular tax on economic income." Congress shared the view that the minimum tax base had to be broadened to ensure that corporations with substantial economic income would pay some tax.

In order to address these perceived deficiencies in the corporate minimum tax, the 1986 Act repealed the add-on minimum tax and created a new AMT for corporations. The AMT was designed to ensure that, in each taxable year, the taxpayer generally must pay a significant tax on an amount more nearly approximating economic income.

In part, the debate over how to define the base subject to the corporate AMT was influenced by widely publicized reports of major companies having paid no taxes in years when they reported substantial earnings, and may even have paid substantial dividends to shareholders. The congressional reaction to these reports is described by the staff of the Joint Committee on Taxation as follows:

> With respect to corporations, Congress concluded that the goal of applying the minimum tax to all companies with substantial economic incomes cannot be accomplished solely by compiling a list of specific items to be treated as preferences. In order to achieve both real and apparent fairness, Congress concluded that there must be a reasonable

certainty that, whenever a company publicly reports significant earnings, that company will pay some tax for the year. General Explanation of the Tax Reform Act of 1986, 434 (1987).

For taxable years beginning in 1987, 1988, and 1989, the 1986 Act addressed this concern by including in the base subject to the corporate AMT an adjustment based upon financial statement or book income reported by the taxpayer pursuant to public reporting requirements or in disclosures made for nontax reasons to regulators, shareholders, or creditors (the "book income adjustment"). The temporary book income adjustment was designed specifically to improve the public perception of the fairness of the tax system immediately following the 1986 Act.

For taxable years beginning after 1989, the book income adjustment is replaced by an adjustment based on a broad, but statutorily defined, measure of economic income known as adjusted current earnings or "ACE." While this adjustment was a response to anticipated problems with the book income adjustment, it was contemplated that switching to this adjustment would not diminish the corporate AMT base.

II. GENERAL DESCRIPTION OF THE CORPORATE AMT UNDER CURRENT LAW

Generally, the tax base for the corporate AMT is the corporation's taxable income, increased by tax preferences for the year and adjusted in a manner designed to negate the deferral of income or acceleration of deductions resulting from the regular tax treatment of certain items. The resulting amount of alternative minimum taxable income ("AMTI"), reduced by an exemption amount, is subject to a 20-percent rate. The exemption amount is $40,000, reduced (but not below zero) by 25 percent of the amount by which AMTI exceeds $150,000. The amount of minimum tax liability so determined may then be offset partially by the minimum tax foreign tax credit, and to a limited extent by investment tax credit carryovers. A corporation is effectively required to pay the higher of the AMT or the regular tax for the taxable year.

Corporations are allowed a minimum tax credit to the extent the excess of the AMT over the regular tax is attributable to preferences or adjustments (such as accelerated depreciation) involving the timing of a deduction or income inclusion. This credit is allowed as a reduction of regular tax liability of the taxpayer in any subsequent taxable year, but may not be used to reduce regular tax below AMT for the subsequent year.

The computation of corporate AMTI is generally a two-step process. First, taxable income is adjusted to reflect specific statutory adjustments and preferences. Second, the resulting amount of AMTI ("unadjusted AMTI") is adjusted further to take

into account the book income adjustment for taxable years beginning in 1987, 1988, and 1989, or the ACE adjustment for taxable years beginning after 1989. Before discussing in detail the book income and ACE adjustments, I will briefly describe the more significant adjustments and preferences applicable in computing unadjusted AMTI.

Depreciation. Depreciation on property placed in service after 1986 generally is determined by using the applicable ADR midpoint life as the period over which the cost is recovered. Depreciation for most personal property is calculated using the 150 percent declining balance method while the straight-line method is required for most real property. This depreciation allowance is in lieu of the regular tax depreciation allowance which generally is determined using a more accelerated method over a shorter life. Thus, the net present value of the depreciation deductions allowed for purposes of the AMT generally is significantly lower than the net present value of the depreciation deductions allowed for regular tax purposes. With respect to certain property placed in service prior to 1987, AMTI after 1986 includes the amount by which the regular tax depreciation for the taxable year exceeds an amount determined using straight-line depreciation. This preference is limited to real property and leased personal property.

Depletion. AMTI is increased by the amount by which the regular tax deduction allowable for depletion exceeds the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year). For regular tax purposes, certain taxpayers are allowed to use percentage depletion. Under this method, the amount of depletion allowed over the life of the property may exceed the cost basis of such property.

Intangible drilling costs. The amount by which "excess intangible drilling costs" exceed 65 percent of the taxpayer's net income from oil, gas, and geothermal properties is includible in AMTI. The amount of excess intangible drilling costs is the amount by which the taxpayer's regular tax deduction for such costs exceeds the amount that would have been allowable if the taxpayer had amortized the costs ratably over 120 months. Generally, for regular tax purposes taxpayers are allowed to expense their intangible drilling costs. Integrated oil companies, however, must for regular tax purposes amortize 30 percent of their intangible drilling costs over 60 months.

Mining exploration and development costs. Mining exploration and development costs are required to be recovered through 120-month ratable amortization. For regular tax purposes, 70 percent of mining exploration and development costs may be expensed while the remaining 30 percent of such costs are amortized over 60 months.

Long-term contracts. The percentage of completion method must be used for all long-term contracts (other than certain home construction contracts) entered into by the taxpayer on or after March 1, 1986.

Installment sales. The installment method of accounting is not available in computing AMTI with respect to dispositions of property (other than timeshares and residential lots) held by the taxpayer for sale to customers in the ordinary course of business ("dealer dispositions"). The installment method is available for regular tax purposes with respect to dealer dispositions of timeshares and residential lots and property used or produced in the trade or business of farming. The installment method is generally available for both regular tax and AMT purposes with respect to nondealer dispositions. In most cases, however, interest must be paid on a portion of the tax deferred by the use of the installment method.

Tax-exempt interest. AMTI is increased by interest received on most private activity bonds issued on or after August 8, 1986. Private activity bonds are bonds issued by a state or local governmental unit if: (1) an amount exceeding 10 percent of the bond issuance proceeds is to be used in any trade or business carried on by any person other than a governmental unit; and (2) more than 10 percent of the payment of principal or interest on the bond issue is to be made with respect to such trade or business use, or is otherwise secured by payments or property used in a trade or business. For regular tax purposes, such interest is excluded from taxable income.

Charitable contributions. AMTI is also increased by the amount by which a regular tax deduction for a corporation's charitable contributions of appreciated capital gain property exceed the adjusted basis of such property. For regular tax purposes, the full fair market value of appreciated property contributed to a charity is generally allowed as a deduction. In addition, the appreciation in the property is not included in taxable income.

Before turning to a description of the book income and ACE adjustments, I would like to note that the AMT in many respects is separate from, but parallel to, the regular tax. Accordingly, the AMT treatment of an item in one year may have corollary consequences with respect to the AMT treatment of other items or the calculation of AMTI in subsequent years. This treatment is particularly evident with respect to adjustments that relate to the time at which items of income and deduction are taken into account.

For example, the AMT depreciation allowance is controlling for all AMT purposes with respect to which the amount of depreciation claimed is relevant. Thus, the adjusted basis of property may differ for regular tax and AMT purposes, giving rise

to differing amounts of gain between the two systems upon the disposition of such property. Similarly, the amount of depreciation that is capitalized as an inventory cost under the uniform capitalization rules of section 263A may differ for regular and AMT purposes.

In the case of a taxpayer that is required to include in AMTI any interest that is tax exempt for regular tax purposes, the regular tax provision denying deductions for interest paid and other expenses relating to tax-exempt income does not apply for purposes of the AMT. For regular tax purposes, however, the application of the provision denying certain interest expense deductions is unaffected by the fact that the related interest income may be includible in income for AMT purposes.

A notable exception to the separate but parallel nature of the AMT exists with respect to the preference for intangible drilling costs. Excess intangible drilling costs are computed for AMT purposes by reducing the intangible drilling costs deductible for regular tax purposes by the amount of such costs paid or incurred in the taxable year that would have been deductible had those costs been capitalized and amortized over a 10-year period. The unamortized portion of such capitalized intangible drilling costs, however, is essentially permanently disallowed for AMT purposes, since it is not taken into account in computing excess intangible drilling costs in subsequent taxable years.

Net operating loss deductions under the AMT are determined by using a separate computation of AMT net operating losses and loss carryovers. Generally, this computation takes into account the differences between the regular tax base and the AMT base. The amount of the AMT net operating loss for any taxable year generally is equal to the amount by which the deductions allowed in computing AMTI for the taxable year (other than the deduction for carryovers to the taxable year of AMT net operating losses) exceed the gross income includible in AMTI for the taxable year. In light of the parallel nature of the regular tax and AMT systems, any limitations applying for regular tax purposes to the use by a consolidated group of net operating losses or current-year losses apply for AMT purposes as well.

<u>Operation and Effect of the Book Income Adjustment</u>

The computation of corporate AMTI for taxable years beginning in 1987, 1988, and 1989 includes an adjustment for the net book income of corporations. The book income adjustment is computed by increasing AMTI by 50 percent of the amount by which the net book income of a corporation exceeds unadjusted AMTI (i.e., AMTI determined without regard to the book income adjustment and the AMT net operating loss deduction) for the taxable year. If net book income falls below unadjusted AMTI, however, AMTI is not reduced by a negative book income adjustment.

Generally, net book income for purposes of the book income adjustment is the net income shown on the taxpayer's applicable financial statement. Net book income takes into account all items of revenue, expense, gain and loss for the taxable year, and includes any extraordinary items, income or loss from discontinued operations, and cumulative adjustments resulting from accounting method changes. In general, a taxpayer's applicable financial statement is its financial statement that has the highest priority according to the following order: (1) a financial statement required to be filed with the Securities and Exchange Commission; (2) a certified audited financial statement used for substantial nontax purposes; (3) a financial statement required to be provided to federal or state regulators; or (4) an unaudited financial statement used for substantial nontax purposes. A corporation that does not have a financial statement in categories (1), (2), or (3) may elect to treat its earnings and profits as its net book income.

For purposes of the minimum tax credit, the book income adjustment is treated entirely as a timing adjustment. As a result, a minimum tax credit is allowed to the extent that the amount by which the AMT exceeds the regular tax is attributable to the book income adjustment.

Comments on Book Income Adjustment

The book income adjustment may be having a detrimental effect on the quality of financial reporting. The linkage between financial statement income and tax liability creates an incentive for corporations potentially subject to the AMT to apply generally accepted accounting principles ("GAAP") in a way that reduces the amount of net book income subject to the book income adjustment. Accordingly, general-purpose financial statements may provide distorted financial data to investors, creditors, and other nontax uses. While we have no hard data from which to conclude that such distortions are being made in any significant way, it is clearly undesirable for the tax system to contain such perverse incentives.

The book income adjustment is also defective in that it overtaxes corporations in certain situations. This result is particularly evident in the case of items for which a deduction is required sooner for financial statement purposes than for regular tax purposes. The same is true of income items that are included in taxable income before they are included in financial statement income. These "reverse" timing differences are generally attributable to the conservative nature of financial accounting.

For example, a corporation may be required to reduce financial earnings for a contingent liability in a taxable year prior to the time such liability is deductible for tax purposes. In the earlier year, the financial statement expense will reduce

net book income as compared to unadjusted AMTI. The corporation generally derives no tax benefit for this reduction in book income either currently or in later years. A current benefit is derived only if (notwithstanding the reduction) the corporation's net book income exceeds its unadjusted AMTI and the corporation's AMT for the year exceeds its regular tax. In such cases, the book income adjustment is partially determinative of the taxpayer's tax liability for the year, and the fact that the amount of this adjustment is reduced by the amount of the contingent liability results in a current tax benefit.

When the amount subsequently becomes deductible for tax purposes, AMTI will tend to be lower than book income causing a book income adjustment to be required. Neither the book income adjustment nor the amount by which AMT for the year exceeds regular tax is reduced to take into account the fact that the net book income subject to tax was previously taxed directly as taxable income or AMTI.

The inequities caused by these reverse timing differences are largely due to the fact that, as noted above, the book income preference is only a positive adjustment, and never a negative one. The "one-way street" nature of the book income preference has been widely criticized, and justifiably so. Neither of the policy goals underlying the AMT--ensuring that corporations pay a minimum amount of tax on their economic income or eliminating the so-called "perception problem"--provides support for this harsh rule.

Another problem associated with the book income adjustment is that the determination of a corporation's applicable financial statement in some cases is unclear or controversial. For example, the extent to which supplemental disclosures or footnote disclosures are treated as part of the applicable financial statement has been an issue with respect to the temporary and proposed book income regulations. In addition, corporations required to file financial data with governmental agencies may disagree with an IRS agent as to whether such financial data constitute a financial statement.

For all of the foregoing reasons, we would generally be opposed to making the book income adjustment permanent.

Operation and Effect of the ACE Adjustment

For taxable years beginning after 1989, the book income adjustment is replaced by an adjustment based on the corporation's adjusted current earnings. The ACE adjustment is equal to 75 percent of the amount by which the adjusted current earnings of a corporation exceed unadjusted AMTI (i.e., AMTI determined without regard to the ACE adjustment and the AMT net operating loss deduction) for the taxable year. If unadjusted AMTI exceeds the amount of ACE, then AMTI is reduced by 75 percent of such difference. This reduction, however, is limited

to the aggregate amount by which AMTI has been increased by the ACE adjustment in prior years.

Generally, ACE is the corporation's unadjusted AMTI increased by: (i) items includible in computing earnings and profits but excluded from unadjusted AMTI; and (ii) items deductible in determining unadjusted AMTI but not deductible in determining earnings and profits. In addition, certain adjustments to the computation of unadjusted AMTI are required in computing ACE.

As described above, ACE is determined with respect to certain items by treating them in the same manner as they are treated for purposes of computing corporate earnings and profits. The reliance on corporate earnings and profits in computing ACE is limited, however, to items of income permanently excluded from unadjusted AMTI and items permanently nondeductible in computing earnings and profits as contrasted with mere "timing" differences. For example, ACE includes interest earned on obligations issued by state and local governments to the extent such interest is excluded from unadjusted AMTI. In addition, the dividends received deduction, allowed in computing unadjusted AMTI, is generally disallowed for purposes of computing ACE.

Generally, ACE is not reduced by deductions allowed in computing corporate earnings and profits if such amounts are not deductible in computing unadjusted AMTI. An exception is provided for items of expense related to items of income required to be included in ACE. Thus, for example, ACE is reduced by costs incurred to carry tax-exempt bonds if such costs would have been deductible in computing unadjusted AMTI had the interest income on such bonds been includible in gross income.

ACE also includes various rules governing the treatment of a number of specific items. These include the following:

Depreciation. For purposes of computing ACE, the depreciation allowance for property placed in service after 1989 is determined using whichever of the following methods yields deductions with a smaller present value: (i) straight-line recovery over the asset depreciation range ("ADR") midpoint life (40 years for real property); or (ii) the method and life used for financial statement purposes. Thus, for example, if the useful life of an asset assumed for financial statement purposes is longer than the ADR midpoint life for such asset, ACE depreciation will likely be determined using such longer life.

The ACE depreciation allowance for property placed in service before 1990 is determined under similar rules: The unrecovered AMT basis of such property (as of the end of the last taxable year beginning before 1990) is either ratably recovered over the remainder of such property's ADR midpoint life or recovered pursuant to the method and life used for financial statement purposes. The applicable treatment is the one that

yields deductions for taxable years beginning after 1989 with a smaller present value.

Depletion. The ACE depletion allowance is determined using either cost depletion or the method used for financial statement purposes, whichever yields depletion deductions with a smaller present value.

Intangible drilling costs. For purposes of computing ACE, intangible drilling costs are required to be capitalized and: (i) amortized ratably over 60 months; or (ii) recovered pursuant to the method used for financial statement purposes if such method yields deductions with a smaller present value.

Construction period carrying charges. In computing ACE, construction period carrying charges, such as interest and taxes, must be capitalized and recovered as part of the asset to which they relate. Such treatment is also generally required for purposes of computing taxable income and unadjusted AMTI. However, the regular tax and unadjusted AMTI exceptions (e.g., with respect to interest allocable to personal property with a production period: (i) not exceeding 1 year; or (ii) exceeding 1 year but not exceeding 2 years if the cost of such property does not exceed $1,000,000) do not apply for purposes of computing ACE.

LIFO inventories. For corporations using the last-in, first-out ("LIFO") inventory method, ACE is increased or decreased by the amount of any increase or decrease in the LIFO recapture amount as of the end of the taxable year. The "LIFO recapture amount" is the amount by which a corporation's inventory determined using the first-in, first-out ("FIFO") inventory method exceeds its inventory using the LIFO method. Thus, an increase in the LIFO recapture amount represents an amount of current-year inventory costs deducted in computing unadjusted AMTI that would have been included in ending inventory had the FIFO method been used.

Long-term contracts. With respect to a corporation using the completed contract method of accounting for long-term contracts entered into on or after March 1, 1986, ACE is determined by using the percentage of completion method. This adjustment has no real effect because the percentage of completion method is required for purposes of computing unadjusted AMTI with respect to all long-term contracts entered into on or after March 1, 1986, for which the completed contract method is likely to be used for regular tax purposes.

Installment sales. The installment method is not allowed in computing ACE for installment sales in taxable years beginning after 1989. This adjustment affects the dispositions of property for which the installment method was allowed for purposes of computing unadjusted AMTI, i.e., dealer dispositions of timeshares and residential lots and nondealer dispositions.

Installment treatment is effectively disallowed with respect to nondealer dispositions, notwithstanding the fact that interest is imposed on the entire deferred regular tax liability. This may be inappropriate in light of the fact that a portion of such tax liability may be "prepaid" by the operation of the ACE adjustment to AMTI.

Ownership changes. For purposes of computing ACE, the basis of assets of a corporation that has experienced a change of ownership after October 22, 1986, may not exceed the allocable portion of the value of the stock of the corporation. The allocation is based on the respective fair market values of the assets. The effect of this provision is to eliminate a net built-in loss as of the date of the ownership change.

For purposes of the minimum tax credit, items included in AMTI by reason of the ACE adjustment that otherwise would be permanently excluded from AMTI (such as tax-exempt interest) are not treated as timing adjustments for which a minimum tax credit is allowed. In this regard, ACE is less generous than the book income adjustment, all of which is deemed to result from timing differences for purposes of the AMT credit. A minimum tax credit is available, however, to the extent the ACE adjustment is attributable to items for which the timing of a deduction or inclusion gives rise to its special treatment for ACE purposes. Examples of such items are depreciation and intangible drilling costs.

Comments on ACE Adjustment

The AMT was enacted, in part, to ensure that taxpayers with significant book income would pay a tax. Whether AMTI based on ACE rather than book income would achieve a similar result is an empirical question that we have tested. Preliminary results of this analysis have not detected any significant groups of taxpayers that would escape paying taxes under ACE or H.R. 1761. However, isolated examples appear to exist.

In many respects, ACE requires computations that are completely separate from the computations required in computing unadjusted AMTI. Accordingly, the ACE treatment of an item in one year may have corollary consequences on other items in that same year of on that same item in subsequent years. This system is separate from the computation of AMTI in a way similar to the way that AMTI is separate from regular taxable income.

For example, the ACE depreciation allowance is controlling for all ACE purposes with respect to which the amount of depreciation claimed is relevant. Thus, the adjusted basis of any corporate asset may differ for ACE and unadjusted AMTI purposes, giving rise to differing amounts of gain between the two systems upon the disposition of such property. Moreover, the separate depreciation allowances applicable for purposes of computing regular taxable income, unadjusted AMTI, and ACE result

in three separate sets of corollary computations with respect to each corporate depreciable asset.

We believe that multiple sets of AMT cost recovery records are not a prerequisite to achieving the objective of the corporate minimum tax, namely to ensure that all corporations pay a minimum effective rate of tax on their economic income. The inordinate complexity imposed by the ACE adjustment is likely to have the effect of significantly reducing general compliance with the corporate AMT. As a practical matter, therefore, the present law corporate AMT effective for taxable years beginning after 1989 may fail to adequately serve the underlying purpose of such a tax, as well as undermine respect for the overall corporate tax system.

We also believe that the provisions in ACE that rely on financial statement cost recovery methods create unwarranted complexity. Such provisions require two net present value computations with respect to each corporate asset in order to determine the operative cost recovery allowances for ACE purposes. These provisions also require a determination of the applicable financial statement from which to derive the financial statement cost recovery methods. In addition, as with the book income adjustment described above, the linkage between financial statement cost recovery and tax liability may have an adverse effect on the quality of financial reporting.

The uncertainty regarding the definition of corporate earnings and profits adds to the complexity of the ACE adjustment. As stated above, ACE, in part, is determined by reference to corporate earnings and profits, a term that is not clearly defined in the Internal Revenue Code or Treasury regulations. Thus, the required inclusion, or disallowed deduction, of significant items for purposes of computing ACE often turns on general earnings and profits principles derived from case law.

<u>Effects of Transition to the ACE Adjustment</u>

As a result of the ACE adjustment, capital costs will be recovered for purposes of the corporate AMT more slowly after 1989. More specifically, this result is due to: (i) the ACE provisions for depreciation, depletion, and intangible drilling costs described above; and (ii) the inclusion in AMTI of 75 percent of the excess of ACE over unadjusted AMTI rather than 50 percent as in the case of the book income adjustment.

The effect of introducing slower cost recovery allowances is that corporations with constant annual additions to capital costs or constant growth in such additions will suffer a substantial reduction in the total annual cost recovery allowances in the years immediately following such a change. In later years, however, the total annual cost recovery allowances will not differ significantly from the total annual allowances available

prior to the change. This transitional effect, known as the "transition spike," can be illustrated by the following example:

> Example. Assume a corporation that began operations in 1985 makes annual additions to its depreciable property of $100. For purposes of illustration only, assume that, prior to 1990, the cost of such property is recovered for AMT purposes ratably over 3 years. Further, assume that the cost of property placed in service after 1989 must be recovered ratably over 5 years. For taxable years beginning after 1989, the ACE adjustment to AMTI would require that the unrecovered AMT basis of property placed in service before 1990 also be recovered ratably over the remainder of a 5-year recovery period.
>
> The corporation's total annual cost recovery allowance for 1987, 1988, and 1989 is $100. In 1990, however, the total annual cost recovery drops to $48 because deductions are allowed for: (i) one-ninth (instead of one-third) of the cost of property placed in service in 1988; (ii) one-sixth (instead of one-third) of the cost of property placed in service in 1989; and (iii) one-fifth of the cost of property placed in service in 1990. After 1990, the total annual cost recovery allowance increases as the old schedule phases out and the new phases in. By 1994, the corporation's total annual cost recovery allowance again reaches $100. See the top half of Table 1.

III. H.R. 1761

In general, H.R. 1761 would incorporate the components of ACE directly into the computation of AMTI and repeal the ACE adjustment with the objective of making AMTI itself approximate economic income and thereby eliminate the need for the book income adjustment or the ACE adjustment. This general objective is pursued by two mechanisms.

First, with respect to cost recovery items that are computed in one manner to arrive at unadjusted AMTI and in a different manner to arrive at ACE, the bill provides a single computation of AMTI. Under H.R. 1761, the depreciation allowance for property placed in service after 1989 would generally be determined using straight-line recovery over the ADR midpoint (40 years for real property); the depletion allowance would be determined using cost depletion; and the intangible drilling cost allowance would be determined using ratable amortization over 60 months. H.R. 1761 would eliminate the present value comparisons currently required in determining the ACE cost recovery allowances as well as the need to refer to financial statement cost recovery methods. With respect to property placed in service prior to 1990, H.R. 1761 uses the same corporate depreciation allowances that are used in computing current unadjusted AMTI. Thus, the extension of the recovery period required in computing ACE with respect to such property would be

eliminated under the bill, and the "transition spike" effect discussed above would be avoided.

Second, the items includible in ACE under present law that are not includible in unadjusted AMTI generally would be incorporated directly into the computation of AMTI under H.R. 1761. As a result, 100 percent of items such as interest on state and local governmental obligations are made includible in corporate AMTI (in contrast to the 75 percent of such items which would be included under the ACE adjustment).

The bill would also make specific changes to the treatment of several items. For example, in computing corporate AMTI, circulation expenses would be amortized over 3 years. With respect to nondealer installment sales, corporate AMTI would not include deferred installment gain to the extent that the taxpayer is required to pay interest on the tax deferred by reason of the installment method. The bill would further repeal as unnecessary the special ACE treatment of long-term contracts and corporate-owned annuities.

Comments on H.R. 1761

Chairman Rostenkowski's bill would significantly simplify the corporate AMT. By repealing the ACE adjustment, the bill would eliminate the need to maintain two sets of cost recovery records for purposes of the AMT. Moreover, corporations can eliminate the need to maintain separate AMT and regular tax cost recovery records by electing to use the AMT basis recovery rules for regular tax purposes. H.R. 1761 would also eliminate the complexity associated with the ACE present value comparisons to financial statement cost recovery methods. This change would eliminate potential conflicts associated with the definition of applicable financial statement and would remove the possible adverse impact on the quality of financial reporting.

Under H.R. 1761 the cost recovery methods for taxable years beginning after 1989 would be slower than the methods under present law for taxable years beginning before 1990. As a result, the usual transition effect of switching to slower cost recovery methods would apply under the bill. This transition effect would, however, be much milder than the transition effects of switching to ACE, as current law provides. The milder transition effect is attributable to the fact that, unlike ACE, H.R. 1761 does not require that the unrecovered cost of depreciable property placed in service before 1990 be recovered over a redetermined and extended recovery period. This treatment, as compared with ACE, results in higher total annual cost recovery allowances for the taxable years immediately following 1989 and consequently lower AMT on affected taxpayers. This contrast is illustrated by comparing the bottom half of Table 1, which represents the transition effects of H.R. 1761, with the top half of Table 1, which represents the transition effects of the ACE adjustment.

For the first several taxable years beginning after 1989, capital intensive corporations adversely affected by the transition effects of the ACE adjustment would pay significantly lower amounts of AMT under H.R. 1761. Some of these corporations, however, may pay higher amounts of AMT under the bill in later years due to the inclusion of certain items at a 100 percent rate rather than the 75 percent rate applicable under ACE. In contrast, corporations with large investments in assets for which the financial statement cost recovery method is significantly slower than straight-line over ADR midpoint life would pay less AMT under H.R. 1761 even in later years. This would occur in those cases where the AMT cost recovery method under H.R. 1761 yields deductions with a higher present value than the effective AMT cost recovery method under present law after taking into account the ACE adjustment.

Corporations that are not capital intensive would tend to pay higher amounts of AMT under H.R. 1761. Such corporations would be adversely affected by the increased inclusion rate from 75 percent to 100 percent without receiving an offsetting benefit associated with H.R. 1761's treatment of cost recovery.

Compared to current law, H.R. 1761 does not change significantly the cost of capital for new investments. Some have noted that because the AMT increases tax from levels that would otherwise apply, the AMT may raise the cost of capital. An increase in the cost of capital--the pre-tax rate of return on new investment required to obtain a given post-tax rate of return--suggests that investment will be lower, other things remaining equal. This is an expected result of the AMT.

Analysis of the switch from a pre-1990 AMT based, in part, on book income to a post-1989 AMT based, in part, on ACE shows no material difference in the cost of capital for corporations paying the AMT. Assuming an equal mix of debt and equity financing, the cost of capital for a corporation permanently on the AMT will be only slightly higher than for a corporation that instead remains permanently on the regular tax; however, these estimates do not materially change with the switch from the book income adjustment to ACE. Nor do these cost of capital estimates change significantly if H.R. 1761 is substituted for current law.

As stated at the outset, the Treasury believes that the corporate AMT should be revised before 1990. We generally agree with the manner in which Chairman Rostenkowski's bill reduces the extreme complexity associated with the ACE adjustment of present law. My remaining comments on the bill will focus first on certain aspects of the bill which we believe should be modified, and second on the revenue effects of the bill.

Oil and Gas Incentives. The corporate AMT under present law and under H.R. 1761 significantly reduces the regular tax incentives (such as percentage depletion and the deduction for

intangible drilling costs) available to independent producers of oil and gas. As reflected in the President's FY 1990 budget proposals, it is essential for both energy security and national security reasons to encourage exploration for new oil and gas fields. Accordingly, we believe H.R. 1761 should be amended to permit independent producers to expense 80 percent of "exploratory" intangible drilling costs for purposes of the corporate AMT.

Dividends Received Deduction. We are opposed to the disallowance of the dividends received deduction ("DRD") for purposes of computing corporate AMTI. Although our tax system fails to provide relief from the double taxation of income earned through corporations, the system has since its inception provided relief from multiple taxation of the same income within the corporate sector. Any further erosion of the DRD may have a number of significant consequences. First, by encouraging corporations to rely on debt to the detriment of equity, the existing bias in the tax system toward debt financing is exacerbated. Second, by moving our system still further away from an integrated corporate tax system, such effective repeal of the dividends received deduction makes the price of achieving integration in the future higher and increases the cost of capital to the extent corporations rely on equity financing. Finally, it bears reemphasizing that dividends have already borne at least one level of corporate tax. Imposition of the AMT represents a heavier burden on these amounts than is borne by any other classes of income.

H.R. 1761 continues a trend to whittle away at the DRD through the mechanism of the minimum tax. For regular tax purposes, dividends received on portfolio stock investments are taxed to corporations at an effective 10.2 percent rate. As a result of the book income adjustment, corporations subject to the corporate AMT in 1988 and 1989 are subject to an effective rate of 13 percent on portfolio stock dividends. As a result of the ACE adjustment applicable to taxable years beginning after 1989, corporations subject to the AMT would pay an effective rate of 16.5 percent on portfolio stock dividends. Finally, under H.R. 1761, dividends on portfolio stock investments would be fully included in AMTI and effectively subjected to a 20 percent tax rate. We think that H.R. 1761 foregoes an opportunity to improve the treatment of intercorporate dividends and instead moves further in the wrong direction.

Discharge of Indebtedness of Insolvent Corporations. In some cases, discharge of indebtedness income of bankrupt or insolvent corporations is includible in ACE and, under H.R. 1761, would be includible in corporate AMTI. This occurs if the corporation does not qualify for the exception applicable for debt-for-stock exchanges or where discharge of indebtedness income is not applied to reduce the adjusted basis of depreciable property. The inclusion of such income in corporate AMTI is inconsistent with the Federal bankruptcy policy of not burdening

a debtor coming out of bankruptcy, or an insolvent debtor outside of bankruptcy, with an immediate tax liability. For taxable years beginning in 1987, 1988, and 1989, the book income adjustment generally results in inclusion of 50 percent of discharge of indebtedness income in corporate AMTI. In many cases, however, corporations may exclude such amounts from net book income, and therefore from AMTI, by accounting for the discharge transaction as a quasi-reorganization as authorized by Accounting Research Bulletin Number 43, chapter 7. Thus, the ACE adjustment and H.R. 1761 significantly increase the likelihood that insolvent or bankrupt corporations will be subject to the AMT. Accordingly, we would urge the Committee to amend H.R. 1761 so that forgiveness of indebtedness income for insolvent or bankrupt corporations will not be included in AMTI.

Regular Tax De Minimis Rules. The treatment of certain items in computing ACE (under present law) and in computing AMTI under H.R. 1761 runs counter to *de minimis* rules in the regular tax provisions that are designed to reduce the complexity of the tax system. For example, interest capitalization requirements under the regular tax do not apply to the construction of certain personal property with a relatively short production period. This exception was intended to apply where the application of the interest capitalization requirement might be unduly burdensome. The AMT treatment of construction-period carrying costs, including interest, however, provides no exception for personal property with a short construction period. As a result, the corporate AMT imposes the exact compliance burden that the regular tax exception was specifically designed to avoid and effectively eliminates any simplicity gains of the regular tax rule. Similarly, one effect of the basis adjustment applicable to ownership changes where the value of the target corporation's assets is less than the price paid for the stock is to limit the availability of built-in losses that are specifically not subject to limitation under the regular tax. The purpose for the regular tax *de minimis* rule, namely simplicity, is defeated by the corporate AMT treatment. Accordingly, we recommend that consideration be given to incorporating various *de minimis* rules in the AMT to address problems of this sort.

Revenue Effects of H.R. 1761

The Department of the Treasury estimates that the transition relief provided in H.R. 1761 with respect to depreciable property placed in service before 1990 is the primary reason for the $2.8 billion revenue loss, which the Department of the Treasury estimates as the cost of this bill for FY 1990-1994 (see Table 2). Thus, if the bill is to be kept revenue neutral, some modification is necessary. I would like to point out, however, that, based on original revenue estimates of the corporate AMT for FY 1990-1994, the revenue expected to be generated by the transition effect of the ACE adjustment was significantly less than the current revenue estimates. Table 2 also shows that the current Treasury estimate for the AMT provision of present law is

$3.5 billion higher for FY 1990-1994 than was previously estimated for receipts purposes in the President's budget. Indeed, much of the revenue cost of H.R. 1761 is simply a loss of revenue that was not anticipated in prior estimates, particularly for this 1990-1991 ACE transition period.

Underlying the AMT changes in current-law receipts is the availability of new data. It is only within the past few months that the first post-Tax Reform tax returns have become available. We have made a special effort to obtain information from these 1987 returns on an expedited basis. We also surveyed major corporations concerning the expected 1988 use of 1987 AMT credits and their expectations of being on this AMT in 1988 and 1989. While the new data have not affected our fundamental understanding of the way in which the AMT works, it has allowed us to better quantify the various effects of this and related provisions of Tax Reform.

The principal reason for the revenue increase is a revised estimate of the relationship between the value of the adjustments for book income and adjusted current earnings (ACE) for AMT taxpayers in the aggregate. Post-1989 AMTI generally replaces 50 percent of book income in excess of unadjusted AMTI with 75 percent of ACE in excess of unadjusted AMTI. The underlying assumption was that these values would be roughly equal because it was thought that the book income adjustment would, on average, be 150 percent of the ACE adjustment. Our current analysis, based on a special sample of 1987 income tax returns obtained in April, suggests that, instead of the book adjustment being 150 percent of the ACE, the two adjustments are more nearly equal for AMT taxpayers during the 1990-1991 ACE transition period.

Depreciation is the major factor associated with this change in the relationship between book and ACE adjustments for affected taxpayers. The earlier assumption that depreciation lives for book income purposes would be approximately equal in the aggregate to depreciation lives prescribed by the ADR system has been refined. It appears that depreciation lives used for book income purposes typically are slightly longer than ADR lives, in the aggregate, for AMT taxpayers. Since ACE requires taxpayers to depreciate their assets under the slower of the straight-line depreciation on ADR lives or book depreciation, it is now expected that more corporate taxpayers will be required to use longer lives for purposes of computing ACE, resulting in a higher value for the ACE depreciation preference and consequently for AMTI. In particular, property acquired prior to 1990 must, under ACE, be depreciated over the longer of remaining book lives or remaining ADR lives. The remaining life restatement for pre-1990 property magnifies the effects of ACE accounting for much of the 1990-1991 transition effect and for much of the change in our estimate of AMT in current receipts. Because of these changes in the assumed relationship of the ACE and book income adjustments, we now estimate that the ACE-based AMT will generate more revenue than the book income-based AMT during the 1990-1991 transition years.

In the long run, H.R. 1761 will generate more revenue than either the ACE or book income formulations. H.R. 1761 will raise more revenues than ACE because H.R. 1761 generally includes all items that ACE includes but at 100 percent rather than 75 percent with the exception of pre-1990 property. The depreciation adjustment required under ACE for pre-1990 property is not required under H.R. 1761. As pre-1990 property is retired, the ACE adjustment and revenues associated with that property also disappear. For similar reasons, H.R. 1761 should produce more revenues in the long run than the current book income adjustment.

These estimates are particularly sensitive to certain elements of the macroeconomic forecast, especially growth in corporate profits, and investment by the corporate sector of the economy. Consequently, our estimates of the revenue consequences of current law AMT as well as H.R. 1761 will be affected by the Administration's macroeconomic forecast for the forthcoming mid-session budget review. Congressional estimates will also be affected by changes in macroeconomic assumptions.

The Treasury strongly endorses the significant simplification effort reflected in H.R. 1761. Nonetheless, budgetary constraints limit the freedom of action and may require modification to achieve revenue neutrality. Two possible alternatives that we have identified are:

1. A bill that eliminates the transition relief provided in H.R. 1761 but retains its simplification measures. This could be accomplished, for example, by adjusting the depreciation allowance for purposes of computing corporate AMTI for taxable years after 1989 with respect to property placed in service prior to 1990. The unrecovered tax basis of such property as of the close of the last taxable year beginning before 1990 could be amortized ratably over the remainder of the ADR midpoint life of such property.

2. A bill that retains some of the transition relief of H.R. 1761 but does not allow corporate AMT revenues for the transition period to fall. This could be accomplished by including in AMTI (as computed under H.R. 1761) some percentage of the amount by which financial statement income exceeds AMTI. Although we generally oppose the book income adjustment for the reasons stated above, a phaseout of the provision over a relatively short period of time could cushion the impact of the depreciation transition relief on revenues, while assuring that desirable simplification is ultimately achieved.

V. CONCLUSION

We commend the Chairman of the Committee for the significant simplification effort which H.R. 1761 represents. As the bill moves through the legislative process, we stand ready to work with you to achieve a measure that is acceptable to all concerned.

Mr. Chairman, that concludes my formal statement. I will be happy to answer questions you and Members of the Subcommittee may wish to ask.

TABLE 1
TRANSITION SPIKE EXAMPLE

ACE-type Spike Occuring when Asset Lives are Lengthened for Existing and New Property

		Deduction Allowed											
Year	**Investment**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
1985	100	33	33	33									
1986	100		33	33	33								
1987	100			33	33	33							
1988	100				33	33	11	11	11				
1989	100					33	17	17	17	17			
1990	100						20	20	20	20	20		
1991	100							20	20	20	20	20	
1992	100								20	20	20	20	20
1993	100									20	20	20	20
1994	100										20	20	20
1995	100											20	20
1996	100												20
Total annual cost recovery....		33	67	100	100	100	48	68	88	97	100	100	100
Income spike (change in taxable income).....				0	0	0	53	33	13	4	0	0	0

H.R. 1761-type Spike Occuring When Asset Lives are Lengthened for New Property Only

		Deduction Allowed											
Year	**Investment**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
1985	100	33	33	33									
1986	100		33	33	33								
1987	100			33	33	33							
1988	100				33	33	33						
1989	100					33	33	33					
1990	100						20	20	20	20	20		
1991	100							20	20	20	20	20	
1992	100								20	20	20	20	20
1993	100									20	20	20	20
1994	100										20	20	20
1995	100											20	20
1996	100												20
Total annual cost recovery		33	67	100	100	100	87	73	60	80	100	100	100
Income spike (change in taxable income).....				0	0	0	13	27	40	20	0	0	0

U.S. Department of the Treasury
Office of Tax Analysis

June 8, 1989

Details may not add due to rounding.

This simplified example is for expository purposes only. It is not intended to reflect any particular class of property under current law. Under current law, most property would receive accelerated depreciation over longer lives.

TABLE 2

CORPORATE ALTERNATIVE MINIMUM TAX RECEIPTS, FY 1990 - 1994

($ billions)

	Fiscal Year					
	1990	1991	1992	1993	1994	Total
FY 1990 Budget AMT receipts estimate.......	2.2	1.8	1.2	0.8	0.7	6.7
Change in AMT receipts estimate.............	1.2	0.3	0.1	0.8	1.0	3.5
Current AMT receipts estimate................	3.5	2.2	1.3	1.5	1.7	10.2
Estimated change in receipts as a result of H.R. 1761.......................	-1.7	-1.1	0.1	*	-0.1	-2.8

U.S. Department of the Treasury
Office of Tax Analysis

June 8, 1989

Details may not add due to rounding.

All estimates include both direct and indirect receipt effects of the alternative minimum tax.

* *Represents a revenue gain/loss of less than $50 million.*

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June 7, 1989

ROBERT R. GLAUBER
APPOINTED UNDER SECRETARY FOR FINANCE
DEPARTMENT OF THE TREASURY

Robert R. Glauber was appointed by President Bush on May 22, 1989 to be Under Secretary of the Treasury for Finance. He was confirmed by the United States Senate on May 17, 1989. Mr. Glauber was sworn in by the Honorable Harrison L. Winter, Circuit Judge, United States Court of Appeals for the Fourth Circuit.

Prior to joining the Treasury Department, Mr. Glauber was Chairman of the Advanced Management Program and a member of the Finance Department at the Harvard Business School. Mr. Glauber joined the Harvard faculty in 1964 and became a full professor in 1973. He has also served as a visiting professor at Stanford University's Graduate School of Business and Keio University (Tokyo). Mr. Glauber also served as Executive Director of President Reagan's Task Force on Market Mechanisms (1987-1988).

Mr. Glauber's publications include a co-authored book, Investment Decisions, Economic Forecasting, and Public Policy, and he has been an editor of several finance and economic journals. He has served as director of Circuit City Stores, Inc., several of the Dreyfus group of mutual funds, Cooke & Bieler, Inc. and Sunbelt Coca-Cola, Inc. He has acted as consultant to a number of corporations, financial institutions, and the U. S. Government.

Mr. Glauber received a bachelor of arts degree from Harvard College in economics and his doctorate in finance from Harvard Business School. He was born March 22, 1939, in New York City. He is married and has two children and resides in Washington, D.C.

NB-327

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EMBARGOED UNTIL DELIVERY
EXPECTED AT 9:30 A.M.
WEDNESDAY, JUNE 7, 1989

NB-310

STATEMENT OF
KENNETH W. GIDEON
NOMINEE FOR ASSISTANT SECRETARY (TAX POLICY)
UNITED STATES DEPARTMENT OF THE TREASURY
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman. The President has honored me by nominating me for the position of Assistant Secretary of the Treasury for Tax Policy, and it is an honor to appear before this Committee today.

There is clearly much work to be done in Tax Policy and I am anxious to get on with it. I believe that I can work together with the members of this Committee and members of the House Ways and Means Committee to fashion solutions consistent with the President's program but reflecting wisdom, insight, and concerns of the Congress as well. Achieving solutions will not be easy. Budgetary constraints, of course, limit all of our freedom of action. There are significant disagreements about what ought to be done. But solutions can be achieved, and I pledge to you that I will work hard--with you--to achieve them.

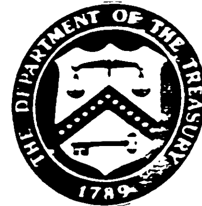
I would like to discuss, very briefly two issues, capital gains and civil tax penalty reform. I support the President's capital gain proposal. I believe that the impact of the American business tax system on the competitiveness of American business will become an increasingly important part of the tax policy debate. Capital gains proposals address an important aspect of that system in a positive way which I believe will have significant long-term benefits for our economy and hence all Americans. The revenues associated with a capital gains proposal would go far toward allowing Congress to meet the budget agreement.

Yesterday, a Subcommittee of the House Ways and Means Committee considered important proposals to significantly reform the civil tax penalty system to make it simpler and fairer. This proposal enjoys bi-partisan support in the House and I hope that it will receive early consideration and similar support by this Committee. Specifically, the bill consolidates many existing penalties into a simplified structure. It provides, for the first time, continuing incentives to comply with information and reporting deadlines even after the initial due date has been missed. While the Treasury Department has made suggestions for improvement, I believe the bill deserves support and it has my personal support.

I wish to thank President Bush for nominating me, Secretary Brady for his confidence in me, and my wife, Carol, and our four children present here today for their understanding and support.

This concludes my statement. I will be happy to answer questions which members of the Committee may have.

// TREASURY NEWS



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For Release Upon Delivery
Expected at 10:00 a.m., EST
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STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to present the Administration's views on Chairman Bentsen's child and health care proposal. Appearing with me today is Deputy Secretary of Labor Roderick DeArment. As you know, on April 19, 1989, Secretary of Labor Elizabeth H. Dole appeared before this Committee to testify concerning the President's child care proposal, which was subsequently introduced in the Senate by Senator Robert Dole as S. 601 and S. 602. I will not repeat that testimony.

Following my testimony on Chairman Bentsen's child and health care proposal, I will comment briefly on S. 1129 which would replace current section 89 of the Internal Revenue Code and defer the effective date of the new provision until next year.

Child Care

Child care is one of the key issues facing the nation. All of us--business, labor, non-profit organizations, and governments at all levels--must play a role in helping families meet this important challenge. However, our policy must have the family as its focus. We must put choices in the hands of parents and not in the hands of government. Increasing the range of child care options available to parents, particularly those who head families of modest means, will benefit the nation's children, their parents, and the country as a whole.

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Based on these ideals, the President has established four fundamental principles which should guide the federal government's role in child care:

> First, parents are best able to make decisions about their children, and should have the discretion to do so. Assistance should go directly to parents. Parents (and not the government) should choose the child care they consider best for their children.
>
> Second, federal policy should not discriminate against two-parent families in which one parent works at home caring for their children.
>
> Third, federal policy should increase, not decrease, the range of choices available to parents. Thus, the federal government should encourage the widest array of child care alternatives, including care by religious groups, friends, neighbors, or relatives. We should not reduce the supply and increase the costs of child care by dictating--or linking federal support for child care to--State licensing and regulatory decisions.
>
> Fourth, federal support for child care should be targeted to those most in need, low-income families, particularly those with young children, because they face the greatest difficulty meeting the needs of their children.

The President's child care proposal embraces these principles by making the current child and dependent care tax credit refundable, by creating a new child tax credit, and by expanding the Head Start Program by $250 million over the current funding level. The President has also directed the Department of Labor to undertake a study to determine the extent to which market barriers or failures prevent employers from obtaining the liability insurance necessary to provide child care on or near their employees' worksites.

I will concentrate my remarks today on the tax provisions of Chairman Bentsen's proposal. However, in the interest of giving the Committee a fuller picture of the issues, my written statement includes a more technical description of current law and the tax provisions of the President's proposal.

Current Law

The Internal Revenue Code provides assistance to working families through five provisions: the personal and dependency exemptions, the standard deduction, the earned income tax credit (EITC), the child and dependent care tax credit (DCTC), and the employee exclusion for employer-provided child care benefits.

Two of these provisions, the EITC and the DCTC, provide enhanced benefits for low-income families.

Personal and dependency exemptions and the standard deduction. The sum of the personal and dependency exemptions and the standard deduction establishes a threshold below which a family's income is exempt from taxation. Families are allowed a personal exemption for each parent and a dependency exemption for each dependent. The amounts of the personal and dependency exemptions are indexed for inflation. For 1989, each exemption reduces a family's taxable income by $2,000. Families are also allowed to take the higher of their itemized deductions or the standard deduction. The amount of the standard deduction is also indexed for inflation, and, for 1989, is $5,200 for families filing a joint return. For a family of four, the combined effect is to exempt the first $13,200 of income from the income tax in 1989.

Earned income tax credit. Low-income workers with minor dependents may be eligible for a refundable income tax credit of up to 14 percent of the first $6,500 in earned income. The maximum amount of the EITC is $910. The credit is reduced by an amount equal to 10 percent of the excess of adjusted gross income (AGI) or earned income (whichever is greater) over $10,240. The credit is not available to taxpayers with AGI over $19,340. Both the maximum amount of earnings on which the credit may be taken and the income level at which the phase-out region begins are adjusted for inflation. The dollar figures I have cited are for 1989.

Earned income eligible for the credit includes wages, salaries, tips and other employee compensation, plus the amount of the taxpayer's net earnings from self-employment. Eligible individuals may receive the benefit of the credit in their paychecks throughout the year by electing advance payments.

Child and dependent care tax credit. Taxpayers also may be eligible for a nonrefundable income tax credit if they incur expenses for the care of a qualifying individual in order to work. A qualifying individual is: (1) a dependent who is under the age 13 for whom the taxpayer can claim a dependency exemption; (2) the spouse of the taxpayer if the spouse is physically or mentally incapable of caring for himself or herself; or (3) a dependent of the taxpayer who is physically or mentally incapacitated and for whom the taxpayer can claim a dependency exemption (or could claim as a dependent except that he or she has more than $1,500 in income).

To claim the DCTC, taxpayers must be married and filing a joint return or be a head of household. Two-parent households with only one earner do not qualify for the credit unless the non-working spouse is disabled or a full-time student.

The amount of employment-related expenses eligible for the credit is subject to both a dollar limit and an earned income limit. Employment-related expenses are limited to $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals. Further, employment-related expenses cannot exceed the earned income of the taxpayer, if a head of household, or for married couples, the earned income of the spouse with the lower earnings. Employment-related expenses are expenses paid for the qualifying individual's care while the taxpayer works or looks for work. Amounts paid for food or schooling are generally not included.

Taxpayers with AGI of $10,000 or less are allowed a credit equal to 30 percent of eligible employment-related dependent care expenses. For taxpayers with AGI of $10,000 to $28,000, the credit is reduced by one percentage point for every $2,000 of income, or fraction thereof, above $10,000. The credit is limited to 20 percent of employment-related dependent care expenses for taxpayers with AGI above $28,000.

Taxpayers can file for the DCTC on a simplified 1040A return, which further helps low-income filers to take the credit.

Employee exclusion for employer-provided child care benefits. If the employer has a dependent care assistance program, employees are allowed to exclude from income amounts paid or incurred by the employer for dependent care assistance provided to the employee. The amount excluded from income may not exceed $5,000 per year ($2,500 in the case of a separate return filed by a married individual). An employee generally may not take advantage of both the DCTC and this income exclusion.

Reasons for Change

Current law does not adequately provide for the child care needs of low-income working families with young children. For low-income families which rely on paid child care arrangements, child care expenditures consume a large proportion of income. A recent study by the Congressional Research Service examined the child care expenditures of working mothers of preschool children. According to this study, child care expenditures constituted about 6 percent of family income for families which paid for child care. However, for low-income families which paid for child care, child care expenditures constituted about 20 percent of income.

In addition, child care by family members and other relatives--much of which is not paid for in cash--is especially prevalent among low-income families. According to the aforementioned Congressional Research Service study, about 60 percent of low-income families with working mothers depend primarily on family members or other relatives to care for their

preschool children. Of course, care by family members and relatives--particularly by those living outside the home--may not be free. In this regard, the study also found that, not counting care by parents or other relatives living in the home, over 50 percent of low-income families with preschool children do not make cash expenditures for child care. Because these parents do not make cash expenditures for child care, they cannot benefit from the DCTC.

Further, because the current DCTC is not refundable, even when low-income working families pay for child care, they cannot benefit from this credit if they have no income tax liability.

Finally, preschool children require more extensive care than do older children who are in school for much of the day. A study conducted for the Department of Health and Human Services by Dr. Lorelei Brush found that the most significant predictor of child care expenditures was the number of preschool children. The EITC, while refundable, does not adjust for differences among working families in the age of the dependent child or the number of dependent children.

Description of the President's Proposal

The following description is limited to the tax provisions of the President's proposal.

Proposed child tax credit. Low-income families containing at least one worker would be entitled to a new tax credit of up to $1,000 for each dependent child under age four. For each child under age four, families could receive a credit equal to 14 percent of earned income, with a maximum credit equal to $1,000 per child. Initially, the credit would be reduced by an amount equal to 20 percent of the excess of AGI or earned income (whichever is greater) over $8,000. As a consequence, the credit would be available to families with AGI or earned income of $13,000 or less. In subsequent years, both the starting and end points of the phase-out range would be increased by $1,000 increments. By 1994, the credit would phase out between $15,000 and $20,000. The credit would be adjusted for inflation, starting in 1995.

The credit would be refundable and would be effective for tax years beginning January 1, 1990. Like the EITC, families would have the option of receiving the refund in advance through a payment added to their paychecks.

Refundable child and dependent care tax credit. The existing DCTC would be made refundable. Families could not claim both the new credit and the DCTC with respect to the same child but could choose either. The refundable DCTC would be effective for tax years beginning January 1, 1990.

Effects of the President's proposal. The President's proposal would increase the funds available to low-income families, better enabling them to choose the child care arrangements which best suit their needs and correspond to their personal values. The proposal does not mandate any particular form of child care, trusting parents to make the best decisions concerning the care of their children. About 2.5 million working families with children under age 4 would initially be eligible for the new child tax credit. When the proposal is fully implemented, eligibility would be expanded to approximately 1 million additional families. These families would also have the option of claiming the refundable DCTC, although they would not be able to claim both credits with respect to the same child. Parents of children between ages 4 and 12 would benefit from the refundability of the DCTC if they incur child care expenses in order to work, even if they do not owe any income tax. By making the DCTC refundable, an additional 1 million families with children age 4 and over would be able to benefit from it.

Consider, for example, a single working mother of two children, ages 3 and 6. The mother earns $10,000 a year and has no other sources of taxable income. She pays a relative $20 a week to care for her younger child. Her older child is enrolled in an after-school program during the school year and a neighborhood park program during the summer at a total cost of $500 per year. In total, she spends $1,540 a year for child care in order to work. Under current law, at a 30 percent credit rate on dependent care expenses, the potential DCTC would be $462. However, because she has no tax liability as a consequence of the standard deduction and personal exemptions, she cannot claim the credit.

Under the proposal, the mother would be able to claim the proposed child tax credit with respect to her younger child. In 1990, she would be entitled to a credit equal to $600. (A mother in similar circumstances in 1992 would be entitled to the full $1,000 credit.) In addition, because the DCTC would be made refundable, the mother would be able to claim a credit of $150 based on the expenses associated with the day care of her older child. In total, she would be entitled to a refund of $750, which is almost one-half of her total child care expenses for the year.

Description of Chairman Bentsen's Proposal

Chairman Bentsen's child and health care proposal would amend the current DCTC in two ways. First, like the President's proposal, it would make the DCTC refundable. Second, it would expand the scope of the DCTC to cover expenditures for health insurance policies that include children. Families could receive both credits. Unlike the President's proposal, the Bentsen proposal does not include a separate child tax credit.

Refundable child and dependent care tax credit. The existing DCTC would be made refundable. The refundable DCTC would be effective for tax years beginning January 1, 1990. Families would have the option of receiving the refund in advance through a payment added to their paychecks.

Health insurance tax credit. To be eligible for the new refundable health insurance tax credit, a family must have a child under age 19. The health insurance policy purchased by the family may cover the child only, or may also include the child's parents.

The credit amount would be based on a percentage of expenditures for the purchase of health insurance up to a maximum expenditure of $1,000. For families with incomes of $12,000 or less, the credit would be equal to 50 percent of qualified expenditures, or up to $500. For each $1,000 (or fraction thereof) in income above $12,000, the credit would be reduced by 5 percentage points. The credit would be phased out completely for families with incomes above $21,000. This new credit would be effective for tax years beginning January 1, 1991. Families would have the option of receiving the refund in advance through a payment added to their paychecks. Families in which either one or both parents have earnings would be eligible for the credit.

Child health demonstration projects. $25 million a year for 5 years would be authorized to enable the Department of Health and Human Services to conduct demonstration programs to extend health coverage to uninsured children under age 19 and their families. I defer to the Department of Health and Human Services for comments on this provision.

Revenue offsets. There are three revenue offsets in the proposal. The first revenue offset is the repeal of the expiring special tax provisions for troubled financial institutions, which are currently scheduled to expire at the end of 1990, effective as of May 10, 1989. May 10, 1989, is the effective date of this same early sunset in the House Ways and Means Committee's amendment to H. R. 1278, the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The second revenue offset would make permanent the 3 percent telephone excise tax, which is scheduled to expire on January 1, 1991. The third revenue offset would require S corporations to pay estimated tax on certain items of income taxable at the S corporation level.

Discussion

I would like to note at the outset that our analysis of the health insurance tax credit is necessarily very preliminary since we have had only a few days to review it. Based on this limited analysis, we have a number of concerns about the design and effectiveness of the credit, and we continue to believe strongly that the President's proposal (S. 601 and S. 602) provides a

superior approach to assisting low-income families. Moreover, we would also like to make clear that the Administration will not support such tax credits as an addition to S. 5, the Act for Better Child Care Services (the "ABC bill"). The Administration remains strongly opposed to the ABC bill, since it is wholly inconsistent with the President's four principles for child care.

The Bentsen proposal's new health insurance tax credit singles out health insurance expenditures for special treatment. Because individual health insurance policies tend to be expensive, low-income families which do not already have health insurance through their employer or through some other group arrangement may well be unable to afford to buy coverage, even with this new credit. It is therefore unlikely that the credit would help a significant proportion of those low-income families which do not have access to group coverage. Indeed, by providing the credit only to families which have such access, the proposal would not target benefits to the neediest segment of low-income families.

Moreover, the health insurance expenditures eligible for the credit are not necessarily related to the cost of providing such benefits to children. The credit would apply to both existing and new health insurance policies and would not be limited to the incremental cost of providing health insurance coverage for children. This credit could, and often would, subsidize health coverage for adults simply because they have children. For these reasons, it is not clear that this credit would significantly expand health insurance coverage for children of low-income families as opposed to shifting to the federal budget the cost of health insurance coverage already being provided. Although this would free up some of the money that the eligible families now spend on health insurance for other expenditures, including child care, the President's proposal would provide this assistance more directly and efficiently--without leaving out low-income families with no access to low cost health insurance.

The advance payment feature of the Bentsen proposal is intended to permit families to receive the benefits of the DCTC and the new health insurance credit throughout the year. However, the design of these credits is not well suited to advance payment, and we are concerned that the implementation and administration of this feature would be very difficult. For example, it would be quite difficult for the IRS to draft "lookup tables" for employers to determine the amount of the advance payments because the amount of the payments would be a function of four variables--earned income, family size, estimated annual dependent care expenses, and estimated annual health insurance expenses.

In addition, the existence of three different credits eligible for advance payment and the resulting larger dollar amounts of the advance payments could place substantial additional administrative burdens on employers--particularly

small employers--and on the IRS, to the extent the feature were actually utilized. In this regard, it should be noted that the advance payment feature of the EITC is not widely used as only about 10,000 taxpayers take advantage of it. We are sympathetic, however, to the Chairman's desire to provide these benefits at the earliest possible time and are willing to explore with the Committee whether an administrable mechanism can be developed.

Further, consideration should be given to the time necessary for the IRS to provide taxpayers with guidance and with new forms. If the advance payment feature is to be effective for 1990, all of this would have to be in place before the end of the year. This would be very difficult for the IRS if the provision were enacted in the first quarter of fiscal 1990.

While we have concerns about the design and effectiveness of the health insurance credit, we note that it has some positive similarities to the President's child tax credit in that it is targeted to low-income families and it is available to families in which only one parent works.

We have previously testified in favor of the first two revenue offsets contained in the Bentsen proposal. The extension of the telephone excise tax was proposed as part of the President's budget. The Administration supports early repeal of the special tax provisions for financially troubled financial institutions in connection with the enactment of a thrift rescue package and has no objection to the Committee choosing an effective date that corresponds to the House Ways and Means Committee's amendment to H. R. 1278. We have no objection to the third revenue offset with respect to S corporations.

Section 89

We have had even less time to analyze S. 1129 than Chairman Bentsen's child and health care proposal. As a result, my prepared statement will be brief and limited to the major design features of the bill. As our analysis continues, we will provide the Committee with further comments.

As we have testified before this Committee and others, the Administration believes that section 89 is overly complex and imposes undue compliance burdens on employers. The basic objectives of the nondiscrimination rules of section 89, the elimination of plans providing health benefits only to highly compensated employees and the promotion of coverage of nonhighly compensated employees, should be achieved by means of workable tests that can be understood by employers and applied without undue expense in a wide variety of circumstances.

On June 6, 1989, Chairman Bentsen and others introduced S. 1129 which repeals section 89 and replaces it with significantly

simpler tests that may be satisfied by plan design. Briefly, the bill provides that an employer must make available to at least 90 percent of its employees a plan providing primarily core health coverage and that highly compensated employees cannot exclude the cost of employer-provided health coverage from income to the extent it exceeds 133 percent of the base benefit. The base benefit generally is the employer-provided premium for the plan that satisfies the 90 percent availability test. In addition, if an employer's health plan and certain other welfare benefit plans do not satisfy certain so-called qualification requirements (i.e., the plan must be in writing, must be enforceable, etc.), an excise tax equal to 34 percent of the employer-provided premium is imposed on the employer.

The Administration favors the delay in the effective date until plan years beginning after December 31, 1989. As you are aware, the Secretary of the Treasury has already provided that employers are not required to test their plans for compliance with section 89 until October 1, 1989, and we believe that the additional delay would allow better implementation of the new provision.

In addition, the Administration favors the provision of S. 1129 requiring an employer to offer core health coverage to at least 90 percent of its nonexcludable employees. This provision is preferable to the provision in current section 89 requiring an employer to make available certain health coverage to at least 90 percent of its nonhighly compensated employees in that the provision does not require an employer to identify those of its employees who are highly compensated within the meaning of section 414(q) and the regulations thereunder.

Under S. 1129, an employer may require an employee to pay up to 40 percent of the premium for a plan providing primarily core health coverage. This "percentage cap" approach to availability testing facilitates accommodation of geographic differences and inflation. While we are aware of concerns that the percentage cap approach could permit abuse in certain situations, for example, where an employer makes available only very expensive health coverage and thereby effectively excludes low-paid employees, we have decided on grounds of simplification to support a percentage cap approach. Should significant abuse emerge, some further limitation may be appropriate.

Salary reduction contributions are subject to special rules. First, such contributions are generally considered employer contributions for highly compensated employees. Second, in applying the 40 percent allowable cost test, salary reduction contributions are generally treated as employee contributions. Finally, for purposes of determining the base benefit to which the 133 percent test is applied, salary reduction contributions are treated as employer contributions to the extent such contributions are matched dollar-for-dollar by employer contributions that are not made by reason of a salary reduction

arrangement. Thus, if the employer pays $600 of a $1000 premium for a plan meeting the availability test and the employee pays $400 of the premium on a salary reduction basis, all of the salary reduction contribution may be treated as employer-provided for purposes of computing the base benefit under the 133 percent benefits test. Under these facts, the result of this treatment of salary reduction contributions is that a highly compensated employee may receive on a tax-favored basis an employer-provided health benefit that is equal to $1330. Although we support the general treatment of salary reduction outlined above, we point out to the Committee that the dollar-for-dollar rule results in the substantial base benefit enhancement described in the foregoing example.

If a salary reduction plan provides that an employee can receive cash instead of employer-provided health coverage when such employee certifies that he or she has other health coverage (i.e., receives a "cashable credit"), more favorable treatment is provided under the bill. "Cashable credits" are treated as employer contributions rather than employee contributions for purposes of the allowable cost test and are treated as employer-provided benefits for purposes base benefit test without regard to the dollar-for-dollar rule.

We are concerned that the special rule provided for cashable credits as opposed to other salary reduction contributions could be abused. Such a rule could result in a shift in plan design so that many salary reduction contributions could be characterized as cashable credits. As a result, we are not in a position to endorse the cashable credit approach adopted in the bill. Moreover, the certification requirement in the cashable credit rule raises issues similar to those which caused many to object to the sworn statement rules in current section 89.

The Administration commends the sponsors of S. 1129 for considering the special circumstances faced by small businesses. The bill provides that businesses with less than 20 employees that are required to pay individually rated premiums to a third party insurer may consider the cost of each employee's premium to be the average of all of the premiums. In addition, the employees who may be excluded from consideration when testing plans for compliance with section 89 because they work less than 25 hours per week is phased-in over two years.

Finally, the bill provides that the sanction for failure to satisfy the qualification rules is an excise tax equal to 34 percent of the employer-provided premium, with a grace period of six months to correct any failures. The Administration believes that the excise tax should be structured in a way that encourages compliance. A smaller excise tax, perhaps 5 percent, should be imposed initially. Only if the failure is not prospectively corrected within a reasonable period after notification from the IRS should the full 34 percent tax would be imposed.

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

Revenue Estimates

The following are Treasury's revenue estimates for the Bentsen proposal, the President's proposal, and the revenue offsets under consideration here today. Our estimates for the repeal of the thrift and bank tax provisions assume current law.

Fiscal Year:	1989	1990	1991	1992	1993	1994	Total
	($ billions)						
Refundable child care credit	0.0	-0.1	-0.8	-0.9	-0.9	-1.0	-3.7
Refundable health credit	0.0	*	-0.1	-1.5	-1.4	-1.4	-4.4
Bentsen proposal (total)	0.0	-0.1	-0.9	-2.4	-2.3	-2.4	-8.1
President's proposal (total)	0.0	-0.2	-1.9	-2.2	-2.5	-2.8	-9.6
Telephone excise tax	0.0	0.0	1.6	2.6	2.8	3.0	10.0
Thrift and bank tax repeal	*	0.2	0.2	0.1	0.0	0.0	0.5
S corp. estimated tax	*	0.0	0.0	0.0	0.0	0.0	*
Revenue offsets (total)	0.0	0.2	1.8	2.7	2.8	3.0	10.5

TREASURY NEWS

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

Contact: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
June 12, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,425 million of 13-week bills and for $6,401 million of 26-week bills, both to be issued on June 15, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing September 14, 1989			:	26-week bills maturing December 14, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.12%	8.41%	97.947	:	7.77% a/	8.20%	96.072
High	8.14%	8.43%	97.942	:	7.80%	8.23%	96.057
Average	8.13%	8.42%	97.945	:	7.79%	8.22%	96.062

a/ Excepting 1 tender of $1,150,000.

Tenders at the high discount rate for the 13-week bills were allotted 12%.
Tenders at the high discount rate for the 26-week bills were allotted 33%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 29,000	$ 29,000	:	$ 25,375	$ 25,375
New York	27,778,270	5,495,775	:	18,631,880	5,467,300
Philadelphia	19,425	19,425	:	20,110	19,440
Cleveland	30,915	30,590	:	30,665	30,665
Richmond	63,870	63,870	:	27,300	27,300
Atlanta	36,410	35,410	:	24,230	24,230
Chicago	1,038,270	52,995	:	810,045	176,545
St. Louis	46,120	23,500	:	24,570	19,180
Minneapolis	7,925	7,925	:	8,580	8,580
Kansas City	37,995	37,995	:	32,395	32,395
Dallas	73,960	26,960	:	48,725	38,675
San Francisco	1,152,275	70,775	:	1,011,045	61,045
Treasury	530,425	530,425	:	470,055	470,055
TOTALS	$30,844,860	$6,424,645	:	$21,164,975	$6,400,785
Type					
Competitive	$27,092,055	$2,671,840	:	$16,811,905	$2,047,715
Noncompetitive	1,258,635	1,258,635	:	956,685	956,685
Subtotal, Public	$28,350,690	$3,930,475	:	$17,768,590	$3,004,400
Federal Reserve	2,400,355	2,400,355	:	2,150,000	2,150,000
Foreign Official Institutions	93,815	93,815	:	1,246,385	1,246,385
TOTALS	$30,844,860	$6,424,645	:	$21,164,975	$6,400,785

An additional $11,685 thousand of 13-week bills and an additional $236,415 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 IMMEDIATE RELEASE
June 12, 1989

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CONTACT: LARRY BATDORF
(202) 566-2041

TUNISIA AND UNITED STATES INITIAL A SUPPLEMENTARY PROTOCOL TO THE INCOME TAX CONVENTION

Delegations from Tunisia and the United States met in Washington from May 23 through 26, 1989, to negotiate amendments to the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, which was signed on June 17, 1985, but is not yet in effect.

The delegations agreed on the provisions of a supplementary Protocol, which will form an integral part of the Convention and will have the same force and effect. The Protocol reflects the strong desire of both countries to promote investment and further bilateral economic relations.

The delegations agreed to move expeditiously to transmit the draft Protocol to the appropriate authorities for signature. The Convention, as modified by the supplementary Protocol, will enter into force after signature and the completion of the legal requirements in both countries.

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TREASURY NEWS

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

Contact: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
June 13, 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 $12,800 million, to be issued June 22, 1989. This offering will result in a paydown for the Treasury of about $1,725 million, as the maturing bills are outstanding in the amount of $14,520 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, June 19, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated March 23, 1989, and to mature September 21, 1989 (CUSIP No. 912794 SY 1), currently outstanding in the amount of $7,562 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated December 22, 1988, and to mature December 21, 1989 (CUSIP No. 912794 SP 0), currently outstanding in the amount of $9,107 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 June 22, 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 $1,246 million as agents for foreign and international monetary authorities, and $3,651 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.

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

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FOR IMMEDIATE RELEASE

June 13, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of April 1989.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $141.2 billion on April 30, 1989, posting a decrease of $702.4 million from the level on March 31, 1989. This net change was the result of increases in holdings of agency debt of $45.0 million and in agency-guaranteed debt of $7.9 million, and a decrease in holdings of agency assets of $755.2 million. FFB made 40 disbursements during April.

Attached to this release are tables presenting FFB April loan activity and FFB holdings as of April 30, 1989.

NB-333

FEDERAL FINANCING BANK

APRIL 1989 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 #487	4/5	$ 1,000,000.00	7/05/89	9.261%	
+Note #488	4/11	14,440,000.00	7/11/89	9.182%	
+Note #489	4/11	2,000,000.00	7/05/89	9.165%	
TENNESSEE VALLEY AUTHORITY					
Advance #1016	4/3	59,000,000.00	4/10/89	9.347%	
Advance #1017	4/6	140,000,000.00	4/13/89	9.271%	
Advance #1018	4/10	126,000,000.00	4/17/89	9.241%	
Advance #1019	4/13	39,000,000.00	4/18/89	9.102%	
Advance #1020	4/13	90,000,000.00	4/20/89	9.102%	
Advance #1021	4/17	109,000,000.00	4/24/89	9.040%	
Advance #1022	4/20	46,000,000.00	4/28/89	8.858%	
Advance #1023	4/24	85,000,000.00	5/02/89	9.072%	
Advance #1024	4/28	85,000,000.00	5/02/89	8.835%	
Advance #1025	4/28	35,000,000.00	5/05/89	8.835%	
Advance #1026	4/30	12,000,000.00	5/03/89	8.829%	
Advance #1027	4/30	142,000,000.00	5/05/89	8.829%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Morocco 12	4/3	52,346.36	9/21/95	9.561%	
Morocco 13	4/3	693,286.45	5/31/95	9.571%	
Greece 16	4/4	2,645,318.97	3/1/13	9.218%	
Greece 16	4/14	2,936,453.45	9/3/13	9.303%	
Morocco 13	4/24	10,812.00	5/31/95	9.353%	
Morocco 12	4/28	2,094.00	9/21/95	9.202%	
Morocco 13	4/28	29,220.50	5/31/95	9.204%	

+rollover

FEDERAL FINANCING BANK

APRIL 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION					
*Colorado-Ute Electric #168A	4/3	$ 15,815,000.00	7/01/91	9.843%	9.725% qtr.
*Wabash Valley Power #206	4/3	438,000.00	1/02/18	9.298%	9.192% qtr.
*Wabash Valley Power #104	4/3	9,670,000.00	1/02/18	9.298%	9.192% qtr.
Cooperative Power Assoc. #240	4/6	8,137,000.00	7/01/91	9.560%	9.448% qtr.
Oglethorpe Power #320	4/7	16,525,000.00	7/01/91	9.650%	9.536% qtr.
Basin Electric #232	4/13	171,000.00	4/15/91	9.713%	9.598% qtr.
*Wabash Valley Power #206	4/13	4,042,000.00	1/02/18	9.291%	9.186% qtr.
*Wabash Valley Power #104	4/13	459,000.00	1/02/18	9.291%	9.186% qtr.
Corn Belt Power Coop. #292	4/14	2,938,000.00	1/02/18	9.386%	9.278% qtr.
Arizona Electric #242	4/17	3,000,000.00	12/31/20	9.186%	9.083% qtr.
*Wabash Valley Power #252	4/17	787,000.00	1/02/18	9.196%	9.093% qtr.
*Colorado-Ute Electric #203A	4/20	988,000.00	7/01/91	9.424%	9.316% qtr.
*Wabash Valley Power #206	4/20	93,000.00	1/02/18	9.119%	9.017% qtr.
Brazos Electric #230	4/25	2,326,000.00	1/02/24	9.137%	9.035% qtr.
Brazos Electric #332	4/28	1,794,000.00	12/31/19	9.093%	8.992% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Evergreen Community Dev. Assoc.	4/5	160,000.00	4/01/14	9.264%	
Greater Chicago Metro Dev. Corp.	4/5	110,000.00	4/01/04	9.351%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-07	4/28	679,698,747.06	7/31/89	8.982%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	April 30, 1989	March 31, 1989	Net Change 4/1/89-4/30/89	FY '89 Net Change 10/1/88-4/30/89
Agency Debt:				
Export-Import Bank	$ 11,000.6	$ 11,000.6	$ -0-	$ 43.0
NCUA-Central Liquidity Facility	111.4	111.4	-0-	-6.8
Tennessee Valley Authority	17,084.0	17,039.0	45.0	-47.0
U.S. Postal Service	6,492.2	6,492.2	-0-	900.0
sub-total*	34,688.2	34,643.2	45.0	889.3
Agency Assets:				
Farmers Home Administration	57,086.0	57,841.0	-755.0	-1,410.0
DHHS-Health Maintenance Org.	79.5	79.5	-0-	-0-
DHHS-Medical Facilities	93.8	93.8	-0-	-2.6
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,076.0	4,076.0	-0-	-63.2
Small Business Administration	13.1	13.4	-0.2	-2.2
sub-total*	61,348.5	62,103.8	-755.2	-1,478.0
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	11,637.3	11,646.7	-9.4	-4,374.4
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	-0-	-0-	-0-	-50.0
DHUD-Community Dev. Block Grant	313.8	314.0	-0.2	-4.2
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	383.0	383.0	-0-	-4.4
DOI-Guam Power Authority	31.5	31.5	-0-	-0.6
DOI-Virgin Islands	26.1	26.1	-0-	-0.5
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,720.5	1,720.5	-0-	-38.3
Rural Electrification Administration	19,230.0	19,195.3	34.7	24.7
SBA-Small Business Investment Cos.	587.3	587.9	-0.7	-45.4
SBA-State/Local Development Cos.	841.3	846.0	-4.6	-29.6
TVA-Seven States Energy Corp.	2,236.1	2,247.9	-11.9	73.7
DOT-Section 511	40.6	40.6	-0-	-5.6
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	45,125.1	45,117.2	7.9	-4,399.9
grand total*	$ 141,161.9	$ 141,864.2	$ -702.4	$ -4,988.6

*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 Upon Delivery
Expected at 1 p.m. EST
June 14, 1989

STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you to discuss the views of the Department of the Treasury regarding employer-provided retiree health benefits. In response to the various questions posed by the Subcommittee, my testimony will review: (1) the factual background against which this issue arises; (2) the tax incentives available to employers to prefund retiree health benefits under current law (including the recent change in position announced by the IRS regarding the computation of section 401(h) contribution limits); and (3) the views of the Department of the Treasury regarding the provision of additional tax incentives beyond those already provided under current law for such prefunding.

FACTUAL BACKGROUND

A significant number of employers, especially large- and medium-sized employers, maintain plans to provide retiree health benefits to their current and future retirees. The liability these plans represent to individual employers depends on a number of factors, including: (1) the type and level of benefits promised; (2) the employer's ability legally and practically to modify or terminate the benefits; and (3) the course of future health care cost inflation. Although the Department of the Treasury has not compiled independent data on the overall magnitude of the liabilities, it is reasonable to believe they are substantial.

A substantial share of the liabilities relate to retiree health benefits promised to those who retire before age 65. Such early retiree health benefit liabilities are substantial on a present value basis because the benefits are paid out at an earlier point in time and the employer-provided portion of benefits shrinks substantially after age 65 when most retirees become eligible for Medicare coverage from the Federal Government. This differential has recently been accentuated by the expansion of Medicare benefits under the Medicare Catastrophic Coverage Act of 1988 (P.L. 100-360).

Publicly traded companies subject to financial reporting requirements under the federal securities laws and other companies that provide certified financial statements to third parties may soon be required to disclose in their financial statements the amount of their retiree health benefit liabilities. The Financial Accounting Standards Board ("FASB") has proposed to require such disclosure for fiscal years beginning after December 15, 1991, subject to certain transition rules. A number of employers have expressed concern that, in the absence of dedicated reserves against retiree health liabilities, their equity values and ability to raise capital may be adversely affected.

CURRENT TAX INCENTIVES FOR PREFUNDING

Current law provides two arrangements through which an employer may prefund retiree health benefits on a tax-favored basis. The first of the two arrangements is the so-called 401(h) account, which the employer may maintain in conjunction with certain qualified retirement plans. Contributions made to a section 401(h) account are currently deductible by the employer, and income earned in the account accumulates on a tax-free basis.

Section 401(h) of the Internal Revenue Code provides for this tax-favored treatment only if the retiree health benefits are "subordinate" to the pension benefits provided under the plan. In general, the regulations provide that the health benefits will be considered subordinate if the cumulative contributions to a 401(h) account at any point in time do not exceed 25 percent of the total cumulative contributions made to the retirement plan since the 401(h) benefit was first added to the plan. In a series of recent private letter rulings, the IRS has expanded the circumstances in which 401(h) retiree health benefits will be considered to meet the subordinate standard. These rulings and their implications are discussed in greater detail below.

The second arrangement permitted under current law to prefund retiree health benefits on a tax-favored basis is the special reserve for retiree medical benefits permitted under a welfare benefit fund, such as a VEBA. Under this arrangement, employer contributions are currently deductible, but income

earned by the fund is subject to current taxation. In addition, contributions to prefund retiree health benefits must be calculated based on current costs, and thus may not take into account future health cost inflation. Congress prescribed the current level of tax incentives available for prefunding retiree health benefits under a welfare benefit fund in the Deficit Reduction Act of 1984. Prior to that Act, funds set aside in a VEBA to provide retiree health benefits could accumulate on a tax-free basis. The effect of this change was to limit full tax-favored treatment to 401(h) accounts, where retiree health benefits are preconditioned on the employer's provision of proportionately greater regular retirement benefits.

Effect of Recent IRS Rulings Under 401(h). The recent IRS private letter rulings mentioned above have expanded the potential availability of section 401(h) to many employers as a means of prefunding some portion of their retiree health liabilities. The rulings do this by allowing an employer to overlook the actual contributions made under the plan, and instead to compare the hypothetical actuarial costs of funding the retiree health and pension benefits available under the plan. Under this new alternative, contributions to a 401(h) account will be considered subordinate if the cumulative "cost" of the retiree health benefits does not exceed 25 percent of the total cumulative "cost" of the plan (including costs attributable to both retiree health and pension benefits) since the 401(h) benefit was first added to the plan. For this purpose, plan costs must be determined pursuant to specified actuarial methods.

Under the traditional approach which looks to actual plan contributions, an employer with a fully funded pension plan could make no contributions to a newly established 401(h) account since the employer would not be making contributions to fund the pension benefits. Pursuant to the new IRS rulings, however, such an employer could establish and prefund a 401(h) account despite the pension plan being fully funded by using the actuarial cost of the pension benefits to establish the limit on contributions to the 401(h) account.

The IRS rulings may enable some employers to make their retiree health promises financially more secure through prefunding. The potential cost of these rulings, however, is uncertain. Predicting the effect of the rulings is extremely difficult because of the unsettled climate surrounding retiree health benefits. First, it is difficult to predict how companies will respond to a change in the 401(h) rules. In contrast to pension benefits, there is no obligation to prefund retiree health benefits, and some companies may choose to prefund while others may choose not to prefund and instead invest their funds in ongoing business operations. Second, the extent of retiree health liabilities is uncertain both because future medical costs are difficult to predict and because the specific terms of the existing retiree health promises employers have made are uncertain. That is, many employers may have generally promised

to provide retiree health benefits, but the exact types of benefits may not be specified. Under current law, it is also unclear whether and to what extent employers may modify their existing retiree health promises. Indeed, some employers may be concerned that by prefunding, they may lose the right to modify the nature of the promises, and thus may choose not to prefund, at least at this time. Finally, the effect of the FASB rules is uncertain. Many employers might choose to prefund only if the FASB rules require disclosure on their financial reports. The FASB rules have not been finalized, with a first exposure draft having been issued only this year, and it is difficult to predict whether, when, and in what form those rules might finally take effect.

For these reasons, we find it difficult to predict with any degree of confidence the effect of the recent IRS rulings. However, under a scenario under which (1) the FASB rules take effect in their current proposed form in 1992, (2) employers do not modify their existing retiree health promises to current retirees, (3) pension plan funding and liabilities remain largely unchanged, and (4) a significant number of employers elect to prefund their retiree medical benefits, we believe that a reasonable ballpark estimate of the effect of the recent IRS rulings on benefited taxpayers would be a reduction in federal tax liabilities of approximately $500 million per year once employers begin prefunding on an ongoing basis. We do not expect this effect to be immediate.

ADDITIONAL TAX INCENTIVES FOR PREFUNDING

All of us are concerned that the health care needs of retirees be met both now and in the future. It is the view of the Department of the Treasury that whether additional tax incentives should be provided for prefunding retiree health benefits should be the subject of careful consideration and thorough debate of the many complex issues involved in health care. The Congress should not rush to act on these important issues without the benefit of that consideration and debate. As a practical matter, a major tax expenditure program cannot be undertaken without an adverse effect, at least ultimately, on the federal deficit. In addition, much of employers' current interest in prefunding is a result of the proposal to change in the future the accounting rules for retiree health liabilities. A full debate should consider the proper role of the federal Government through entitlement programs, such as Medicare and Medicaid, and through the tax system with tax incentives for employer-provided health benefits and for individually purchased health coverage. In addition, such debate should carefully consider the protections that might be imposed on employer-sponsored retiree health plans. The debate should also address many of the problems faced by our health care system, including escalating costs and access to insurance, both on a group and individual basis.

Perhaps the fundamental issue to consider is whether employer-sponsored retiree health plans should be provided additional tax incentives, or whether, assuming limited government resources, these tax benefits should be provided in a manner that is available to all individual retirees, regardless of their employer. Although the employer-sponsored system has achieved significant health and retirement coverages, it is still the minority of employers that choose to provide retiree health benefits, and accordingly the minority of employees that receive such benefits. This is so even though the existing incentives available to employers are not insubstantial; for example, section 401(h) permits employers to prefund on a fully tax-favored basis for future health liabilities in conjunction with a pension plan. The ability to prefund on a fully tax-favored basis for potential future liabilities is almost without parallel in the tax law.

Expanding tax incentives would redound to the benefit of those employers, and their employees, that have already promised to provide retiree health benefits, but would not necessarily insure that others receive any benefits, thus potentially expanding inequities between those individuals whose employers choose to take advantage of the tax incentives and those whose employers do not. In addition, we believe it would be inappropriate for any additional tax incentives to be applied to prefunding of retiree health benefits to be paid out before age 65. Such early retirement benefits are especially expensive to prefund and thus tend to spend down overall savings that might better be reserved for later years when earning capacity is more likely to be reduced. We do not believe that it is appropriate for the tax system to provide additional tax incentives for early retirement benefits.

A second important issue is the type of benefit promise to which tax-favored prefunding should be extended; that is, whether the tax system should encourage the promise of a defined health benefit, such as indemnity insurance or membership in an HMO, or a promise of a specified dollar amount intended to meet projected costs of retiree health coverage, or a defined contribution plan approach under which the employer obligates itself only to make a specific contribution to an account dedicated to the provision of retiree health coverage. These approaches have different advantages and disadvantages. The defined health benefit approach may provide employees with some protection from health care inflation that the defined dollar and defined contribution approaches do not. At the same time, we believe that a defined dollar or defined contribution approach offers an important degree of flexibility and individual choice that a defined health benefit approach lacks. For example, a defined dollar or defined contribution approach could be structured to permit individual retirees to exercise individual choice in meeting their retirement needs. Some retirees might prefer to purchase long-term care insurance rather than be provided with additional health insurance. Other, alternative health care needs and programs may

evolve in the future, and we should be careful that the tax system not create artificial preferences among alternative modes of health care.

A third issue is what role the Federal Government should play in increasing the security of the retiree health benefit promises made by employers. As the members of the Subcommittee are no doubt aware, current law provides few protections to employees with regard to the retiree health care promises made by their employers. Minimum standards regarding participation, accrual, vesting, and funding that apply to qualified pension plans under ERISA and the Code do not apply to retiree health benefits promised by employers. It is the position of the Treasury that similar minimum standards are a necessary precondition to any additional tax incentives for employer prefunding of retiree health benefits. Such standards may be very difficult to construct, particularly if applied to a defined benefit type retiree health plan, and should be carefully considered before the tax system is forced to absorb the additional regulation and complexity the implementation of such standards would entail.

Excess Asset Transfers. Most of the points made in my preceding testimony apply with equal force to the various proposals to permit transfers of excess pension assets to prefund retiree health benefits. We understand that certain employer-sponsored estimates show such transfers producing a revenue gain in the near term. The Treasury Department has only recently obtained a written explanation of these estimates; however, the Treasury's initial reaction is that the estimated revenue gain may be a result of an accounting that focuses on a relatively narrow set of all possible transactions. In fact, we are concerned with a potential for revenue loss in the near term when all transactions are accounted for. In addition, we would note that any near-term effect would almost certainly be more than offset by larger revenue losses in later years.

CONCLUSION

This concludes my written remarks. I would be happy to answer any questions the members of the Subcommittee might have at this time.

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

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June 13, 1989

STATEMENT BY
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY

When floor debate begins tomorrow in the House of Representatives on the Administration's Savings & Loan proposal, amendments will be offered to circumvent capital standards approved by the House Banking Committee. We strongly urge the House to reject any amendments that would weaken the capital standards. Only tangible capital -- real, hard cash -- provides the deposit insurance fund and the taxpayers with protection necessary to ensure a thrift crisis never happens again.

Another amendment will be offered to adopt the Ways and Means Committee's financing alternative. History will show that busting Gramm-Rudman-Hollings is a grave mistake and will affect markets. In addition, the Administration's plan is the best method to lock up the thrift industry's contribution.

NB-335

TREASURY NEWS

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

Statement by
The Honorable Nicholas F. Brady
Secretary of the Treasury
Before the
Subcommittee on Foreign Operations
Committee on Appropriations
United States Senate
June 15, 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 members of this Committee know only too well, 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 this 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 U.S. funding for the the MDBs has had its 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.

THE STRENGTHENED INTERNATIONAL DEBT STRATEGY

As you know, we have proposed a new approach to strengthen the debt strategy and to provide financial support for debtor countries' efforts to reform their economies and achieve

sustained economic growth. This strengthened strategy puts new emphasis on debt and debt service reduction as a complement to new lending, while also giving more attention to investment and flight capital repatriation as important sources of capital for debtor countries.

The key elements of this strategy are:

- adoption of sound economic policies, with stronger emphasis on measures to increase foreign and domestic investment and the repatriation of flight capital;

- timely support from the IMF and World Bank for debtor countries' reform programs, including through debt and debt service reduction transactions; and

- active participation by commercial banks in providing debt reduction, debt service reduction, or new lending to debtors implementing economic reforms.

Since the strategy was outlined in early March, we have made significant progress in developing its operational details and moving toward implementation.

The IMF and World Bank have recently adopted guidelines governing their support for debt and debt service reduction. For countries requesting such support, the IMF and World Bank will set aside approximately one-fourth of their regular policy-based lending programs to support debt reduction. The IMF will provide additional resources of up to 40 percent of a country's quota for interest support. The World Bank also will make available additional resources to support interest payments in connection with debt or debt service reduction transactions.

This financing will be available to countries with large external bank debt which have adopted sound medium-term adjustment programs and which can demonstrate a clear need for debt and debt service reduction to accomplish medium-term growth and development objectives. Sound adjustment programs will include measures aimed at encouraging foreign investment and flight capital repatriation and should, in our view, also emphasize debt/equity swap programs.

Mexico, the Philippines and Costa Rica have already received IMF Board approval for strong economic programs which provide support for debt reduction. These countries have also initiated discussions with the commercial banking community on financing arrangements that could take advantage of the IMF and World Bank policies and financing. Simultaneously, the Paris Club has agreed to reschedule both outstanding principal and interest obligations of these three countries. Japan, which has agreed to provide an additional $4.5 billion in support of the strengthened strategy, is currently discussing with Mexico

and the Philippines specific commitments to support their programs.

In short, the official community has acted expeditiously to clarify the nature and amount of support it will provide to facilitate debt and debt service reduction. The official community has also made clear the importance of sound economic programs. It is important that commercial banks and debtor countries now reach agreement on financing packages which include debt reduction, debt service reduction, and new money to help provide the external financial basis for sustained growth.

The Role of the MDBs in the Debt Strategy

As you can see from the above, the World Bank is critical to successful implementation of this debt strategy. In addition to providing the financial support that I have outlined, the World Bank has vital expertise and credibility which are fundamental to helping design and implement reforms in the various sectors of debtor economies. Debtor countries depend on the Bank in their efforts to liberalize trade, reform labor markets, develop financial markets, increase the role of the private sector in improving employment and efficiency, and liberalize their investment policies.

The World Bank's project lending activities are also important to the debt strategy, since they affect policies at the micro and sector levels which are key to stimulating growth. Project loans 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 World Bank's efforts to help countries implement broader-based structural reforms.

The regional development banks will also play an important role in supporting 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.

U.S. Commitment to the Debt Strategy

It is important for the United States to back up its conceptual and policy leadership on this issue with funding for all these institutions as they seek to make the strengthened strategy work for debtor countries. The United States cannot expect to maintain leadership if we do not participate actively in new funding for these institutions and honor the payment schedules agreed to during replenishment negotiations.

Unfortunately, in the 1980s, the United States has been unable to meet its financial commitments to the MDBs on a timely basis. As one example, the United States is over two installments behind in its purchase of shares in a capital increase for the International Finance Corporation (IFC) which supports private sector development activities strongly endorsed by the United States. We are also concerned that as the United States arrears on funding for the World Bank GCI continues to grow, we will not be able to meet our scheduled purchase of shares in the Bank. As this occurs, it could place us in jeopardy of losing our veto over changes in the Bank's Charter. This would seriously undermine our leadership position in the Bank and internationally.

Frankly, this is not good government and does not speak well for the United States. We must do better in meeting our commitments if we realistically expect the MDBs to work actively to fulfill their policy commitments to us. Our credibility as a leader in these institutions is at stake, and, therefore, I urge full funding for the World Bank and each of the regional development banks.

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 develop new and cooperative ways to deal with them more effectively.

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 under current law 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 its 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.

Again, as with the debt strategy, if we are to maintain a leadership role, we must back up our policy initiatives with 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. That unit was upgraded to divisional status earlier this spring, and new staff are being recruited. 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 is being held in Paris this week.

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 exchange views on 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. In April, 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.

For that reason, we have highlighted these two elements of environmental reform in U.S. speeches at the annual meetings of the regional development banks this spring. We have taken a similar tack at the ministerial meeting of the Organization for Economic Cooperation and Development held earlier this month in Paris, and we plan to raise these issues again at the Summit meetings in July. These issues have also become key conditions in our negotiations for replenishment of IDA resources. 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 serious 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 any others 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 increases 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 by 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 billion in contracts from the MDBs last year. This compares with U.S. budget expenditures for the MDBs averaging about $1.3 billion 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. businesses 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 international financial institutions 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 bilateral 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 3.5 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 amount 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 I mentioned earlier, 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, in tandem with its lending, 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 to 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 intensive 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 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 encourage 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 -- both ongoing replenishments and arrears -- in order for this process to be implemented fully.

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 them 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, not only by participating actively in new MDB replenishments, but also by honoring past-due financial commitments to them.

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

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

FOR IMMEDIATE RELEASE June 15, 1989

JUN 19

STATEMENT BY
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY

The American taxpayers won a major victory today when the House of Representatives voted for strong, tangible capital requirements for the nation's savings and loans. We commend the members of the House for their courageous action. They have taken a very positive step toward ensuring the resolution of the savings and loan crisis.

It is unfortunate, however, that the House voted to ignore the budgetary discipline of Gramm-Rudman-Hollings in the amount of $44 billion by voting against the Administration's financing plan which was adopted by the Senate.

oOo

NB-337

TREASURY NEWS

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

5310

FOR IMMEDIATE RELEASE JUNE 15, 1989

STATEMENT BY
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY

We commend Phil Gramm, Pete Domenici and the other senators who have pledged their support to the Gramm-Rudman-Hollings budget discipline by voicing their opposition to the so-called "on-budget" financing plan for the Savings and Loan proposal. We urge the rest of the Senate to join them.

These senators clearly see the attempt to exempt $44 billion from the GRH mechanism for what it is -- a direct attack on the integrity of the GRH budget discipline. We join the senators in urging the Congress to adopt the Administration's funding proposal.

oOo

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TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
June 19, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,415 million of 13-week bills and for $6,407 million of 26-week bills, both to be issued on June 22, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing September 21, 1989			:	26-week bills maturing December 21, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.18%	8.47%	97.932	:	8.00%	8.45%	95.956
High	8.22%	8.51%	97.922	:	8.09%	8.55%	95.910
Average	8.22%	8.51%	97.922	:	8.08%	8.54%	95.915

Tenders at the high discount rate for the 13-week bills were allotted 100%.
Tenders at the high discount rate for the 26-week bills were allotted 57%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 30,085	$ 29,335	:	$ 19,770	$ 19,770
New York	21,305,520	5,737,015	:	17,192,660	5,675,420
Philadelphia	21,695	21,695	:	13,675	13,675
Cleveland	36,245	36,245	:	30,215	30,215
Richmond	37,620	37,620	:	21,840	21,840
Atlanta	32,720	32,720	:	22,285	22,285
Chicago	1,178,245	51,495	:	798,685	88,585
St. Louis	41,495	21.495	:	21,675	13,675
Minneapolis	4,940	4,940	:	5,925	5,925
Kansas City	41,505	41,505	:	42,330	42,330
Dallas	20,770	20,760	:	10,960	10,960
San Francisco	912,855	58,355	:	965,595	109,445
Treasury	321,450	321,450	:	353,335	353,335
TOTALS	$23,985,145	$6,414,630	:	$19,498,950	$6,407.460
Type					
Competitive	$21,058,925	$3,488,410	:	$16,106,760	$3,015,270
Noncompetitive	971,835	971,835	:	758,795	758,795
Subtotal, Public	$22,030,760	$4,460,245	:	$16,865,555	$3,774,065
Federal Reserve	1,851,380	1,851,380	:	1,800,000	1,800,000
Foreign Official Institutions	103,005	103,005	:	833,395	833,395
TOTALS	$23,985,145	$6,414,630	:	$19,498,950	$6,407.460

An additional $39,795 thousand of 13-week bills and an additional $265,605 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

LM 5310

June 20, 1989

**Caroline Hopper Haynes
Appointed Deputy Assistant Secretary
for Legislative Affairs**

Secretary of the Treasury Nicholas F. Brady today announced the appointment of Caroline Hopper Haynes to serve as Deputy Assistant Secretary for Legislative Affairs. Ms. Haynes will serve as principal adviser to the Assistant Secretary for Legislative Affairs on all issues related to the Department's initiatives and on the relations of the Department with Members of the U.S. Senate and the staffs of Congressional Committees.

Ms. Haynes has been with the Treasury Department since November 1988 in the position of Senior Legislative Manager. Before joining Treasury, she was Legislative Assistant to Senator Alan K. Simpson (R-WY).

Ms. Haynes received an M.B.A. in International Business (1987) from George Washington University, Washington, D.C., and a B.A. in Economics and Political Science (1981) from the University of the South, Sewanee, Tennessee. She is originally from Denver, Colorado and now resides in Arlington, Virginia.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE June 20, 1989

William J. Bremner
Deputy Assistant Secretary
(Federal Finance)
to Leave Treasury

Secretary of the Treasury Nicholas F. Brady announced that William J. Bremner, Deputy Assistant Secretary for Federal Finance, has resigned his post at the Treasury Department, effective July 7, 1989.

Mr. Bremner has served as Deputy Assistant Secretary for Federal Finance since April 1986, and has been responsible for the management of the Federal debt, the Federal Financing Bank, Federal credit program policy, and policy direction for the government securities market.

Mr. Bremner directed the development of regulations for the government securities market, the largest securities market in the world and the primary source of funding the Federal debt. He has maintained a leadership role throughout the implementation of the Government Securities Act of 1986.

In announcing his departure, Secretary Brady commended Mr. Bremner for his "dedication to public service" and noted that he "has made invaluable contributions throughout his broad range of responsibilities, and we wish him success in his future endeavors."

Before assuming his duties as Deputy Assistant Secretary, Mr. Bremner was a Vice President and Manager of a regional office of Chase Manhattan. Prior to that he was President of Bremner Advisory Corp., an investment advisory and financial consulting firm.

Mr. Bremner received his Bachelor of Arts degree from Marquette University in 1965. He resides in Potomac, Maryland with his wife, Mary Lou, and sons, Joe and Tom. He is the son of Mr. and Mrs. David F. Bremner of Louisville, Kentucky.

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TREASURY NEWS

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

5310

JUN 21 9 11 AM

June 20, 1989

Kenneth W. Gideon
Assistant Secretary of the Treasury
(Tax Policy)

Kenneth W. Gideon was confirmed by the United States Senate as Assistant Secretary of the Treasury for Tax Policy on June 8, 1989 and appointed by President Bush on June 9.

As Assistant Secretary for Tax Policy, Mr. Gideon will serve as the chief Treasury spokesman and advisor to the Secretary in the formulation and execution of domestic and international tax policies and programs.

Prior to his nomination to the Assistant Secretary post, Mr. Gideon was a partner with the law firm of Fried, Frank, Harris, Shriver and Jacobson in Washington, D.C., where his practice included Federal tax planning and litigation. He served as Chief Counsel for the Internal Revenue Service, 1981-1983.

Mr. Gideon graduated from Harvard University (B.A., 1968) and Yale Law School (J.D., 1971).

Mr. Gideon, a native of Lubbock, Texas, is married to the former Carol Almack. They have four children and reside in McLean, Virginia.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE   ?M 5310   June 20, 1989

THOMAS J. BERGER
DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY AFFAIRS
TO LEAVE TREASURY

Deputy Assistant Secretary for International Monetary Affairs Thomas J. Berger will leave the Treasury Department in June to return to the private sector.

In announcing Mr. Berger's upcoming departure, Secretary of the Treasury Nicholas F. Brady noted: "Tom has done an excellent job on a wide range of complicated international issues. His skills and abilities will be missed."

Under Secretary for International Affairs David C. Mulford, for whom Mr. Berger worked directly, said, "Since joining the Treasury, Tom has played a key role in all of the Department's major international initiatives. He did an outstanding job in negotiating a landmark financial services agreement with Canada during the U.S.-Canada Free Trade Agreement talks. In addition, he has made continuing important contributions to the development of the economic policy coordination process that is now used by the Group of Seven industrial countries."

Mr. Berger was appointed to his current position on February 3, 1986 by Secretary of the Treasury James A. Baker III. Prior to becoming Deputy Assistant Secretary, Mr. Berger served, since 1983, as an investment advisor to the Saudi Arabian Monetary Agency (SAMA) and resided in Riyadh. His activities at SAMA focused on the ongoing development and implementation of an international investment program for the surplus oil revenues that Saudi Arabia built up during the 1970s and early 1980s.

From 1977 to 1983, Mr. Berger was a Vice President in the Investment Banking Division of Merrill Lynch Capital Markets in New York. While at Merrill Lynch he worked with U.S. and foreign corporations in arranging financings, both domestically and abroad. From 1973 until 1975, Mr. Berger was a corporate lending officer with Citibank, N.A. in New York.

Originally from Princeton, New Jersey, Mr. Berger holds a bachelors degree cum laude from Harvard College and a masters degree in business administration from the Harvard Business School. He and his wife, Diane, reside in Washington, D.C.

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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.
June 20, 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 $12,800 million, to be issued June 29, 1989. This offering will result in a paydown for the Treasury of about $1,825 million, as the maturing bills are outstanding in the amount of $14,627 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, June 26, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated September 29, 1988, and to mature September 28, 1989 (CUSIP No. 912794 SL 9), currently outstanding in the amount of $16,678 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,400 million, to be dated June 29, 1989, and to mature December 28, 1989 (CUSIP No. 912794 TJ 3).

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 June 29, 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 $1,437 million as agents for foreign and international monetary authorities, and $3,501 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.

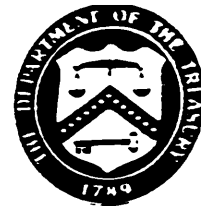
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments 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 Release Upon Delivery
Expected at 10:00 AM
June 21, 1989

JUN 22 ... DEPAR

STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to present the views of the Treasury Department regarding the tax implications of two bills dealing with the serious and recurring problem of spills of crude oil and other products upon our nation's waterways. I will start by discussing S. 1066, which proposes to set up a cleanup fund as part of a comprehensive oil spill act. I will then turn to S. 771, which would disallow deductions for costs incurred in a cleanup program not found to be in good faith compliance with certain federal standards.

S. 1066

The Administration strongly supports S. 1066, which would enact the Comprehensive Oil Pollution Liability and Compensation Act of 1989. S. 1066 has several components designed to achieve a number of important goals, including assurance of fiscal responsibility of crude oil shippers, implementation of international conventions on oil spills, and activation of the Oil Spill Liability Trust Fund. Today I would like to address the provisions concerning the oil spill financing rate (the "fee") and the Oil Spill Liability Trust Fund (the "Fund"). I would like to start by briefly reviewing the purposes of the Fund before turning to the amendments to the Internal Revenue Code of 1986 (the "Code") proposed by the bill.

Under S. 1066, the Fund would consolidate the functions of a number of separate oil spill funds that have been established over the years. The Fund would be available to cover costs of cleanup and natural resource restoration which exceed the liability limits of the polluter. The Fund would also provide a source of immediate money for such operations and would seek to recover these amounts from liable polluters up to their liabilit

limits. In cases where a polluter proves financially unable to satisfy its liabilities, the Fund would end up bearing all or part of the cost of cleanup. Thus, the Fund would constitute a measure of insurance, spreading the risk and providing a savings fund for any future spills.

The bill provides three separate sources of money for the Fund. Initially, the balances in two existing cleanup funds (the Offshore Oil Pollution Compensation Fund and the Deepwater Port Liability Fund) are to be rolled into the Fund when it becomes operational. The balance in these funds is approximately $152 million. Secondly, the Fund is to receive the proceeds from a 1.3 cent per barrel fee to be levied upon all domestic and imported oil. We estimate that the fee would generate revenue to the Fund of $296 million, assuming an effective date of July 1, 1989 and a termination date of June 30, 1994. Thirdly, the Fund would recoup cleanup and restoration costs from liable polluters.

I would like to now turn to the provisions of the Internal Revenue Code that would be affected by S. 1066. The 1.3 cent per barrel fee that would be collected under the bill is found in section 4611(c) of the Code. It was enacted by the Omnibus Budget Reconciliation Act of 1986. The fee would be collected on the same base as the Hazardous Substance Superfund fee. Thus, it would be generally imposed on all crude oil received at a US refinery, domestic crude oil used in the United States or exported before received at a US refinery, and upon imported petroleum products. A credit against a taxpayer's liability under Code section 4611(c) is provided by Code section 4612(d) for amounts paid by the taxpayer prior to January 1, 1987 to the Offshore Oil Pollution Compensation Fund and the Deepwater Port Liability Fund. Code section 9509 establishes the Fund as part of the Trust Fund Code, a subtitle of the Internal Revenue Code.

S. 1066 would make four changes to the provisions of the Internal Revenue Code which currently control the fee and the Fund. First, under current law, the Code section 4611(c) fee is scheduled to expire at the end of 1991. However, that termination date was selected in 1986, meaning that as originally enacted the Fund would receive revenues from the fee for approximately five years. Since the bill would start collection of the fee 30 days after enactment, the bill extends the termination date of the fee to June 30, 1994. The purpose of the extension is to ensure that, assuming timely enactment, the Fund receives approximately the amount of revenues contemplated in 1986 when the Fund was established.

Second, S. 1066 would amend Code section 9509(c)(1), which currently contains specific rules concerning the uses of amounts in the Fund. S. 1066 itself contains rules governing the uses of the Fund. It would be confusing and unnecessary to have two sets of rules governing the permissible uses of the Fund. Therefore, the bill amends Code section 9509(c)(1) to provide that the amounts in the Fund may be used only for purposes specified by

the bill.

Third, S. 1066 modifies Code section 9509(c)(2), which provides limitations on expenditures by the Fund. Under current law, there is a maximum of $500 million per incident. The bill would empower the President to waive this limit if he determines it is necessary and in the best interests of the country. Also, Code section 9509(c)(2)(B) currently limits natural resource damage assessments and claims to $250 million per incident; this limitation would be deleted under S. 1066. The Exxon Valdez spill has demonstrated that natural resource restoration costs can be very large; thus, the Adminstration does not believe a separate $250 million per incident limit is appropriate.

Finally, under Code section 4611, in its current form, collection of the fee does not commence until 30 days after the passage of qualifying authorizing legislation, defined as any legislation which is substantially identical to certain legislation passed by the House of Representatives during the 99th Congress. The bill is similar in most respects to this prior legislation, and we believe it constitutes "qualifying authorizing legislation" within the meaning of Code section 4611(c). However, to avoid any question as to whether the Act does indeed constitute "qualifying authorizing legislation", S. 1066 amends Code section 4611 to provide that collection of the fee commences 30 days after enactment of S. 1066.

These are the only changes that S. 1066 would make to the Internal Revenue Code. We believe they are generally consistent with the intent of Congress when it initially enacted Code sections 4611(c) and 9509. We also believe this legislation is extremely important, and should be enacted quickly.

S. 771

S. 771 would amend the Internal Revenue Code to disallow a deduction for any costs incurred in a cleanup of a spill of oil or any hazardous substance, unless the Administrator of the Environmental Protection Agency or the Commandant of the Coast Guard certifies that the taxpayer has made a good faith effort to comply with certain Federal laws. The bill would require the Treasury Department to prepare an estimate of the total revenue cost from 1970 to 1987 of deductions for cleanup costs that would not have been deductible under the rules provided by the bill, and would require the Treasury Department to prepare annual reports in future years estimating revenue increases from disallowed deductions. The stated purposes of the bill are (1) that the public should not pay for discharges of oil or hazardous substances, either directly through payment of cleanup cost or indirectly through tax deductions; (2) that those injured by discharges of oils or hazardous substances should be fully compensated; (3) that all ecological damages from a discharge should be mitigated; and (4) that a taxpayer should receive a tax

deduction only if the cleanup meets federal standards. The bill also states its intention that any increase in federal revenues attributable to disallowed deductions should be dedicated to cleanup of environmental damage.

We strongly oppose this bill for several reasons. The bill would violate the fundamental principle of business taxation that a taxpayer's ordinary and necessary business expenses may be deducted in computing net income. Expenses incurred in cleanup of an oil spill satisfy this standard. If a taxpayer fails to satisfy applicable federal regulations, then the penalty should be determined under and imposed by those regulations. The denial of all deductions might bear little or no relation to the severity of the violation. Denial of a deduction to a taxpayer who refused to spend any money on a cleanup would be a meaningless sanction. On the other hand, a taxpayer who spent large sums in a cleanup effort that was determined after the fact not to constitute a "good faith effort" to satisfy federal standards would be denied a deduction, thereby imposing a significant disincentive to incur any cost at all if it is feared that the expenditures will be inadequate. Although we fully agree that cleanup of spills should be conducted in accordance with federal rules, we do not believe those rules should be inserted into the tax code.

We believe that the objectives of S. 771 would be better achieved by enactment of S. 1066. We also believe that the provisions of S. 771 will result in undue complexity. A taxpayer would frequently be unaware of whether deductions were allowable at the time the tax return was filed, requiring amended returns. Taxpayers would be required to list disallowed expenses on a separate form. Such expenses would apparently be broadly defined, resulting in controversy over whether an expense was part of cleanup costs. Furthermore, the bill would require the Treasury Department to prepare an estimate of the total revenue cost from 1970 to 1987 of allowing deductions for cleanup costs, and would require the Treasury Department to prepare annual reports in future years estimating revenue increases from disallowed deductions. We believe that these provisions would result in unnecessary complexity and effort for taxpayers and the government.

For these reasons we oppose the enactment of S. 771. This concludes my prepared remarks. I would be glad to answer any questions.

// TREASURY NEWS

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

M 5310

FOR IMMEDIATE RELEASE   June 21, 1989

Michael L. Williams
Appointed Deputy Assistant Secretary
For Enforcement

Secretary of the Treasury Nicholas F. Brady announced the appointment of Michael L. Williams to serve as Deputy Assistant Secretary for Enforcement. Mr. Williams will serve as a principal advisor to the Assistant Secretary for Enforcement, with oversight responsibility for the Federal Law Enforcement Training Center, the U.S. Secret Service, the U.S. Customs Service, and the Bureau of Alcohol, Tobacco and Firearms. He will supervise the Office of Law Enforcement, the coordinating office for Operation Alliance, and the Office of Financial Enforcement, the implementing agency for the Bank Secrecy Act.

Prior to joining Treasury, Mr Williams served as a Special Assistant to the Attorney General. He is a former Federal and state prosecuting attorney, having served at the Department of Justice from 1984 to 1988 and as an Assistant District Attorney in his hometown, Midland, Texas. He had also served as a domestic policy analyst in the area of law enforcement for BUSH-QUAYLE 88 and as an Economic Development Planner for the Midland Chamber of Commerce.

Mr. Williams holds a B.A. (1975), an M.P.A. (1979), and a J.D. (1979) from the University of Southern California. He now resides in Falls Church, Virginia with his wife Donna.

NB-346

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
June 21, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION 2-YEAR AND 4-YEAR NOTES TOTALING $16,250 MILLION

The Treasury will auction $8,750 million of 2-year notes and $7,500 million of 4-year notes to refund $17,379 million of securities maturing June 30, 1989, and to paydown about $1,125 million. The $17,379 million of maturing securities are those held by the public, including $2,258 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $16,250 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 prices of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks, for their own accounts, hold $1,434 million of the maturing securities that may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

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

oOo

Attachment

NB-347

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
OF 2-YEAR AND 4-YEAR NOTES TO BE ISSUED JUNE 30, 1989

June 21, 1989

Amount Offered to the Public ...	$8,750 million	$7,500 million
Description of Security:		
Term and type of security	2-year notes	4-year notes
Series and CUSIP designation ...	Series AB-1991 (CUSIP No. 912827 XR 8)	Series P-1993 (CUSIP No. 912827 XS 6)
Maturity date	June 30, 1991	June 30, 1993
Interest Rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	December 31 and June 30	December 31 and June 30
Minimum denomination available .	$5,000	$1,000
Terms of Sale:		
Method of sale	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None	None
Payment Terms:		
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment 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
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Receipt of tenders	Tuesday, June 27, 1989, prior to 1:00 p.m., EDST	Wednesday, June 28, 1989, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):		
a) funds immediately available to the Treasury ...	Friday, June 30, 1989	Friday, June 30, 1989
b) readily-collectible check ...	Wednesday, June 28, 1989	Wednesday, June 28, 1989

TREASURY NEWS

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

FOR IMMEDIATE RELEASE June 22, 1989

Monthly Release of U.S. Reserve Assets

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

As indicated in this table, U.S. reserve assets amounted to $54,976 million at the end of May, up from $50,303 million in April.

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					
Apr.	50,303	11,061	9,379	20,731	9,132
May	54,976	11,060	9,134	26,234	8,548

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.

NB-348

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 12:00 NOON
June 23, 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 July 6, 1989, and to mature July 5, 1990 (CUSIP No. 912794 UM 4). This issue will result in a paydown for the Treasury of about $ 225 million, as the maturing 52-week bill is outstanding in the amount of $9,234 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, June 29, 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 July 6, 1989. In addition to the maturing 52-week bills, there are $14,792 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $2,525 million as agents for foreign and international monetary authorities, and $ 7,655 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 $292 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.

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
June 26, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,418 million of 13-week bills and for $6,418 million of 26-week bills, both to be issued on June 29, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing September 28, 1989			:	26-week bills maturing December 28, 1989		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.05%	8.33%	97.965	:	7.72%	8.15%	96.097
High	8.08%	8.36%	97.958	:	7.80%	8.23%	96.057
Average	8.07%	8.35%	97.960	:	7.78%	8.21%	96.067

Tenders at the high discount rate for the 13-week bills were allotted 30%.
Tenders at the high discount rate for the 26-week bills were allotted 52%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 24,760	$ 24,760	:	$ 24,295	$ 24,295
New York	21,819,145	5,495,305	:	17,249,615	5,444,015
Philadelphia	18,865	18,865	:	16,940	16,940
Cleveland	45,720	44,990	:	39,485	39,485
Richmond	35,450	35,450	:	27,795	27,795
Atlanta	42,165	37,765	:	23,685	23,685
Chicago	1,124,650	68,150	:	847,270	188,270
St. Louis	42,715	22,715	:	28,980	24,020
Minneapolis	7,705	7,705	:	9,180	9,180
Kansas City	35,590	35,590	:	33,365	33,365
Dallas	37,855	27,855	:	26,605	24,205
San Francisco	1,081,925	122,925	:	948,005	172,005
Treasury	477,015	476,015	:	391,145	391,145
TOTALS	$24,793,560	$6,418,090	:	$19,666,365	$6,418,405
Type					
Competitive	$21,723,745	$3,348,275	:	$15,836,840	$2,588,880
Noncompetitive	1,146,735	1,146,735	:	813,995	813,995
Subtotal, Public	$22,870,480	$4,495,010	:	$16,650,835	$3,402,875
Federal Reserve	1,851,210	1,851,210	:	1,650,000	1,650,000
Foreign Official Institutions	71,870	71,870	:	1,365,530	1,365,530
TOTALS	$24,793,560	$6,418,090	:	$19,666,365	$6,418,405

An additional $1,930 thousand of 13-week bills and an additional $123,070 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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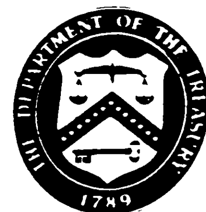
TREASURY NEWS


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

FOR IMMEDIATE RELEASE
June 27, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $8,759 million of $23,185 million of tenders received from the public for the 2-year notes, Series AB-1991, auctioned today. The notes will be issued June 30, 1989, and mature June 30, 1991.

The interest rate on the notes will be 8-1/4%. The range of accepted competitive bids, and the corresponding prices at the 8-1/4% rate are as follows:

	Yield	Price
Low	8.25%	100.000
High	8.27%	99.964
Average	8.26%	99.982

Tenders at the high yield were allotted 48%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 43,010	$ 43,010
New York	20,344,900	7,452,355
Philadelphia	28,965	28,965
Cleveland	56,030	56,030
Richmond	59,375	59,375
Atlanta	30,585	30,545
Chicago	1,142,935	437,935
St. Louis	88,515	68,515
Minneapolis	29,465	29,465
Kansas City	94,330	94,300
Dallas	31,680	24,080
San Francisco	1,080,290	280,290
Treasury	154,460	154,460
Totals	$23,184,540	$8,759,325

The $8,759 million of accepted tenders includes $987 million of noncompetitive tenders and $7,772 million of competitive tenders from the public.

In addition to the $8,759 million of tenders accepted in the auction process, $955 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $934 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-351

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.
June 27, 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 $13,200 million, to be issued July 6, 1989. This offering will result in a paydown for the Treasury of about $1,600 million, as the maturing bills are outstanding in the amount of $14,792 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, July 3, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,600 million, representing an additional amount of bills dated April 6, 1989, and to mature October 5, 1989 (CUSIP No. 912794 SZ 8), currently outstanding in the amount of $7,795 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 6,600 million, to be dated July 6, 1989, and to mature January 4, 1990 (CUSIP No. 912794 TK 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 July 6, 1989. In addition to the maturing 13-week and 26-week bills, there are $ 9,234 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $2,212 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,504 million as agents for foreign and international monetary authorities, and $7,655 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

FOR IMMEDIATE RELEASE
June 28, 1989

CONTACT: LARRY BATDORF
202/566-2041

UNITED STATES SIGNS CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

Ambassador Denis Lamb, the U.S. Permanent Representative to the Organization for Economic Cooperation and Development (OECD), signed the Convention on Mutual Administrative Assistance in Tax Matters in Paris on June 28, 1989. The Convention provides for the exchange of tax information between any two parties to the Convention. The Convention, developed by the OECD and the Council of Europe over a five-year period, will apply only to OECD or Council of Europe member countries that agree to be bound by it.

Exchange of information under the Convention will be similar to information exchange taking place currently under a network of bilateral tax treaties. Although the Convention also provides for assistance in collection of taxes and in the service of documents, the United States will enter reservations on these forms of assistance, as a party is permitted to do under the Convention.

The United States will indicate that U.S. authorities may inform a U.S. resident or national before transmitting information concerning him under the Convention. The United States will issue an administrative procedure generally providing for such notification to a U.S. resident or national in cases where such notice is not required by law.

The Convention will be sent to the Senate for its advice and consent to ratification. The Convention will be effective for the United States after U.S. ratification and ratification by five member countries of the OECD or the Council of Europe.

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// TREASURY NEWS

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

FOR IMMEDIATE RELEASE
June 28, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 4-YEAR NOTES

The Department of the Treasury has accepted $7,527 million of $20,348 million of tenders received from the public for the 4-year notes, Series P-1993, auctioned today. The notes will be issued June 30, 1989, and mature June 30, 1993.

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

	Yield	Price
Low	8.19%	99.782
High	8.20%	99.749
Average	8.19%	99.782

Tenders at the high yield were allotted 50%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 26,037	$ 26,037
New York	17,971,649	6,508,149
Philadelphia	18,073	18,073
Cleveland	30,232	30,232
Richmond	136,509	81,509
Atlanta	16,526	16,526
Chicago	1,164,559	429,559
St. Louis	56,948	31,948
Minneapolis	16,569	16,567
Kansas City	43,159	43,159
Dallas	19,227	14,727
San Francisco	804,122	266,620
Treasury	43,986	43,986
Totals	$20,347,596	$7,527,092

The $7,527 million of accepted tenders includes $620 million of noncompetitive tenders and $6,907 million of competitive tenders from the public.

In addition to the $7,527 million of tenders accepted in the auction process, $320 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $500 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

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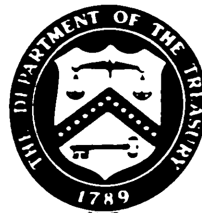
TREASURY NEWS



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

FOR IMMEDIATE RELEASE June 29, 1989

Robert M. Bestani
Appointed Deputy Assistant Secretary for
International Monetary Affairs

Secretary of the Treasury, Nicholas F. Brady, has announced the appointment of Robert M. Bestani as Deputy Assistant Secretary of the Treasury for International Monetary Affairs.

Mr. Bestani will play a key role in developing and implementing U.S. international economic policies and will focus on U.S. economic and financial relationships with the other industrial countries. His responsibilities will also encompass the International Monetary Fund, third world debt, international banking issues and foreign exchange operations.

Prior to becoming Deputy Assistant Secretary, Mr. Bestani was a Vice President and Global Account Officer with the Bank of America in New York. In this capacity, his activities included the management, negotiation and development of the Bank's relationships with a number of major multinational corporations. In addition he was responsible for providing advice on corporate funding in the domestic and international financial markets, foreign exchange and interest rate risk management, corporate financial planning and project finance.

Previously, Mr. Bestani was with the Treasury and Finance Department of Texaco Inc., where he was involved in the domestic and international money markets and strategic financial planning. He also has had extensive international banking experience with Citibank and the Irving Trust.

Living in Tenafly, New Jersey where he serves as an elected member of the Board of Education, Mr. Bestani holds a M.B.A from the University of Chicago and a B.A. in International Economics from Rutgers University.

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TREASURY NEWS

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

5310

FOR IMMEDIATE RELEASE June 29, 1989

Statement of
Nicholas F. Brady
Secretary of the Treasury

The President has made a capital gains tax differential a key element of the Administration's economic program. It will lower the cost of capital, create incentives for investment in the long-term productive capacity of American industry, make American firms more competitive internationally, and create new job opportunities. All Americans will benefit. We will emphasize these economic benefits as we work with Congress to achieve enactment of the capital gains measure.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE
June 29, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,003 million of 52-week bills to be issued July 6, 1989, and to mature July 5, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	7.55%	8.12%	92.366
High -	7.62%	8.20%	92.295
Average -	7.58%	8.16%	92.336

Tenders at the high discount rate were allotted 79%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 23,215	$ 23,215
New York	19,263,425	8,268,925
Philadelphia	16,065	16,065
Cleveland	25,670	25,670
Richmond	24,625	24,625
Atlanta	15,645	15,645
Chicago	1,034,035	146,935
St. Louis	22,490	19,490
Minneapolis	13,530	13,530
Kansas City	34,720	34,720
Dallas	8,870	8,870
San Francisco	986,450	159,450
Treasury	245,685	245,685
TOTALS	$21,714,425	$9,002,825
Type		
Competitive	$18,272,935	$5,561,335
Noncompetitive	641,490	641,490
Subtotal, Public	$18,914,425	$6,202,825
Federal Reserve	2,800,000	2,800,000
Foreign Official Institutions	-0-	-0-
TOTALS	$21,714,425	$9,002,825

NB-357

TREASURY NEWS

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

FOR IMMEDIATE RELEASE June 30, 1989

EMILY FORD COOKSEY
APPOINTED DEPUTY TREASURER OF THE UNITED STATES

Secretary of the Treasury, Nicholas F. Brady, has named Emily Ford Cooksey as the Deputy Treasurer of the United States.

Mrs. Cooksey has been with the Treasury Department since 1985 serving as the Director, Office of Administrative Operations. During this time, she also managed the administrative services for the 1987 Presidential Task Force on Market Mechanisms in New York City. Prior to joining Treasury, she was Director for Administrative Operations for the 1985 Presidential Inaugural Committee after having served on the staff of the 1984 Republican National Convention in Dallas, Texas.

From 1981 to 1985, Mrs. Cooksey served in the White House as Executive Assistant to the Assistant to the President for Management and Administration, except for a period in 1983 when she helped organize the 1983 Economic Summit hosted by the President in Williamsburg, Virginia.

Mrs. Cooksey served on the staff of the George Bush for President Campaign in 1979 and 1980. She then worked in the Vice Presidential Scheduling Office in the 1980 Reagan-Bush Campaign and in the Vice President's Office for the 1981 Presidential Inaugural Committee.

Mrs. Cooksey was born June 6, 1958 and is from Houston, Texas. She resides with her husband, Paul Cooksey, in Alexandria, Virginia.

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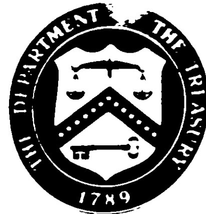
TREASURY NEWS



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

N 5310

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
July 3, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 6,602 million of 13-week bills and for $ 6,610 million of 26-week bills, both to be issued on July 6, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 5, 1989			:	26-week bills maturing January 4, 1990		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.90%	8.17%	98.003	:	7.58%	7.99%	96.168
High	7.97%	8.25%	97.985	:	7.64%	8.06%	96.138
Average	7.96%	8.24%	97.988	:	7.63%	8.05%	96.143

Tenders at the high discount rate for the 13-week bills were allotted 17%.
Tenders at the high discount rate for the 26-week bills were allotted 57%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 31,615	$ 31,615	:	$ 29,015	$ 29,015
New York	23,096,125	5,558,830	:	19,693,930	5,113,570
Philadelphia	16,205	16,205	:	14,645	14,645
Cleveland	47,365	47,365	:	35,030	35,030
Richmond	47,460	47,460	:	37,850	37,850
Atlanta	36,400	36,400	:	32,410	32,410
Chicago	928,970	87,470	:	1,369,620	555,320
St. Louis	24,970	24,970	:	28,595	28,595
Minneapolis	11,270	11,270	:	10,110	10,110
Kansas City	44,195	44,195	:	44,935	44,935
Dallas	32,765	32,765	:	21,285	21,285
San Francisco	727,850	115,850	:	719,400	172,400
Treasury	547,625	547,625	:	514,945	514,945
TOTALS	$25,592,815	$6,602,020	:	$22,551,770	$6,610,110
Type					
Competitive	$20,923,415	$2,232,620	:	$17,611,935	$1,970,275
Noncompetitive	1,296,960	1,296,960	:	1,105,540	1,105,540
Subtotal, Public	$22,220,375	$3,529,580	:	$18,717,475	$3,075,815
Federal Reserve	2,455,435	2,155,435	:	2,400,000	2,100,000
Foreign Official Institutions	917,005	917,005	:	1,434,295	1,434,295
TOTALS	$25,592,815	$6,602,020	:	$22,551,770	$6,610,110

An additional $30,595 thousand of 13-week bills and an additional $ 48,205 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR RELEASE AT 4:00 P.M.
July 3, 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 $13,200 million, to be issued July 13, 1989. This offering will result in a paydown for the Treasury of about $1,800 million, as the maturing bills are outstanding in the amount of $15,010 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, July 10, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,600 million, representing an additional amount of bills dated April 13, 1989, and to mature October 12, 1989 (CUSIP No. 912794 TA 2), currently outstanding in the amount of $7,901 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,600 million, to be dated July 13, 1989, and to mature January 11, 1990 (CUSIP No. 912794 TL 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 July 13, 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 $1,602 million as agents for foreign and international monetary authorities, and $3,804 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.

TREASURY NEWS

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

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

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION $7,250 MILLION OF 7-YEAR NOTES

The Department of the Treasury will auction $7,250 million of 7-year notes to refund $4,437 million of 7-year notes maturing July 15, 1989, and to raise about $2,825 million new cash. The public holds $4,437 million of the maturing 7-year notes, including $390 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $7,250 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 $286 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-361

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

July 5, 1989

Amount Offered:

To the public	$7,250 million

Description of Security:

Term and type of security	7-year notes
Series and CUSIP designation	G-1996 (CUSIP No. 912827 XT 4)
Maturity date	July 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	January 15 and July 15
Minimum denomination available ..	$1,000

Terms of Sale:

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

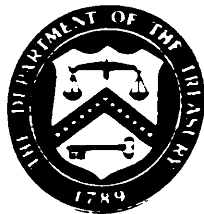
Payment Terms:

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

Key Dates:

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

TREASURY NEWS



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

FOR IMMEDIATE RELEASE
July 6, 1989

Contact: Peter Hollenbach
(202) 376-4302

FINAL REGULATIONS PUBLISHED FOR STATE AND LOCAL GOVERNMENT SERIES (SLGS) U.S. TREASURY SECURITIES

The Treasury Department today announced the publication of final regulations regarding its State and Local Government Series securities (SLGS). The final regulations are effective August 1, 1989, for Demand Deposit securities and September 1, 1989, for all other securities offered in the series.

SLGS are nonmarketable securities issued to state and local governments and certain other entities as an investment medium for the proceeds of tax exempt securities issues that are subject to yield restrictions or arbitrage rebate requirements under the Internal Revenue Code.

Time Deposit Securities

Treasury will issue a new SLGS interest rate table each day, instead of weekly, for Time Deposit securities. Although the new Time Deposit SLGS rates do not become effective until September 1, they will be available on the Commerce Department Economic Bulletin Board and at the Federal Reserve Banks beginning on July 10. Call 202-377-3870 for information about the EBB.

The formula to calculate the redemption proceeds for Time Deposit securities issued beginning on September 1 and redeemed before maturity has been modified in a way that generally will result in higher proceeds than under the formula for earlier issues of SLGS. The certification requirements in place since October 1987, pertaining to investments of proceeds derived from the sale of escrowed open market securities, have been incorporated in the final regulations.

Demand Deposit Securities

The final regulations provide for an extension of the maturity of Demand Deposit securities from overnight to 90 days in the event the debt ceiling prevents the Treasury from issuing new 1-day

securities. This change will assure that investors, who will have the option to redeem their Demand Deposit SLGS earlier without penalty, can continue to earn interest.

Interest rates on Demand Deposit securities will be calculated using a formula based on the results of the most recent weekly 91 day (3- month) Treasury bill auction. Rates for these securities were previously calculated using an adjustment to the federal funds rate. In a separate notice, also released today, the Treasury announced a reduction in the administrative cost component and a small increase in the marginal tax rate component of the rate formula. Investors in Demand Deposit securities will be required to certify that neither the aggregate issue price nor the stated redemption price at maturity of the tax exempt bonds is in excess of $35 million.

Special Zero Interest Securities

The final regulations create special Zero Interest securities, whose terms are similar to Time Deposit securities, except that the subscriber need not certify that all the proceeds of a tax exempt securities issue that are subject to yield restrictions are being invested in SLGS. This new security is intended to increase the flexibility of the SLGS program.

Approximately $155 billion of Time and Demand Deposit securities are outstanding.

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TREASURY NEWS

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

ROOM 5310

FOR RELEASE AT 3:00 PM
July 7, 1989

Contact: Peter Hollenbach
(202) 376-4302

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

The Department of the Treasury announced activity figures for the month of June 1989, of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS).

Dollar Amounts in Thousands

Principal Outstanding (Eligible Securities)	$346,648,566
Held in Unstripped Form	$264,058,156
Held in Stripped Form	$82,590,410
Reconstituted in June	$3,680,440

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-363

TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, JUNE 30, 1989
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Reconstituted This Month[1]
		Total	Portion Held in Unstripped Form	Portion Held in Stripped Form	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,586,554	$1,072,000	-0-
11-1/4% Note A-1995	2/15/95	6,933,861	6,184,101	749,760	$7,840
11-1/4% Note B-1995	5/15/95	7,127,086	5,312,206	1,814,880	63,200
10-1/2% Note C-1995	8/15/95	7,955,901	7,123,501	832,400	117,600
9-1/2% Note D-1995	11/15/95	7,318,550	6,431,750	886,800	58,400
8-7/8% Note A-1996	2/15/96	8,411,519	8,109,119	302,400	3,200
7-3/8% Note C-1996	5/15/96	20,085,643	19,882,443	203,200	-0-
7-1/4% Note D-1996	11/15/96	20,258,810	20,126,010	132,800	100,800
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	9,773,129	35,200	-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	9,135,387	30,000	-0-
9-1/4% Note C-1998	8/15/98	11,342,646	11,253,046	89,600	-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	9,719,628	9,719,628	-0-	-0-
9-1/8% Note B-1999	5/15/99	10,047,103	10,047,103	-0-	-0-
11-5/8% Bond 2004	11/15/04	8,301,806	3,266,606	5,035,200	478,400
12% Bond 2005	5/15/05	4,260,758	1,800,908	2,459,850	66,000
10-3/4% Bond 2005	8/15/05	9,269,713	6,467,313	2,802,400	165,600
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	1,378,384	4,627,200	49,600
11-1/4% Bond 2015	2/15/15	12,667,799	2,830,839	9,836,960	-0-
10-5/8% Bond 2015	8/15/15	7,149,916	1,847,516	5,302,400	40,000
9-7/8% Bond 2015	11/15/15	6,899,859	2,463,059	4,436,800	-0-
9-1/4% Bond 2016	2/15/16	7,266,854	5,164,454	2,102,400	-0-
7-1/4% Bond 2016	5/15/16	18,823,551	14,948,351	3,875,200	1,128,800
7-1/2% Bond 2016	11/15/16	18,864,448	9,719,968	9,144,480	48,000
8-3/4% Bond 2017	5/15/17	18,194,169	7,592,729	10,601,440	284,800
8-7/8% Bond 2017	8/15/17	14,016,858	9,028,058	4,988,800	-0-
9-1/8% Bond 2018	5/15/18	8,708,639	4,883,039	3,825,600	62,400
9% Bond 2018	11/15/18	9,032,870	4,467,270	4,565,600	589,800
8-7/8% Bond 2019	2/15/19	19,250,793	16,559,593	2,691,200	416,000
Total		346,648,566	264,058,156	82,590,410	3,680,440

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form.

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 940-012

TREASURY NEWS

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

FOR IMMEDIATE RELEASE

Remarks by
Secretary of the Treasury
Nicholas F. Brady
at a Press Briefing
Washington, D.C.
July 10, 1989

Good afternoon. Before leaving to join the President at the Economic Summit in Paris, I want to say something about the work that will be going on here in Washington in the House-Senate conference on the President's savings and loan reform plan.

We are on the brink of a major achievement. The Congress has worked diligently on the President's plan and our hope is that the conference will complete its deliberations in time for a bill to be sent to the President for signature well before the scheduled August Congressional recess.

When President Bush announced his plan back in February, he urged the Congress to take steps to assure that such a crisis could never happen again. The most important reform was the President's proposal that S&Ls be required to meet the same capital standards that are applied to national banks. As we enter the conference, we're extremely optimistic that this is exactly what will emerge. The Congress is to be commended for standing up to significant S&L industry lobbying and adopting capital standards that will require all thrift owners to put their own money at risk ahead of the taxpayers'.

But in its eagerness to resolve the savings and loan crisis, the House has adopted a financing plan that represents a dangerous precedent. As you know, the Administration, the Congress, the Federal Deposit Insurance Corporation, and the Federal Reserve all agree that $50 billion is needed to resolve currently insolvent S&Ls and those likely to become insolvent over the next three years. How that money is raised is the issue.

The President proposed creating a private company, the Resolution Funding Corporation (REFCORP), which would issue bonds to raise the $50 billion. The Senate adopted the President's proposal, but the House passed an alternative plan requiring the Treasury to borrow the $50 billion directly.

NB-364

The Bush-Senate plan would back the REFCORP bonds with Treasury bonds purchased with private funds from the S&L industry. That would provide the money necessary to pay off the REFCORP bonds, and it would lock the S&L industry funds into REFCORP. A combination of industry and taxpayer funds would pay the interest.

Under the House plan, on the other hand, the industry money isn't locked in and there is no guarantee that the S&L industry won't succeed in reclaiming these funds for its own uses in future years. That is exactly what happened last year when Farm Credit System member banks persuaded Congress to allow them to reclaim a substantial portion of their funds that had been pledged to the resolution of the farm credit crisis the previous year.

Proponents of the House plan claim it will save the taxpayers at least $125 million per year. But they are short-sighted in counting these savings, because they have failed to think through the consequences of their proposal. By issuing Treasury bonds for direct government financing, the House plan places the full burden of the $50 billion on the federal budget, thereby exceeding Gramm-Rudman-Hollings deficit reduction targets. To make the plan work, therefore, they will need a Gramm-Rudman-Hollings waiver. Once it becomes clear to the financial markets that we're no longer going to observe Gramm-Rudman-Hollings budget discipline, we are likely to see interest rates respond. An increase of only one-hundredth of one percent would more than wipe out the House plan's anticipated savings.

So the President's plan is cheaper for the taxpayer: first because it preserves Gramm-Rudman-Hollings, and second because it locks industry money into the solution.

The Bush-Senate plan counts every dollar of taxpayer funds in the budget deficit and within Gramm-Rudman-Hollings targets. There is no waiver to future Gramm-Rudman-Hollings targets. Only private funds are counted off-budget, as they should be. The House plan claims to be on-budget, but the Gramm-Rudman waiver makes the term "on-budget" meaningless.

Finally, the Bush-Senate plan would be harder for other spending programs to duplicate. To qualify for this sort of a program, a project would have to provide substantial private funds up front. The House plan sets a precedent for seeking an exemption from Gramm-Rudman-Hollings for every new spending program that finds its way through Congress.

In closing, I'd like to congratulate the Congress for acting wisely in insisting on strong capital standards to ensure that the savings and loan crisis can never be repeated. And I urge the Congress to act just as wisely by adopting a financing plan that makes sure the industry pays its fair share and preserves essential budget discipline.

TREASURY NEWS

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

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
July 10, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,615 million of 13-week bills and for $6,603 million of 26-week bills, both to be issued on July 13, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 12, 1989			:	26-week bills maturing January 11, 1990		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.74%a/	8.00%	98.044	:	7.47%	7.87%	96.224
High	7.77%	8.04%	98.036	:	7.52%	7.93%	96.198
Average	7.76%	8.03%	98.038	:	7.50%	7.90%	96.208

a/ Excepting 1 tender of $6,670,000.

Tenders at the high discount rate for the 13-week bills were allotted 68%.
Tenders at the high discount rate for the 26-week bills were allotted 25%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 42,620	$ 42,620	:	$ 32,710	$ 32,710
New York	18,601,455	5,463,105	:	17,369,950	5,054,450
Philadelphia	19,395	19,395	:	19,540	19,540
Cleveland	42,890	42,890	:	32,570	32,570
Richmond	44,015	43,375	:	42,000	42,000
Atlanta	32,510	32,510	:	29,635	29,635
Chicago	1,043,025	60,025	:	815,980	90,980
St. Louis	53,920	33,280	:	38,120	30,120
Minneapolis	10,585	10,585	:	10,685	10,685
Kansas City	40,745	40,745	:	48,205	45,885
Dallas	26,180	26,180	:	23,615	23,615
San Francisco	1,013,445	159,445	:	993,060	539,060
Treasury	640,795	640,795	:	651,600	651,600
TOTALS	$21,611,580	$6,614,950	:	$20,107,670	$6,602,850
Type					
Competitive	$18,275,175	$3,578,545	:	$15,473,890	$2,269,070
Noncompetitive	1,322,325	1,322,325	:	1,269,030	1,269,030
Subtotal, Public	$19,597,500	$4,900,870	:	$16,742,920	$3,538,100
Federal Reserve	1,903,830	1,603,830	:	1,900,000	1,600,000
Foreign Official Institutions	110,250	110,250	:	1,464,750	1,464,750
TOTALS	$21,611,580	$6,614,950	:	$20,107,670	$6,602,850

An additional $30,650 thousand of 13-week bills and an additional $359,850 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

TREASURY NEWS

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S&L FINANCING PLAN

BUSH/SENATE	HOUSE
o Preserves GRH fiscal discipline	o Removes GRH fiscal discipline
o Cheaper -- Lower interest rates	o More expensive -- Only one basis point increase in interest rates wipes out savings
o Protects taxpayer by locking in industry funds	o Possible for industry to get money back
o Sound budget accounting -- Private money should be off-budget and is off-budget	o GRH waiver makes term "on-budget" meaningless
o Avoids precedent for other big spending programs	o Sets precedent for other budget-busting programs

June 29, 1989

ADMINISTRATION'S LIST OF MAJOR AND IMPORTANT ISSUES IN THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

MAJOR ISSUES

1. Thrift Capital Standards
   a. Tangible capital
   b. Subsidiary capital deduction
   c. Capital standard for temporary suspension of insurance at discretion of FDIC
   d. Mortgage servicing rights

2. Financing
   a. Senate plan vs. House plan
   b. Cap on SAIF obligations

3. RTC
   a. Streamlining
   b. Note cap
   c. "Right of first refusal"
   d. Appropriation for line of credit from Treasury
   e. Authority to establish Federal mutuals and bridge banks
   f. Open thrift assistance

4. Subsidized Housing

5. State-Chartered Thrift Regulator

IMPORTANT ISSUES

1. Legislative and Budgetary Bypass: OCC and Thrift Regulator

2. Junk Bonds

3. State Thrift Powers

4. Qualified Thrift Lender Test
   a. House version vs. Senate version
   b. Consequences of failure
   c. Eligibility of banks and credit unions to become FHL Bank members

5. Continuation of Current Bank Board Chairman

6. Pay Cap Exemptions

7. Enforcement Issues

   a. Approval of employment of senior financial institutions officials by regulatory agencies
   b. Disposition of civil penalties
   c. Grand jury secrecy
   d. Civil penalty provisions
   e. Justice Department fraud field offices
   f. Civil statute of limitations
   g. FDIC as agency of the United States
   h. Priority of FDIC claims
   i. Litigating authority

8. FHL Banks' $300 Million Annual Contribution

   a. Contribution for REFCORP principal
   b. Contribution for REFCORP interest

9. Exemptions from SAIF-BIF Conversion Moratorium

10. Interim Funding for New Agencies

11. FDIC Accountability

   a. Reporting requirements
   b. FDIC note cap

12. Composition of Federal Housing Finance Board

13. Cost of Reviewing 1988 FSLIC Deals

14. Community Reinvestment Act Provisions

15. Studies of Government Sponsored Enterprises

   a. Capital requirements
   b. Relationship between public debt and GSE activities

16. Appropriations/Authorizations

ADMINISTRATION POSITION ON ISSUES IN THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

MAJOR ISSUES

Area of Concern	Senate	House	Administration Position
1. Thrift Capital Standards			
a. Tangible capital	National bank tangible capital standard by June 1, 1991 (probably 3 percent). Thrifts with goodwill must have only 1.5 percent tangible capital by 1991 deadline, with a maximum of 25 years to amortize the goodwill. (Sec. 301, HOLA 5(t), p. 260)	In essence 3 percent tangible capital is required by June 1, 1990. Thrifts with supervisory goodwill and/or certain MSRs must have only 1.5 percent tangible capital by 1990 deadline, with 4 1/2 years to phase-up to 3 percent (January 1, 1995). (Sec. 314, p. 235)	Prefer House provision.
b. Subsidiary capital deduction	Thrifts must deduct from capital investments in, and loans to, subsidiaries engaging in activities not allowed for national banks (with certain exceptions). 5-year phase-in. (Sec. 301, HOLA 5(t), p. 260)	Nominally similar, except extremely broad grandfather provision. Most thrifts allowed to maintain current levels and types of non-conforming activities without deduction from capital, including direct investment in real estate. (Sec. 314, p. 240)	Prefer Senate provision.

Area of Concern	Senate	House	Adm. Position
c. Capital standard for temporary suspension of insurance at discretion of FDIC	Zero tangible capital, but some additional requirements for thrifts with goodwill. (Sec. 913, p. 445)	Zero tangible capital and zero risk-adjusted capital (which includes supervisory goodwill). (Sec. 926, p. 654-655)	Prefer Senate provision.
d. Mortgage servicing rights	Accounting for MSRs in thrifts will be no less stringent than that for national banks (OCC limits purchased MSRs to a maximum of 25% of core capital; retained MSR's not allowed in capital). (Sec. 301, HOLA 5(t), p. 260)	Accounting for purchased and retained MSR's to conform to FDIC treatment of purchased MSRs. FDIC places no limit on amount of purchased MSRs allowed in core capital, but MSRs are amortized over 15 years or their useful life, whichever is less. (Sec. 314, p. 236)	Prefer the Senate provision, especially for retained mortgage servicing rights. No regulator (including the FHLBB) currently permits retained MSRs to be included in capital.
2. Financing			
a. Senate plan vs. House plan	$50 billion borrowed by REFCORP to ensure industry contributions and maintain G-R-H process intact. (Sec. 502, p. 375)	$50 billion borrowed by Treasury, but is exempted from G-R-H. (Sec. 502, p. 393)	Prefer the Senate version. The large G-R-H exemption sets an unacceptable precedent.

Area of Concern	Senate	House	Adm. Position
b. Cap on SAIF obligations			
For thrifts that fail from 1992-99, issues are what amount of federal funds is available to SAIF; whether appropriation of these amounts is mandatory or discretionary; and whether a large contribution could be made in a single year.	Treasury funds authorized for contributions to SAIF from FY 1991-99. Uncertain whether appropriations would be mandatory or discretionary. In addition, SAIF obligations (spending) are subject to a $24 billion cap during same period. Appears that a large Federal contribution (up to $24 billion) could be made in one year. (Sec. 211, p. 63)	Unlimited Treasury funds authorized for contributions to SAIF from FY 1992-99. But appropriations would be discretionary. (Sec. 212, p. 84)	(1) Should clarify that appropriation is mandatory and that a large amount could be available in a single year. (2) The cap should be on Treasury's contribution to SAIF spending rather than on SAIF's obligations (which would enable SAIF to spend resources it has in excess of the Treasury funds, if it needs to do so).

Area of Concern	Senate	House	Adm. Position
3. RTC			
a. Streamlining Numerous provisions must be added or deleted from each bill in order for RTC to function effectively. Examples not exhaustive.	Problem provisions in Senate bill include the following (unless otherwise noted, all cites are to subsections of new section 21A of the Federal Home Loan Bank Act, which is added by Section 501 of bill): requiring 12 Regional Advisory Board districts [(t), p. 370]; distressed areas defined and RTC prohibited from selling properties below 95% of an established market value [(t), p. 372]; unnecessary expansion of membership of the Oversight Board [(d), p. 348]; submitting annual and semiannual reports to Congress on the operations,	Problem provisions in House bill include: requiring both national and 12 regional advisory boards [(h), p. 326]; establishing a real estate asset division with oversight for all actions involving real property assets [(g), p. 324]; unnecessary expansion of the membership of the Oversight Board [(c), p. 309]; submitting detailed employment plan to Congress before hiring any employees [(t), p. 309]; extensive reporting requirements to Congress [(w), p. 355]; making the RTC a wholly-owned government	Provisions must be rewritten in conference to preserve 3 basic goals: (1) the RTC Oversight Board must maintain broad oversight authority over the RTC because of the huge infusion of taxpayer funds; (2) the FDIC must handle all the basic operations of the RTC without micro-management; and (3) recognizing Congressional concerns, neither the RTC nor the Oversight Board should be hamstrung with specific, inflexible rules written into the legislation and overly burdensome reports.

Area of Concern	Senate	House	Adm. Position
	activities, budget, etc. [(s), p. 364]; lack of enforcement powers; not authorizing RTC to organize Federal mutuals or bridge banks for thrifts.	corporation [505].	

Area of Concern	Senate	House	Adm. Position
b. Note cap	No provision.	Contains two caps. Taken together they provide that total RTC obligations at any time may not exceed the sum of amounts actually received from REFCORP and the amounts actually borrowed from the Treasury ($5 billion maximum). Guarantees would be counted according to total potential loss, rather than expected loss. (Sec. 501, p. 357)	Oppose House provision, because it: o severely curtails RTC working capital financing; o creates strong pressure for asset dumping; o strongly discourages liquidations; o assures that RTC would get off to slow start; and o would require Congress to revisit issue and provide more working capital although RTC would have plenty of assets. Prefer cap which limits RTC's obligations to REFCORP proceeds authorized, amount of outstanding Treasury borrowing, and the market value of assets held by RTC. Expected loss on guarantees would count toward the cap.

Area of Concern	Senate	House	Adm. Position
c. "Right of First Refusal"	No provision.	Mandates 3 month "right of first refusal" to public agencies, non-profit organizations, or low income families on eligible RTC residential property. RTC required to sell property at "below the net realizable market value." RTC may provide 100 percent financing of purchase price, and must provide below market interest rates under certain circumstances. (Sec. 501, p. 338)	Oppose House version, because the right of first refusal provision will significantly increase cost of entire program to the taxpayers.
d. Appropriation for line of credit from Treasury	RTC authorized to borrow and Treasury directed to lend up to $5 billion from Treasury. (Sec. 501, p. 363)	RTC shall borrow, as provided for in advance in appropriations acts, up to $5 billion from Treasury. (Sec. 501, p. 338)	Prefer Senate bill, because its language makes appropriations unnecessary. House bill would require advance Congressional approval before drawdown of line of credit, which defeats purpose of emergency availability.

Area of Concern	Senate	House	Adm. Position
e. Federal mutuals and bridge banks			
(1) Federal mutual savings association	No provision on federal mutuals.	Authorizes RTC to organize federal mutuals, which shall be chartered by DOTS and insured under SAIF. (Sec. 501, p. 321)	Prefer House provision, but needs technical changes to make sure RTC has flexibility to establish institutions to hold insured deposits, which may be sold as core deposits, rather than paying off depositors immediately.
(2) Bridge banks for failed thrifts	Permits FDIC to form bridge banks for insured banks only. (Sec. 213, p. 102)	Same as Senate. (Sec. 212, p. 132)	Neither bill permits the FDIC to form a bridge bank or new bank to take over the assets and liabilities of a failed thrift. Both RTC and FDIC should have authority to form such institutions where desirable.

Area of Concern	Senate	House	Adm. Position
f. Open thrift assistance	No provision.	Requires the RTC to consider granting assistance to open thrifts with negative tangible capital in economically depressed areas. Negative tangible capital position must be substantially attributable to acquisition and merger transactions instituted by the FHLBB. (Sec. 215, p. 173)	Oppose House provision. It would be inappropriate to encourage RTC to bailout managers or shareholders of tangible insolvent thrifts. This is almost certain to be more expensive than other forms of assistance.
4. Subsidized Housing	No provision.	Requires FHLBanks to subsidize advances to members engaged in lending for low- and moderate-income housing. Begins with $75 million per year and escalates to at least $150 million in 1995. (Sec. 717, p. 447)	Oppose House provision, since low-income housing subsidies should go through normal Congressional authorization and appropriation process.

Area of Concern	Senate	House	Adm. Position
5. State-Chartered Thrift Regulator	Primary federal regulator of state-chartered thrifts will be the Chairman of OSA. (Sec. 301, HOLA 4(a), p. 193)	Primary federal regulator of state-chartered thrifts will be Chairman of FDIC. (Sec. 201, p. 9)	Prefer Senate provision. The FDIC, would be forced to assume burden of supervisory responsibilities for 1,200 state-chartered thrifts in addition to the new authority for thrift insurance and RTC case resolutions. Also violates underlying principle in FIRREA to separate insurance and regulatory functions in order to achieve two different layers of protection for safety and soundness. Finally, should not fragment current integrated thrift examination and supervision workforce between two regulators.

IMPORTANT ISSUES

Area of Concern	Senate	House	Adm. Position
1. Legislative and Budgetary Bypass: OCC and Thrift Regulator	Provides legislative and budgetary bypasses: OCC and COSA would submit legislative recommendations directly to Congress, i.e., Treasury and Executive branch review would be prohibited. Budget estimates would be sent to Congress and the President concurrently. (Sec. 301, HOLA 4(g), p. 196)	OCC and DOTS, both as Treasury bureaus, would be subject to Executive branch review of legislative recommendations and budgets. (Sec. 302, p. 204)	Prefer House provision. Senate provision is unconstitutional. A legislative bypass for a subordinate unit of a cabinet department would be unprecedented.
2. Junk Bonds	Retains ability of federal thrifts to invest 11 percent of assets in junk bonds. State thrifts have same limit unless FDIC approves greater amount within one-year. Four-year transition rule. (Sec. 223, p. 173)	Prohibits all thrifts from investing in junk bonds, whether directly or through a subsidiary. Overbroad definition of "junk bond." Two-year transition rule. (Sec. 223, p. 198)	Junk bond investments should be permitted, but only in subsidiaries and only if thrift's investment in the subsidiary is completely deducted from thrift's capital. Definition of "junk bond" should be narrowed.

Area of Concern	Senate	House	Adm. Position
3. State Thrift Powers (Restrictions on state thrift activities that are engaged in directly, rather than through a subsidiary.)	Direct or equity investments prohibited. State thrifts may not engage in other activities broader than those permitted for federal thrifts unless they (1) meet the fully phased-in capital standards, and (2) receive FDIC approval that the proposed activities pose no significant risk to the deposit insurance fund. (Sec. 223, p. 172) Exception for activities conducted as agent, which are riskless. General FDIC authority to prohibit any activity that poses a serious risk to the deposit insurance fund. (Sec. 222, p. 168)	Direct or equity investments prohibited. No specific restriction on other state powers that are broader than federal powers. General FDIC authority to prohibit any activity that poses a serious risk to the deposit insurance fund. (Sec. 315, p. 249)	House provision is closer to original Administration bill.

Area of Concern	Senate	House	Adm. Position
4. Qualified Thrift Lender Test			
a. Test (Current law requires that 60 percent of thrift assets must be housing-related, broadly defined, in order to receive certain special benefits that apply to thrifts and not banks.)	Changes the composition of the numerator ("qualified thrift investments") and the denominator ("portfolio assets") but maintains the 60 percent qualifying level. The category of qualified thrift investments is smaller than under the current test. (Sec. 303, p. 324)	Increases the QTL test from 60 percent of assets to 80 percent. But 80 percent includes much broader array of assets than current test, including such items as consumer loans that have nothing to do with home lending. (Sec. 320, p. 263)	Prefer existing QTL level. 80 percent test is too high, and includes so much that is unrelated to housing that it is too lenient. Senate definitions may be too narrow.
b. Consequences of failure	Thrifts that fail the QTL test must obtain bank charters within three years. (Sec. 303, p. 327)	Deletes the provision requiring thrifts that fail QTL test to obtain a bank charter.	Prefer Senate provision.
c. Eligibility of banks and credit unions to become FHLBank members	Permits any insured bank or credit union to become FHLBank member so long as it satisfies QTL test. (Sec. 703, p. 417)	Any insured bank or credit union can become an FHLBank member without satisfying QTL test. (Sec. 714, p. 443)	Prefer Senate version.

Area of Concern	Senate	House	Adm. Position
5. Continuation of Current Bank Board Chairman	Current Chairman of the FHLBB shall serve out the remainder of his term as COSA. (Sec. 301, HOLA 4(b), p. 193)	The current FHLBB Chairman may not serve as DOTS, unless nominated by the President and confirmed by the Senate. (Sec. 302, p. 205)	Prefer Senate provision.
6. Pay Cap Exemptions	OCC and COSA compensation schedules could be set without regard to any laws or regulations governing federal employees. No Treasury approval required. NCUA would also receive an exemption. (Sec. 301, HOLA 4(d), p. 195 and Sec. 1402, p. 570)	OCC, DOTS, NCUA, the Farm Credit Administration (FCA), and the Federal Housing Finance Board (FHFB) would be able to provide compensation and benefits if currently offered, or authorized to be offered, by any other bank regulatory agency. OCC and DOTS would consult with the Treasury Secretary, but would still not need Treasury approval. (Sec. 302, p. 208)	Prefer original Administration provision, in which OCC and the new thrift regulator compensation schedules would require Treasury Secretary approval. NCUA, FCA, and FHFB should remain subject to Federal salary caps.

Area of Concern	Senate	House	Adm. Position
7. Enforcement Issues			
a. Approval of employment of senior financial institution officials by regulatory agencies	No provision.	Requires the agencies to expressly approve members of the board and other senior officials of new or troubled institutions or institutions that have undergone a change in control. (Sec. 914, p. 607)	Oppose House provision, which would create burdensome amount of administrative work and may create barriers to future enforcement action.
b. Disposition of civil penalties	The Senate provisions require that proceeds of civil penalties continue to be deposited in the Treasury general fund. (Sec. 921, p. 459 and 930-931, p. 469-475)	Several House provisions allow regulatory agencies to keep the proceeds of civil penalties they assess for their own use. (Sec. 907(a),(c),(e)-(k) and 907(d), p. 528, 543, 552, 550)	Oppose House provisions allowing retention of penalties outside the usual budget process. It is also inappropriate and unnecessary to use funding as an "incentive" for administrative action.

Area of Concern	Senate	House	Adm. Position
c. Grand jury secrecy	Allows court ordered disclosure to any federal agency of information developed in a grand jury investigation of any type of crime upon showing that the agency has a "substantial" need for the information. (Sec. 1004, p. 549).	Allows court ordered disclosure of grand jury information only to federal financial institution regulatory agencies, and only of matters relating to "banking law violation" upon a showing of "particularized need" (a higher standard than "substantial need"). (Sec. 964, p. 687)	Prefer the more comprehensive Senate version.
d. Civil penalty provisions	Provides the Attorney General with summons authority necessary to develop civil penalty cases and sets the standard of proof in any legal action to recover such a penalty as "preponderance of the evidence," the usual standard for civil litigation. (Sec. 1001, p. 506)	Provides no summons authority for the Attorney General and sets the standard of proof in any recovery action as "clear and convincing evidence," which is a higher standard than preponderance of the evidence. (Sec. 951, p. 671)	Prefer Senate version. Summons authority is essential to use of this new authority. Also the government's burden of proof for recovery should not be as high as in the House version.

Area of Concern	Senate	House	Adm. Position
e. Justice Department fraud field offices	No provision.	Directs establishment of two specific field offices. (Sec. 965, p. 689)	Oppose House provision. Establishment of permanent field offices is not the most effective way to deal with current fraud caseload and infringes on Executive authority.
f. Civil statute of limitations	Permits the regulators to proceed against parties who have removed themselves from financial institutions, with no statute of limitations. (Sec. 928, p. 467)	Imposes a five-year statute of limitations on this new authority. (Sec. 905, p. 521)	Prefer Senate bill. Regulators require extensive periods of time to develop cases, and five years is too short. Also, could lead to anomalous result that following a criminal conviction, no related enforcement action could be brought.
g. FDIC as agency of the United States	No provision.	Provides that the FDIC "in any capacity" would be an agency of the United States. (Sec. 212, p. 79)	Oppose designation of the FDIC as an agency in its capacity as receiver or conservator. This would expand the liability of the U.S. for actions the FDIC takes on behalf of private entities.

Area of Concern	Senate	House	Adm. Position
h. Priority of FDIC claims	Grants the FDIC priority over the claims of certain other government agencies. (Sec. 212, p. 71)	No provision.	Prefer House bill.
i. Litigating authority	Same as Administration bill - preserves the right of the Attorney General to litigate on behalf of U.S. Government. However, also provides statutory litigating authority for COSA. (Sec. 1005, p. 552)	A heading suggests that there is a substantive grant of litigating authority to FDIC. (Sec. 210, p. 76)	Prefer explicit Senate language preserving the right of the Attorney General to conduct and coordinate litigation on behalf of the U.S. Government. Oppose COSA's litigation authority in Senate bill and any suggestion in House bill that the FDIC may have litigating authority.
8. FHLBanks' $300 Million Annual Contribution a. Contribution for REFCORP principal	The FHLBanks' contribution to purchase REFCORP stock is limited to a maximum of $2,995,800,000, less amounts required to be invested in the capital stock of FICO. Could be interpreted to mean that FHLBanks could contribute less than $300 million a year. (Sec. 502, p. 380)	In addition to retained earnings, guarantees $300 million during first three years, without cap. (Sec. 502, p. 379)	Prefer House bill. If less than $300 million, taxpayers pick up additional cost.

Area of Concern	Senate	House	Adm. Position
b. REFCORP interest	After defeasing REFCORP principal, provides for $300 million per year contribution from the FHLBanks to REFCORP interest costs. (Sec. 502, p. 391)	Same as Senate, plus inflation adjuster of lower of CPI or FHLBanks' earnings growth; $600 million annual cap. (Sec. 502, p. 379)	Prefer House version.
9. Exemptions from SAIF-BIF Conversion Moratorium	(1) Permits the transfer of 20 percent of insured liabilities during the five-year moratorium. (2) Also permits conversions during the five-year moratorium that help the transferring institution meet a capital standard agreed with its Federal regulator prior to enactment of CEBA. (3) Permits certain conversions during the five year moratorium for which a letter of intent was entered into prior to 12/31/88. (Sec. 206, p. 27)	(1) Permits the transfer of 50 percent of insured liabilities (10 percent per year) during the five year moratorium. (2) Permits conversion of a SAIF member to a state savings bank if the institution agrees to remain a SAIF member during that period. (Sec. 206, p. 32)	Generally oppose exceptions to conversion moratorium. Particularly oppose the House provision regarding the transfer of liabilities, which constitutes a substantial loophole. Also oppose any attempt to grandfather current litigation efforts to exit from FSLIC, as was proposed in colloquy on House floor.

Area of Concern	Senate	House	Adm. Position
10. Interim Funding for New Agencies	No provision.	No provision.	New thrift agencies must have interim funding. FHLBB proposes (1) to authorize the COSA/DOTS to assess the FHLBanks for start-up funding for the first 12 months; and (2) to authorize the FHLBA/FHFB to make an interim assessment against the FHLBanks.
11. FDIC Accountability			
a. Reporting requirements	Prior to the beginning of each fiscal quarter, FDIC would submit reports to the Treasury Secretary and the OMB Director. These reports would include financial operating plans and forecasts, and information on financial commitments, guarantees and other contingent liabilities. (Sec. 221, p. 160)	At the end of each fiscal quarter, FDIC would submit to the Treasury Secretary a report of FDIC's financial condition and results of operations. These reports would contain estimates required to be made under obligation limitations. (Sec. 218, p. 182)	Prefer Senate provision. Under GRH, OMB determines budget deficit and need for sequester. Direct access to accurate budget information is critical for this reason as well as to develop the President's budget.

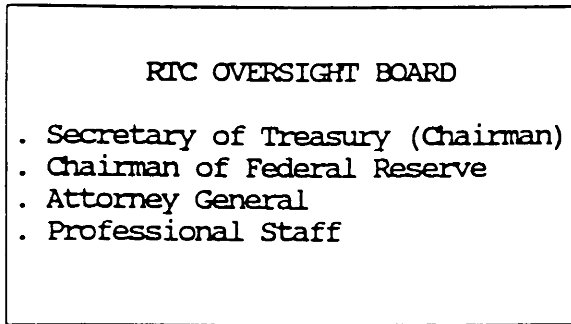
Area of Concern	Senate	House	Adm. Position
b. FDIC note cap	FDIC may not issue any note and shall not incur any liability under a guarantee if the estimated cost of such action would reduce the net worth of BIF/SAIF below 15% of assets. (Sec. 220, p. 157)	Limitations on BIF/SAIF notes; cannot exhaust 100% of net worth. (Sec. 217, p. 180)	Prefer Senate version, although asset measure should be tied to most recent GAO audit.
12. Composition of Federal Housing Finance Board	Creates FHLBank Agency with three-person board, all of whom are appointed by the President. (Sec. 702, p. 414)	Seven-person board consisting of HUD Secretary, two FHLBank presidents and four Presidential appointees (two of whom must be consumer representatives). (Sec. 702, p. 423)	Prefer Senate version, although President should be free to designate Cabinet members (e.g. Secretary of HUD) as such appointees; House version does not appear to satisfy constitutional requirements because of two FHLBank presidents on Board (board members of independent agencies in executive branch must be Presidential appointees). Treasury should also be required to approve aggregate amount of credit extended by the FHLBanks.

Area of Concern	Senate	House	Adm. Position
13. Cost of Reviewing 1988 FSLIC Deals	RTC decides if the cost of, or income from, restructuring is borne by the RTC or the FSLIC Resolution Fund. (Sec. 501, p. 358)	The cost of any restructuring will be a liability of the RTC. (Sec. 501, p. 323)	Prefer Senate version because it provides much more flexibility except authority should rest with Oversight Board. Any amount RTC pays will be subtracted from amount available for new case resolutions.
14. Community Reinvestment Act Provisions	No provision.	Amends the CRA to require (1) disclosure of the regulators' numerical rating for a bank's CRA activity, and (2) requires regulators to break the examination report into a public portion to be given to the institution and to the public, and a private portion kept for the regulators' files and not shared with the institution. (Sec. 1214, p. 760)	Oppose this provision in the House Bill. (1) Bank regulators are concerned that the public will confuse the numerical rating with the banks' financial safety and soundness rating, and (2) bank regulators want to be able to give confidential written reports to the boards of banks (without giving them to the public) that might warn them that they need to improve in this area.

Area of Concern	Senate	House	Adm. Position
15. Study of Government Sponsored Enterprises			
(a) Capital requirements	No comparable provision.	Requires the GAO to study the appropriate capital level and risk exposure for GSEs, including the applicability of a risk-based capital requirement. (Sec. 725, p. 481)	Prefer the House bill and the application of a risk-based capital standard to GSEs.
(b) Relationship between public debt and GSE activities	No comparable provision.	Requires the Treasury to conduct an annual study analyzing the risk exposure to the federal government of GSE activities. (Sec. 1404, p. 773)	Prefer House provision, but object to study being conducted annually.

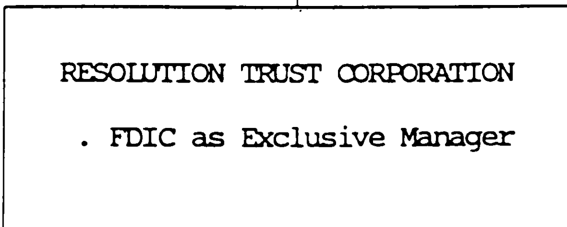
Area of Concern	Senate	House	Adm. Position
16. Appropriations/ Authorizations	Various provisions.	Various provisions.	The authorization and appropriation language differ in many cases. There must be clarification regarding those provisions that have discretionary and mandatory appropriations.

Proposed Organization and Management of the Resolution Trust Corporation



Oversight Responsibility

- Establish policy guidelines.
- Review and monitor RTC activities.
- Approve funding.



Operating Responsibility

- All responsibility for RTC resolution and liquidation activities.
- Subcontract with private sector.

July 11, 1989

Administration's Substitute Proposal for the Resolution Trust Corporation

As the Conference resumes on the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), the Administration remains especially concerned about provisions in both the House and Senate bills affecting the Resolution Trust Corporation (RTC). The RTC will resolve hundreds of insolvent thrifts over the next three years, and it must be provided the tools necessary to function efficiently and expeditiously. The RTC must also be subject to effective oversight because of the size of its undertaking and because of the billions of taxpayer dollars that it will use to resolve cases.

A number of legislative changes in both the Senate and House have strengthened the Administration's original RTC proposal to achieve both of these goals. But other changes to both the structure and operations of the RTC and its Oversight Board are likely to have the opposite effect. At the same time, concerns have been expressed about the likelihood that the RTC will become a huge bureaucracy that would compete directly with the Federal Deposit Insurance Corporation (FDIC), or have problems similar to FADA, which was never the intent of the original Administration proposal.

The Administration believes that the RTC must be streamlined in Conference so that it will achieve the goals of efficiency and effective oversight while at the same time addressing other important concerns. But rather than picking and choosing from individual provisions in the House and Senate bills, it would be preferable to substitute a new RTC title that incorporates the best aspects of the Administration, Senate, and House versions.

Accordingly, set forth below is an outline of the Administration's substitute proposal for the RTC and the RTC Oversight Board. Legislative language to implement the proposal will be provided.

I. Basic Structure

The magnitude of the RTC's task is unprecedented, and for the first time in history it will be necessary to use taxpayer funds -- in substantial amounts -- to resolve failed institutions. For these reasons, the following two principles should govern the basic structure of the RTC:

(1) Operating Responsibility with the FDIC. The FDIC should be responsible for carrying out the basic work of the thrift clean-up because it has the most experience of any government agency in this area.

(2) Oversight Responsibility with a Separate Oversight Board. The Administration, which along with Congress is directly responsible to the taxpayer, must have the necessary tools to protect the taxpayer's interest by exercising effective oversight over the thrift clean-up.

A. The Resolution Trust Corporation

The FDIC would be provided, by statute, direct authority and responsibility for managing and carrying out all the activities of the RTC ("exclusive manager"), subject to policy direction by the RTC Oversight Board. Since the FDIC would carry out its responsibilities under statutory mandate, there would be greater clarity in the relationship between the two entities and no need for a "contract" between them. The FDIC's operational role would be carried out under the FDIC's Board of Directors, and this role would be substantially broader than is provided for under either the House or Senate bill.

The FDIC, under general policy guidance by the Oversight Board, would be solely responsible for providing the personnel, facilities, and other direct services needed for the RTC to resolve insolvent institutions and undertake asset disposition, including the sale or dissolution of FADA. The FDIC would also have the authority and responsibility to subcontract with private sector firms to carry out RTC asset disposition or other functions.

In addition, the FDIC would be responsible for submitting RTC operating plans and budget requests to the Oversight Board on a periodic basis, as well as detailed reporting on the financial results and overall performance of the RTC. This would include actual and future cash needs and use of notes, guarantees, or other contingent liabilities.

In short, the FDIC would conduct the day-to-day operations of the RTC. As such, FDIC would be in charge of the use of funds, operations, personnel, contracts, asset dispositions, case resolutions, and legal matters involving the RTC.

B. The RTC Oversight Board

Because the Administration will be accountable for the substantial taxpayer funds that will be used, a completely separate RTC Oversight Board will be established that will be

answerable to the President and Congress. The Oversight Board would be responsible for establishing overall RTC strategy and general policy guidelines, approving financial plans, and assessing RTC performance against such guidelines and plans. These would include the following:

- establishing broad policy guidelines for the management and disposition of assets;
- reviewing and approving RTC strategic, budget and financial plans;
- authorizing the use of REFCORP proceeds and RTC obligations and guarantees;
- periodically evaluating and assessing the overall performance of the RTC relative to approved budgets, plans, and internal control procedures;
- reviewing and approving general standards governing the use of liquidations vs. assisted mergers;
- evaluating audits by the RTC Inspector General and other audits required by Congress;
- establishing general policy governing RTC contracts with the private sector; and
- periodically updating policy guidelines.

The Oversight Board would also engage in liaison activities with a national advisory board (discussed below) and, in its oversight capacity, prepare appropriate reports and responses to the President, Congress, and the public on the progress and performance of the RTC.

To effectively perform its oversight function, it is critical that the Oversight Board have an independent staff. Nonetheless, Oversight Board staff would be kept as "lean" as possible consistent with its responsibilities. It is expected that a core staff would be employed, with member agencies of the Oversight Board available on a reimbursable basis to provide additional resources at its request. It would _not_ become a large parallel or competing bureaucracy with the FDIC.

The Oversight Board would not be involved in the decision or approval process for any individual transactions; that would remain the exclusive province of the RTC to be carried out by the FDIC as the RTC's exclusive manager. There is no intention for the Oversight Board to micromanage the basic operations of the RTC. Rather, its charge would be to provide

policy guidance and oversight for the RTC as exclusively managed by the FDIC.

While the Oversight Board will fully share with the FDIC the objective of an efficient and cost-effective thrift clean-up, the Board should be independent from the RTC and FDIC in order both to carry out its oversight mission with fully independent judgment and to accept independent responsibility for this mission. Therefore, the Oversight Board and the FDIC Board should not have overlapping membership.

To include the Chairman or a member of the FDIC board on the Oversight Board would compromise that independent judgment. It would be awkward and difficult for the Oversight Board to effectively oversee and evaluate the FDIC's managerial stewardship of the RTC if the FDIC held Board membership. It would also merge the responsibility for operations and oversight, which should be kept separate. In short, this potential conflict of interest should be avoided.

At the same time, however, the Administration recognizes the important need for full consultation with the FDIC in connection with the Oversight Board's responsibility to set policy. The proposed statutory language specifically requires this consultation.

C. Intervention Under Extraordinary Circumstances

As outlined here the FDIC would have day-to-day managerial and operational control of the RTC, and the Oversight Board would have responsibility for establishing general policies for RTC activities. Ultimately, however, the Oversight Board and the Administration are accountable for the use of taxpayer funds. Because of this, the Oversight Board would retain the right to appoint a new exclusive manager (with an appropriate transition period) whenever it made the judgment that any of the following extraordinary events had occurred:

- significant failure of the RTC to adhere to policy guidelines;

- significant failure of the RTC to meet established financial goals, including over-commitment of financial resources;

- evidence of fraud, abuse, or gross mismanagement in RTC programs or activities; or

- significant inability to realize proceeds from asset disposition near appraised market values.

II. Other Concerns Addressed

The proposal specifically includes certain important provisions that were added by either the House or the Senate, as well as several new provisions that address other important concerns and that are not likely to be controversial. Examples include the following:

A. Use of Private Sector Entities

The proposal expressly addresses the concern raised in both the House and Senate bills that the RTC should use the resources available in the private sector whenever that would be more efficient. The language specifically provides that the FDIC, acting for the RTC, may enter into contracts with any persons, corporations, or other entities, including State Housing Authorities and insured financial institutions, to carry out its responsibilities under the Act. The FDIC is also expressly encouraged to utilize the services of private persons and entities for services, including real estate and loan portfolio asset management, property management, and brokerage if such services are determined to be practicable and efficient. Finally, through its policy guidance the Oversight Board will be able to ensure the appropriate private sector involvement in RTC plans.

B. National and Regional Advisory Boards

Both the House and Senate bills include different provisions to establish private advisory boards to coordinate with and provide information to the Oversight Board and the RTC. The proposal addresses this concern by requiring the Oversight Board to establish a national advisory board to provide information and to assist and advise the Oversight Board in development of policies and programs for real property asset disposition. In addition, the proposal authorizes the establishment of up to six regional advisory boards, especially from areas where RTC asset dispositions will be significant. These boards will advise the RTC and the Oversight Board in the creation and implementation of policies and programs for the sale or other disposition of assets.

The Oversight Board would appoint the members of the regional advisory boards, who would work directly with the RTC. The national advisory board, which would report directly to the Oversight Board, would consist of the chairpersons of the regional advisory boards and one person each as appointed by the new thrift regulator, the Comptroller of the Currency, and the Chairman of the FDIC.

C. Minority Outreach Program

Consistent with the provision in the House bill, the proposal requires the RTC to establish and oversee a minority outreach program to include minorities and women in contracts entered into by the RTC, including contracts with financial institutions, investment banking firms, underwriters, accountants, and providers of legal services.

D. Reports to Congress

The proposal streamlines the extensive reporting requirements in both bills by requiring the Oversight Board to submit a comprehensive annual report to Congress and the President. This report is required to cover (1) the Oversight Board's operations and activities; (2) the annual report of the RTC to the Oversight Board; and (3) the results of the Comptroller General's annual audit of the RTC. The first comprehensive report would be due for the year ending December 31, 1989, less than six months after date of enactment, and would provide details about start-up operations and initial strategic decisions.

E. Inspector General

The proposal would include a provision that would establish an Inspector General for the RTC that would report to the Oversight Board. This would help ensure that the RTC operates efficiently, impartially, and subject to all appropriate ethical standards. Given the magnitude of the federal funds and assets involved in the RTC's activities, the importance of an Inspector General cannot be overemphasized.

F. RTC Borrowing Cap

The proposal would include a specific cap on the borrowing authority of the RTC. Borrowing would be limited to the RTC's tangible assets, marked down to fair market value, and available proceeds from REFCORP bonds and RTC's line of credit from Treasury. This cap would protect the taxpayer by prohibiting the RTC from issuing commitments that exceed its available resources, while maintaining critical flexibility to use working capital during the real estate workout process.

G. Asset Disposition Guidelines

The proposal addresses the concerns raised in both the House and Senate bills for asset disposition guidelines, but without hamstringing the RTC or the Oversight Board with inflexible limitations.

H. Conflicts of Interests Rules and Ethical Standards

Finally, employees and independent contractors of the RTC would be subject to the conflicts of interests rules and ethical standards that apply under current law to employees of the FDIC.

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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.
July 11, 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 $ 13,200 million, to be issued July 20, 1989. This offering will result in a paydown for the Treasury of about $ 1,650 million, as the maturing bills are outstanding in the amount of $14,853 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, July 17, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 6,600 million, representing an additional amount of bills dated April 20, 1989, and to mature October 19, 1989 (CUSIP No. 912794 TB 0), currently outstanding in the amount of $ 7,242 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 6,600 million, representing an additional amount of bills dated January 19, 1989, and to mature January 18, 1990 (CUSIP No. 912794 TM 6), currently outstanding in the amount of $ 9,119 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 July 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 $1,345 million as agents for foreign and international monetary authorities, and $ 3,941 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).

NB-366

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.

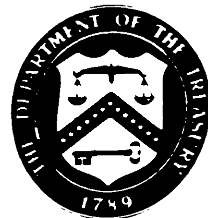
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments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



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

FOR IMMEDIATE RELEASE
July 12, 1989

CONTACT: Bob Levine
(202) 566-2041

BOLIVIAN BRIDGE LOAN

The Department of the Treasury today announced an agreement with the Republic of Bolivia to provide a $100 million short-term bridge financing facility. The proceeds of this loan are expected to strengthen Bolivia's financial position as it continues its program of comprehensive structural reform to lay the basis for sustained economic growth. These funds will complement on-going, longer-term financial assistance from the International Monetary Fund, the World Bank, the Inter-American Development Bank and bilateral donors.

The United States Government supports the determination of the Bolivian Government to consolidate its success in reforming the economy and achieving a dramatic reduction of inflation.

oOo

NB-367

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

FOR IMMEDIATE RELEASE July 12, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of May 1989.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $140.2 billion on May 31, 1989, posting a decrease of $942.0 million from the level on April 30, 1989. This net change was the result of decreases in holdings of agency debt of $143.7 million, in agency assets of $775.4 million, and in agency-guaranteed debt of $22.9 million. FFB made 51 disbursements during May.

Attached to this release are tables presenting FFB May loan activity and FFB holdings as of May 31, 1989.

NB-368

FEDERAL FINANCING BANK

MAY 1989 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 #490	5/11	$ 30,560,000.00	8/8/89	8.953%	
+Note #491	5/22	8,520,000.00	8/24/89	8.788%	
+Note #492	5/26	45,000,000.00	8/24/89	8.973%	
TENNESSEE VALLEY AUTHORITY					
Advance #1028	5/2	106,000,000.00	5/8/89	9.048%	
Advance #1029	5/5	186,000,000.00	5/10/89	8.962%	
Advance #1030	5/8	269,000,000.00	5/15/89	8.850%	
Advance #1031	5/10	194,000,000.00	5/18/89	8.932%	
Advance #1032	5/15	6,000,000.00	5/19/89	8.618%	
Advance #1033	5/15	222,000,000.00	5/22/89	8.618%	
Advance #1034	5/18	7,000,000.00	5/23/89	8.699%	
Advance #1035	5/18	212,000,000.00	5/24/89	8.699%	
Advance #1036	5/22	194,000,000.00	5/30/89	8.765%	
Advance #1037	5/24	156,000,000.00	5/31/89	8.699%	
Advance #1038	5/24	45,000,000.00	6/1/89	8.699%	
Advance #1039	5/30	79,000,000.00	6/5/89	8.943%	
Advance #1040	5/31	44,000,000.00	6/5/89	9.004%	
Advance #1041	5/31	347,000,000.00	6/7/89	9.004%	
U.S. Postal Service					
*Note #16.1	5/31	24,000,000.00	5/31/97	8.795%	
*Note #16.2	5/31	36,000,000.00	5/31/98	8.773%	
*Note #16.3	5/31	36,000,000.00	5/31/99	8.762%	
*Note #16.4	5/31	36,000,000.00	5/31/00	8.761%	
*Note #16.5	5/31	36,000,000.00	5/31/01	8.760%	
*Note #16.6	5/31	36,000,000.00	5/31/02	8.759%	
*Note #16.7	5/31	36,000,000.00	5/31/03	8.758%	
*Note #16.8	5/31	36,000,000.00	5/31/04	8.757%	
*Note #16.9	5/31	36,000,000.00	5/31/05	8.756%	
*Note #16.10	5/31	36,000,000.00	5/31/06	8.756%	
*Note #16.11	5/31	36,000,000.00	5/31/07	8.755%	
*Note #16.12	5/31	36,000,000.00	5/31/08	8.754%	
*Note #16.13	5/31	36,000,000.00	5/31/09	8.754%	
*Note #16.14	5/31	36,000,000.00	5/31/10	8.753%	
*Note #16.15	5/31	36,000,000.00	5/31/11	8.753%	
*Note #16.16	5/31	36,000,000.00	5/31/12	8.752%	
*Note #16.17	5/31	36,000,000.00	5/31/13	8.752%	

+rollover
*maturity extension

FEDERAL FINANCING BANK

MAY 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 16	5/1	$ 686,350.45	9/3/13	9.065%	
Greece 16	5/16	61,873.00	9/3/13	8.964%	
Greece 17	5/16	22,100,000.00	2/25/13	8.963%	
Greece 17	5/22	1,853,329.75	2/25/13	8.839%	
Greece 16	5/31	2,000,000.00	9/3/13	8.752%	
Greece 17	5/31	2,046,195.87	2/25/13	8.752%	
Morocco 13	5/31	461,708.72	5/31/95	8.803%	
RURAL ELECTRIFICATION ADMINISTRATION					
New Hampshire Electric #270	5/3	406,000.00	1/2/18	9.128%	9.026% qtr.
Oglethorpe Power #320	5/4	2,288,000.00	7/1/91	9.338%	9.231% qtr.
*Colorado-Ute Electric #203A	5/8	620,000.00	7/1/91	9.165%	9.062% qtr.
*Western Farmer Elec. Coop. #196	5/8	1,239,000.00	12/31/19	9.086%	8.985% qtr.
Associated Electric #328	5/10	1,600,000.00	7/1/91	9.352%	9.245% qtr.
*United Power #159A	5/11	1,325,000.00	7/1/91	9.388%	9.280% qtr.
*United Power #212A	5/11	365,000.00	5/13/91	9.392%	9.284% qtr.
*Wabash Valley Power #206	5/11	5,722,000.00	1/2/18	9.257%	9.152% qtr.
Sho-Me Power Corp. #324	5/31	2,000,000.00	7/1/91	8.995%	8.896% qtr.
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-08	5/31	727,214,019.58	8/31/89	8.956%	

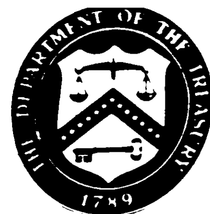
*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	May 31, 1989	April 30, 1989	Net Change 5/1/89-5/31/89	FY '89 Net Change 10/1/88-5/31/89
Agency Debt:				
Export-Import Bank	$ 11,000.6	$ 11,000.6	$ -0-	$ 43.0
NCUA-Central Liquidity Facility	108.9	111.4	-2.5	-9.3
Tennessee Valley Authority	17,240.0	17,084.0	156.0	109.0
U.S. Postal Service	6,195.0	6,492.2	-297.2	602.8
sub-total*	34,544.5	34,688.2	-143.7	745.5
Agency Assets:				
Farmers Home Administration	56,311.0	57,086.0	-775.0	-2,185.0
DHHS-Health Maintenance Org.	79.5	79.5	-0-	-0-
DHHS-Medical Facilities	93.8	93.8	-0-	-2.6
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,076.0	4,076.0	-0-	-63.2
Small Business Administration	12.7	13.1	-0.4	-2.6
sub-total*	60,573.1	61,348.5	-775.4	-2,253.4
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	11,604.8	11,637.3	-32.5	-4,406.9
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	-0-	-0-	-0-	-50.0
DHUD-Community Dev. Block Grant	311.5	313.8	-2.3	-6.6
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	381.9	383.0	-1.1	-5.5
DOI-Guam Power Authority	31.5	31.5	-0-	-0.6
DOI-Virgin Islands	26.1	26.1	-0-	-0.5
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,720.5	1,720.5	-0-	-38.3
Rural Electrification Administration	19,236.3	19,230.0	6.3	31.0
SBA-Small Business Investment Cos.	583.2	587.3	-4.1	-49.5
SBA-State/Local Development Cos.	836.5	841.3	-4.8	-34.4
TVA-Seven States Energy Corp.	2,254.7	2,236.1	18.6	92.3
DOT-Section 511	37.6	40.6	-3.0	-8.6
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	45,102.2	45,125.1	-22.9	-4,422.8
grand total*	$ 140,219.8	$ 141,161.9	$ -942.0	$ -5,930.7

*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 IMMEDIATE RELEASE
July 12, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 7-YEAR NOTES

The Department of the Treasury has accepted $7,289 million of $20,456 million of tenders received from the public for the 7-year notes, Series G-1996, auctioned today. The notes will be issued July 17, 1989, and mature July 15, 1996.

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

	Yield	Price
Low	7.88%	99.974
High	7.90%	99.868
Average	7.89%	99.921

Tenders at the high yield were allotted 37%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 17,632	$ 17,632
New York	18,343,681	6,747,021
Philadelphia	4,266	4,266
Cleveland	8,043	8,043
Richmond	34,034	15,134
Atlanta	10,939	6,939
Chicago	1,242,259	331,779
St. Louis	27,531	19,531
Minneapolis	6,742	6,742
Kansas City	6,062	6,042
Dallas	9,450	6,190
San Francisco	744,841	118,441
Treasury	963	963
Totals	$20,456,443	$7,288,723

The $7,289 million of accepted tenders includes $338 million of noncompetitive tenders and $6,951 million of competitive tenders from the public.

In addition to the $7,289 million of tenders accepted in the auction process, $150 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $286 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

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TESTIMONY OF KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
WASHINGTON, D.C.
JULY 13, 1989

Mr. Chairman and Members of the Committee:

It is a pleasure to be here today on behalf of the Administration, to discuss S. 712, a bill "To Provide for a Referendum on the Political Status of Puerto Rico." This bill would give the people of Puerto Rico an historic opportunity to vote upon the status of that island. The bill would provide for a referendum, to be held in 1991, in which the Puerto Rican people could decide among the options of statehood, independence, or commonwealth status.

The Administration strongly supports the right of the people of Puerto Rico to decide for themselves on the status of the island. Further, as the President has noted a number of times, he favors the admission of Puerto Rico to the Union as a state, thereby assuring the people of Puerto Rico an equal standing with other United States citizens. However, by providing for a status referendum, the United States Government would be assisting the Puerto Rican people to exercise the basic political right to determine the nature of their government.

The choice facing the people of Puerto Rico is fundamentally a political one, with long-term implications for their rights and obligations as citizens. Each voter must determine for himself or herself the type of political relationship that should exist between Puerto Rico and the United States. By its very nature, a status referendum determines a people's political future. Individual voters must weigh the implications of their vote not only for themselves but also for future generations.

The Administration firmly believes that the Puerto Rican people should be given an opportunity to express their will in a manner that recognizes the historic and fundamentally political nature of their decision of self-determination. The importance of the decision they face as a people transcends any narrow concern about specific aspects of economic or fiscal structures.

For this reason, the Administration believes that the discussion of Puerto Rico's future status should not be

encumbered at this stage by the tax and financial provisions in the current bill. The selection among the possible status options should be a choice made by the people of Puerto Rico unaffected by the bias which specific economic costs and benefits could bring to the process. After that choice has been made, appropriate tax and financial relationships between Puerto Rico and the United States could be formed consistent with the choice of the Puerto Rican people.

The Administration recognizes the difficulty of isolating the impact of tax and financial issues from the question of Puerto Rico's future status. Appropriate transition mechanisms will ultimately have to be developed to minimize economic disruption to Puerto Rico resulting from any change from the current commonwealth status. In addition, we believe that a transition to statehood can be structured so that the Puerto Rican government, after making appropriate use of its own resources, would not be forced to incur a net revenue loss during this transition. The Administration would support a "transition grant" to Puerto Rico to assist in achieving that result. The budgetary treatment of a transition to statehood should be consistent with sound budget discipline. Finally, we believe that there should be a level economic playing field among options.

The development of provisions which will properly achieve these goals will require a careful cooperative analysis by the Administration, Congress, and the government of Puerto Rico. The resulting package would probably consist of interrelated provisions affecting Puerto Rico's own tax system, the Federal tax system, and direct Federal grants. Accordingly, depending on the specific alternatives chosen, many will be involved in the process, including, for example, the tax-writing committees of the Congress.

The Administration looks forward to working with your committee at the appropriate time in fashioning an integrated economic package which meets the Administration's commitments to Puerto Rico and which is fully acceptable to both Congress and the Puerto Rican government. To lay a foundation for that process, I would like to review with you today some of the technical issues which are presented by the provisions in the current bill. While not intended as either an endorsement or rejection of these provisions, my comments will hopefully highlight particular problems which the current language raises.

Each of the political options covered by the bill -- statehood, independence, and commonwealth status -- raises special issues that affect the tax systems of both Puerto Rico and the United States. The following comments are limited to those issues. They are not intended to reflect any views on the desirability of any of the status options.

Regardless of the status option under consideration, we believe that a primary goal of the bill in question should be to ensure that the tax implications of the option are clearly defined. Certainty in the application of the tax law is always a goal of tax policy, and we believe that it is especially important to strive for that certainty in these circumstances, where the Puerto Rican people are facing the possibility of fundamental changes to their government's structure. The focus of my testimony, therefore, will be to identify the tax results of this bill's provisions as drafted, to note those ambiguities which the bill raises, and to highlight those issues which the bill's tax provisions do not currently address.

I. GENERAL REVENUE EFFECTS OF S. 712

It is difficult to present very precise estimates of the Federal revenue consequences of the various options described in the bill, but it may be helpful for purposes of this discussion to consider some rough guidelines.

Both the independence and the statehood options assume some form of reduction of the tax incentives currently provided under Internal Revenue Code ("Code") section 936. It should be noted that even under the commonwealth option, Congress can continue to review and revise section 936 and other tax benefits as necessary.

We estimate that in FY 1989 the tax benefits received by section 936 corporations amount to about $1.9 billion. If section 936 benefits are phased out, some section 936 corporations may choose to leave Puerto Rico. However, the nature of most section 936 company operations makes it unlikely that they could find a good substitute for Puerto Rico in some low-tax foreign location. Thus, if companies do leave the island, it is most likely that they would move back to the mainland where they would be subject to U.S. tax.

A phase-out of section 936 benefits would cause economic dislocation on Puerto Rico, at least in the short run. Employment in 936 companies now accounts for about 12 percent of total Puerto Rican employment. However, it is very difficult to project the extent to which Federal tax collections would be affected by this dislocation. Under the statehood option, collections of personal income tax may be somewhat reduced for a time; but as discussed below, fully phased-in Federal personal income tax collections from Puerto Rico can be expected to be relatively modest.

The statehood option presents the issue of how a newly-imposed Federal income tax will interact with a Puerto Rican state tax system. The effects of this change must be considered for both individual and business tax revenues.

The extension of Federal income tax to individuals in Puerto Rico would perhaps raise some $500 million per year. In comparison, the Puerto Rican government collected about $900 million in personal income taxes in their fiscal year ending June 30, 1989, or about 30 percent of total Puerto Rican revenue from local sources. This amounted to only about 5 percent of personal income in Puerto Rico.

As a state, Puerto Rico could design an income tax which would maintain combined revenue levels. Under either the commonwealth or independence options, Puerto Rico could continue a system similar to the current Puerto Rican tax.

With respect to business taxation, the Puerto Rican government now collects about $1.0 billion a year in taxes from business, which represents about 10 percent of business income. Since about 40 percent of this revenue is collected from exempt section 936 corporations, Puerto Rico may experience some loss of revenue if a phase-out of section 936 benefits causes any of these companies to reduce their Puerto Rican operations.

Under statehood, Federal corporate tax would also apply to Puerto Rican business that does not now benefit from section 936. This includes locally incorporated, or foreign, companies as well as section 936 corporations that do not receive a full or partial exemption from Puerto Rican tax. This would increase Federal revenues by about $300 million per year at 1989 levels.

Puerto Rico does not now pay Federal excise taxes. Assuming that by virtue of its becoming a state, U.S. excise taxes became applicable within Puerto Rico, this change would result in an increase in revenues of approximately $150 million. In addition, the Federal Government would gain approximately $100 million per year in customs duties which are now collected and segregated for the benefit of Puerto Rico.

Finally, Puerto Rico may choose to make adjustments on the expenditure side instead of, or in addition to, adjustments on the revenue side. Government employment now accounts for 23 percent of total employment in Puerto Rico. In addition, Puerto Rican government enterprises play a very important role in the Puerto Rican economy. A reduction of these expenditures, either to reduce taxes or to provide incentives to business may, therefore, be one of the consequences of any phase-out of current provisions.

Under the independence option, a phase-out of section 936 benefits would increase Federal tax collections if 936 corporations remained in Puerto Rico as U.S. corporations or if they moved back to the United States. However, some Puerto Rico-oriented companies in routine industries, such as apparel or food processing, may choose to reincorporate as Puerto Rican companies. The Federal revenue gain may therefore not be quite as large as under statehood. Under the independence option,

Federal excise taxes would only apply, as they do now, on imports from Puerto Rico; and the Federal Government would not collect any customs duties on goods imported into Puerto Rico. However, this would be offset somewhat by increased customs collections on imports from Puerto Rico. In addition, there might be a modest revenue pickup from withholding taxes on dividends paid to Puerto Rican residents, etc.

* * * *

With the above rough estimates in mind, I would now like to turn to a technical review of bill as drafted. Before discussing the bill's specific provisions, however, it may be useful to briefly summarize the tax relationship that currently exists between Puerto Rico and the United States.

II. SUMMARY OF EXISTING TAX LAWS

Generally speaking, the Commonwealth of Puerto Rico is not considered part of the "United States", as that term is used in the Internal Revenue Code ("Code") (see section 7701(a)(9) and (d)). Thus, Puerto Rico has its own tax laws, and the U.S. internal revenue laws do not extend fully to Puerto Rico. Depending upon the nature of the tax involved, different methods have been used to allocate taxing jurisdiction between the two governments.

A. Income taxes

United States income tax. The United States generally taxes the worldwide income of U.S. citizens, resident alien individuals, and domestic corporations. It also taxes the U.S. income of foreign corporations and nonresident alien individuals. Two important provisions affect the U.S. taxation of U.S. persons with Puerto Rican income.

First, under section 933 of the Code, the United States exempts the Puerto Rican source income of individuals who are bona fide residents of Puerto Rico. Consistent with section 933, U.S. citizens resident in Puerto Rico may be exempted from the withholding of Federal tax on their Puerto Rican source earnings (see section 3401(a)(8)).

Second, section 936 provides an effective exemption for certain Puerto Rican income of qualifying U.S. corporations that elect its benefits and that are engaged in business in Puerto Rico. The exemption is granted in the form of a "tax sparing" credit, under which the company's U.S. tax liability on its qualifying Puerto Rican income is reduced by a credit for a hypothetical Puerto Rican tax equal to the amount of U.S. tax due on that income. Because Puerto Rican tax law provides generous exemptions to certain business operations there, section 936 corporations enjoy a very low aggregate effective tax rate.

Puerto Rican income tax. Puerto Rico is authorized by Congress to enact its own income tax system. In 1954, the Puerto Rican legislature adopted its present income tax system, which is based on the U.S. Internal Revenue Code of 1939. In the absence of a tax exemption grant, Puerto Rico taxes all Puerto Rican source income earned by U.S. and foreign persons (including corporations) and taxes the worldwide income of all Puerto Rican resident individuals and Puerto Rican corporations.

The Puerto Rican individual income tax rates are somewhat higher than corresponding U.S. rates, and the Puerto Rican personal exemptions are somewhat lower than the U.S. exemptions. This will remain true even after tax law changes enacted by the Puerto Rican legislature in 1987 are fully phased in.

Under a series of industrial incentives laws, Puerto Rico has granted generous exemptions to certain business and investment income of qualifying businesses. Thus, while Puerto Rico's nominal corporate tax rate is slightly higher than the U.S. corporate tax rate, the exemption grants significantly reduce the effective Puerto Rican corporate tax rate.

B. Estate and gift taxes

United States estate and gift taxes. The United States taxes the worldwide estates of U.S. citizens and noncitizen decedents domiciled in the United States, as well as the U.S. situs estates of nondomiciliary aliens. The United States allows a foreign tax credit for Puerto Rican estate taxes imposed on the Puerto Rican situs estate of U.S. decedents (see section 2014(g)). Similarly, the U.S. gift tax applies to all gifts by U.S. citizens and noncitizen domiciliaries, and to gifts of U.S. situs property by nondomiciliary aliens. For purposes of the U.S. estate and gift taxes, U.S. citizens resident in Puerto Rico who are citizens solely because of being citizens of Puerto Rico or because of their birth or residence in Puerto Rico are treated as nondomiciliary aliens, taxable only on transfers of U.S. situs property (see sections 2208, 2209, 2501(b), and 2501(K)).

Puerto Rican estate and gift taxes. Puerto Rico generally taxes the worldwide estate of Puerto Rican resident decedents and the Puerto Rican situs estate of nonresident decedents. The amount of Puerto Rican estate tax on the Puerto Rican situs estate of a U.S. citizen resident in Puerto Rico can depend upon whether the United States includes that property in the U.S. gross estate. Puerto Rico allows a credit for U.S. estate taxes paid on the U.S. situs property of a Puerto Rican resident decedent. Similarly, Puerto Rico taxes all gifts by Puerto Rican resident donors and gifts of Puerto Rican situs property by nonresident donors.

C. Employment taxes

The various Federal employment taxes, including the self-employment tax (section 1401), the social security or FICA taxes (sections 3101 and 3111), and the unemployment insurance or FUTA tax (section 3301), are fully applicable within Puerto Rico as in the United States. (See sections 1402(b), 3121(e), and 3306(j)).

D. Excise/sales taxes

U.S. excise taxes. The United States does not impose a broad-based Federal sales tax. The Code does, however, impose a wide variety of excise taxes, including retail taxes, manufacturer taxes, services taxes, environmental taxes, alcohol taxes, etc. Generally, these taxes do not apply within Puerto Rico because of an exemption in the Puerto Rico Federal Relations Act (48 U.S.C. sec. 734).

Code sections 7652 and 7653 provide special rules with respect to taxes on articles manufactured in Puerto Rico and shipped into the United States, and *vice versa*. Basically, these rules treat such shipments as if they were imports from or exports to a foreign country. Under section 7652, articles of Puerto Rican manufacture shipped into the United States are subjected to a Federal tax equal to the amount of the Federal tax that would apply to similar articles manufactured in or imported into the United States. For example, by virtue of section 7652, the United States imposes a tax at the rate of $12.50 per proof gallon on distilled spirits produced in Puerto Rico and shipped into the United States, because that is the tax imposed on U.S.-produced distilled spirits.

The special feature about these rules, however, is that they call for a rebate or "cover-over" of these equalization taxes to Puerto Rico. Section 7652(a) generally requires the United States to cover over to the Puerto Rican Treasury the amount of these Federal equalization taxes imposed on Puerto Rican articles shipped into the United States. In addition, section 7652(e) generally requires the United States to cover over to Puerto Rico (and, under a sharing arrangement, to the Virgin Islands) the Federal tax collected on all rum imported into the United States. By virtue of section 7652(f), however, the amount of these alcohol taxes to be covered over to Puerto Rico cannot exceed $10.50 per gallon.

Section 7653(b) provides that articles otherwise subject to Federal taxes will be exempt from the normal taxes if they are shipped into Puerto Rico. Instead, section 7653(a) imposes a tax on such items equal to the amount of Puerto Rican tax applicable to similar items manufactured in Puerto Rico.

Puerto Rican excise taxes. Pursuant to excise tax amendments enacted in 1987, Puerto Rico imposes a 5 percent excise tax on a broad range of commodities, transactions, and occupations.

* * * * *

I would now like to turn to a review of the issues presented by the tax provisions under each of the three political options described in the bill.

III. COMMENTS ON STATEHOOD OPTION

A. In General

Status of pre-existing laws. Title II of S. 712, relating to the statehood option, contains three sections which are particularly relevant to the application of both the U.S. and Puerto Rican tax laws. These sections are:

- Section 9 (Laws in Effect), which provides that Puerto Rico's territorial laws remain in force after statehood until amended or repealed by Puerto Rico, and that all Federal laws will have the same force and effect within Puerto Rico as elsewhere in the United States.

- Section 14 (Repeal and Amendment of Inconsistent Laws), which provides that all Puerto Rican or Federal laws or parts thereof which are in conflict with S. 712 are repealed or amended to conform with S. 712.

- Section 16 (Economic Adjustment from Territory to State), which provides a number of special rules relating to the adjustment of Puerto Rico's tax status.

We are not at all sure how these three provisions are intended to interact in the tax area. The ambiguity affects the status of pre-existing laws of both Puerto Rico and the United States.

For example, section 16(a) provides that Puerto Rico's income tax laws shall stand repealed upon admission of the state. Section 16 is silent about the remainder of Puerto Rico's tax laws. This could mean that all of Puerto Rico's tax laws, other than the income tax laws explicitly mentioned in section 16, remain in effect as state taxes until amended, by virtue of section 9. In other words, section 14 might be read narrowly to repeal or amend only those Puerto Rican tax laws which are manifestly inconsistent with S. 712 by virtue of being explicitly repealed or amended by some other specific provision of S. 712. Alternatively, one might read section 14 broadly to repeal or amend those Puerto Rican tax provisions, in addition to the

income tax provisions explicitly mentioned in section 16, which are inconsistent with the general structure of a state tax system (e.g., the provision granting a credit against Puerto Rican estate tax liability for Federal estate taxes imposed on the U.S. situs property of a Puerto Rican resident decedent).

Similarly, section 9 provides that Federal laws shall have the same force and effect within Puerto Rico as elsewhere in the United States. Section 16(a) generally reaffirms this approach with respect to Federal income tax laws by providing that "Federal Income Taxes" shall immediately apply to Puerto Rico. However, section 16(b) requires Congress to make provision so that "economic and fiscal exceptions of the Internal Revenue Code, already granted, such as those allowed under Section 936 of said code" shall remain in full effect for an unspecified number of years. Section 16(b) does not provide further guidance on the scope of the Federal tax exceptions that are to continue to apply to Puerto Rico. It is therefore impossible to tell which exceptions other than Code section 936 are intended to continue to apply to Puerto Rico.

Thus, S. 712 as currently drafted does not provide clear guidance as to the types of provisions of pre-existing Puerto Rican or U.S. tax law that are intended either to continue or to be repealed upon admission of the state. The draft bill indicates that detailed additional provisions are expected to be added to section 16 of Title II of the bill. Such additional provisions could undoubtedly help to provide greater certainty to both taxpayers and the revenue authorities on the tax implications of the statehood option.

Each of the special tax arrangements which would apply to Puerto Rico under the statehood option of S. 712 could be subject to challenge under the uniformity clause of the Constitution (Art. I, sec. 8, cl. 1), which broadly requires taxes to be uniform throughout the United States. We recognize that the tax committees would have to address the specific issues that could be presented with respect to each particular tax arrangement. Nevertheless, these issues must be fully addressed with respect to such tax provisions before a definitive position on their inclusion and effect can be developed.

Bearing in mind the fact that certain key provisions in the bill's tax provisions remain incomplete at this time, I would like to discuss certain implications of those provisions.

B. Specific Provisions of Section 16

1. Section 16(a)

Basic approach. Paragraph (a) of section 16 describes the basic structure of the income tax changes that would take place upon Puerto Rico's admission as a state. First, it provides that Puerto Rico's income tax laws would stand repealed immediately.

Second, subject to certain exceptions to be discussed later, it provides that Federal income tax laws would apply immediately to Puerto Rico. Third, it provides that there would be some cover-over of Federal income tax revenues to Puerto Rico for an unspecified transitional period.

Repeal of Puerto Rican income tax laws. There are a few points worth noting about the repeal of Puerto Rico's income tax laws. First, as already noted, section 16(a) repeals only the income tax laws of the Commonwealth of Puerto Rico. Accordingly, the bill would apparently leave in place other Puerto Rican tax laws (e.g., estate and gift taxes, excise taxes, property taxes, etc.). Second, the repeal of the income tax laws would reduce annual Puerto Rican tax collections by about $2 billion (based upon the Governor's proposed fiscal 1989 budget). Finally, as a technical matter, the bill seems to tie the effective date of the repeal of the income tax laws to the date of admission of Puerto Rico as a state, rather than to the beginning or end of a taxable year. The bill does not indicate whether administrative provisions of the Puerto Rican income tax law would remain in effect to allow the Puerto Rican tax authorities to complete processing of pre-admission taxable years. If Federal income taxes were to become applicable on the January 1 following admission, tax administration would be facilitated. The Puerto Rican income tax law could be continued thereafter for the limited purpose of allowing Puerto Rican authorities to continue to process and collect liabilities under prior law. Moreover, any such provision would explicitly acknowledge the power of the Puerto Rican Commonwealth Legislature to provide an interim state income tax should it choose to do so, pending enactment of a permanent income tax system by the state legislature after statehood.

Extension of Federal income taxes to Puerto Rico. There are also several points worth noting about the immediate extension of Federal income taxes to Puerto Rico. Again, as already noted, the bill does not clearly indicate whether other Federal taxes are meant to be extended fully to Puerto Rico.

With respect to U.S. citizens resident in Puerto Rico, the extension of the income tax laws presumably means that they will become subject to Federal taxes, rather than Puerto Rican taxes, on their Puerto Rican source income. This will be the result as long as the exclusion of Puerto Rican source income formerly provided by Code section 933 is not preserved under section 16(b) of the bill. The bill would also seem to require that these individuals become subject to the withholding of Federal income taxes on their Puerto Rican earnings.

With respect to non-U.S. citizens resident in Puerto Rico, their U.S. income tax status would depend upon their classification as either resident aliens or nonresident aliens,

taking into account the inclusion of Puerto Rico as part of the United States for purposes of applying the resident alien definition of Code section 7701(b).

The substitution of the Federal income tax regime for the Puerto Rican income tax regime also raises a number of issues for Puerto Rican corporations. Because of the inclusion of Puerto Rico as part of the United States after admission, these corporations, which are now treated as foreign corporations for U.S. income tax purposes, would be treated as domestic corporations. This would generally mean that Puerto Rican corporations would become subject to full U.S. income tax on their worldwide income.

If the section 936 credit become available to these corporations under the statehood option -- because they would become U.S. corporations -- they might thereby preserve their exemption from U.S. tax on their Puerto Rican income. The availability of the section 936 exemption, combined with the repeal of the Puerto Rican income tax, could result in a decrease in the income tax liability of Puerto Rican corporations that pay partial or full Puerto Rican income tax now (because they do not qualify for full exemption under the Puerto Rican incentives tax legislation). The section 936 benefit is potentially available to a broader, or at least a different, class of companies than the Puerto Rican incentives tax exemptions. In addition, Puerto Rican locally incorporated companies that had been fully exempt under the Puerto Rican tax system might become subject to tax (for example, if they failed to qualify for exemption under section 936).

The recharacterization of Puerto Rican corporations as domestic corporations could have a number of corollary effects on those corporations, their affiliates, shareholders, and lenders, none of which are explicitly addressed by the draft bill. For example, the change might or might not be treated as an inbound reorganization triggering the provisions of Code section 367, which could result in a taxable event. The change would raise the question of whether various corporate tax attributes from the Puerto Rican system would carry over for Federal income tax purposes (e.g., net operating losses, earnings and profits, method of accounting, etc.). The change could result in a Puerto Rican corporation becoming eligible for the first time to join in the consolidated return of its U.S. affiliated group, with corresponding questions about its ability to use accumulated losses against the income of such a group.

The Puerto Rican corporation could become eligible for the first time to be treated as a small business ("S") corporation as defined in Code section 1361, with the effect of eliminating its corporate tax liability altogether. (This effect would be independent of section 936 and would provide an alternative exemption for qualifying corporations if section 936 also remained in effect.) If the Puerto Rican corporation had been a

controlled foreign corporation under Subpart F of the Code, it would presumably shed that status, although the impact of such a change on matters such as its section 959 "previously taxed income" account would have to be addressed. Interest and dividends paid by the Puerto Rican corporation would become U.S. source income, potentially ineligible for the section 936 exemption in the hands of recipient section 936 companies, but eligible for the 70% or 100% deduction of dividends received under Code section 243.

As indicated by the issues just discussed, the extension of the Federal income tax law to the state of Puerto Rico would raise a myriad of highly complex tax questions. Accordingly, careful consideration should be given to ensuring that there would be a flexible mechanism for resolving such issues.

Cover-over of Federal income taxes to Puerto Rico. Section 16(a) also provides for the cover-over to the Puerto Rican Treasury of certain Federal income taxes. The bill's language raises a number of issues.

First, the bill does not clearly indicate how to measure the amount of Federal income taxes that would be covered over to Puerto Rico. A number of different measurement approaches and combinations thereof are conceivable. For example, the cover-over could be equal to the amount of Federal income taxes collected on Puerto Rican source income of all U.S. taxpayers. This would require all U.S. taxpayers to report separately the amount of their Puerto Rican source income and their other income, and to allocate an appropriate amount of deductions to their Puerto Rican source income in order to determine the amount of their Federal tax liability attributable to that income.

Alternatively, or in combination with that approach, the cover-over could include the amount of Federal income taxes collected on the worldwide income of Puerto Rican residents. For purposes of this alternative, Puerto Rican residents could be deemed to mean individuals resident in Puerto Rico and Puerto Rican corporations. This alternative would require individuals to report their status as residents of Puerto Rico under whatever residency standard would be established for that purpose. The calculation of the separate Federal tax liability of a Puerto Rican corporation could be difficult where, for example, that corporation is part of a U.S. consolidated group.

If the cover-over measure is intended to be linked to the amount of income tax Puerto Rico would have collected if its income tax law had remained in effect, the cover-over measures just described could be limited by imposing as a cap the amount of Puerto Rican tax that would have been collected from the taxpayer on the affected income if Puerto Rico's tax laws were still in effect. Such an approach would require the additional computation and reporting of the hypothetical Puerto Rican tax liability under the principles of pre-statehood Puerto Rican law,

or some rough estimate based on actual Puerto Rican collections in the last pre-statehood years.

The bill calls for a phase-down of the cover-over during an unspecified number of years ("the proceeds of said taxes shall be transferred to the Treasury of Puerto Rico in an amount to be diminished by ____% of the monies collected each year for a ____year period"). Apparently, this language is intended to result in a straight-line reduction of the cover-over during the transitional period. The bill does not mention any other adjustment to the cover-over amount. For example, the cover-over amount apparently would not be adjusted to reflect in any way the amount of state income tax revenues that Puerto Rico might collect during the transition period by enacting state income tax laws. In addition, the bill does not mention any adjustment that might be made to the cover-over amount to reflect rebates or other subsidies that Puerto Rico might grant to taxpayers whose Federal income tax payments are being covered over to Puerto Rico. The bill does not provide the rule enacted in 1984 (in Code section 7652(c) and (d)) to limit certain Federal excise tax cover-overs in cases where the Federal tax revenues attributable to Puerto Rico are liable to be artificially inflated or otherwise manipulated.

2. <u>Section 16(b)</u>

Section 16(b) calls upon Congress to make provision so that "economic and fiscal exceptions of the Internal Revenue Code, already granted, such as those allowed under Section 936" shall be continued in full for an unspecified period after statehood, to be phased out gradually thereafter. This provision raises a number of questions. For example, it does not indicate which "exceptions", other than section 936, are intended to be retained during the transitional period. Thus, the provision does not specify whether it is intended to cover section 243(b)(1)(C) (relating to the 100 percent dividends received deduction for certain dividends from section 936 companies) or section 933 (relating to the exemption from Federal tax for the Puerto Rican source income of bona fide residents of Puerto Rico).

In addition, the bill does not clearly indicate when or how Congress would make provision to continue section 936 or other exceptions, nor does it indicate how long such exceptions would continue. Moreover, the bill provides no guidance on whether section 936, if it were to continue for Puerto Rico, would be frozen in its current form, or whether Puerto Rico's version of section 936 would be subject either to whatever amendments Congress might subsequently make to section 936 as it applies to other possessions, or to subsequent amendments specifically applicable to Puerto Rico.

The bill appears to envision that section 936 would remain in effect not only for corporations which had elected its benefits

prior to statehood, but also those which might elect its benefits after Puerto Rico becomes a state.

While most section 936 companies currently benefit from Puerto Rican income tax exemptions under the industrial incentives legislation, thereby paying very little income tax, the effect of continuing section 936 while simultaneously repealing Puerto Rico's income tax laws could mean that all section 936 companies would enjoy a total elimination of their income tax liability as a result of statehood.

The section 936 exemption applies not only to Puerto Rican business profits of U.S. corporations, but also to their Puerto Rican source investment income derived from qualifying investments of those profits. The latter category of investment income, known as QPSII ("qualified possession source investment income"), can include income from lending section 936 funds through a Puerto Rican financial institution to qualifying borrowers in beneficiary countries of the Caribbean Basin Initiative (CBI). The bill does not indicate whether the transitional period during which section 936 would remain in effect would be the same for both operating profits and the income from investing those profits in QPSII investments.

3. Section 16(c)

Section 16(c) calls for Congress to enact an omnibus act to, among other things, "assure appropriate continuity in the treatment...of alcohol excise taxes". It is not clear whether this provision contemplates a permanent continuation of the cover-over of U.S. alcohol excise taxes that occurs under Code section 7652 or a gradual phase-out similar to those mentioned in sections 16(a) and 16(b).

The Federal excise tax cover-over method of providing funding to the Puerto Rican Government has given rise to concerns about equity relative to state governments. For example, the Senate Finance Committee in 1984 expressed the view that the practice should not be expanded without a thorough examination of that issue. S. Rep. 98-169, I-1000. Additional concerns have arisen from the provision by Puerto Rico of subsidies to producers of articles subject to the Federal excise tax.

IV. COMMENTS ON INDEPENDENCE OPTION

A. In General

Title III of S. 712 deals with the independence option, and section 5.4 of Title III specifically addresses a number of tax issues. More generally, however, section 4.1(a) deals with the status of pre-existing law upon proclamation of independence. Section 5.3 commits the United States not to impose trade barriers or quotas on merchandise coming into the United States

from Puerto Rico until proclamation of independence and for twenty years thereafter.

Status of pre-existing laws. Under section 4.1(a)(2), all U.S. laws applicable to Puerto Rico immediately prior to independence shall no longer apply in the Republic of Puerto Rico. For purposes of U.S. tax laws, this provision presumably means that those Federal tax laws that treat Puerto Rico either as part of the United States or as a possession of the United States shall no longer apply, and that Puerto Rico shall instead be treated exclusively as a foreign country for U.S. tax purposes. Thus, for example, U.S. citizens living and working in Puerto Rico could become eligible for the foreign earned income exclusion under Code section 911. Generally, except for the section 911 exclusion, income derived by U.S. citizens and residents from foreign sources is subject to U.S. tax with a credit for foreign income taxes. However, this system would be substantially modified with respect to Puerto Rico by the bill's proposal to continue section 936.

Under section 4.1(a)(3),

> all laws and regulations of the Commonwealth of Puerto Rico in force immediately before the proclamation of independence shall continue in force and shall be read with such modifications, adaptions, qualifications, and exceptions as may be necessary to bring them into conformity with the Constitution of the Republic of Puerto Rico, until such time as they shall be replaced with new legislation . . . .

In other words, Puerto Rico's tax laws would generally remain in effect as national tax laws in an independent Puerto Rico, until changed by new legislation.

Both of these general conclusions are subject to the special provisions of section 5.4, to which we now turn.

B. Section 5.4(a)

Continuation of section 936. Section 5.4(a) provides that the section 936 credit currently allowed under the Code shall remain in full force for 15 years after independence with respect to corporations which now or at any time during that period meet the requirements of section 936. There are several points to note about this provision.

First, this language indicates that it is the present intention of Congress that section 936 benefits, as currently provided in the Code, would continue to apply without change to companies doing business in Puerto Rico. Pursuant to this language, this would seem to be the case regardless of whether the basic 936 credit, as it applies to the remaining U.S.

possessions, might be changed by Congress after Puerto Rico's independence. This feature of the bill is problematic in light of the numerous amendments that have been made to section 936 in recent years.

Second, the bill would not only preserve 936 benefits for those companies which are currently receiving them, but would also provide them to U.S. companies which might set up operations in Puerto Rico at any time during the transition period. Moreover, the proposed continuation of section 936 is not tied to any continuation of the industrial incentives tax legislation of Puerto Rico. In other words, the bill as drafted would require the United States to continue to exempt the Puerto Rican income of section 936 companies even if Puerto Rico substantially increased its level of taxation on those companies.

Third, the proposed continuation of section 936 raises a significant question about the bill's impact on understandings reached with a number of U.S. income tax treaty partners (including China, Korea, Barbados, Cyprus, Jamaica, Malta, and Morocco) to the effect that those treaties would be renegotiated or amended to include tax sparing provisions if the United States ever gave tax sparing to any other foreign country. We have not attempted to quantify the revenue cost of implementing those changes in the event this provision triggers such changes. However, it should be noted that it has been a cornerstone of U.S. tax treaty policy, supported by both Congress and the Executive Branch, that tax sparing credits (such as those provided under section 936) will not be included in U.S. tax treaties with other countries.

Finally, the bill is unclear with respect to the scope of the U.S. tax benefits that are intended to be preserved along with section 936. For example, section 5.4(a) does not mention the 100 percent dividends received deduction applicable to certain dividends from 936 companies under section 243. However, the language of section 5.4(b), to which we now turn, implies that the dividends received deduction is intended to be preserved.

C. Section 5.4(b)

Phase-out of section 936. Section 5.4(b) contains a number of provisions relating to the phase-out of the section 936 benefit after the initial 15-year period.

First, the section provides that in the tenth year after independence, an joint Puerto Rican-U.S. commission shall be established to recommend changes to the section 936 benefit to take place at the end of the 15-year period. If this group cannot agree on changing the credit, the bill provides that the basic exemption shall remain in full force through the 25th year after independence. In other words, Puerto Rico would have to agree to give up the section 936 credit in order for it to disappear before the expiration of 25 years after independence.

In the absence of an agreement by the joint commission, the only change that would be made during the period that is 15-25 years after independence would be to begin to subject "earnings repatriations" (presumably referring to dividends) by section 936 companies to U.S. tax on a phased-in basis. This proposal seems to assume that the section 243 one hundred percent dividends received deduction had remained in effect after independence. Even the U.S. taxation on the dividends is subjected to the requirement that the United States grant a credit for Puerto Rican taxes on the dividends. It is not clear how the drafters intended this proposal to interact with the provisions of the U.S. corporate alternative minimum tax, which include some portion of section 936 dividends in the alternative minimum taxable income base.

D. Section 5.4(c)

Business profits/permanent establishment. Section 5.4(c) contains a provision, commonly found in much more expanded form in income tax treaties, which would exempt enterprises resident in either Puerto Rico or the United States from taxation by the other country on their business profits, unless those profits are attributable to a permanent establishment in that other country. This provision differs, however, from comparable provisions in U.S. income tax treaties. For example, it does not define either "business profits" or "permanent establishment", both of which are commonly defined in tax treaties. It is not accompanied by the kind of "anti-treaty-shopping" provision that would prevent third country residents from abusing the relationship between Puerto Rico and the United States by setting up a Puerto Rican company to enjoy the U.S. tax benefit. It is not accompanied by other provisions (e.g., nondiscrimination, exchange of information, competent authority procedures, etc.) which typically form part of the overall bargain in a treaty relationship. Moreover, like the other treaty-type provisions in section 5.4, this provision does not clearly indicate whether its drafters intended it to create an obligation under international law, which neither jurisdiction could change unilaterally.

We have asked the State Department for its views on this question, and defer to its conclusions. We would also defer to the State Department on the issue of whether these provisions, including the part of section 5.4(f) which calls for a tax treaty to be negotiated between Puerto Rico and the United States, infringes in any way on the constitutional allocation of treaty-making power to the President with the advice and consent of the Senate.

E. Section 5.4(d)

Source/situs taxing jurisdiction. Section 5.4(d) provides that both the United States and Puerto Rico shall have taxing jurisdiction over income sourced within its territory and

earned by individuals resident in the other jurisdiction, over property situated within its territory (including transfers of such property by gift or at death), and over products consumed in its territory. This provision seems designed to allocate taxing jurisdiction between the United States and Puerto Rico for purposes of income, estate, gift, and excise taxes. It is unclear whether the provision is intended to allocate exclusive (as opposed to merely primary) taxing jurisdiction to the source or situs country. For example, it is unclear whether the provision is suggesting that only Puerto Rico can tax the income earned in Puerto Rico by U.S. resident individuals. We note that section 5.4(f) provides that sourcing determinations shall be made according to the terms of a tax treaty to be entered into promptly upon Puerto Rico's independence, and meanwhile by the laws of each country.

F. Section 5.4(e)

Foreign tax credit and tax sparing. Section 5.4(e) contains two provisions. First, it guarantees taxpayers resident in either the United States or Puerto Rico that they may take a foreign tax credit for taxes payable to the other country in accordance with the various provisions of section 5.4 In the case of Puerto Rican taxes, the bill appears to guarantee a credit without regard to the normal Code rules relating to the creditability of foreign taxes.

Section 5.4(e) also gives Puerto Rico most favored nation status in the event that the United States grants tax sparing credits to any other country. It does this by saying that such credits shall be available "ipso facto" to Puerto Rico in the event that the United States amends its laws on the provision of tax sparing credits or reaches an agreement on the provisions of a tax sparing credit with any other nation. By contrast, most understandings between the United States and its developing country treaty partners referring to tax sparing would say that tax sparing will be granted to them only by amendment of their treaty in the event their most favored nation understanding on tax sparing is triggered.

G. Section 5.4(f)

Treaty relationship. Section 5.4(f) provides that the various source, situs, and other definitional determinations required under section 5.4 shall be made according to the terms of a tax treaty to be entered into promptly between the United States and Puerto Rico. As indicated above, the provision indicates that such determinations would be made, in the meantime, under the "current" domestic laws of the two jurisdictions. Here again, it is unclear whether the relevant domestic laws could be unilaterally amended without violating some international law agreement that might be deemed to arise from this type of provision.

H. Section 5.6(b)

Continuation of exemption for interest on Puerto Rican government obligations. Section 5.6 of the independence option contains a provision which would require the United States to continue to provide an exemption for 25 years after independence for interest payments made on debt obligations issued by the government of Puerto Rico, whether issued before or after independence. This provision would be unique; the United States does not provide such exemptions to U.S. taxpayers holding foreign government obligations even in the context of income tax treaties. Moreover, the exemption would apparently have to be equivalent to that "currently provided by law" on Puerto Rican bonds, raising the question whether any subsequent amendments to the domestic tax exempt bond provisions would apply to Puerto Rican bonds if this provision were enacted.

I. Section 5.3

Duty-free trade. While I defer to my USTR colleague to comment on the trade aspects of this bill, I do want to underscore an area of particular Treasury concern. Section 5.3 provides that the United States will not impose trade barriers or quotas on articles coming into the United States from Puerto Rico until proclamation of independence and for twenty years thereafter.

This provision does not distinguish between (1) products of Puerto Rico, that is, products that are either wholly obtained or substantially processed in Puerto Rico, and (2) third-country goods shipped through Puerto Rico. The consequences are far-reaching, going beyond our bilateral trade relationship with Puerto Rico, since third-country textiles and other goods could circumvent U.S. quotas and tariffs.

A more effective and typical formulation is to specify that duty-free treatment be accorded to "products of" Puerto Rico. This narrows eligibility, excluding third-country goods in which Puerto Rico does not have a significant economic stake.

V. COMMENTS ON THE COMMONWEALTH OPTION

Subpart 4 of the commonwealth option provides for an amendment to section 9 of the Puerto Rico Federal Relations Act. One part of that amendment would render Federal statutes inapplicable in Puerto Rico unless they are consistent with the policy established under subpart 3 of that option (i.e., to enable the people of Puerto Rico, among other things, to accelerate their economic and social development), and unless they have proper regard for the economic, cultural, ecological, geographic, demographic, and other local conditions of the Commonwealth of Puerto Rico. It is not clear to us how that part of the amendment would affect U.S. tax statutes currently

applicable in Puerto Rico, if at all. Indeed, it would seem appropriate for the Congress to clarify that these provisions would not be applicable to tax, customs, or similar revenue measures.

In addition, we believe Congress should make clear that tax benefits such as section 936 cannot be regarded as benefits that will last indefinitely under commonwealth status, but rather as incentives which Congress will continue to review and revise as necessary.

A further part of the amendment to section 9 would provide that the Commonwealth of Puerto Rico may "continue" to enter in its own right into international cultural, commercial, educational, and sports agreements, and other agreements of like nature. In addition, the same amendment would authorize the Governor of Puerto Rico to take "any official action" to promote the international interests of Puerto Rico that requires the consent of the United States Government and is not expressly prohibited by law. The amendment appears to contemplate that U.S. consent would be implicit unless the President objected to the action on foreign relations or national defense grounds, after being notified of the proposed action by the Governor. Currently, Puerto Rico does not have the authority to negotiate or enter into international double taxation or similar agreements in its own right, and it is unclear how the proposed amendment would affect that issue. It is certain, however, that the grant of independent tax treaty authority to Puerto Rico would significantly complicate the negotiations of United States treaties and quite possibly undermine several existing conventions.

TREASURY NEWS

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FOR IMMEDIATE RELEASE

Paris, France
July 13, 1989

STATEMENT BY
NICHOLAS F. BRADY
SECRETARY OF THE TREASURY

Today, the Senate conferees offered a proposal to resolve many of the outstanding differences between House and Senate versions of the pending thrift legislation in a single overall package. The Senate offer seems to embody the best of both the House and Senate bills. I applaud the effort to move the conference process forward rapidly.

We have not yet seen all the specific details, as well as the specific implementing legislative language. However, based on our understanding of the outline that has been released, the Administration would strongly support this proposal taken as a whole. It appears to contain excellent provisions on many issues, including strong capital requirements to protect against future risks, a financing plan that would preserve the Gramm-Rudman-Hollings process intact and lock in industry contributions, and a substantially strengthened thrift supervisory structure. The proposal also seeks to satisfy the objectives set forth by the President for responsible action to prevent any reoccurrence of this problem.

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NB-371

16 July 1989

ECONOMIC DECLARATION

1) We, the Heads of State or Government of seven major industrial nations and the President of the Commission of the European Communities, have met in Paris for the fifteenth annual Economic Summit. The Summit of the Arch initiates a new round of Summits to succeed those begun at Rambouillet in 1975 and at Versailles in 1982. The round beginning in 1982 has seen one of the longest periods of sustained growth since the Second World War. These Summits have permitted effective consultations and offered the opportunity to launch initiatives and to strengthen international cooperation.

2) This year's world economic situation presents three main challenges:

- The choice and the implementation of measures needed to maintain balanced and sustained growth, counter inflation, create jobs and promote social justice. These measures should also facilitate the adjustment of external imbalances, promote international trade and investment, and improve the economic situation of developing countries.

- The development and the further integration of developing countries into the world economy. Whilst there has been substantial progress in many developing countries, particularly those implementing sound economic policies, the debt burden and the persistence of poverty, often made worse by natural disasters affecting hundreds of millions of people, are problems of deep concern which we must continue to face in a spirit of solidarity.

- The urgent need to safeguard the environment for future generations. Scientific studies have revealed the existence of serious threats to our environment such as the depletion of the stratospheric ozone layer and excessive emissions of carbon dioxide and other greenhouse gases which could lead to future climate changes. Protecting the environment calls for a determined and concerted international response and for the early adoption, worldwide, of policies based on sustainable development.

INTERNATIONAL ECONOMIC SITUATION

3) Growth has been sustained by focusing policies on improving the efficiency and flexibility of our economies and by strengthening our cooperative efforts and the coordination process. In the medium term, the current buoyant investment seen during this period should pave the way for an increased supply of goods and services and help reduce the dangers of inflation. The outlook is not, however, without risks.

4) Until now, the threat of inflation in many countries has been contained, thanks to the concerted efforts of governments and monetary authorities. But continued vigilance is required and inflation, where it has increased,

will continue to receive a firm policy response so that it will be put on a downward path.

5) While some progress has been made in reducing external imbalances, the momentum of adjustment has recently weakened markedly. There needs to be further progress in adjusting external imbalances through cooperation.

6) In countries with fiscal and current account deficits, including the United States of America, Canada and Italy, further reductions in budget deficits are needed. Action will be taken to bring them down. This may help reduce the saving-investment gap and external imbalances, contribute to countering inflation and encourage greater exchange rate stability in a context of decreasing interest rates.

7) Countries with external surpluses, including Japan and Germany, should continue to pursue appropriate macroeconomic policies and structural reforms that will encourage non-inflationary growth of domestic demand and facilitate external adjustment.

8) All our countries share the responsibility for the sound development of the world economy. Over the medium term, deficit countries have to play a key role in global adjustment through their external adjustment and increased exports; surplus countries have to contribute to sustaining global expansion through policies providing favourable conditions for growth of domestic demand and imports.

9) The emergence of the newly industrializing economies and the initiation of a dialogue with them are welcome. We call on those with substantial surpluses to contribute to the adjustment of external imbalances and the open trade and payments system. To that end, they should

permit exchange rates to reflect their competitive position, implement GATT commitments and reduce trade barriers.

INTERNATIONAL MONETARY DEVELOPMENTS AND COORDINATION

10) Under the Plaza and Louvre agreements, our countries agreed to pursue, in a mutually reinforcing way, policies of surveillance and coordination aimed at improving their economic fundamentals and at fostering stability of exchange rates consistent with those economic fundamentals.

There has been progress in the multilateral surveillance and coordination of economic policies with a view to ensuring internal consistency of domestic policies and their international compatibility. The procedures to be used have been more clearly defined and improved in cooperation with the International Monetary Fund.

11) The coordination process has made a positive contribution to world economic development and it has also contributed greatly to improving the functioning of the International Monetary System. There has also been continued cooperation in exchange markets.

It is important to continue, and where appropriate, to develop this cooperative and flexible approach to improve the functioning and the stability of the International Monetary System in a manner consistent with economic fundamentals. We therefore ask the Finance Ministers to continue to keep under review possible steps that could be taken to improve the coordination process, exchange market cooperation, and the functioning of the International Monetary System.

12) We welcome the decision to complete the work on the ninth review of the International Monetary Fund quotas with a view to a decision on this matter before the end of the year.

We note that the question of a resumption of S.D.R. allocation remains under consideration in the Executive Board of the International Monetary Fund.

13) Within the European Community, the European Monetary System has contributed to a significant degree of economic policy convergence and monetary stability.

IMPROVING ECONOMIC EFFICIENCY

14) We will continue to promote measures in order to remove inefficiencies in our economies. These inefficiencies affect many aspects of economic activity, reduce potential growth rates and the prospects for job creation, diminish the effectiveness of macroeconomic policies and impede the external adjustment process. In this context, tax reforms, modernization of financial markets, strengthening of competition policies and reducing rigidities in all sectors including energy, industry and agriculture are necessary. So are the improvement of education and vocational training, transportation and distribution systems and further policies aimed at giving more flexibility and mobility to the labour market and reducing unemployment. Within the European Community, the steady progress towards the completion by the end of 1992 of the program contained in the Single Act has already given a strong momentum to economic efficiency.

15) The decline of saving in some of our countries in this decade is a cause for concern. This lower level of

saving can contribute to high real interest rates and therefore hamper growth. Inadequate saving and large fiscal deficits are associated with large external deficits. We recommend, within the framework of policy coordination, policies to encourage saving and remove hindrances where they exist.

16) Financial activities are being increasingly carried out with new techniques on a worldwide basis. As regards insider trading, which could hamper the credibility of financial markets, regulations vary greatly among our countries. These regulations have been recently, or are in the process of being, strengthened. International cooperation should be pursued and enhanced.

TRADE ISSUES

17) World trade developed rapidly last year. Yet protectionism remains a real threat. We strongly reaffirm our determination to fight it in all its forms. We shall fulfill the Punta del Este standstill and rollback commitments which, inter alia, require the avoidance of any trade restrictive or distorting measure inconsistent with the provisions of the General Agreement and its instruments. We agree to make effective use of the improved GATT dispute settlement mechanism and to make progress in negotiations for further improvements. We will avoid any discriminatory or autonomous actions, which undermine the principles of the GATT and the integrity of the multilateral trading system. We also are pledged to oppose the tendency towards unilateralism, bilateralism, sectoralism and managed trade which threatens to undermine the multilateral system and the Uruguay Round negotiations.

18) The successful negotiation of the Trade Negotiations Committee of the Uruguay Round in Geneva last April, thereby completing the mid-term review, is a very important achievement. It gives a clear framework for future work in all sectors including the pursuit of agricultural reform in the short term as well as in the long term. It also gives the necessary framework for substantive negotiations in important sectors not yet fully included in GATT disciplines, such as services, trade-related investment measures and intellectual property.

Developing countries participated actively in these negotiations and contributed to this success. All countries should make their most constructive contribution possible.

We express our full commitment to making further substantive progress in the Uruguay Round in order to complete it by the end of 1990.

19) We note with satisfaction the entry into force of the Free Trade Agreement between Canada and the US, as well as more recent initiatives to intensify the close economic relations between the European Community and EFTA countries. It remains our policy that these and other developments in regional cooperation, should be trade-creating and complementary to the multilateral liberalization process.

20) It is the firm intention of the European Community that the trade aspects of the single market program should also be trade-creating and complementary to the multilateral liberalization process.

21) We note with satisfaction the progress that has been made in strengthening the multilateral disciplines on trade and aid distorting export credit subsidies. This effort

must be pursued actively and completed in the competent bodies of the OECD with a view to improving present guidelines at the earliest possible date.

GENERAL PROBLEMS OF DEVELOPMENT

22) Development is a shared global challenge. We shall help developing countries by opening the world trading system and by supporting their structural adjustment. We shall encourage too economic diversification in commodity dependent countries and the creation of a favourable environment for transfers of technology and capital flows.

We underline the continuing importance of official development assistance and welcome the increased efforts of Summit participants in this respect. We note the targets already established by international organizations for the future level of official development assistance and stress the importance of overall financial flows to development.

We underline simultaneously the importance attached to the quality of the aid and to the evaluation of the projects and the programs financed.

23) We urge developing countries to implement sound economic policies. A vital factor will be the adoption of financial and fiscal policies which attract inward investment and encourage growth and the return of flight capital.

24) We note with satisfaction that there has been substantial progress in the multilateral aid initiative for the Philippines that was given special attention in the Toronto economic declaration.

25) Faced with the worrying economic situation of Yugoslavia, we encourage its government to implement a strong economic reform program that can command bilateral and multilateral support.

THE SITUATION IN THE POOREST COUNTRIES

26) The enhancement of the International Monetary Fund Structural Adjustment Facility, the World Bank special program of assistance for the poorest and most indebted countries and the fifth replenishment of the African Development Fund are all important measures benefiting those countries having embarked upon an adjustment process. We stress the importance attached to a substantial replenishment of International Development Association resources.

27) As we urged last year in TORONTO, the Paris Club reached a consensus in September 1988 on the conditions of implementation of significant reduction of debt service payments for the poorest countries. Thirteen countries have already benefitted by this decision.

28) We welcome the increasing grant element in the development assistance as well as the steps taken to convert loans into grants and we urge further steps to this end. Flexibility in development aid as much as in debt rescheduling is required.

29) We attach great importance to the efficient and successful preparation of the next general conference of the United Nations on the least developed countries, which will take place in Paris in 1990.

STRENGTHENED DEBT STRATEGY FOR THE HEAVILY INDEBTED COUNTRIES

30) Our approach to the debt problems has produced significant results, but serious challenges remain: in many countries the ratio of debt service to exports remains high, financing for growth promoting investment is scarce, and capital flight is a key problem. An improvement in the investment climate must be a critical part of efforts to achieve a sustainable level of growth without excessive levels of debt. These improvements of the current situation depend above all on sustained and effective adjustment policies in the debtor countries.

31) To address these challenges, we are strongly committed to the strengthened debt strategy. This will rely, on a case-by-case basis, on the following actions:

- borrowing countries should implement, with the assistance of the Fund and the Bank, sound economic policies, particularly designed to mobilize savings, stimulate investment and reverse capital flight;

- banks should increasingly focus on voluntary, market-based debt and debt service reduction operations, as a complement to new lending;

- the International Monetary Fund and World Bank will support significant debt reduction by setting aside a portion of policy-based loans;

- limited interest support will be provided, through additional financing by the International Monetary Fund and the World Bank, for transactions involving significant debt and debt service reduction. For that purpose the use of escrow accounts is agreed;

- continued Paris Club rescheduling and flexibility of export-credit agencies;

- strengthening of the international financial institutions capability for supporting medium-term macroeconomic and structural adjustment programs and for compensating the negative effects of export shortfalls and external shocks.

32) In the framework of this strategy:

- we welcome the recent decisions taken by the two institutions to encourage debt and debt service reduction which provide adequate resources for these purposes;

- we urge debtor countries to move ahead promptly to develop strong economic reform programs that may lead to debt and debt service reductions in accordance with the guidelines defined by the two Bretton Woods institutions;

- we urge banks to take realistic and constructive approaches in their negotiations with the debtor countries and to move promptly to conclude agreements on financial packages including debt reduction, debt service reduction and new money. We stress that official creditors should not substitute for private lenders. Our governments are prepared to consider as appropriate tax, regulatory and accounting practices with a view to eliminating unnecessary obstacles to debt and debt service reductions.

ENVIRONMENT

33) There is growing awareness throughout the world of the necessity to preserve better the global ecological balance. This includes serious threats to the atmosphere, which could lead to future climate changes. We note with great concern the growing pollution of air, lakes, rivers, oceans and seas; acid rain, dangerous substances; and the rapid desertification and deforestation. Such environmental degradation endangers species and undermines the well-being of individuals and societies.

Decisive action is urgently needed to understand and protect the earth's ecological balance. We will work together to achieve the common goals of preserving a healthy and balanced global environment in order to meet shared economic and social objectives and to carry out obligations to future generations.

34) We urge all countries to give further impetus to scientific research on environmental issues, to develop necessary technologies and to make clear evaluations of the economic costs and benefits of environmental policies.

The persisting uncertainty on some of these issues should not unduly delay our action.

In this connection, we ask all countries to combine their efforts in order to improve observation and monitoring on a global scale.

35) We believe that international cooperation also needs to be enhanced in the field of technology and technology transfer in order to reduce pollution or provide alternative solutions.

36) We believe that industry has a crucial role in preventing pollution at source, in waste minimization, in energy conservation, and in the design and marketing of cost-effective clean technologies. The agricultural sector must also contribute to tackling problems such as water pollution, soil erosion and desertification.

37) Environmental protection is integral to issues such as trade, development, energy, transport, agriculture and economic planning. Therefore, environmental considerations must be taken into account in economic decision-making. In fact good economic policies and good environmental policies are mutually reinforcing.

In order to achieve sustainable development, we shall ensure the compatibility of economic growth and development with the protection of the environment. Environmental protection and related investment should contribute to economic growth. In this respect, intensified efforts for technological breakthrough are important to reconcile economic growth and environmental policies.

Clear assessments of the costs, benefits and resource implications of environmental protection should help governments to take the necessary decisions on the mix of price signals (e.g., taxes or expenditures) and regulatory actions, reflecting where possible the full value of natural resources.

We encourage the World Bank and regional development banks to integrate environmental considerations into their activities. International organizations such as the OECD and the United Nations and its affiliated organizations, will be asked to develop further techniques of analysis which would help governments assess appropriate economic measures to promote the quality of the environment. We ask the OECD, within the context of its work on integrating environment and economic decision-making, to examine how selected environmental indicators could be developed. We expect the 1992 UN Conference on Environment and Development to give additional momentum to the protection of the global environment.

38) To help developing countries deal with past damage and to encourage them to take environmentally desirable action, economic incentives may include the use of aid mechanisms and specific transfer of technology. In special cases, ODA debt forgiveness and debt for nature swaps can play a useful role in environmental protection.

We also emphasize the necessity to take into account the interests and needs of developing countries in sustaining the growth of their economies and the financial and technological requirements to meet environmental challenges.

39) The depletion of the stratospheric ozone layer is alarming and calls for prompt action.

We welcome the HELSINKI conclusions related, among other issues, to the complete abandonment of the production and consumption of chloro-fluorocarbons covered by the MONTREAL protocol as soon as possible and not later than the end of the century. Specific attention must also be given to those ozone-depleting substances not covered by the Montreal protocol. We shall promote the development and use of suitable substitute substances and technologies. More emphasis should be placed on projects that provide alternatives to chloro-fluorocarbons.

40) We strongly advocate common efforts to limit emissions of carbon dioxide and other greenhouse gases, which threaten to induce climate change, endangering the environment and ultimately the economy. We strongly support the work undertaken by the Intergovernmental Panel on Climate Change, on this issue.

We need to strengthen the worldwide network of observatories for greenhouse gases and support the World Meteorological Organisation initiative to establish a global climatological reference network to detect climate changes

41) We agree that increasing energy efficiency could make a substantial contribution to these goals. We urge international organizations concerned to encourage measures, including economic measures, to improve energy conservation and, more broadly, efficiency in the use of energy of all kinds and to promote relevant techniques and technologies.

We are committed to maintaining the highest safety standards for nuclear power plants and to strengthening international cooperation in safe operation of power plants and waste management, and we recognize that nuclear power also plays an important role in limiting output of greenhouse gases.

42) Deforestation also damages the atmosphere and must be reversed. We call for the adoption of sustainable forest management practices, with a view to preserving the scale of world forests. The relevant international organizations will be asked to complete reports on the state of the world's forests by 1990.

43) Preserving the tropical forests is an urgent need for the world as a whole. While recognizing the sovereign rights of developing countries to make use of their natural resources, we encourage, through a sustainable use of tropical forests, the protection of all the species therein and the traditional rights to land and other resources of local communities. We welcome the German initiative in this field as a basis for progress.

To this end, we give strong support to rapid implementation of the Tropical Forest Action Plan which was adopted in 1986 in the framework of the Food and Agricultural Organization. We appeal to both consumer and producer countries, which are united in the International Tropical Timber Organization, to join their efforts to ensure better conservation of the forests. We express our readiness to assist the efforts of nations with tropical forests through financial and technical cooperation, and in international organizations.

44) Temperate forests, lakes and rivers must be protected against the effects of acid pollutants such as sulphur dioxide and nitrogen oxides. It is necessary to pursue actively the bilateral and multilateral efforts to this end.

45) The increasing complexity of the issues related to the protection of the atmosphere calls for innovative solutions. New instruments may be contemplated. We believe that the conclusion of a framework or umbrella convention on climate change to set out general principles or guidelines is urgently required to mobilize and rationalize the efforts made by the international community. We welcome the work under way by the United Nations Environment Program, in cooperation with the World Meteorological Organization, drawing on the work of the Intergovernmental Panel on Climate Change and the results of other international meetings. Specific protocols containing concrete commitments could be fitted into the framework as scientific evidence requires and permits.

46) We condemn indiscriminate use of oceans as dumping grounds for polluting waste. There is a particular problem with the deterioration of coastal waters. To ensure the sustainable management of the marine environment, we recognize the importance of international cooperation in preserving it and conserving the living resources of the sea. We call for relevant bodies of the United Nations to prepare a report on the state of the world's oceans.

We express our concern that national, regional and global capabilities to contain and alleviate the consequences of maritime oil spills be improved. We urge all countries to make better use of the latest monitoring and clean-up technologies. We ask all countries to adhere to and implement fully the international conventions for the prevention of oil pollution of the oceans. We also ask the International Maritime Organization to put forward proposals for further preventive action.

47) We are committed to ensuring full implementation of existing rules for the environment. In this respect, we note with interest the initiative of the Italian government to host in 1990 a forum on international law for the environment with scholars, scientific experts and officials, to consider the need for a digest of existing rules and to give in-depth consideration to the legal aspects of environment at the international level.

48) We advocate that existing environment institutions be strengthened within the United Nations system. In particular, the United Nations Environment Program urgently requires strengthening and increased financial support. Some of us have agreed that the establishment within the United Nations of a new institution may also be worth considering.

49) We have taken note of the report of the sixth conference on bioethics held in Brussels which examined the elaboration of a universal code of environmental ethics based upon the concept of the "human stewardship of nature".

50) It is a matter of international concern that Bangladesh, one of the poorest and most densely populated countries in the world, is periodically devastated by catastrophic floods.

We stress the urgent need for effective, coordinated action by the international community, in support of the Government of Bangladesh, in order to find solutions to this major problem which are technically, financially, economically and environmentally sound. In that spirit, and taking account of help already given, we take note of the different studies concerning flood alleviation, initiated by France, Japan, the US and the United Nations Development Program, which have been reviewed by experts from all our countries. We welcome the World Bank's agreement, following those studies, to coordinate the efforts of the international community so that a sound basis for achieving a real improvement in alleviating the effects of flood can be established. We also welcome the agreement of the World Bank to chair, by the end of the year, a meeting to be held in the United Kingdom by invitation of the Bangladesh Government, of the countries willing to take an active part in such a program.

51) We give political support to projects such as the joint project to set up an observatory of the Saharan areas, which answers the need to monitor the development of that rapidly deteriorating, fragile, arid region, in order to protect it more effectively.

DRUG ISSUES

52) The drug problem has reached devastating proportions. We stress the urgent need for decisive action, both on a national and an international basis. We urge all countries, especially those where drug production, trading and consumption are large, to join our efforts to counter drug production, to reduce demand, and to carry forward the fight

against drug trafficking itself and the laundering of its proceeds.

53) Accordingly, we resolve to take the following measures within relevant fora:

- Give greater emphasis on bilateral and United Nations programs for the conversion of illicit cultivation in the producer countries. The United Nations Fund for Drug Abuse Control (UNFDAC), and other United Nations and multilateral organizations should be supported, strengthened and made more effective. These efforts could include particular support for the implementation of effective programs to stop drug cultivation and trading as well as developmental and technical assistance.

- Support the efforts of producing countries who ask for assistance to counter illegal production or trafficking.

- Strengthen the role of the United Nations in the war against drugs through an increase in its resources and through reinforced effectiveness of its operation.

- Intensify the exchange of information on the prevention of addiction, and rehabilitation of drug addicts.

- Support the international conference planned for 1990 on cocaine and drug demand reduction.

- Strengthen the efficiency of the cooperative and mutual assistance on these issues, the first steps being a prompt adhesion to, ratification and implementation of the Vienna Convention on illicit traffic in narcotic drugs and psychotropic substances.

- Conclude further bilateral or multilateral agreements and support initiatives and cooperation, where appropriate, which include measures to facilitate the identification, tracing, freezing, seizure and forfeiture of drug crime proceeds.

- Convene a financial action task force from Summit Participants and other countries interested in these problems. Its mandate is to assess the results of cooperation already undertaken in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance. The first meeting of this task force will be called by France and its report will be completed by April 1990.

54) International cooperation against AIDS

We take note of the creation of an International Ethics committee on AIDS which met in Paris in May 1989, as decided at the Summit of Venice (June 1987). It assembled the Summit Participants and the other members of the EC, together with the active participation of the World Health Organization.

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* *

55) We take note of the representations that we received from various Heads of State or Government and organizations and we will study them with interest.

56) <u>Next Economic Summit</u>

We have accepted the invitation of the President of the United States to meet next year in the United States of America.

TREASURY NEWS

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

CONTACT: Office of Financing
5310 202/376-4350

FOR IMMEDIATE RELEASE
July 17, 1989

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,626 million of 13-week bills and for $6,602 million of 26-week bills, both to be issued on July 20, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 19, 1989			:	26-week bills maturing January 18, 1990		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.87%a/	8.14%	98.011	:	7.62%	8.03%	96.148
High	7.87%	8.14%	98.011	:	7.69%	8.11%	96.112
Average	7.87%	8.14%	98.011	:	7.67%	8.09%	96.122

a/ Excepting 1 tender of $5,300,000.

Tenders at the high discount rate for the 13-week bills were allotted 75%.
Tenders at the high discount rate for the 26-week bills were allotted 31%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 36,730	$ 36,730	:	$ 35,995	$ 35,995
New York	21,927,415	5,811,370	:	17,957,015	5,769,765
Philadelphia	24,155	23,995	:	13,130	13,130
Cleveland	56,160	56,160	:	60,315	60,315
Richmond	45,635	42,635	:	41,200	41,200
Atlanta	30,925	30,925	:	33,045	33,045
Chicago	1,337,550	46,040	:	842,100	88,650
St. Louis	50,590	27,090	:	38,170	34,790
Minneapolis	10,540	10,540	:	7,125	7,125
Kansas City	38,690	38,690	:	41,985	41,985
Dallas	31,010	21,010	:	26,430	21,430
San Francisco	1,071,120	63,120	:	1,067,825	64,445
Treasury	417,510	417,510	:	389,920	389,920
TOTALS	$25,078,030	$6,625,815	:	$20,554,255	$6,601,795
Type					
Competitive	$21,762,180	$3,609,965	:	$16,392,925	$2,740,465
Noncompetitive	1,230,300	1,230,300	:	960,480	960,480
Subtotal, Public	$22,992,480	$4,840,265	:	$17,353,405	$3,700,945
Federal Reserve	1,991,400	1,691,400	:	1,950,000	1,650,000
Foreign Official Institutions	94,150	94,150	:	1,250,850	1,250,850
TOTALS	$25,078,030	$6,625,815	:	$20,554,255	$6,601,795

An additional $22,650 thousand of 13-week bills and an additional $402,350 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 IMMEDIATE RELEASE

STATEMENT BY
NICHOLAS F. BRADY
SECRETARY OF THE TREASURY
MID-SESSION BUDGET REVIEW
July 18, 1989

Good morning. We've completed the Mid-Session Review of the budget. This review provides an update on the economic outlook that reflects changing conditions and policies.

The Mid-Session Review also revises the federal budget estimates for fiscal 1989 and 1990 and provides a preliminary look at fiscal years 1991 through 1994.

These estimates are particularly important in the context of the Gramm-Rudman-Hollings law because they provide the analysis needed by OMB to prepare its report to Congress on the mandatory budget deficit targets. OMB is required to submit by August 25 its evaluation of the prospects for achieving the fiscal 1990 budget deficit target of $100 billion.

We believe the economy is healthy, and we predict that growth will continue, but at a somewhat slower pace. We expect real output this year, as measured from fourth quarter to fourth quarter, to increase 2.7 percent (or 2.1 percent after adjusting for last year's drought). In 1990, we expect moderate growth to continue, with a 2.6 percent gain for the year. This compares to the February estimates of 3.5 percent for 1989 and 3.4 percent for 1990.

Personal income gains will support moderate consumer spending, providing a solid base for the economy. The growth will come from good performances in business investment and net exports, resulting from lower interest rates and a stable dollar. I've just returned from the Economic Summit in Paris, where our trading partners pledged further efforts to keep their economies growing in ways that will support strong demand for our exports.

On the inflation front, we expect significant improvement over the next few months over the figures earlier this year that were distorted by large increases in energy and food prices. Wages and salaries have not accelerated markedly. The producer price index already reflects this improvement and consumer prices should begin to show better results shortly.

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With respect to the budget, we are making progress in meeting Gramm-Rudman-Hollings deficit reduction targets. The President reiterated at the Economic Summit our determination to continue reducing the deficit. In that regard, I'd like to note that the Senate conferees in the savings and loan legislation conference have proposed a package that pulls together the best of the House and Senate bills. It includes the financing plan that will best preserve the Gramm-Rudman-Hollings fiscal discipline and also save taxpayer dollars by locking in the savings and loan industry contribution.

In conclusion, I would characterize our economic and budget forecasts as being realistic and internally consistent. Economic forecasting is not an exact science, but we believe our figures are sound forecasts that are consistent with those of other government and private forecasters.

Now, Mike Boskin will make some further comments on the economic forecast and Dick Darman will give an explanation of the budget implications of our estimates.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
July 18, 1989

Contact: Peter Hollenbach
(202) 376-4302

TREASURY ESTABLISHES MATURITY SCHEDULE FOR U.S. SAVINGS BONDS

The Treasury Department established a schedule of final maturity dates for U.S. Savings Bonds by announcing a series of extended maturity periods for outstanding bonds and notes, as well as, new issues of bonds. Treasury's action will significantly reduce confusion for many of the millions of Americans who own bonds but are unaware of when their bonds stop earning interest.

Financial institutions and savings bond and note owners will now only have to recall an easy to remember "40-30-20" formula to determine how long bonds will earn interest.

* Series E savings bonds issued before December 1965 will stop earning interest exactly 40 years from their issue dates.

* Series E bonds, Series EE bonds and Savings Notes (Freedom Shares) issued after November 1965 will stop earning interest exactly 30 years from their issue dates. Outstanding Series H bonds, issued between 1959 and 1979, also have a 30-year final maturity.

* Series HH bonds issued since 1980 will stop earning interest 20 years from their issue dates.

Savings bonds are sold with a designated "initial" maturity and are then granted maturity extensions. Treasury's announcement today means that new issues of Series EE bonds, in addition to the current 12-year initial maturity, will be granted one 10-year maturity extension, and one 8-year extension---resulting in a final maturity of 30 years. Outstanding Series EE bonds having initial maturities of 8, 10, 11, and 12 years will receive the required number of 10-year and shorter extensions, when appropriate, to provide a final maturity of 30 years.

NB-374

By announcing its policy on savings bond extensions and final maturity, Treasury has taken another step in improving the savings bond program. Bond owners will now be able to better plan for their children's education, retirement and other long-term goals by knowing the final maturity of their savings bonds.

Treasury's administrative costs will also be reduced by simplifying the program and significantly reducing the thousands of inquiries received each year from bond owners asking when their bonds will stop earning interest. Within the next year, as new bonds are printed and issued, the final maturity, or interest earning life, will appear on the face of the bonds.

Accompanying this release is a table that illustrates the extensions that will be applied to outstanding bonds and notes, as well as, new issues of bonds to effect the new policy.

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MATURITY SCHEDULE FOR U. S. SAVINGS BONDS

ISSUE DATES	PREVIOUS MATURITIES	ADDITIONAL INTEREST PERIOD	LIFE OF BOND (YRS)	FINAL MATURITIES
		40 YEAR GROUP		
Series E				
May 1941 - Jul 1949	40 yrs	ISSUE MATURED	40	May 1981 - Jul 1989
Aug 1949 - Apr 1952	40 yrs	NONE	40	Aug 1989 - Apr 1992
May 1952 - Jan 1957	39 yrs, 8 mos	4 mos	40	May 1992 - Jan 1997
Feb 1957 - May 1959	38 yrs, 11 mos	1 yr, 1 mo	40	Feb 1997 - May 1999
Jun 1959 - Nov 1965	37 yrs, 9 mos	2 yrs, 3 mos	40	Jun 1999 - Nov 2005
		30 YEAR GROUP		
Series E				
Dec 1965 - May 1969	27 yrs	3 yrs	30	Dec 1995 - May 1999
Jun 1969 - Nov 1973	25 yrs, 10 mos	4 yrs, 2 mos	30	Jun 1999 - Nov 2003
Dec 1973 - Jun 1980	25 yrs	5 yrs	30	Dec 2003 - Jun 2010
Savings Notes (Freedom Shares)				
May 1967 - Oct 1970	24 yrs, 6 mos	5 yrs, 6 mos	30	May 1997 - Oct 2000
Series EE				
Jan 1980 - Oct 1980	11 yrs	19 yrs	30	Jan 2010 - Oct 2010
Nov 1980 - Apr 1981	9 yrs	21 yrs	30	Nov 2010 - Apr 2011
May 1981 - Oct 1982	8 yrs	22 yrs	30	May 2011 - Oct 2012
Nov 1982 - Oct 1986	10 yrs	20 yrs	30	Nov 2012 - Oct 2016
Nov 1986 -	12 yrs	18 yrs	30	Nov 2016 & Later
Series H (Current income bonds)				
Jun 1952 - Jan 1957	29 yrs, 8 mos	ISSUE MATURED		Feb 1982 - Sep 1986
Feb 1957 - Jul 1959	30 yrs	ISSUE MATURED		Feb 1987 - Jul 1989
Aug 1959 - Dec 1979	30 yrs	NONE	30	Aug 1989 - Dec 2009
		20 YEAR GROUP		
Series HH (Current income bonds)				
Jan 1980 -	10 yrs	10 yrs	20	Jan 2000 & Later

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
July 18, 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 $13,200 million, to be issued July 27, 1989. This offering will result in a paydown for the Treasury of about $1,500 million, as the maturing bills are outstanding in the amount of $14,695 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, July 24, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,600 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 $17,033 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,600 million, to be dated July 27, 1989, and to mature January 25, 1990 (CUSIP No.912794 TN 4).

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

The bills will be issued for cash and in exchange for Treasury bills maturing July 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. Due to the public debt limit and Treasury's need to plan for the debt level on August 15, additional amounts of Treasury bills will not be issued to Federal Reserve Banks as agents for foreign and international monetary authorities in this auction. Federal Reserve Banks currently hold $1,853 million as agents for foreign and international monetary authorities, and $3,332 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 5176-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

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

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of 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

EMBARGOED FOR RELEASE UNTIL DELIVERY
Expected at 9:00 a.m., D.S.T.
July 19, 1989

Testimony of
the Secretary of the Treasury
Nicholas F. Brady
Before the Joint Economic Committee
on the Paris Economic Summit
on
July 19, 1989

Thank you, Mr. Chairman. It is a pleasure to testify today before the Joint Economic Committee on the Paris Economic Summit.

Certainly we can regard the Paris Summit as a success. Two days of productive discussions with our counterparts from the other six largest industrial countries produced endorsement of U.S. objectives on eight key issues.

In particular, the strengthened debt strategy was discussed in detail and firmly endorsed, with a call for the banks to move ahead with appropriate financial packages. The Summit leaders reaffirmed their commitment to continued economic growth with low inflation and external adjustment, and to the policy coordination process that is key to achieving these goals. It was also agreed that more progress is needed on structural reforms to improve economic performance in the Summit countries. On trade, we agreed to push ahead toward successful conclusion of the Uruguay Round and reiterated our commitment to an open multilateral trading system.

Environmental issues were given particular emphasis at this Summit, and in this connection we succeeded in obtaining a clear signal of support for greater integration of environmental considerations in the activities of the multilateral development banks. On the drug problem, we took a major step forward by creating a task force to improve our ability to combat the laundering of drug money. Finally, we agreed to a cooperative approach to encouraging economic and political reform in Eastern Europe.

Let me now review each of the key economic issues of the Paris Summit.

Debt Strategy

We are particularly pleased that the Summit affirmed full support for the strengthened debt strategy. Now that the key elements of this strategy are in place, all participants must focus on the actual implementation of the plan. The IMF and World Bank have agreed to provide resources in support of debt and debt service reduction. Japan has added to the funds available to support the strengthened strategy, and we welcome this step.

NB-376

Debtor countries are implementing the kind of fundamental policy reforms necessary to achieve long-term economic growth. As you know, serious negotiations are continuing between the banks and debtors.

The Summit concluded that adequate resources are now available and urged the banks to pursue realistic and constructive approaches in their negotiations and to move promptly to conclude agreements on financial packages including debt and debt service reduction and new money.

Summit discussion focussed in particular on the intensive negotiations now underway between Mexico and its commercial creditors. Both parties have put forward proposals that incorporate the key elements of the strengthened debt strategy, including voluntary debt reduction, and are now working together to reach an agreement. Considerable progress has been made toward reaching a final agreement, and discussions continue to resolve remaining issues.

Macroeconomic Policy

A main economic policy objective at the Paris Summit was to consider how we can sustain and improve the industrial country economic expansion, now into its seventh year. We expect growth to continue at a sustainable pace at least through 1990, and earlier inflation concerns have receded somewhat in recent months.

Progress has been made in reducing large trade and current account imbalances, especially in the United States. The latest trade figures confirm continued progress in reducing the U.S. deficit. But progress elsewhere has not been as substantial as would have been hoped, and it is important to guard against a slowdown in the adjustment process.

We were therefore pleased with the Summit participants' firm commitment to ensuring growth with low inflation and further progress in reducing external imbalances.

Reducing large global current account imbalances is necessarily a multilateral responsibility. The United States has made a substantial contribution already and will continue to do so in the future by maintaining growth and reducing the federal deficit. Our Summit partners recognize that they need to do their part as well. The major surplus countries, including Japan and Germany, committed themselves to pursuing appropriate macroeconomic policies and structural reforms to encourage non-inflationary growth of domestic demand and contribute to sustaining global expansion. This will facilitate external adjustment and provide favorable conditions for imports.

Both Japan and Germany had strong growth last year, and both enjoyed very strong first quarter growth of this year. Our trade deficits with both countries fell last year and continued to

improve in the first quarter. But it is vital that both also be ready to consider additional macroeconomic measures if domestic demand growth falters. In this connection, further structural reforms are needed to ensure that the surplus countries can expand their growth potential, thereby allowing more rapid demand growth without risk of inflation.

Economic Policy Coordination

The progress made in promoting sustained growth with low inflation and reducing external imbalances, particularly in 1988, is testimony to the international economic policy coordination process that has evolved over the past years. We were very pleased by the Summit's strong reaffirmation of support for the G-7 coordination process and the important contribution it has made in improving the functioning of the international monetary system.

This process has provided a cooperative framework for policy-makers in the major countries to assess macroeconomic developments and trends, identify emerging problems and develop mutually agreed policy approaches. The consensus on macroeconomic policy priorities described above, and the commitments it reflects, is the product of this process.

But despite the broad agreement that exists, and the considerable successes achieved in recent years, challenges remain. On exchange rates, although the dollar is now not too far above levels prevailing at the time of the April 2 meeting of G-7 Finance Ministers, we must continue to monitor this situation closely and cooperate on exchange markets. The position taken by the G-7 Finance Ministers in April remains our view: that a rise of the dollar which undermined adjustment efforts, or an excessive decline, would be counterproductive.

More broadly, the United States and the other G-7 remain firmly committed to the coordination process. This commitment was reaffirmed at the highest level at the Summit. In addition, the Summit leaders instructed their Finance Ministers to keep under review possible steps to improve the coordination process and cooperation in exchange markets.

Structural Reform

As I indicated earlier, we believe that structural adjustment measures to improve the efficiency of the industrial economies would be particularly helpful to reduce large current account surpluses abroad. And these measures have other benefits as well: higher real output, more employment, and better functioning of markets.

Trade Issues

On trade issues, the Summit gave a strong endorsement to the successful and on-time completion of the Uruguay Round. The communique notes the importance of agricultural reform and stresses the importance of a constructive contribution by all developing countries to a world-wide reduction of trade barriers. Both are points on which we have pushed hard at every opportunity.

We also pressed hard for -- an obtained -- a strengthened Summit statement on limiting the competitive use of trade and aid distorting export credit subsidies, a matter of considerable concern to us. The Summit leaders directed the OECD actively to pursue efforts to strengthen multilateral discipline on practices of this kind, with a view to making further improvements at the earliest possible date.

Environment

This year's Summit was remarkable in its emphasis on decisive action to protect the environment. This is an area where international cooperation is particularly vital, indeed essential, to ensure that serious challenges are addressed and the full benefits of environmental protection steps are realized. The final Summit communique covers an unprecedented range of issues and outlines specific objectives and actions on particular areas of concern.

Many of the issues discussed in the communique fall outside the traditional purview of the Treasury Department. Nevertheless, we had some basic Summit objectives on several points, and they were achieved.

In particular, the Summit leaders encouraged the World Bank and the regional development banks to integrate environmental considerations into their lending activities. This has been an explicit U.S. objective for some time. We believe that the Paris Summit represents substantial progress and provides further impetus for the development banks to implement fully the kind of changes necessary to achieve this objective.

Additionally, the Summit leaders recognized that in special cases, debt-for-nature swaps could play a useful role for environmental protection in the less developed countries. These swaps provide an avenue for achieving both debt reduction and environmental objectives.

Drug Issues

The Summit leaders were strong in their commitment to use the Summit to give a new emphasis to the need for decisive action to combat the growing drug problem. It was resolved to increase support for bilateral and multilateral initiatives, including a prompt implementation of the Vienna Convention on illicit traffic in narcotic drugs and measures to identify, trace, seize and forfeit drug crime proceeds.

It was agreed that the laundering of drug money is a particularly serious aspect of the broader drug problem, and one where greater international cooperation is both needed and potentially extremely effective in striking at one of the pillars of the drug trade.

A financial action task force was created and instructed to assess the results of international cooperation already undertaken in order to prevent the use of the banking system and financial institutions for the purpose of money laundering. In addition, the task force is instructed to consider additional preventive measures, including legal and regulatory changes.

We are confident that this new task force will be a valuable tool in our efforts to combat money laundering, and we look forward to reviewing the report it has been instructed to provide.

East-West Issues

The remarkable political events in Eastern Europe that we have witnessed in recent months and the initiatives announced by the President during his recent visit to Poland and Hungary were the focus of considerable attention at the Summit. The Summit leaders welcomed the process of reform underway in Poland and Hungary, and announced that they were prepared to support this process.

Clearly there are no short-run solutions or quick fixes for the serious economic challenges faced by Poland. But it is equally clear that a supportive position by the Summit countries is important at this time. We hope that our actions can help encourage and extend the very positive movement toward market-oriented economic reforms and political pluralism that are now underway.

Conclusion

In conclusion, Mr. Chairman, the Paris Economic Summit was an important opportunity to review not only the international economic challenges that confront us, but also other challenges such as the evolving East-West relationship, environmental protection, and attacking the scourge of drugs.

I believe that we made significant progress towards improving our collective appreciation of these challenges and developing appropriate policy responses. Our task now is to work together to continue this progress.

TREASURY NEWS

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

FOR RELEASE UPON DELIVERY
Expected at 2:30 p.m.
July 19, 1989

TESTIMONY OF THE HONORABLE
ROBERT R. GLAUBER
UNDER SECRETARY OF THE TREASURY FOR FINANCE
BEFORE THE SUBCOMMITTEE ON
TAXATION AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE

I appreciate the opportunity to appear before you today to advise you of the need for Congressional action to increase the public debt limit by August 1 and to propose a change in the way debt is counted for purposes of the limit.

I. DEBT LIMIT

A. Current Limit Insufficient

Our immediate need is for legislation to increase the debt limit.

Treasury's current estimates, which are affected by a variety of unpredictable variables, show that the permanent debt ceiling of $2,800 billion will be sufficient only into early August. The limited flexibility provided by the $15 billion of Federal Financing Bank authority to borrow, which is not subject to the debt limit, has already been used. Without an increase in the debt limit by August 1, full investment of the social security trust funds may not be possible.

It is virtually certain, absent such action, that Treasury will run out of cash and default on its obligations on August 15, when interest payments in excess of $17 billion are due on outstanding Treasury notes and bonds.

And if Congress were to leave for its recess -- scheduled for August 5 through September 5 -- without increasing the debt limit, in addition to defaulting on other obligations, the United States could not honor, on September 1, $3.0 billion of military retirement and salary payments or payments totaling over $20 billion to social security and supplemental security income recipients, railroad and civil service retirees and veterans.

Defaulting on obligations already incurred is very different from halting operations of the Government when spending authority is allowed to lapse, such as occurs when appropriations are delayed. Once an obligation is incurred, it must be paid.

What would be the broader ramifications of failure to act? We would repeat past dislocations which have hampered the normal investment activities of the trust funds and have generally hampered Treasury financing operations. Past delays in action on the debt limit have generated market uncertainty about Treasury financing schedules and have tended to raise the cost of financing the debt. On several occasions, costly emergency measures have been undertaken, including suspensions of sales of saving bonds and the state and local government series Treasury securities, as well as an inability to invest the trust funds fully.

Finally, default would have adverse consequences on domestic and international confidence and trust in the United States.

B. Proposed New Debt Limit*

Treasury recommends adoption of the Congressional May budget resolution debt limit amount of $3,122.7 billion for Fiscal Year 1990, which assumes a $30 billion cash balance on September 30, 1990. Based on our latest estimates, this debt limit figure appears to be adequate. It also fairly reflects the July Mid-Session Review of the FY 1990 budget estimate of debt subject to limit of $3,096.7 billion on September 30, 1990, which also assumes a $30 billion cash balance on that date.

Both the Congressional budget resolution and the Mid-Session Review include an allowance of $35 billion for Treasury issues of zero-coupon securities to the Resolution Funding Corporation that are expected in Fiscal Years 1989 and 1990 under the thrift legislation that is currently in conference. In addition, the Treasury may be asked to issue zero-coupon securities to foreign governments in connection with Secretary Brady's initiative to reduce the debt burden of highly indebted countries. Those zero-coupon issues would be counted at face value under the current statutory definition of debt subject to limit, whereas the amount of money actually raised is only a fraction of the face amount.

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*The debt limit is deemed to have been passed by the House (H.J. Res. 280), since both the House and Senate have approved the FY 1990 budget.

I urge you to seek the cooperation of your colleagues and to act quickly on the debt limit in order to prevent unnecessary problems in Treasury financing operations and default on the Government's obligations.

II. SCORING OF DEBT SUBJECT TO LIMIT

I would now like to turn to our proposal to change the scoring of debt for the purposes of the limit.

As you know, the debt limit applies to the "face amount" of securities issued by the Treasury. This definitional restriction, when applied to Treasury securities issued at a discount, like Treasury bills or zero-coupon securities, requires larger increases in the debt limit than reflected in cash raised. Accordingly, we propose that the debt subject to limit be scored on the basis of funds raised on original issue, plus interest that has accrued but will not be paid until maturity.

"Face amount" scoring was enacted at a time when zero-coupon and other innovative accrual-type securities were not in common usage, as they are today. That scoring was not intended as a restriction on the Treasury's flexibility to manage the debt.

In 1946, the Congress amended the public debt statute to provide that securities that are "issued at a discount and redeemable before maturity at the option of the holder" are to be scored at the current accrual value for purposes of the debt limit. This provision was intended to change the debt limit accounting treatment for savings bonds. It is limited to securities that are redeemable at the option of the holder. This restriction is not appropriate for accrual-type securities that the Treasury might issue in the market or nonmarketable special purpose securities, such as the zero-coupon bond that the Treasury issued to the Government of Mexico in 1988.

There are several reasons to score debt at the accrual value including:

1. Treasury would have greater flexibility to issue innovative types of obligations such as zero-coupon securities, whose principal amount changes over time. Thorough analyses would have to be done to assure that such issuance would reduce the cost of financing the debt and, by extension, reduce future deficits.

2. Treasury could tailor special securities issues to facilitate achieving other policy goals without increasing budget outlays.

3. It would make uniform the debt limit accounting treatment for all Treasury securities. It would expand the provision in current law that restricts debt limit scoring at accrual value only to securities that are issued at a discount and redeemable before maturity at the option of the holder.

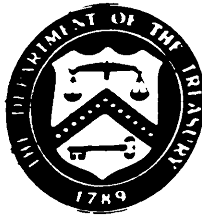
4. It would be consistent with the accrual accounting approach of the unified budget for interest on public debt held by the public. Currently, over $15 billion of debt limit authority is used to account for the unamortized discount on Treasury securities held by the public, including that on Treasury bills and on the zero-coupon bond issued to the Government of Mexico.

For these reasons Treasury seeks your support for legislation to score the public debt at accrual value.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to your questions.

OoO

TREASURY NEWS



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

For Release Upon Delivery
Expected at 3:15 p.m. EST
July 19, 1989

STATEMENT OF
DANA L. TRIER
ACTING DEPUTY ASSISTANT SECRETARY (TAX POLICY)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEES ON TAXATION AND DEBT MANAGEMENT
AND ON PRIVATE RETIREMENT PLANS AND OVERSIGHT
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairmen and Members of the Subcommittees:

I am pleased to appear before you to discuss the views of the Department of the Treasury regarding the current proposals being considered by Congress concerning employer-provided retiree health benefits and employee stock ownership plans. The first portion of my testimony will review the retiree health proposals the Subcommittees have asked us to address and will include: (1) a description of the factual background against which the proposals arise; (2) a review of the tax incentives available to employers to fund retiree health benefits under current law; (3) a brief summary of the proposals; and (4) the views of the Department of the Treasury regarding the provision of additional tax incentives beyond those already provided under current law. Proposed changes in tax treatment of employee stock ownership plans will be addressed in the second portion of my testimony.

PART I. RETIREE HEALTH BENEFITS

BACKGROUND

Some employers maintain plans to provide retiree health benefits to their current and future retirees. The liability the plans represent to individual employers depends upon a number of factors, including: (1) the type and level of benefits promised; (2) the employer's ability legally and practically to modify or terminate the benefits; and (3) future health care cost

inflation. Although the Department of the Treasury has not compiled independent data on the overall magnitude of the liabilities, it is reasonable to believe they are substantial.

A significant share of the liabilities relate to retiree health benefits promised to those who retire before age 65. Such early retiree health benefit liabilities are particularly significant on a present value basis because the benefits are paid out at an earlier point in time and the employer-provided portion of benefits paid after age 65 shrinks substantially when most retirees become eligible for Medicare coverage from the Federal Government. As an indication of the relative magnitude of early retiree health benefits, data gathered by the General Accounting Office suggest that of the $8.6 billion in retiree health benefits paid out by employers in 1988, fully 56 percent went to pay for early retiree health benefits.

Publicly traded companies subject to financial reporting requirements under the federal securities laws and other companies that provide certified financial statements to third parties may be required in the future to disclose the amount of their retiree health benefit liabilities. The Financial Accounting Standards Board ("FASB") has proposed to require such disclosure for fiscal years beginning after December 15, 1991, subject to certain transition rules. The proposed FASB standards would not create any new retiree health benefit liabilities, but rather would require employers to disclose the amount of their already existing liabilities on their financial statements.

CURRENT TAX INCENTIVES

Current law provides two arrangements through which an employer may prefund retiree health benefits on a tax-favored basis. The first of these two arrangements is the so-called 401(h) account, which an employer may maintain in conjunction with qualified pension and annuity plans. Contributions made to a 401(h) account are currently deductible by the employer, and income earned in the account accumulates on a tax-free basis.

Section 401(h) of the Internal Revenue Code provides for this tax-favored treatment only if the retiree health benefits are "subordinate" to the pension benefits provided under the plan. In general, the regulations provide that the health benefits will be considered subordinate if the cumulative contributions to a 401(h) account at any point in time do not exceed 25 percent of the total cumulative contributions made to the plan since the 401(h) benefit was first added to the plan. In a series of recent private letter rulings, the IRS has expanded the situations in which 401(h) retiree health benefits will be considered to meet the subordinate standard, essentially permitting contributions to a 401(h) account despite a plan's fully funded status at the time the 401(h) account feature is added.

The second arrangement under current law that permits prefunding retiree health benefits on a tax-favored basis is the special reserve for retiree medical benefits permitted under a welfare benefit fund such as a voluntary employee beneficiary association ("VEBA"). Under this arrangement, employer contributions are currently deductible, but income earned in the fund is subject to current taxation. In addition, contributions to prefund retiree health benefits must be calculated on the basis of current costs, and thus may not take into account future health cost inflation. Congress prescribed the current level of tax incentives available for prefunding retiree health benefits under a welfare benefit fund in the Deficit Reduction Act of 1984. Prior to that Act, income on funds set aside in a VEBA to provide retiree health benefits could accumulate on a tax-free basis. The effect of this change was to limit full tax-favored treatment to 401(h) accounts, where retiree health benefits are preconditioned on the employer's provision of proportionately greater regular pension benefits.

DESCRIPTION OF PROPOSALS

The Subcommittees have asked for the views of the Department of the Treasury on three of the proposals currently under consideration in the Congress concerning the tax treatment of employer-provided retiree health benefits: (1) a private proposal advanced by the Coalition for Retirement Income Security ("CRIS"); (2) Senator Pryor's bill, S. 812; and (3) the proposal included in the revenue reconciliation bill pending in the House Ways and Means Committee. A brief description of each of these proposals follows.

The CRIS Proposal. CRIS, a private group of large corporate sponsors of overfunded pension plans, has circulated a proposal to permit intermittent transfers of excess pension assets to a retiree medical trust. Excess assets are defined as the excess of the value of plan assets (determined as the lesser of market or actuarial value) over the lesser of: (1) 125 percent of current liability; or (2) 100 percent of "actuarial accrued liability" plus normal cost as of the latest valuation (taking into account future pay increases). The transfer would be free of income and excise taxes, would not trigger vesting or annuitization of accrued benefits for participants in the transferor plan, and would be permitted to provide for the payment of retiree health benefits to persons other than participants and former participants in the transferor plan. The amount of the transfer would be limited to the cost of funding all future retiree health benefits for every former employee of the employer who is entitled to such benefits and who has retired as of the date of transfer, taking into account future health care cost trends and medical inflation. A maximum of three transfers would be permitted within a 10-year period.

The retiree medical trust would be free of income tax, but would not, it appears, be subject to any requirements regarding coverage, nondiscrimination, vesting, or minimum funding, including any of the requirements applicable under current law to 401(h) accounts or welfare benefit funds such as a VEBA. No deductions would be allowed the employer with respect to benefits intended to be paid out of the retiree medical trust, and excess assets remaining after the satisfaction of all trust liabilities would revert back to the transferor retirement plan.

The Joint Committee on Taxation has scored the CRIS proposal as raising $3.2 billion over the five-year budget period, with $500 million falling in 1990, $800 million in 1991, $700 million in 1992, and $600 million in each of 1993 and 1994. Treasury's own revenue estimates show the CRIS proposal raising $2.3 billion over the five-year period, with $400 million in 1990, $650 million in 1991, $525 million in 1992, $400 million in 1993, and $350 million in 1994.

The Pryor Bill. Senator Pryor's bill (S. 812) parallels an identical bill (H.R. 1865) introduced in the House of Representatives by Rep. Chandler and others on April 13, 1989. The bill would expand the present law rules governing the use and funding of 401(h) accounts. For the first time, these accounts would be permitted to provide retirees with long-term care benefits in addition to medical benefits which are already permitted under present law. The bill would require up to two separate accounts for each covered employee, i.e., one each for long-term care benefits and medical benefits.

The funding rules applicable to 401(h) accounts would also be revised and no longer would limit the amount of 401(h) contributions to a portion of the regular pension contributions going into the plan. Instead, in the case of a defined benefit plan, the employer could make annual contributions up to an amount actuarially determined to be necessary to fund an annual retirement benefit of $2,500 for long-term care and $2,500 for medical benefits. Under the bill, it is unclear whether funding would be allowed under actuarial methods that permit faster than level funding or that assume retirement will commence before age 65. In the case of a defined contribution plan, annual employer contributions would be limited to $825 for long-term care benefits and $825 for medical benefits. These funding limitations would be indexed. In addition, the bill would permit employees to make salary reduction contributions to either or both of their 401(h) accounts.

The second portion of the bill permits an employer to transfer certain excess assets from an ongoing defined benefit plan to a 401(h) account, generally without income or excise tax consequences, as long as certain procedures are followed and transfers occur no more frequently than once every five years. Excess assets are defined as those in excess of 125 percent of current pension liabilities at the time of transfer. The bill

does not specify how transferred assets are to be allocated among the individual employee accounts created under the bill or with respect to any preexisting 401(h) accounts that might have been created under the provisions of present law. We understand that no revenue estimates have been prepared by the Joint Committee on Taxation at this time, and the Treasury Department also has not prepared complete revenue estimates.

The Ways and Means Proposal. The revenue reconciliation bill pending in the House Ways and Means Committee would permit an employer to make a one-time transfer during 1990-91 of certain excess assets from an ongoing defined benefit plan to a 401(h) account. The transfer would be limited to the lesser of: (1) assets in excess of the full funding limitation (using 140 percent of current liability instead of 150 percent); or (2) the total amount of retiree health benefits estimated to be paid or incurred by the employer during the employer's 1990 and 1991 tax years. The transfer generally would be free of income and excise taxes, except to the extent the transfer amount is not actually used to pay the estimated retiree health benefits. No deduction would be permitted the employer for payments or contributions with respect to benefits that may be funded out of the transferred assets. Full vesting and annuitization would be required for accrued benefits of participants in the transferor retirement plan, but payment of retiree health benefits out of the transferred assets would not be limited to participants or former participants in the plan. In addition, the transferor plan would be subject to a reduced full funding limitation during the plan year of the transfer and for four succeeding plan years.

In a separate provision, the House Ways and Means proposal would reverse the Internal Revenue Service's position taken in recent IRS private letter rulings permitting 401(h) contributions to a fully funded pension plan.

The Joint Committee on Taxation has scored the House Ways and Means proposal as raising $930 million over the five-year budget period, with $286 million falling in 1990, $465 million in 1991, $176 million in 1992, and no significant revenues in 1993-94. Treasury's estimate of the projected revenue gain is $665 million over the five-year budget period, with $172 million in 1990, $348 million in 1991, $144 million in 1992, and no significant revenues in 1993-94. No revenue estimates have been prepared by either the Joint Committee on Taxation or the Treasury Department on the separate provision reversing the IRS private letter rulings.

ADDITIONAL GENERAL TAX INCENTIVES FOR RETIREE HEALTH COVERAGE

The first question which we will address is whether it is appropriate to provide new general tax incentives for the prefunding of retiree health at this time. As described above, such incentives would be provided under Senator Pryor's bill, S. 812, as well as incentives for the prefunding of long term care.

All of us are concerned that the health care needs of retirees be met both now and in the future. Moreover, we understand that much of employers' current interest in retiree health benefits is a result of the FASB proposal to change the financial accounting rules for retiree health liabilities. It is the view of the Department of the Treasury, however, that the question whether additional general tax incentives should be provided for employer-provided retiree health benefits should be the subject of careful consideration and thorough debate prior to enactment of any new such incentive.

Perhaps the fundamental issues to consider are whether employer-sponsored retiree health plans should be provided additional tax incentives, and whether, assuming limited government resources, these tax benefits should be provided in a manner that is available to all individual retirees, regardless of their employer. The existing incentives available to employers are substantial. For example, section 401(h) essentially grants the employer a current deduction for an addition to a reserve for a future contingent liability, the payment of which will be excluded from the beneficiary's gross income. Such treatment, in combination with tax-free inside buildup, is almost without parallel in the tax law.

Thus, this treatment should only be extended under conditions that minimize the potential for tax abuse and maximize the likelihood the promised benefits will be provided in an equitable and efficient manner. But although the employer-sponsored system has expanded health and retirement coverages substantially, it is still the minority of employees that receive such benefits. For that reason, we are skeptical that increased tax incentives for employer-provided health benefits represent the optimal approach to the problem of funding retiree health costs.

Assuming that a decision is made to provide additional tax incentives for providing such benefits, a second important issue is the type of benefit promise that might receive tax-favored treatment. One question is whether the tax system should encourage the promise of: (1) a defined health benefit such as indemnity insurance or membership in an HMO; (2) a defined dollar benefit intended to meet projected costs of retiree health coverage; or (3) a defined contribution benefit under which the employer obligates itself only to make specific contributions to

an account dedicated to the provision of retiree health coverage. Each approach has its own advantages and disadvantages.

The defined health benefit approach may provide employees with some protection from health care inflation that the defined dollar and defined contribution approaches do not. At the same time, a defined dollar or defined contribution approach can offer an important degree of flexibility and individual choice that a defined health benefit approach may lack. For example, a defined dollar or defined contribution approach could be structured to permit individual retirees to exercise individual choice in meeting their retirement needs. Some retirees might prefer to purchase long-term care insurance rather than be provided with additional health insurance. Other alternative health care needs and programs may evolve in the future, and we should be careful that the tax system not create artificial preferences among alternative modes of health care.

The timing of the retiree health benefit is also a significant issue. We oppose proposals that would grant any additional tax incentives for retiree health benefits to be paid out before age 65. Provision of such early retiree health benefits tends to spend down overall savings that might better be reserved for later years when earning capacity is more likely to be reduced. We believe it is inappropriate for the tax system to provide additional tax incentives for such early retirement benefits at this time.

A third issue is what role the Federal Government should play in increasing the security of the retiree health benefit promises made by employers. As the members of the Subcommittees are no doubt aware, current law provides few protections to employees with regard to the retiree health care promises made by their employers. Minimum standards regarding participation, accrual, vesting, and funding that apply to qualified pension plans under ERISA and the Code do not apply to retiree health benefits promised by employers. It is the position of the Treasury Department that similar minimum standards are a necessary precondition to any additional general tax incentives for employer prefunding of retiree health benefits. Such standards may be very difficult to construct, particularly if applied to a defined benefit type retiree health plan, and should be carefully considered before the tax system is forced to absorb the additional regulation and complexity the implementation of such standards would entail.

An additional concern is the effect that increases in employer-provided retiree health benefits will have on health care cost inflation and thus on health costs borne by retirees and others who do not have these benefits. Health care inflation also raises costs for federal health care programs, such as Medicare.

We believe these issues are important ones and should be treated comprehensively after substantial analysis and debate. For that reason, we cannot support the basic additional incentives provided in the Pryor bill.

EXCESS ASSET TRANSFERS

Most of these general points regarding tax incentives for the provision of retiree health also apply to the various specific proposals to permit transfers of excess pension assets to fund retiree health benefits. The principal difference is that, at least in the short term, the revenue consequence may not be the granting of new federal tax expenditure subsidies for current and future retiree health benefits, but rather the spending down of federal tax expenditure subsidies granted in years past and originally intended to favor the provision of pension retirement benefits to employees. Budgetary prudence calls for us to be as vigilant in dipping into savings accumulated out of prior revenues as in deciding to spend current and future revenues. If, however, viewed on an overall basis there is a present value revenue savings to these proposals, we believe it is appropriate to consider such proposals as interim measures without the full study that is appropriate before a new general tax incentive for funding retiree health benefits is adopted, assuming the considerations discussed below are adequately addressed.

We believe that the three excess asset transfer proposals discussed above should be analyzed in terms of several general considerations. First, Congress should carefully weigh the limitations that are appropriate to impose on transfers from an existing qualified retirement plan arrangement that relieve an employer from obligations for retiree health benefits and that may be used for the provision of retiree health benefits to employees other than current and former participants in the transferor plan. In general, the rationale of the exclusive benefit doctrine would indicate that assets from a qualified retirement plan may not be used for other than the benefit of covered employees unless the plan is terminated, benefits are fully vested and the liability for accrued benefits of the participants fully annuitized. Thus, the appropriate type and level of employee protection that should be required with respect to the benefits under the plan from which the proposed transfers are made should be carefully thought through. On the one hand, we believe the CRIS proposal does not provide an appropriate level of protection for participants under the retirement plan. On the other hand, the protection imposed in the House Ways and Means proposal perhaps could be better focused. The drain on pension assets imposed by annuitization, for example, could well be foregone under circumstances in which adequate assets remain for employees in the pension plan. We believe the level of excess assets required under the retirement plan pursuant to the House Ways and Means Committee proposal would be sufficient without annuitization.

The second important consideration in analyzing these proposals is the retiree health benefits provided with the funds transferred. In this regard, as discussed above, we believe it is inappropriate to provide another significant tax incentive for early retirement benefits. Moreover, at this point, we prefer to limit the liabilities that may be funded with the transferred assets under the House Ways and Means Committee proposal, because of our lack of actual experience with the operation of such a proposal in practice.

Third, the precise treatment of the transferred assets under all three proposals is insufficiently developed at this point. The Subcommittees should consider whether it is appropriate for the class of beneficiaries of such health benefits to be different from the class covered by the qualified retirement plan from which the transfers are made, and the nature of the non-discrimination rules which should apply with respect to the health benefits. We would be pleased to work with the staff of the Subcommittees on the technical aspects of this treatment as expeditiously as possible.

If an acceptable interim excess asset transfer proposal can be structured that generally meets the policy criteria outlined above and that produces a net present value revenue gain over the long term, the Treasury Department would not oppose such a proposal. In this regard, we believe the House Ways and Means Committee proposal represents the best framework for developing a conservative statutory approach to this issue which balances all the competing considerations. However, proper consideration of pension policy issues, such as adequacy of funding for the Pension Benefit Guaranty Corporation and its potential measured liability, and retiree health policy issues would be required before the Administration could agree to proposals similar to those discussed above. The Treasury Department stands ready to work with the Members of these Subcommittees and with Congress to address our mutual concerns immediately.

PART II. EMPLOYEE STOCK OWNERSHIP PLANS

I would now like to turn my attention to the issues the Subcommittees have asked the Treasury Department to address regarding the tax treatment of employee stock ownership plans (ESOPs). My remarks are here briefly set forth: (1) the relevant tax benefits enjoyed by ESOPs under present law; (2) the three proposals currently pending before Congress in which the Subcommittees have expressed particular interest (i.e., Senator Bentsen's bill, S. 1303, Senator Dole's bill, S. 1171, and the ESOP provisions of the revenue reconciliation bill presently being developed in the House Ways and Means Committee); and (3) the views of the Treasury Department regarding these proposals.

PRESENT LAW

Since the enactment of ERISA, ESOPs have been afforded special treatment relative to other qualified retirement plans. ESOPs, together with other "eligible individual account" plans, are not subject to ERISA's prohibition on acquiring and retaining an investment in qualifying employer securities that exceeds 10 percent of the fair market value of their assets, and they are generally exempt from the prudence and diversification requirements of ERISA. An ESOP may also purchase the stock from (or sell the stock to) the employer, a major stockholder, or another party in interest without violating the prohibited transaction rules if the stock is purchased or sold for adequate consideration and if no commission is charged. Finally, despite the general prohibition on the extension of credit between a plan and a party in interest, an ESOP may finance its stock purchase by a loan guaranteed by the employer if the interest rate is reasonable, the loan is primarily for the benefit of plan participants and their beneficiaries, and certain other conditions are met. As a result of these rules, taken together, ESOPs have proven to be a major tool of corporate finance.

In addition, in recent years, a number of additional tax benefits have been provided with respect to ESOPs. The two provisions of present law that have attracted the greatest attention in the current legislative debate are sections 133 and 404(k) of the Internal Revenue Code. Under section 133, commercial banks, insurance companies, corporations in the business lending money and regulated investment companies (collectively "qualified lenders") may exclude from gross income 50 percent of the interest received with respect to a "securities acquisition loan" used to acquire employee securities for an ESOP. A securities acquisition loan is generally defined as: (1) a loan to a corporation or to an ESOP to the extent the proceeds are used to acquire employer securities for the ESOP; or (2) a loan to a corporation to the extent the corporation transfers an equivalent amount of employer securities to the ESOP that are allocable to accounts of ESOP participants within one year of the date of the loan (a so-called "immediate allocation loan").

In Revenue Ruling 89-76, the Internal Revenue Service held that the section 133 interest exclusion applies to qualified lenders regardless of whether the original purchaser of the debt, or other purchasers in the chain of title, are qualified lenders. Thus, as long as the purchaser claiming the section 133 exclusion is itself a qualified lender, it is immaterial that other purchasers before or after it in the chain of title are not qualified lenders. The effect of the ruling is to expand the capital markets for ESOP debt and to permit investment banks (which are barred from acting as commercial banks under the Glass-Steagall Act) to underwrite ESOP debt issues on a firm commitment basis.

Section 404(k) of the Internal Revenue Code grants corporations a current deduction on dividends paid with respect to employer securities held by an ESOP to the extent the dividend is passed through to participants or is used to make payments on an exempt loan to the ESOP. If the dividend is paid with respect to stock already allocated to a participant's account and is used by the plan to make payments on an exempt loan, the plan must replace those earnings by providing that employer securities with a fair market value at least equal to the amount of the dividend are allocated to the participant's account for the year (the "make-whole" provision). In a recent private letter ruling, the Internal Revenue Service held that the deduction under section 404(k) applies to dividends paid with respect to employer securities allocated to participants' accounts and used to make payments on an exempt loan, even though the employer securities involved were not acquired with the exempt loan. The practical effect of this ruling has been to expand significantly the size of an ESOP debt issue where an ESOP already holds large amounts of employer securities.

The Internal Revenue Code also provides several other tax benefits that are unique to ESOPs. A special limit on deductions for amounts used to pay principal on an ESOP loan is provided under section 404(a)(9). Section 2057 grants an estate tax deduction, subject to certain limitations, equal to 50 percent of the proceeds for sales of employer securities by an estate to an ESOP. Section 2210 permits an ESOP to assume the estate tax liability of an estate under certain circumstances to the extent the ESOP has received employer securities from the estate or its decedent. Annual additions to participant accounts in an ESOP generally enjoy a special higher limit under section 415(c)(6)(A). Under section 382(l)(3)(C), acquisitions of employer securities by an ESOP are ignored for purposes of determining a change in ownership that otherwise might lead to a reduction in net operating losses from the pre-change period under section 382(a).

DESCRIPTION OF PROPOSALS

The Subcommittees have asked for the views of the Department of the Treasury on three of the proposals currently under consideration in the Congress regarding the tax treatment of ESOPs. The three proposals are: (1) Senator Dole's bill, S. 1171; (2) Senator Bentsen's bill, S. 1303; and (3) the ESOP provisions included in the revenue reconciliation bill pending in the House Ways and Means Committee. A brief description of each of these proposals follows.

The Dole Bill. Senator Dole's bill (S. 1171) would repeal section 133 in its entirety effective for loans made after June 6, 1989, subject to certain transition rules.

The Bentsen Bill. Senator Bentsen's bill (S. 1303) would amend section 133 to disallow the 50 percent interest exclusion for qualified holders of ESOP debt unless: (1) immediately after the acquisition of employer securities with the exempt loan the ESOP owns at least 30 percent of each class of outstanding stock of the corporation issuing the employer securities or 30 percent of the total value of all outstanding stock of the issuing corporation; (2) the term of the loan does not exceed 15 years; and (3) each participant is entitled to direct the plan as to the manner in which shares acquired with the loan and allocated to the participant's account are to be voted. The bill also imposes an excise tax, subject to certain exceptions, if the ESOP disposes of employer securities either within three years of their acquisition or without having allocated either the securities or the sale proceeds to participants' accounts. The bill is generally effective for loans made after June 6, 1989, subject to certain transition rules.

The Ways and Means Proposal. Under the Ways and Means proposal, the benefits under sections 133 and 404(k) would be eliminated, effective as of July 10, 1989, except in the case of ESOPs which own at least 30 percent of the outstanding stock of the corporation, and the section 404(k) deduction would only be available if the dividend is paid out to participants or, with respect to stock purchased with an exempt loan, if the dividend is used to pay the exempt loan. At the same time, the special estate tax provisions, the ESOP modification to the section 415 limit, and the special section 382 rule for ESOPs would be eliminated. Moreover, Revenue Ruling 89-76 would be legislatively overruled.

ADMINISTRATION POSITION

The Administration strongly supports the broad objectives of ESOPs and recognizes that the purpose of enacting the section 133 partial interest exclusion to encourage the use of ESOPs was a laudatory one. Unfortunately, however, the revenue cost of the interest exclusion has proven to be too large in this period of budgetary constraint to justify the full continuation of this tax benefit. For that reason, the Administration would support either the repeal of section 133 or the imposition of substantial constraints on section 133 consistent with the purposes of ESOPs, as in the case of Chairman Bentsen's proposal or the House Ways and Means Committee proposal.

Because of its concern that the simultaneous elimination or modification of sections 133 and 404(k) would have a material effect on the rate of adoption of ESOPs, the Administration

opposes the repeal of section 404(k) at this time. Nonetheless, we recognize concern that this benefit has been insufficiently targeted to promote the increase of meaningful ESOP participation. For that reason, we do not oppose the House Ways and Means Committee proposal restricting the circumstances under which the section 404(k) deduction is permitted to better target the tax benefit in accordance with its purpose.

This concludes my written remarks. I would be happy to answer any questions the members of the Subcommittees might have at this time.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
July 19, 1989

CONTACT: Office of Financing
202/376-4354

TREASURY TO SUSPEND SALE OF STATE AND LOCAL GOVERNMENT SECURITIES

Because of Treasury's need to plan and avoid exceeding the debt limit in August, the Department today announced that the sale of time deposit State and Local Government Series securities would be suspended until further notice, effective July 20, 1989. Securities will be issued on all subscriptions for time deposit State and Local Government Series securities received at Federal Reserve Banks through today, July 19, 1989. Subscriptions for time deposit securities will continue to be accepted, but no securities will be issued until the suspension is lifted.

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NB-379

TREASURY NEWS

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

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

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION $9,000 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,000 million of 2-year notes to refund $10,569 million of 2-year notes maturing July 31, 1989, and to pay down about $1,575 million. The public holds $10,569 million of the maturing 2-year notes, including $1,167 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $9,000 million is being offered to the public. Due to Treasury's need to plan and avoid exceeding the debt limit, no notes will be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, in this auction.

In addition to the public holdings, Federal Reserve Banks, for their own accounts, hold $787 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-380

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF 2-YEAR NOTES TO BE ISSUED JULY 31, 1989

July 19, 1989

<u>Amount Offered</u>:

To the public	$9,000 million

<u>Description of Security</u>:

Term and type of security	2-year notes
Series and CUSIP designation	AC-1991 (CUSIP No. 912827 XU 1)
Maturity date	July 31, 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	January 31 and July 31
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, July 26, 1989, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):	
a) funds immediately available to the Treasury ..	Monday, July 31, 1989
b) readily-collectible check ..	Thursday, July 27, 1989

TREASURY NEWS

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

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

STATEMENT OF
THE HONORABLE DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE SENATE FOREIGN RELATIONS
SUBCOMMITTEE ON
INTERNATIONAL ECONOMIC POLICY

THE PARIS ECONOMIC SUMMIT

July 20, 1989

Thank you, Mr. Chairman. It is a pleasure to appear today before this Subcommittee to testify about the Paris Economic Summit. Two days of intensive discussions with our Summit counterparts in Paris revealed a solid consensus on key issues and produced support for key U.S. objectives in all the major areas.

The strengthened debt strategy was firmly endorsed; commitments to the policy coordination process, structural reform and the multilateral trading system were strongly reaffirmed; important initiatives were launched on environmental and narcotics issues; and a clear statement of Summit support was made for economic and political reform in Eastern Europe, particularly Poland and Hungary.

I'd like briefly to review Summit developments and commitments in each of these important areas.

The Strengthened Debt Strategy

We are particularly pleased with the strong emphasis and firm endorsement given by the Heads of State to the strengthened international debt strategy. The Summit leaders agreed that the available resources are adequate and that it is now essential for all parties to take the steps needed to make the strategy work. In particular, the Heads of State urged banks to adopt a constructive and realistic approach in their negotiations in order to ensure agreement to financial packages including debt and debt service reduction and new money. Discussion focused in particular on Mexico, where considerable progress has been made toward finalizing agreement on a financial package.

Macroeconomic. Developments

Maintaining steady growth with low inflation and reducing large trade and current account imbalances remain the top macroeconomic policy priorities. The industrial country economic expansion, now well into its seventh year, is expected to continue at a moderate and sustainable pace. Recent developments on the price front, and favorable expectations for the coming year, have substantially eased the heightened inflation concerns of earlier this year.

Last year's progress in reducing trade and current account imbalances, particularly in the United States, was welcomed. Nevertheless, there was concern that the pace of the adjustment process might be slowing, with imbalances still at excessive levels.

Against this background, the Heads of State reaffirmed that responsibility for continued adequate external adjustment is shared by both the deficit and surplus countries. The United States must make further progress in cutting its federal budget deficit while, for their part, Japan and Germany must help maintain global expansion by ensuring robust domestic demand and import growth.

Economic Policy Coordination

We agreed that the economic policy coordination process remains an important tool for achieving these objectives, and reaffirmed our shared commitment to its implementation. But despite the considerable successes achieved through this process, challenges remain. We must continue to monitor and cooperate closely in the exchange markets as appropriate. The position taken by the G-7 Finance Ministers in April remains our view: that a rise of the dollar which undermined adjustment efforts, or an excessive decline, would be counterproductive. The Heads of State also directed their Finance Ministers to consider steps that might be taken to improve the coordination process, exchange market cooperation, and the functioning of the international monetary system.

Structural Reform

It was also recognized that achieving our objectives over the medium-term requires additional efforts to reduce structural rigidities which constrain growth and job creation and impede external adjustment. Some progress has been made in recent years in reforming taxes, reducing excessive regulations and subsidies, and improving labor market flexibility. But there is broad agreement that there is substantial scope and need for additional steps, particularly in Europe and Japan. The Summit participants reaffirmed their commitment to moving ahead with the kind of basic structural improvements necessary to ensure balanced and sustained growth in the future.

U.S./Japan Structural Impediments Initiative

In this regard, an important step forward was taken in Paris with the announcement of a joint U.S./Japan Structural Impediments Initiative. The Initiative is designed to identify and solve structural problems in both countries that act as an impediment to trade and current account adjustment. It is entirely separate from, but will be complementary to, the macroeconomic policy coordination process and trade policy. We believe that this new Initiative will allow us systematically to examine and propose concrete responses to problems that to date have not been adequately addressed in the existing bilateral and multilateral fora.

Trade Issues

Turning to trade policy, the Summit reaffirmed the determination of all participants to strengthen the multilateral trading system by ensuring a successful, timely conclusion of the Uruguay Round, extending GATT discipline to new areas such as services, investment and intellectual property, and making progress in reducing agricultural sector distortions.

The competitive use of tied-aid credits, a matter of considerable importance to the United States was discussed. With our firm support and strong endorsement, it was agreed to work to improve multilateral discipline further in this area.

Environmental Issues

As you know, environmental issues were the focus of much attention at the Paris Summit, and a number of U.S. initiatives were approved. For example, we pressed hard for -- and obtained -- Summit endorsement of the need for the multilateral development banks to take environmental considerations into account in their lending operations. In addition, it was agreed that debt for nature swaps could play a useful role in special cases in promoting environmental protection in the LDCs. These are both important statements by the Heads of State and ones we will use to push ahead in both of these areas.

Drug Problem

There was also much discussion of the growing drug problem, and a strong Summit call for enhanced bilateral and multilateral efforts, including prompt ratification of the U.N. Vienna Convention. It was agreed that drug money laundering is one of the more serious elements of the problem, and that there is scope for a more effective joint response. Again with U.S. leadership, the Summit established a financial action task force to examine the status of our efforts in this area, consider possible legal and regulatory improvements, and report on its findings next Spring. We believe the work of this task force will provide us with important additional ammunition to expand the international fight against money laundering.

Eastern Europe

The Summit also endorsed the President's recent initiatives to provide further assistance and support for economic and political reform in Poland. The reform process that is underway in Poland was welcomed, and agreement was reached to provide specific support for this process, both bilaterally and multilaterally. We are also moving ahead with preparations for a special White House Conference on Eastern Europe, which would coincide with the November visit of Lech Walesa.

I believe I share the President's view when I say that the Paris Summit was a highly successful one. We came away with consensus on the major economic issues, agreement on important new initiatives in the environment and drugs areas, and a common position on emerging developments in Eastern Europe. All in all, Paris provides a very solid foundation to build on when we host the Summit next year.

Thank you.

TREASURY NEWS

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EMBARGOED FOR RELEASE UNTIL DELIVERY
EXPECTED AT 2:00 P.M. EST

STATEMENT BY THE HONORABLE DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
ON THE STRUCTURAL IMPEDIMENTS INITIATIVE
BEFORE THE SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON INTERNATIONAL TRADE
JULY 20, 1989

Mr. Chairman and Members of the Committee, I welcome this opportunity to explain briefly the origins, status and goals of the U.S.-Japan Structural Impediments Initiative (SII).President Bush and Prime Minister Uno launched the SII last week by establishing a joint interagency working group. The President has designated the Departments of State and Treasury and the Office of the U.S. Trade Representative as tri-chairs on the U.S. side, while the Prime Minister has appointed the Ministries of Foreign Affairs, Finance and International Trade and Industry.

Structural Impediments Initiative Goals

The purpose of the SII is to identify and solve structural problems in both countries that stand as impediments to trade and balance of payments adjustment with the goal of contributing to the reduction of payments imbalances. Our initiative emerged from the lessons learned from two recent economic policy experiences.

First, discussion of structural problems on a multilateral and bilateral basis is, of course, not new. Structural issues have been included on the agendas of Economic Summits since 1984, and were particularly highlighted in the 1988 Toronto Summit's Communique. Substantial attention has been given to structural issues by the OECD. The U.S. Government has undertaken in-depth studies on structural rigidities for several years. We have even previously engaged in a U.S.-Japan Structural Dialogue. However, we believe the approach we are using in the SII is a clear departure from past practices.

We learned from the previous Structural Dialogue that, although the exchange of information broadened our knowledge of Japan, it did not produce the structural adjustment needed to change Japan's economy. Our aim is to correct that weakness by explicitly designing the SII's purpose to be one not only of identifying problems, but most importantly, of accomplishing change through intensive sessions with the Japanese.

Second, discussion with Japan on ways to address balance of payments imbalances in both our economies is also not new. We have had success in persuading the Japanese to take adjustment measures through the macroeconomic policy coordination process. There has been substantial adjustment as a result. For example, their 1987 Economic Stimulus Program helped bring about two years of particularly strong Japanese domestic demand growth, and a drop in Japan's global trade surplus by nearly 13 percent in yen terms in 1988. Adjustment was also aided by the substantial appreciation of the yen since 1985. We also recognize and appreciate continuing efforts by Japan to open its markets and rely less on exports for growth. At the same time, the U.S. economy has also been adjusting.

These have been encouraging trends. But despite the changes in domestic demand patterns and the significant exchange rate realignment, the adjustment in payments imbalances has been less than adequate. Projections for 1989 suggest a return to a Japanese current account surplus of over $80 billion and an end to the decline in the U.S. current account deficit. Meanwhile, the net effect of product-by-product trade negotiations on U.S. or Japanese trade imbalances has not been and cannot be expected to be anything but modest compared with the potential impact of macroeconomic policy changes.

Structural Impediments Initiative: Origins

As we surveyed the situation in the opening days of the Bush Administration, we felt that the appropriate time had come to introduce a new U.S.-Japan initiative. This new initiative could be a creative way to reach our stated goals. It could solve structural problems affecting the U.S. and Japanese global trade and current account imbalances through a multi-step process. It could highlight deep rooted structural problems in the Japanese and U.S. economies that could not be addressed in traditional fora on trade and macroeconomic issues. Once pinpointing these problems, practical solutions could be identified and a timetable put forward for their enactment.

When these ideas were discussed informally within the Adminstration early this past spring, we found considerable interest on the part of others. We were later able to gain the agreement of the Japanese government.

The origins of the SII framework stem from our experience over the past five years with Japan on both a bilateral and multilateral basis. We developed the format from the Yen/Dollar

Talks and the derivative Market Oriented Sector Specific (MOSS) Talks and applied it on a broader basis. These negotiations possessed a unique format for bilateral talks which we believe proved essential in successfully deregulating the Japanese financial markets and other specific economic sectors. However, the SII's aim is to address structural practices that cut across the Japanese economy, rather than those that are limited to a specific sector. For example, among the list of issues we have presented to the Japanese is their distribution system and exclusionary business practices. We will examine both of these problems across all sectors of the economy. Thus, the SII is considerably more complex and crosses a far greater range of bureaucratic jurisdictions than our earlier talks. It also includes the specific goal of contributing to a reduction in payments imbalances.

Although we cite reduction of payments imbalances as a goal, the SII is not intended to replace macroeconomic policy coordination within the G-7. Other bilateral or multilateral efforts to reduce trade and current account imbalances, or to redress specific trade restrictions, will continue in established fora. In sum, the SII is intended to complement those other efforts.

Structural Impediments Initiative: Current Status

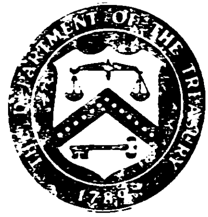
The SII framework we have agreed to within the Administration and with the Japanese Government reflects the basic Yen/Dollar Talks approach. Within the U.S. SII Working Group, we have agreed to commit extensive staff time to study intensively and further our detailed knowledge of the Japanese economy. We will be consulting with the private sector in conducting our research. We are proceeding with the awareness that many of the Japanese economic issues we address are domesticaly sensitive, while for others there is considerable domestic support for change in Japan. Among ourselves, we understand that full inter-agency cooperation is essential to our success. While each agency involved will have its own point of view on the SII, our goals of structural change are common.

In June we met with the Japanese and worked out a mutually agreed format and approach. This includes the essential concepts of flexibility and openness to ensure that we have the ability to allow the agenda to evolve as research proceeds. We have also agreed to subcabinet level meetings that will be held approximately every two months. In recognition of the changing U.S.-Japan economic relationship, we have agreed to look at rigidities in both the U.S. and Japanese economies. Finally, as President Bush and Prime Minister Uno stated in their joint press statement of July 14, we are planning to release in the summer of 1990 the results of these talks in a joint final report to the Heads of Government. An interim assessment will be made public in the spring of 1990.

This internal and external SII approach is time-consuming and requires extensive commitments of staff across agencies in both countries. But I believe it is the only way to ensure that long-term changes are accomplished in Japan.

Before I yield to my colleagues, I would like to add that I have often advocated the need for increasingly greater U.S. and Japanese economic cooperation. I have also spoken in favor of a more thoughtful, ordered approach to U.S.-Japanese economic relations. I believe the SII will prove to be fully consistent with both these aims.

TREASURY NEWS



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

For Immediate Release
July 20, 1989

Contact: Larry Batdorf
566-2041

TREASURY ANNOUNCES ISSUANCE OF NEW CURRENCY TRANSACTION REPORT FORM

The Department of the Treasury today announced that the Office of Management and Budget has approved use of a revised Form 4789, the Currency Transaction Report, a copy of which is attached. The form is used by financial institutions to report deposits, withdrawals, exchanges of currency, payments or other transfers of more than $10,000 in currency, as required by the Bank Secrecy Act.

Filers must continue to use the present Form 4789 through December 31, 1989. The new form may be used only for transactions commencing January 1, 1990. Filers should note that the revised form cannot be used for transactions occurring prior to January 1, 1990.

Several changes have been made to the form. Some of the more significant ones are the inclusion of the date of birth of both the individual conducting a reportable transaction and any individuals on whose behalf it was made, the social security number of the individual conducting the transaction, and the telephone number of a contact person to answer any questions about the report. The current requirement of providing detailed information on checks and wire transfers involved in the reported transaction has been eliminated. The revised form will be filed at a new post office box. The new address for the revised form will be: Internal Revenue Service Detroit Computing Center, P.O. Box 33604, Detroit, Michigan, 48232-5604. This new address is not to be used for transactions occurring prior to January 1, 1990.

The instructions to the new form refer to BSA Administrative Ruling 89-5. This ruling, which will deal with the reporting of information on the person on whose behalf a reportable transaction is conducted, will be issued before October 1, 1989.

Informational copies of the revised form are available by contacting the Repro Coordinator, Internal Revenue Service Eastern Area Distribution Center, 4300 Carolina Avenue, Richmond, Virginia 23222. The telephone number is (804) 329-1056. Camera ready reproduction proofs will be available after October 1, 1989, at the above address.

NB-383

Copies of the printed forms for use by filers will be available through the regional Internal Revenue Service distribution centers on November 15, 1989. Again, these printed forms only may be used for transactions occurring <u>after</u> December 31, 1989.

Those wishing additional information should contact the Office of Financial Enforcement, Department of the Treasury, at (202) 566-8022.

Form **4789** (Rev. January 1990) Department of the Treasury Internal Revenue Service

Currency Transaction Report

▷ File a separate report for each transaction. ▷ Please type or print.
▷ For Paperwork Reduction Act Notice, see page 3.
(Complete all applicable parts—See instructions)

OMB No. 1545-0183 Expires: 12-31-91

1 Check appropriate boxes if: a ☐ amends prior report, b ☐ exemption limit exceeded, c ☐ suspicious transaction.

Part I Identity of individual who conducted this transaction with the financial institution

2 If more than one individual is involved, see instructions and check here . . . ▶ ☐

3 Reason items 4–15 below are not fully completed (check all applicable boxes): a ☐ Armored car service (name) ▷
b ☐ Mail deposit/shipment c ☐ Night deposit or ATM transaction d ☐ Multiple transactions (see instructions)

4 Last name	5 First name	6 Middle initial	7 Social security number
8 Address (number and street)		9 Occupation, profession, or business	

10 City	11 State	12 ZIP code	13 Country (if not U.S.)	14 Date of birth (see instructions)

15 Method used to verify identity: a Describe identification ▶
b Issued by ▶ c Number ▶

Part II Person (see General Instructions) on whose behalf this transaction was conducted

16 If this transaction was conducted on behalf of more than one person, see instructions and check here . . . ▶ ☐

17 This person is an: ☐ individual or ☐ organization 18 ☐ trust, escrow, brokerage or other 3rd party account, see instructions and check here ▶ ☐

19 Individual's last name or Organization's name	20 First name	21 Middle initial	22 Social security number

23 Alien identification: a Describe identification ▶
b Issued by ▶ c Number ▷
Employer identification number

24 Address (number and street)	25 Occupation, profession, or business

26 City	27 State	28 ZIP code	29 Country (if not U.S.)	30 Date of birth (see instructions)

Information Copy Do Not File

Part III Types of accounts and numbers affected by transaction (If more than one of the same type, use additional spaces provided below)

31 S ☐ Savings ▶ T ☐ Securities ▶ H ☐ CD/Money market ▷
C ☐ Checking ▶ L ☐ Loan ▶ O ☐ Other (specify) ▷
☐ ▶ ☐ ▶ ☐ ▶

Part IV Type of transaction. Check applicable boxes to describe transaction

32 E ☐ Currency exchange (currency for currency)

33 CASH IN: D ☐ Deposit; G ☐ Security purchased; P ☐ Check purchased; F ☐ CD/Money market purchased; H ☐ For wire transfer; A ☐ Receipt from abroad; K ☐ Other (specify) ▶

34 CASH OUT: C ☐ Check cashed; T ☐ Security redeemed; W ☐ Withdrawal; R ☐ CD/Money market redeemed; U ☐ From wire transfer; B ☐ Shipment abroad; Y ☐ Other (specify) ▷

35 Total amount of currency transaction (in U.S. dollar equivalent) (always round up)	36 Amount in Item 35 in U.S. $100 bills or higher	37 Date of transaction (see instructions)
Cash in $ .00	Cash in $ .00	
Cash out $ .00	Cash out $ .00 ☐ Unknown	

38 If other than U.S. currency is involved, please furnish the following information: a Exchange made ☐ for or ☐ from U.S. currency
b Country c Amount of currency (in U.S. dollar equivalent) $ .00
b Country c Amount of currency (in U.S. dollar equivalent) $ .00

39 If a negotiable instrument or wire transfer was involved in this transaction, please furnish the following information and check this box (see instructions) ▶ ☐
a Number of negotiable instruments involved
b Number of wire transfers involved
c Total amount of all negotiable instruments and all wire transfers (in U.S. dollar equivalent) ▷ $ .00

Part V Financial institution where transaction took place

40 a ☐ Bank (enter code number from instructions here) ▷ [ ]
b ☐ Savings and loan association c ☐ Credit union d ☐ Securities broker/dealer e ☐ Other (specify) ▷

41 Name of financial institution	42 Address where the transaction occurred (see instructions)	43 Employer identification number

44 City	45 State	46 ZIP code	47 MICR number	Social security number

48 If this is a multiple transaction, please indicate: a Number of transactions ▶ c ZIP codes ▶
b Number of branches ▷

Sign Here ▶

49 Signature (preparer)		50 Title	51 Date
52 Type or print preparer's name	53 Approving official (signature)	54 Date	55 Telephone number ( )

Multiple Transactions

(Complete applicable parts below if box 2 or 16 on page 1 is checked)

Part I Continued—Complete if box 2 on page 1 is checked

4 Last name	5 First name	6 Middle initial	7 Social security number
8 Address (number and street)		9 Occupation, profession, or business	
10 City	11 State / 12 ZIP code / 13 Country (if not U.S.)		14 Date of birth (see instructions)

15 Method used to verify identity: a Describe identification ▶
b Issued by ▶ c Number ▶

Information Copy

4 Last name	5 First name	6 Middle initial	7 Social security number
8 Address (number and street)		9 Occupation, profession, or business	
10 City	11 State / 12 ZIP code / 13 Country (if not U.S.)		14 Date of birth (see instructions)

15 Method used to verify identity: a Describe identification ▶
b Issued by ▶ c Number ▶

Do Not File

Part II Continued—Complete if box 16 on page 1 is checked

17 This person is an: ☐ individual or ☐ organization | 18 If trust, escrow, brokerage or other 3rd party account, see instructions and check here ▶ ☐

19 Individual's last name or Organization's name	20 First name	21 Middle initial	22 Social security number
23 Alien identification: a Describe identification ▶ b Issued by ▶ c Number ▶			Employer identification number
24 Address (number and street)		25 Occupation, profession, or business	
26 City	27 State / 28 ZIP code / 29 Country (if not U.S.)		30 Date of birth (see instructions)

17 This person is an: ☐ individual or ☐ organization | 18 If trust, escrow, brokerage or other 3rd party account, see instructions and check here ▶ ☐

19 Individual's last name or Organization's name	20 First name	21 Middle initial	22 Social security number
23 Alien identification: a Describe identification ▶ b Issued by ▶ c Number ▶			Employer identification number
24 Address (number and street)		25 Occupation, profession, or business	
26 City	27 State / 28 ZIP code / 29 Country (if not U.S.)		30 Date of birth (see instructions)

Paperwork Reduction Act Notice.—The requested information is useful in criminal, tax, and regulatory investigations, for instance by directing the Federal Government's attention to unusual or questionable transactions. Financial institutions are required to provide the information under 31 CFR 103.22, 103.26, and 103.27.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is 24 minutes. If you have comments concerning the accuracy of this time estimate or suggestions for making this form more simple, we would be happy to hear from you. You can write to the **Internal Revenue Service**, Washington, DC 20224, Attention: IRS Reports Clearance Officer T:FP; or the **Office of Management and Budget**, Paperwork Reduction Project (1545-0183), Washington, DC 20503.

General Instructions

Filing Requirements.—Each financial institution other than a casino must file a Form 4789 for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through, or to the financial institution which involves a transaction in currency of more than $10,000. Multiple transactions must be treated as a single transaction if the financial institution has knowledge that: (1) they are by or on behalf of any person, and (2) result in either cash in to or cash out of the financial institution totalling more than $10,000 during any one business day. For a bank, a business day is the day on which transactions are routinely posted to customers' accounts, as normally communicated to depository customers. For all other financial institutions other than casinos, a business day is a calendar day.

This form also must be filed when a transaction conducted by a bank customer which has been granted an exemption from filing exceeds the exemption limit. (For bank exemptions, see 31 CFR 103.22 (b)). In addition, this form may be filed for any suspicious transaction, even if it does not exceed $10,000.

Identification Requirements.—All individuals (except employees of armored car services) conducting a currency transaction for themselves or for another person must be positively identified by obtaining their name, address, social security or other identifying number, and date of birth. In addition, the individual's name and permanent address must be verified and recorded. See 31 CFR 103.27.

For individuals who are established customers, identifying information previously obtained from the customer and kept in the financial institution's records may be used for verification. For instance, if a customer's account was opened after documents establishing the person's identity were examined and recorded on the signature card, the financial institution may obtain that information from the signature card. However, statements such as "known customer" or "bank signature card on file" are not permitted. For a U.S. citizen, a driver's permit or any other written identification document acceptable to the financial institution in normal check cashing operations for nonaccountholders (other than a bank signature card) is acceptable for verification. For a nonresident alien, his or her passport, alien ID card, or other official document showing nationality or residence must be examined for verification.

When and Where To File.—File this form by the 15th day after the date of the transaction with the Internal Revenue Service Detroit Computing Center, P.O. Box 33604, Detroit, MI 48232-5604 ATTN: CTR or with your local IRS office. Keep a copy of each Form 4789 for 5 years from the date you file it.

Penalties.—Civil and criminal penalties (up to $500,000 and 10 years imprisonment) are provided for failure to file a report or to supply information or for filing a false or fraudulent report. See 31 U.S.C. 5321 and 5322.

Definitions

Currency.—The coin and currency of the United States or any other country, which circulates in and is customarily used and accepted as money in the country in which issued. It includes United States silver certificates, United States notes, and Federal Reserve notes, but does not include bank checks or other negotiable instruments not customarily accepted as money.

Financial Institution.—Each agency, branch, or office in the United States of any person doing business in one or more of the capacities listed:

(1) a bank as defined in 31 CFR 103.11

(2) a broker or dealer in securities, registered or required to be registered with the SEC;

(3) a person who engages as a business dealing in or exchanging currency (for example, a dealer in foreign currency or a person engaged primarily in the business of check cashing);

(4) a person who issues, sells, or redeems checks, money orders, or similar instruments, except as provided in 31 CFR 103.11;

(5) a licensed transmitter of funds or other person engaged in the business of transmitting funds;

(6) a telegraph company;

(7) the U.S. Postal Service with respect to selling money orders.

Person.—An individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture, or other unincorporated organization or group, and all entities treated as legal personalities.

Transaction in Currency.—A transaction involving the physical transfer of currency from one person to another. A transaction in currency does not include a transfer of funds by means of bank check, bank draft, wire transfer or other written order that does not include the physical transfer of currency.

Negotiable Instruments.—For purposes of this form, all checks (including personal, business, bank, cashiers, and third-party checks), money orders, traveler's checks, certificates of deposit, and promissory notes.

Specific Instructions

Because of the limited space available on the form, in supplying information requested, you may find it necessary to submit additional sheets of paper. If you must furnish additional information, submit it on plain paper and fasten the paper to the form. Be sure to reference the additional paper to the form, so that if it becomes separated, it can be reassociated.

Item 1—Report filed for exceptional reason.—If this report is filed because it amends a previously filed report, or because deposits or withdrawals exceed a bank customer's exemption limit, or because the transaction is suspicious, check the appropriate box(es) in Item 1. For an amended report, staple a copy of the previously filed report to this report and complete Part V and only those entries which you are amending

For a suspicious transaction, you should telephone as soon as possible the local office of the Internal Revenue Service, Criminal Investigation Division, in addition to submitting this form. If you do not know the telephone number, call 1-800-BSA-CTRS, which will put you in contact with an IRS employee. This toll-free number is operational Monday through Friday, from approximately 9 a.m. to 6 p.m. Eastern time. See BSA Admin. Ruling 88-1.

Part I—Identity of Individual(s) who conducted the transaction.—Always complete this part.

Item 2—Multiple Individuals.—Check the box if two or more individuals conducted the transaction you are reporting. Enter information in Part I for one of the individuals. Enter information on the back of the form for the remaining individuals. For example, if John Doe and Thomas Smith enter your financial institution together and each one deposits $6,000 in cash into their joint account, more than one individual has conducted the transaction. Provide information on either John or Thomas in Part I on the front of the form, and information on the other individual in Part I on the back. If more than three individuals are involved, provide identifying information on additional sheets of paper and attach them to this report.

Item 3—Excluding certain identifying information.—Check the appropriate box or boxes (a,b,c,or d) in Item 3 if you are reporting any of the following transactions: a withdrawal or deposit by an armored car service, a mail deposit or shipment, a night deposit or ATM transaction, or multiple transactions where none of the individual transactions exceeds $10,000 or the exemption limit. For withdrawals or deposits by an armored car service only (Box 3a), you must enter the complete name of the armored car service. However, you need not complete Items 4–15. For mail deposits and shipments (Box 3b), night deposits and ATM transactions (Box 3c), and multiple transactions where none of the individual transactions exceeds $10,000 or the exemption limit (Box 3d), all of the information might not be available. For these transactions, check the appropriate box or boxes and complete as many of Items 4–15 as you can. Complete as much of the back of the form as you can, as well, if Box 3d is checked.

Items 4, 5, and 6—Name of individual who conducted the transaction.—Please complete these items with the name of the individual who actually conducted the transaction with your financial institution. For example, if James B. Jones, an employee of Bill's Grocery Store, makes a deposit into Bill's Grocery Store's account, the name of James B. Jones (not Bill's Grocery Store) would be filled in here. Enter the individual's last name in Item 4, first name in Item 5, and middle initial in Item 6.

Item 7—Social security number.—The social security number of the individual whose name you entered in Items 4, 5, and 6 must be filled in here. If that individual is an alien who does not have a social security number, write NONE in the space, and complete Item 15.

Items 8, 10, 11, 12, and 13—Address.—Enter the permanent street address, including ZIP code, of the individual whose name you entered in Items 4, 5, and 6. Item 11 will always be the 2-letter state abbreviation used by the Postal Service. A P.O. box number may never be used by itself and may only be used if there is no street address. If a P.O. box number is used, the name of the street, road, or route number where the person lives must be provided in Item 8 along with the P.O. box number.

Item 9—Occupation, profession, or business.—Fully identify the occupation, profession or business of the individual whose name was entered in Items 4, 5, and 6, for example, secretary, shoe salesman, insurance salesman, carpenter, attorney, etc. Do not use nondescriptive terms such as merchant, self-employed, businessman, etc.

Item 14—Date of birth.—The date of birth of the individual whose name you entered in Items 4, 5, and 6 must be included here. Six numerals must be inserted for each date. The first two numerals will reflect the month of birth, the second two numerals the calendar day of birth, and the last two numerals the year of birth. Zero (0) should precede any single-digit number. For example, if the individual's birth date was April 3, 1948, Item 14 should be filled in as 04 03 48.

Item 15—Method used to verify identity.—Review the identification requirements under *General Instructions*. Then, in Item a, enter the type of document used to verify the individual's identity, such as driver's license, passport, etc. In Item b, provide the name of the issuer of the document you entered in Item a. For example, if a driver's license was used to verify the individual's identity, provide the name of the state that issued the license in Item b. Enter the number of the license, passport, etc., in Item c.

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Part II—Person on whose behalf this transaction was conducted.—Refer to the definition of *Person* on page 3. If the individual in Part I conducted the transaction for himself or herself only, do not complete Part II. If the individual in Part I is conducting a transaction for another person, Part II must be completed. If the individual in Part I conducted the transaction for himself or herself and another person, Part II must be completed. (See the instructions for Box 16.) In all other cases, including armored car service, mail deposit/shipment, night deposit, and ATM transactions, complete Part II. See BSA Admin. Ruling 89-5.

Box 16—Multiple individuals or organizations.—If this transaction is being conducted for more than one individual (including the individual described in Part I) or organization (see instructions for Box 17), check Box 16, provide identifying information on one of the persons, and complete the applicable entries on the back of the form. For example, if William Brown, the owner of Bill's Grocery Store, Inc., deposits $4,000 in cash into his personal savings account and $7,000 in cash into his store's operating account, Box 16 should be checked; William Brown should be identified in Part I and Part II, and Bill's Grocery Store, Inc. should be identified in Part II on the back of the form. If more than three individuals are involved, provide additional information on additional sheets of paper and attach them to this report.

Box 17—Individual or organization.—If the person on whose behalf the transaction was completed is an individual, check the "individual" box in Item 17. For any person other than an individual, check the "organization" box. Check both boxes if the transaction is on behalf of both an individual and an organization.

Box 18—Trust, escrow, brokerage, and other third party accounts.—If the transaction affects a trust, escrow, brokerage, or other third party account, check Box 18. In completing Part II, enter identifying information on the beneficiary of the account. For example, if Karen Cole, the trustee of the Linda Scott Living Trust, makes a reportable deposit for the trust, identifying information on Karen must be entered in Part I on the front of the form, and identifying information on Linda must be entered in Part II on the front of the form. However, if the transaction is not conducted by the trustee, agent, broker, or fiduciary, on the back of the form in Part II enter identifying information on the trustee, agent, broker, or fiduciary.

Items 19, 20, and 21.—Name of person on whose behalf the transaction was conducted.—If the person on whose behalf the transaction was conducted was an individual, put his or her last name in Item 19, first name in Item 20, and middle initial in Item 21. If the person is an organization, put its name in Item 19 and leave Items 20 and 21 blank.

Items 22 and 23—Identifying number; alien identification.—If the person whose name you provided in Items 19, 20, and 21 is a citizen of the U.S. or an alien with a social security number, enter his or her social security number in Item 22. If that person is an organization (see Box 17 above), provide its employer identification number. If the person is an alien who does not have a social security number, you must complete Item 23. Enter a general description of the type of official document issued to that person in Item 23a (e.g., "passport"), the country that issued it in Item 23b, and its number in Item 23c.

Items 24, 26, 27, 28, and 29—Address.—Provide the permanent street address of the person whose name you entered in Items 19, 20, and 21. Follow the instructions for Items 8 and 10–13. If a P.O. box number is used, the name of the street, road, or route number where the person lives must be provided in Item 24 along with the P.O. box number.

Item 25—Occupation, profession or business.—Follow the instructions for Item 9.

Item 30—Date of Birth.—If an individual is named in Items 19, 20, and 21, complete Item 30. Follow the instructions in Item 14 for furnishing this 6-figure date.

Part III—Accounts affected by the transaction.

Box 31—Types of account and account numbers.—Check the boxes and enter the account numbers of the accounts affected by the transaction. If more than one of the same type of account is affected by the transaction, check the box which has a code letter beside it and enter the account number; then, for each remaining account, enter the same code letter next to a box having no code letter beside it, check that box, and enter that account number. For example, if 2 savings accounts are affected, check the box with "S" beside it and fill in the account number; then print "S" to the left of the box with no code beside it (to signify the type of account), and enter the account number. You may have to use additional sheets of paper to show all of the accounts affected.

If the transaction does not affect any account, make no entry in Part III. For example, a cashier's check purchased only with cash would not affect any account and therefore would not require any entry in this part.

Part IV—Type of transaction.—Check the box or boxes that describe the transaction. The code letters beside the boxes in Items 31 through 34 are for IRS processing purposes.

Box 32—Currency exchange.—Check this box if currency was exchanged for currency. This includes exchanging U.S. currency for foreign currency, foreign currency for U.S. currency, and U.S. currency for other U.S. currency. It also may include a transaction where negotiable instruments are involved, so long as currency is both received and paid out by your financial institution. See Item 35.

Items 33 and 34—Cash in; cash out.—Check the appropriate box or boxes under Item 33 when currency is received by the financial institution, and the appropriate box or boxes under Item 34 when currency is paid out by the financial institution.

Item 35—Total amount of currency.—In the space provided, reflect the total amount of Cash in or Cash out. In some instances, such as a currency exchange, both the Cash in and Cash out areas must be filled in. For example, if an individual transfers Mexican pesos to your financial institution strictly for "$40,000" in U.S. currency, you should check Box 32, and enter "$40,000" for both the Cash in and Cash out amounts of Item 35. If less than a full dollar amount is involved, round that figure to the next higher dollar. For example, if the Cash in totalled $10,000.05, show the figure as $10,001.00.

If the transaction involves a negotiable instrument (see *General Instructions*), as well as currency, enter only the amount of currency. Therefore, if an individual transfers a check in the amount of $6,000 and Mexican pesos in the amount of $7,000 (U.S. equivalent) in exchange for $13,000 in U.S. currency, you should check Box 32, write in "$7,000" for the Cash in amount of Item 35, and write in "$13,000" in the Cash out amount of Item 35.

Item 36—Amount in $100 bills or higher.—Enter the amount of the transaction reported in Item 35 that is in denominations of U.S. currency of $100 or higher. For example, if the currency transaction involves Cash in of $100,000 and $50,000 is in U.S. currency of $100 or higher bills, enter $100,000 in the Cash in portion of Item 35, and $50,000 in the Cash in portion of Item 36. If none of the denominations of currency are $100 or higher, enter "0." If the financial institution does not know the amount of total currency that is in U.S. currency of $100 or higher (e.g., because there are multiple transactions), check "Unknown." Do not leave this item blank.

Item 37—Date.—Enter the business day date of the transaction. Refer to Item 14 for instructions in furnishing this 6-figure date.

Item 38—Foreign currency.—If the currency transaction involves a foreign currency, enter the information in the appropriate spaces. Check the appropriate box in Item a if foreign currency was exchanged for or exchanged from U.S. currency. Enter each country in Item b, and the amount of the foreign currency in U.S. dollar equivalent in Item c. For example, a deposit of Italian lire would have "Italy" entered in Item b, and the amount, converted into U.S. dollars, entered in Item c. Since currency was not exchanged, no entry is made in Item a. If currency of more than two foreign countries is involved in the transaction, attach a separate sheet of paper that clearly identifies the individual or organization for whom the transaction was completed and report the information for each foreign currency required by Item 38.

Item 39—Negotiable instrument or wire transfer.—If the transaction involved one or more negotiable instruments (see *General Instructions*) or wire transfers, check the box. In Item a, state the number of negotiable instruments involved. In Item b, state the number of wire transfers involved. Then, in Item c, state the total amount of all negotiable instruments and wire transfers involved in U.S. dollar equivalent. Round less than full dollar amounts to the next higher dollar.

Part V—Financial institution where transaction took place.

Box 40—Type of financial institution.—Check the box that describes the type of financial institution where the transaction occurred. If you check Box 40e, be sure to specify the type of financial institution (e.g., check casher, currency exchange).

Box 40a—Banks.—Enter the appropriate code number in the bracket provided for the Federal agency that performs examinations for compliance with the Bank Secrecy Act regulations:

- Code 1—Comptroller of the Currency
- Code 2—FDIC
- Code 3—Federal Reserve System
- Code 4—None of the above

Items 41, 42, 44, 45, and 46—Name and address.—Enter the full legal name, street address, city, state, and ZIP code of the branch or office of the financial institution where the transaction occurred. A P.O. box number is not a street address. If multiple transactions occurred at different locations, provide information in these items on any office or branch where one of the transactions occurred. Also, see Item 48.

Item 43—EIN or SSN.—Enter the financial institution's employer identification number (EIN) in Item 43. However, if the financial institution does not have an EIN, enter the social security number of the financial institution's principal owner.

Item 47—MICR number.—Enter the MICR number of the branch or office entered in Item 41.

Item 48—Multiple transactions.—If this was a multiple transaction, state the number of transactions in Item a; the number of branches involved in Item b; and the 5-digit ZIP codes of all the branches involved in Item c. If the branches are in the same ZIP code, show the ZIP code only once. If only one branch was involved, list the ZIP code of that branch.

Items 49, 50, 51, and 52—Preparer's signature, title, and date.—Form 4789 must be signed in Item 49 by an individual authorized or designated by the financial institution to sign it. His or her title should be shown in Item 50 and the date of signature entered in Item 51. This signer's name should be typed or printed legibly in Item 52.

Items 53, 54, and 55—Signature, date, and telephone number.—The official who reviews and approves the information on the form must sign in Item 53 and enter the date signed in Item 54. In Item 55 provide the commercial telephone number of a contact person to answer any questions about this report.

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TREASURY NEWS

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

3310

FOR IMMEDIATE RELEASE
July 20, 1989

CONTACT: Office of Financing
202/376-4350

TREASURY CLARIFIES 2-YEAR NOTE ANNOUNCEMENT

The Treasury clarified that tenders will be accepted from foreign and international monetary authorities in the auction of 2-year notes on Wednesday, July 26. Maturing notes held by the Federal Reserve Banks as agents for such accounts may be rolled over on a noncompetitive basis within the $9,000 million offering.

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NB-384

TREASURY NEWS

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

FOR RELEASE AT 12:00 NOON
July 21, 1989

CONTACT: Office of Financing
202/376-4350

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 August 3, 1989, and to mature August 2, 1990 (CUSIP No. 912794 UN 2). This issue will result in a paydown for the Treasury of about $275 million, as the maturing 52-week bill is outstanding in the amount of $9,287 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, Thursday, July 27, 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 August 3, 1989. In addition to the maturing 52-week bills, there are $14,377 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $2,337 million as agents for foreign and international monetary authorities, and $5,958 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Due to the public debt limit and Treasury's need to plan for the debt level in August, 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 only to the extent of maturing securities held by those accounts. Foreign and international monetary authorities are considered to hold $395 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.

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 5510 July 21, 1989

Monthly Release of U.S. Reserve Assets

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

As indicated in this table, U.S. reserve assets amounted to $60,502 million at the end of June, up from $54,941 million in May.

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					
May	54,941r	11,060	9,134	26,234	8,513r
June	60,502	11,063	9,034	31,517	8,888

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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NB-386

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
July 23, 1989

STATEMENT BY SECRETARY BRADY

Treasury Secretary Nicholas F. Brady today welcomed the announcement by Mexico and its major creditor banks that agreement had been reached on a multi-year financial package to support Mexico's economic reform program:

"The agreement between Mexico and its creditor banks will provide significant debt and debt-service reduction for Mexico, as well as new money, to support Mexico's economic growth. It represents a major step forward in the implementation of the strengthened debt strategy. In recognition and support of this progress, and Mexico's continued sound economic policies, the United States Treasury and the Federal Reserve will work with other monetary authorities to develop a short-term bridge loan of up to $2 billion. This interim financing would provide Mexico with added liquidity pending disbursements from the IMF, World Bank and commercial banks."

NB-387

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
July 24, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $ 6,615 million of 13-week bills and for $ 6,614 million of 26-week bills, both to be issued on July 27, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 26, 1989			:	26-week bills maturing January 25, 1990		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	8.06%	8.34%	97.963	:	7.71% a/	8.13%	96.102
High	8.10%	8.38%	97.953	:	7.74%	8.17%	96.087
Average	8.09%	8.37%	97.955	:	7.73%	8.16%	96.092

a/ Excepting 1 tender of $1,500,000.

Tenders at the high discount rate for the 13-week bills were allotted 19%.
Tenders at the high discount rate for the 26-week bills were allotted 21%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 30,235	$ 30,235	:	$ 27,040	$ 27,040
New York	18,285,090	5,424,235	:	19,266,810	5,647,630
Philadelphia	29,155	29,155	:	15,790	15,790
Cleveland	56,725	56,725	:	31,035	31,035
Richmond	46,075	46,075	:	34,330	34,330
Atlanta	36,355	36,355	:	18,680	18,680
Chicago	1,631,865	106,455	:	1,015,590	65,590
St. Louis	87,500	66,450	:	26,720	18,720
Minneapolis	26,340	26,340	:	6,240	6,240
Kansas City	54,050	50,000	:	40,640	40,640
Dallas	22,155	22,155	:	13,845	13,845
San Francisco	655,870	120,120	:	648,680	48,680
Treasury	600,960	600,960	:	645,310	645,310
TOTALS	$21,562,375	$6,615,260	:	$21,790,710	$6,613,530
Type					
Competitive	$18,351,050	$3,703,935	:	$17,496,935	$2,619,755
Noncompetitive	1,446,565	1,446,565	:	1,137,375	1,137,375
Subtotal, Public	$19,797,615	$5,150,500	:	$18,634,310	$3,757,130
Federal Reserve	1,632,160	1,332,160	:	1,700,000	1,400,000
Foreign Official Institutions	132,600	132,600	:	1,456,400	1,456,400
TOTALS	$21,562,375	$6,615,260	:	$21,790,710	$6,613,530

1/ Equivalent coupon-issue yield.

NB-388

TREASURY NEWS

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

FOR RELEASE AT 4:00 P.M.
July 25, 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 $12,800 million, to be issued August 3, 1989. This offering will result in a paydown for the Treasury of about $1,575 million, as the maturing bills are outstanding in the amount of $14,377 million. This $400 million reduction in the amount offered, compared with the $13,200 million auction on July 24, is part of Treasury's need to plan debt levels in August and allow for an orderly regular mid-quarter refunding on August 15. 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, July 31, 1989. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,400 million, representing an additional amount of bills dated May 4, 1989, and to mature November 2, 1989 (CUSIP No. 912794 TC 8), currently outstanding in the amount of $7,392 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,400 million, to be dated August 3, 1989, and to mature February 1, 1990 (CUSIP No. 912794 TP 9).

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

The bills will be issued for cash and in exchange for Treasury bills maturing August 3, 1989. In addition to the maturing 13-week and 26-week bills, there are $9,287 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. Due to the public debt limit and Treasury's need to plan for the debt level on August 15, only those foreign and international monetary authorities who made original issue purchases of and continued to hold bills of the maturing 13-week and 26-week issues will be allowed to make tenders, and their tender in each auction may not exceed the amount of their original issue purchases of maturing bills of like maturity. Foreign and international monetary authorities hold $1,755 million of the original 13-week and 26-week issues that meet the preceding conditions. Federal Reserve Banks currently hold $2,150 million as agents for foreign and international monetary authorities, and $5,955 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.

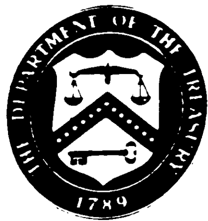
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. Cash adjustments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

10/87

TREASURY NEWS



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

Remarks by
Secretary of the Treasury
Nicholas F. Brady
at the Department's Annual Awards Ceremony
Departmental Auditorium
July 26, 1989

Thank you, Linda (Combs, Assistant Secretary of the Treasury for Management Designate), and good morning.

It is a special privilege for me to meet with all of you today. We gather as colleagues in the Department of the Treasury to celebrate the outstanding achievements of many of our friends and co-workers.

It was a quarter century ago that Treasury Secretary Douglas Dillon inaugurated this tradition of an awards program that honors many of the best efforts of our people. This annual event serves as a reminder of the values and rewards that flow from the pursuit of excellence.

Today, we will pay special attention to some 130 outstanding individual and group achievements. I think it is a tribute to the rich diversity of the Treasury Department that we are able to recognize individual creativity in so many different capacities.

This year's awards ceremony underscores the often unique or specialized tasks that Treasury people are called upon to perform. They include investigations that have greatly contributed to our nation's war against illegal drugs as well as the dedicated efforts of an administrative secretary who improves the performance of the entire office.

We honor several who have used their technical expertise to make us more efficient, productive and cost-effective. At a time when the President and his Administration are moving ahead with initiatives to bring down our budget deficit, I am particularly pleased with these frequently unheralded actions that provide greater service to the taxpayer at less cost.

Treasury honors today those who have provided exceptionally sound advice and counsel over the past year, and we also applaud the commendable efforts of physically disabled employees. And we take time to thank again those who remind us of our mutual commitment to community service and equal opportunity.

Perhaps no one better exemplifies the continuity of this department than the three individuals we will recognize here, each of whom has more than 50 years of government service. From the presidency of Franklin Roosevelt to that of President Bush, Treasury's work force has been recognized as a model for high standards in federal service.

Many of you know that I believe all Americans must strive to make our country as intellectually and economically competitive in the future as possible, and that we as a nation must concentrate more on long-term goals, less on the quick fix.

Our rededication to the values that helped make America great is why I am so pleased to be here today. The commitment of today's honorees illustrates the very qualities that we as a nation need to emulate.

I congratulate each of the award recipients on this occasion. Keep up the good work, and thank you for the example you set for all of us.

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FOR IMMEDIATE RELEASE
July 26, 1989

CONTACT: Office of Financing
202/376-4350

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,007 million of $28,675 million of tenders received from the public for the 2-year notes, Series AC-1991, auctioned today. The notes will be issued July 31, 1989, and mature July 31, 1991.

The interest rate on the notes will be 7-3/4%. The range of accepted competitive bids, and the corresponding prices at the 7-3/4% rate are as follows:

	Yield	Price
Low	7.73%	100.036
High	7.75%	100.000
Average	7.75%	100.000

Tenders at the high yield were allotted 49%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 31,020	$ 31,020
New York	25,743,245	7,669,525
Philadelphia	26,785	26,785
Cleveland	63,025	63,025
Richmond	94,860	56,090
Atlanta	27,165	26,655
Chicago	1,390,295	603,265
St. Louis	53,420	45,420
Minneapolis	25,355	24,355
Kansas City	70,305	70,280
Dallas	18,915	18,915
San Francisco	974,745	214,995
Treasury	156,290	156,290
Totals	$28,675,425	$9,006,620

The $9,007 million of accepted tenders includes $1,491 million of noncompetitive tenders, including $750 million awarded to Federal Reserve Banks as agents for foreign and international monetary authorities, and $7,516 million of competitive tenders from the public.

In addition to the $9,007 million of tenders accepted in the auction process, $787 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-391

TREASURY NEWS

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ROOM 5310

PREPARED STATEMENT OF R. RICHARD NEWCOMB
DIRECTOR, OFFICE OF FOREIGN ASSETS CONTROL
DEPARTMENT OF THE TREASURY

before the

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY
AND TRADE
SUBCOMMITTEE ON WESTERN HEMISPHERE AFFAIRS
COMMITTEE ON FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES

July 27, 1989

Panama: The Role of U.S. Economic Sanctions

Chairman Gejdenson, Chairman Crockett, and Members of the Subcommittees:

My name is R. Richard Newcomb and I am the Director of the Treasury Department's Office of Foreign Assets Control. I am pleased to be with you today to discuss the Treasury Department's implementation of the economic sanctions program against the Noriega regime in Panama.

The Office of Foreign Assets Control ("FAC") has primary responsibility within the executive branch for administering financial and trade sanctions against foreign countries under the authority of the International Emergency Economic Powers Act ("IEEPA"), the Trading with the Enemy Act, the Comprehensive Anti-Apartheid Act, and the International Security and Development Cooperation Act.

FAC dates from 1950, when President Truman imposed an assets freeze and trade embargo against the People's Republic

of China and North Korea during the Korean War. It is a successor to the office that administered the broad trading with the enemy and alien property programs during World War II. Today, FAC implements sanctions programs against Cuba, Vietnam, Cambodia, North Korea, Libya, Iran, Nicaragua, South Africa, and Panama. It also administers certain residual assets controls involving the Baltic Republics and East Germany, as well as restrictions on exports of strategic materials to communist nations.

I have been asked this morning to discuss three aspects of our current policy toward Panama. These three aspects are: 1) our experience in the application of economic sanctions against Panama; 2) the role of the public and private sector in the recovery of the Panamanian economy; and 3) the efficacy of proposed legislation to support democracy and economic recovery in a post-Noriega Panama.

My statement this morning will focus primarily on the purpose and development of the economic sanctions, including how they have been implemented, how and why adjustments have been made, and where we are now. I will also discuss briefly why we feel the proposed legislation and detailed discussions concerning the rebuilding of the post-Noriega Panamanian economy are premature until the political crisis there has been resolved.

Since early 1988, after the public revelations concerning General Noriega's involvement with drug smuggling and money laundering and his subsequent indictment in Federal Court, the U.S. Government has pursued an intensive, multifaceted campaign to oust the General from power in Panama. Following the March 31, 1988 resolution calling for economic sanctions against the Noriega regime which was approved by the Senate by a vote of 92-1, the U.S. Government took a series of steps against General Noriega. These steps included a declaration by the President that the situation in Panama constituted a threat to the national security, foreign policy, and economy of the United States and the limited use of IEEPA to pressure the Noriega regime economically. The application of IEEPA was designed in recognition of the large U.S. presence in Panama of over 45,000 American residents and over 100 U.S. businesses and in an effort to avoid destroying the local Panamanian economy.

The economic sanctions imposed under IEEPA are thus one part of the overall U.S. Government policy to pressure General Noriega to leave or resign and return stable democratic rule to Panama.

The sanctions have been carefully crafted to help achieve the two objectives stated in that policy. As embodied in the sanctions, these two objectives compete to some degree because they focus on different time frames. The sanctions have been shaped by the delicate balancing act required to achieve both.

The short term objective is to place maximum pressure on the Noriega regime economically by denying cash from U.S. persons to the regime. The longer term objective is to preserve the American presence in Panama so that economic conditions favorable to the return of stable democratic rule are not destroyed.

The sanctions have thus far denied the Noriega regime the use of over $296 million. The U.S. economic presence in Panama remains intact, albeit diminished somewhat along with the rest of the Panamanian economy.

Clearly, a full economic embargo against Panama, with no exceptions of any kind, would have placed the maximum economic pressure possible on the Noriega regime. Just as clearly, such an embargo would have immediately destroyed the U.S. economic presence in Panama since U.S.-owned or controlled businesses would have been prohibited from carrying on any business activity whatsoever. The actions we have taken are a measured approach which addresses the reality of the U.S. business presence in Panama and the long term interest of maintaining that presence. It is in this context, with these realities, that the actions we have taken must be viewed.

Another reality is the complexity inherent in the political, legal, and financial environment in which the sanctions have been imposed. While some of the issues which

have arisen have been faced in earlier sanctions programs, many are unique to the Panamanian sanctions. The continued presence of U.S. businesses in Panama accounts for most of these. Of the 10 sanctions and embargo programs currently administered by FAC, Panama is one of the few instances where there has been such a large U.S. business presence involved when the sanctions were imposed. The usual situation has been that U.S. businesses are either gone or in the process of departure when sanctions or embargos are imposed -- take, for example, Iran, Libya, Cuba, Vietnam, Cambodia, and North Korea. This complicating factor will become even more apparent during my discussion below of the decision to license blocked reserve accounts.

As in other programs involving the extraterritorial application of U.S. law, such as our programs against Libya and Iran, difficult interpretative questions have arisen which impact on the enforcement of sanctions. Many of these questions involve complicated legal issues related to effective jurisdiction and control of subsidiaries abroad by U.S. businesses.

We have consulted with hundreds of interested businesses, professional groups, and businessmen concerning problems encountered in coping with the sanctions. We recognize that the sanctions are creating hardships for many individuals and businesses, both Panamanian and American. But as I stated

above, it is not our goal to drive U.S. businesses out of Panama. The Noriega regime is the target of the sanctions, not the U.S. companies.

At this point I think it would be useful to provide you with an account of the regulatory evolution of the Panamanian Transactions Regulations (the "Regulations").

On March 2, 1988, the State Department officially certified that President Eric Arturo Delvalle is the Panamanian head of state recognized by the United States. This action conferred standing on President Delvalle's ambassador to the United States, Juan B. Sosa, to bring action in federal court to establish title to Panamanian government funds located in the United States.

On March 25, 1988, President Delvalle issued a decree suspending payment of fiscal obligations to the Panamanian treasury.

On April 8, 1988, President Reagan, invoking his authority under IEEPA and, consistent with President Delvalle's decree and the Senate resolution of March 31, 1988, signed Executive Order 12635 (the "Executive Order"), blocking property of the Government of Panama ("GOP") located in the United States and prohibiting payment or transfer of currency or other financial or investment assets or credits from the United States to the

Noriega regime. Also prohibited were payments and transfers to the Noriega regime from U.S. persons in Panama, including branches and subsidiaries of U.S. companies. These payments were required to be made into an account at the Federal Reserve Bank of New York ("FRBNY") to be held for the benefit of the Panamanian people. The Executive Order did not affect transfers to the Noriega regime from branches or subsidiaries of U.S. companies located in third countries, and it exempted interbank clearing payments from the prohibitions.

Both exceptions were intended to avoid extraterritorial application of U.S. law in third countries, to which other governments would object. Neither of these were expected to provide the Noriega regime with large infusions of ready cash.

The latter exception also recognized that interbank clearing payments are not, strictly speaking, payments by U.S. entities; rather, they are payments of funds held by banks on behalf of others including Panamanian citizens and other non-U.S. persons. Also, clearing activities involve many third country businesses and banks which have activities both inside and outside Panama.

Prohibiting U.S. bank branches from participating in interbank clearing in a foreign country -- in effect denying a foreign depositor the use of his own funds placed in a U.S. bank branch overseas -- would be counter-productive. Branches

of U.S. banks in third countries might be held accountable both for the funds and for the impact on third country residents of any denial of payments in the country where interbank clearing was prohibited.

Regulations implementing the Executive Order were delayed pending the outcome of negotiations with General Noriega seeking his voluntary removal from power. However, a press release was issued on April 30, 1988, to provide guidance to U.S. subsidiaries in Panama in the meantime on categories of permissible payments. These categories of permissible payments had been developed in close consultation with representatives of affected companies to ascertain what basic fees and taxes must be paid in order for these companies to continue to exist and conduct basic business activities.

On June 3, 1988, we issued the Panmanian Transactions Regulations, 31 CFR Part 565, to implement the prohibitions and requirements contained in the Executive Order. All payments to the regime were prohibited. This included: corporate and individual income taxes; social security taxes (when paid by corporations or U.S. government agencies, but not by individuals who ordinarily paid such taxes directly); direct taxes and fees (i.e., port fees, import duties, and related expenses); direct payment of excise taxes collected as agent for the GOP; and rental fees. Additionally, individuals could

not make payments directly or indirectly, for or on behalf of U.S. firms.

These Regulations included certain exceptions to the prohibitions which were designed to permit American citizens and companies in Panama to continue to function so they could perform the most basic business activities while at the same time continuing to deprive the Noriega regime of financial liquidity to the greatest possible extent.

Those exceptions were:

* Travel-related payments by individuals, including departure fees and ticket taxes, or by U.S. firms in connection with the provision of travel services to individuals, e.g., landing fees and fuel. This was permitted to enable U.S. persons to travel to and from Panama.

* Payments for postal services and for telephone, telegraph, and other telecommunications services. This was permitted to allow U.S. persons to send and receive mail, to communicate with other persons inside and outside Panama, and to conduct day to day business.

* Payments for utilities including electricity, water, and similar municipal services. This was permitted so that U.S. persons in Panama could continue to receive basic services

necessary to function in a tropical climate, such as electricity for air conditioning and refrigerated storage of food and medical supplies and water for sanitary waste disposal.

* Payments of indirect taxes (i.e., those normally collected in the purchase of goods and services such as sales and excise taxes) and certain administrative fees and taxes paid in connection with basic business activity. This was permitted to enable U.S. persons to purchase basic goods, such as gasoline and fuel, on which sales or excise taxes are normally levied, and to enable U.S. businesses to continue functioning by the payment of relatively insignificant fees such as corporate registration and trademark and copyright fees.

* Payments other than income tax by individuals. Individuals who made their own social security payments could continue to do so. This was permitted to exempt relatively minor payments on the part of individuals to relieve undue hardships they would otherwise experience.

The Regulations have since been amended three times. The first amendment, effective June 15, 1988, authorized the payment of social security taxes pursuant to a second decree issued by President Delvalle on June 17, 1988. The decree specifically excepted payment of social security taxes which

fund retirement, health, and maternity benefits from other prohibited payments that were directed to be paid into the FRBNY. This regulatory change was made at the specific request of President Delvalle so that Panamanian employees working for U.S. firms would not lose their benefits.

The second amendment, effective August 24, 1988, permitted payment to the Noriega regime of port fees and other import related fees in order to enable U.S. businesses in Panama to continue their operations. This change was made to permit U.S. businesses and subsidiaries in Panama to retain access to the U.S. market. The sanctions program was never intended as a trade embargo and prohibiting these relatively minor amounts was turning the program into a de facto trade embargo by preventing U.S. firms from importing into Panama without having the desired trade impact on the regime.

The third and most recent amendment to the Regulations, effective January 3, 1989, added Section 565.509, which allows U.S. persons and U.S.-controlled Panamanian entities to apply to FAC for a specific license to establish blocked reserve accounts ("Section 509 Account") on their books, or with a commercial bank, for funds owed to the GOP, in lieu of payment into Account No. 2 at the FRBNY. Such substitute accounts established under Treasury Department license must record the full amounts due and unpaid to the GOP since the effective date of the sanctions, without reduction for any offsets or claims

of the applicant against the Panamanian Government. Such accounts must earn interest at a rate at least equal to that which would have been earned had payment been made into the FRBNY at the time the amount was due.

In order to comply with the Executive Order, any U.S. or U.S.-controlled Panamanian business which owes, or has owed since the effective date, any amounts to the GOP, the payment of which is prohibited by the Order, is required to have either transferred the full amounts owed (without reduction for offsetting claims) to Account No. 2 at the FRBNY or to have established a Section 509 Account for the full amounts owed pursuant to a Treasury Department license.

The decision to permit substitute blocked reserve accounts, either on the books of the companies involved, or at commercial banks, was adopted for practical legal and administrative reasons. I will describe these reasons, but first I would like to clarify the meaning of the term "blocked assets" so that my discussion of the issues involved can be understood in the proper context.

Blocking foreign-owned assets can be used along with other economic weapons to accomplish a variety of foreign policy objectives. In the case of Panama, the purpose is to deny as much cash as possible to the Noriega regime. As I have explained, we have attempted to accomplish this without

simultaneously forcing U.S. companies located in Panama to cease business activities altogether.

The accounting situs of blocked amounts owed by U.S. parties to the GOP is, for the present time, of little practical or legal significance, as long as the funds are denied to the Noriega regime and the unpaid obligations can be accounted for at the proper time. Whether amounts owed to the GOP are paid immediately or later, with accrued interest, there are no changes to the underlying obligations between the parties or to any related legal issues.

Immediately following the President's Executive Order, several U.S. companies expressed concern that they might not receive proper credit from a successor Panamanian government against the underlying obligations if payments due were made to the FRBNY. This fear was based largely on the perception that either the executive or legislative branches of the U.S. government, in order to negotiate a settlement or fund a recovery program, might find an alternative use for the funds in a manner that would not ensure that the payments were properly credited by the Panamanian government.

Since the amounts owed are due to the GOP, not the U.S. Government, the Treasury Department should not, and did not, issue assurances, receipts, or indemnification of any kind concerning the discharge of the underlying obligations. To do

so would subject the U.S. Government, and subsequently U.S. taxpayers, to potential liability for the amounts involved.

To force the immediate payment of obligations due by a U.S. party or its subsidiaries to an escrow account established on behalf of a foreign government without any assurance or guarantee concerning the discharge of underlying obligations would raise a number of difficult questions, particularly in cases involving mutual indebtedness and counterclaims between the principal parties. Such precipitous action by the Treasury would likely have provoked immediate litigation against the U.S. Government for a matter that we do not want to litigate at this time. It would have entailed risking the entire program over an issue that is relatively inconsequential to the primary objective of denying cash to the Noriega regime. For this reason an alternative to immediate payment into Account No. 2 at the FRBNY was created. This has allowed us to accomplish the primary goal of the payment prohibitions without running unnecessary legal risks at the same time.

Legal issues similar to those at stake here were raised in the Dames & Moore v. Regan litigation immediately following the Algiers Accords with Iran in 1981. Now is not the time to litigate these issues, particularly since immediate payment is unnecessary to prevent use of the funds by the Noriega regime and the terms of a financial settlement at the cessation of the blocking may well render the underlying issues moot.

We also had to address the practical problem of how to properly determine the exact amounts due to the GOP, especially when such a determination must by necessity rely on a voluntary reporting system that may under Panamanian law involve the netting out of tax credits or other mutual indebtedness. Since the U.S. Government is not one of the two principal parties involved in the underlying transactions which create the obligations due and the related records, receipts, and tax rulings are not subject to U.S. control or jurisdiction, precise verification of the net amounts due are not possible.

In short, the U.S. Treasury should not, has not, and cannot, assume the role of tax or bill collector for the Government of Panama.

In recent economic sanctions programs administered by Treasury, most notably the Iranian blocking from 1979 to 1981, the most practical and equitable method of accounting for liabilities by U.S. persons to a foreign entity, especially when details concerning the obligation are subject to dispute, has been to require the U.S. party to establish a booked liability for the gross amount due. This effectively freezes and acknowledges the legal rights and obligations of all principal parties until an appropriate mechanism or framework can be established to effect a settlement.

For the sake of this discussion, the attached chart (Attachment I) shows the blocked assets of the GOP in four general categories. These are assets which have effectively been denied to the Noriega regime.

1. Federal Reserve Bank of New York

The first category includes the three GOP accounts at the FRBNY. The funds in these accounts are invested daily by the FRBNY in overnight government security repurchase agreements which earn money market rates. FAC receives a daily statement of all transactions, including earnings and payments credited, affecting the accounts. We have a computerized database which can reconstruct all activity in the accounts.

Account No. 1 was established in March 1988 with approximately $10.5 million in GOP funds transferred from a commercial bank in connection with litigation brought by the recognized Government of Panama. This account has been drawn down to fund operations of the Panamanian embassy and consulates in the United States which are loyal to the recognized government.

In accordance with prescribed audit and accounting procedures collectively devised after the Executive Order by Treasury, State, the FRBNY, and the Panamanian embassy, FAC has periodically licensed transfers to the Panamanian embassy from

this account, following certification by the State Department that the amounts are necessary to pay for the legitimate expenses incurred by the recognized GOP and the issuance of the licenses is consistent with U.S. foreign policy interests. Ten transfers from the account, involving approximately $9.3 million, have been licensed since the Executive Order. In addition, FAC has licensed five consulate accounts that operate within strict constraints.

Account No. 2 was established in March 1988 to receive payments to the GOP made by non-USG entities, primarily U.S. companies and their Panamanian subsidiaries. The account was created prior to the Executive Order so that U.S. parties would have a place to make payments to the GOP, especially those companies wishing to receive foreign tax credits under the Internal Revenue Code. The Executive Order later required that payments owed to the GOP by non-USG entities be made into this account.

Approximately 57 entities have made 232 payments, totaling $7.4 million, into Account No. 2 as of July 17, 1989. One transfer out of the account, involving approximately $659,000, has been licensed. The funds from this transfer were returned to the four entities who had made payments into the account for items that were previously prohibited but subsequently permitted by the Regulations.

Account No. 3 was established to receive payments owed to the GOP by USG agencies, primarily the Panama Canal Commission ("PCC") and the Defense Department. 214 payments into the account, involving $136.4 million, have been made by ten USG agencies. The PCC has made 87 payments, totaling $123.8 million, into the account.

Two transfers out of Account No. 3, involving approximately $2.1 million and $245,000, have been licensed by FAC. The funds were returned to the PCC and the U.S. Postal Service for payments made into the account by those agencies for items that were previously prohibited but subsequently permitted by the Regulations.

2. Blocked Deposits at Commercial Banks

The second category on Attachment I shows that blocked deposits at commercial banks total over $29.6 million. These assets of the GOP were in the United States at the time of the freeze order. They include deposits belonging to Banco Nacional de Panama, Caja de Ahorros, and IHRE, Panama's state-owned electric utility company.

3. Section 565.509 Blocked Reserve Accounts

The third category concerns the 30 licenses authorizing the establishment of blocked reserve accounts under Section

565.509 of the Regulations. The licenses amount to $116.3 million and affect an estimated 78 subsidiaries, branches, or divisions of U.S. entities.

Withheld payments totaling $66.1 million have been licensed for credit to blocked reserve accounts on the books of 29 U.S. entities and their Panamanian subsidiaries. Another $50.2 million in withheld payments has been licensed for credit to a blocked deposit at a commercial bank. This deposit involves a U.S.-controlled Panamanian firm in which the GOP has a significant equity interest.

4. Miscellaneous Property

The miscellaneous property shown in the forth category is GOP-owned police and military equipment seized by the Customs Service in 1988. The value is approximate.

I will now summarize some of the actions that have been taken to ensure compliance with the sanctions. First, I would again point out that we have denied nearly $300 million to the Noriega regime. We have made considerable efforts to achieve this goal.

For example, we are in direct, routine phone and written contact with all known holders of blocked deposits and the

principal U.S. businesses operating in Panama. We have initiated several efforts to contact on a comprehensive basis all U.S. persons potentially affected by the sanctions. The initial effort, conducted immediately before and after the Executive Order, involved contacting, primarily by telephone, approximately 200 U.S. companies believed to have business or financial connections with Panama.

A more recent effort was begun soon after the Regulations were amended to include Section 565.509. We wrote to approximately 200 U.S. persons believed to be affected by, or interested in, the licensing options provided by the amendment. This letter informed the recipients of their obligation to either pay into the FRBNY or apply for Section 565.509 licenses for all payments owed to the GOP which are not expressly permitted to be paid by the Regulations.

Approximately 168 of the 200 persons contacted were U.S. companies whose names we obtained from various sources, including our initial phone survey, the American Embassy in Panama, and a review of our files. In order to be comprehensive, we included all U.S. companies believed to have any connection, however remote, with Panama. We have constructed a database with information concerning the licensing status and business relationship, or lack thereof, of each of the above companies with the GOP. The companies who failed to either request Section 565.509 licenses or respond in

writing that they have no liabilities to the GOP have been systematically contacted for explanations of their exact financial relationship with the GOP.

Additionally, the Section 565.509 licenses we have issued contain reporting requirements which provide us with very useful, detailed accounting information. This information is being systematically reviewed to identify and target companies whose situations indicate the need for closer scrutiny or audit.

The Regulations provide that any unauthorized transfer of blocked property is null and void (i.e. the holder may be held liable for the entire value of the property if it is wrongly transferred) and violators are subject to criminal and civil penalties. Records concerning all transactions are required to be retained for at least two years and must be produced on demand. These regulatory stipulations provide significant incentives for the holders of blocked property to comply with the freeze order.

While I will not comment on any ongoing investigations or other enforcement inquiries related to the sanctions, I can state that FAC has taken steps to pursue and investigate every alleged violation that we have uncovered or has been brought to our attention. Enforcement actions are currently ongoing. I can assure you that civil and criminal penalties will be taken

against violators of the sanctions, if appropriate and legally sustainable.

I will now comment very briefly on the question of economic recovery in Panama and make some technical comments concerning certain legal and administrative aspects of subsection (m) of Section 4 of the bill. Subsection (m) concerns the disposition of funds held for the GOP at the FRBNY.

As my discussion of the reserved blocked accounts indicated, a financial settlement must take into account the interests of many different parties. Until the political crisis concerning the legitimacy of the Panamanian government is resolved, it will be impossible for the necessary parties to participate in crafting a financial settlement acceptable to all. It would therefore be premature to speculate at this time concerning what terms such a settlement should contain or what role such a settlement should play in the economic recovery of Panama.

Both the payors and the successor GOP have present interests in the funds held in escrow by the FRBNY. Thus, Congress would have to pass supplemental legislation to vest the funds in the United States before making any disposition of the funds inconsistent with these existing interests, as

apparently contemplated under the bill. Peacetime vesting of assets is a very serious step, unprecedented in recent times, as Congress recognized when it refused to provide the President with vesting authority over foreign assets under IEEPA -- in contrast to the continued vesting authority provided in time of war under section 5(b) of the Trading with the Enemy Act. The usual and preferred method of disposing of blocked assets is to establish a claims settlement program following a negotiated settlement. But it is too soon to say if this is the method that will be followed in resolving the Noriega crisis.

Under the deposit contract between the FRBNY and Ambassador Sosa, acting on behalf of the GOP, the funds in Accounts No. 2 and 3 can be released only under two circumstances: (1) when the Secretary of State certifies that constitutional government has been restored in Panama; or (2) if the funds were placed in the accounts by error, including deposits for payments that have later been authorized in our Regulations to be made locally in Panama -- such as social security payments. The bill, by contrast, seeks to condition release of the escrowed funds upon certification by the President that seven additional conditions set out in section 4(a) have been met. These conditions are an improper interference with the existing deposit contract established by agreement between the legitimate GOP and the FRBNY and an improper interference with the authority of the President to conduct foreign affairs.

This subsection of the bill also ignores the interests I have already noted of U.S. corporations and the U.S. Government in the funds deposited in Accounts No. 2 and 3 at the FRBNY. If, for whatever reason, those funds are not credited to the appropriate Panamanian governmental agencies against these payor's obligations in a post-Noriega government, or if no normalization occurs, then the funds will almost certainly be the subject of claims against the U.S Government. The bill's apparent earmarking of these funds for some inconsistent use would complicate the return of those funds to legitimate private and governmental claimants.

From an administrative standpoint, the provisions contained in subsection (m)(2) are unnecessary and inappropriate. The subsection requires the Treasury to arrange for a "financial audit" by an "independent accounting firm" of GOP funds held in the FRBNY and that the transfer of such funds to the GOP be held in abeyance for thirty days after the submission of the auditor's report to Congress. There is no definition of the scope or purpose of such an audit, or exactly what such an audit would verify.

No such activity was deemed necessary, or even seriously considered, in the program against Iran which originated during the Hostage Crisis and culminated in the transfer of nearly $10 billion to fund various escrow accounts and to Iran under the provisions of the Algiers Accords. This settlement of claims

with the Government of Iran is still an ongoing endeavor of the United States in the Iran-U.S. Claims Tribunal in The Hague.

If the purpose of the audit is to determine the identity, amount, and date of payments into GOP accounts at the FRBNY, and whether such funds have been properly invested, such information is immediately available from an examination of both FAC and FRBNY computer records. There is nothing for an accounting firm to audit or certify.

If the purpose of the audit is broader, such as to determine whether U.S. parties have properly calculated and paid amounts due to the GOP, there are more appropriate agencies to address such questions. The auditors would have to make determinations most appropriately made by sovereign Panamanian tax authorities. Only these authorities can issue assurances concerning the discharge of the underlying obligations and have access to the records and rulings required to make such determinations. Certifying the accuracy of these calculations is not the proper role of the U.S. Government or any entity acting on its behalf. Such activity would be tantamount to acting as tax or bill collector for the Government of Panama.

If the purpose of the audit is to determine whether Treasury has administered the sanctions properly, then the auditors must address most of the legal, administrative, and

policy issues I have just discussed. These issues have implications that go far beyond those that can be appropriately addressed by an accounting firm. An examination of this scope is more appropriately conducted by an independent and objective U.S. Government agency, such as the GAO. Indeed, we have spent nearly six months with the GAO on this matter.

For these legal and administrative reasons, we oppose the inclusion of subsection 4(m) of Section 4 in the bill.

ATTACHMENT I

BLOCKED ASSETS OF THE GOVERNMENT OF PANAMA

1.) Federal Reserve Bank of New York (as of 7/17/89):

GOP Account No. 1 =	$ 935,797.72	
GOP Account No. 2 =	7,260,266.20	
GOP Account No. 3 =	142,521,601.37	

Subtotal		$ 150,717,665.29

2.) Blocked Deposits at Commercial Banks (recent balances):

Bank 1	$ 14,237,537.13	
Bank 2	13,049,986.16	
Bank 3	1,000,000.00	
Bank 4	524,991.28	
Bank 5	443,863.50	
Bank 6	139,524.39	
Bank 7	104,646.94	
Bank 8	89,101.61	
Bank 9	29,035.77	
Bank 10	396.00	

Subtotal		$ 29,619,082.78

3.) Section 565.509 Blocked Reserve Accounts (as of 7/17/89):

Reserve Accounts	$ 66,092,075.29	
Bank Deposits	$ 50,206,483.65	

Subtotal		$ 116,298,558.94

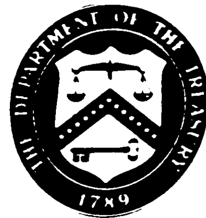
4.) Miscellaneous Property (as of 7/17/89):

Tangible Property	$ 183,000.00	

Subtotal		$ 183,000.00

GRAND TOTAL		$ 296,818,307.01
		===============

TREASURY NEWS



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

CONTACT: Office of Financing
202/376-4350

FOR IMMEDIATE RELEASE
July 27, 1989

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $9,037 million of 52-week bills to be issued August 3, 1989, and to mature August 2, 1990, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	7.20%	7.72%	92.720
High -	7.22%	7.75%	92.700
Average -	7.22%	7.75%	92.700

Tenders at the high discount rate were allotted 50%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 20,230	$ 20,230
New York	28,832,555	8,254,055
Philadelphia	8,320	8,320
Cleveland	20,030	20,030
Richmond	20,200	20,200
Atlanta	15,605	15,605
Chicago	1,602,620	164,820
St. Louis	20,035	14,525
Minneapolis	7,445	7,445
Kansas City	23,285	23,285
Dallas	8,280	8,280
San Francisco	831,985	249,485
Treasury	230,320	230,320
TOTALS	$31,640,910	$9,036,600
Type		
Competitive	$28,865,070	$6,260,760
Noncompetitive	550,140	550,140
Subtotal, Public	$29,415,210	$6,810,900
Federal Reserve	2,200,000	2,200,000
Foreign Official Institutions	25,700	25,700
TOTALS	$31,640,910	$9,036,600

NB-393

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

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DEPARTMENT OF THE TREASURY

FOR IMMEDIATE RELEASE July 27, 1989

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of June 1989.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $139.6 billion on June 30, 1989, posting a decrease of $652.1 million from the level on May 31, 1989. This net change was the result of an increase in holdings of agency debt of $112.1 million, and decreases in holdings of agency assets of $725.3 million and in agency-guaranteed debt of $38.9 million. FFB made 144 disbursements during June.

Attached to this release are tables presenting FFB June loan activity and FFB holdings as of June 30, 1989.

FEDERAL FINANCING BANK

JUNE 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note #78	6/1	$ 269,000,000.00	6/1/99	8.729%	8.636% qtr.
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #493	6/6	7,330,000.00	9/5/89	8.664%	
Note #494	6/7	150,000.00	9/5/89	8.573%	
Note #495	6/27	5,000,000.00	9/25/89	8.501%	
TENNESSEE VALLEY AUTHORITY					
Advance #1042	6/5	151,000,000.00	6/12/89	8.776%	
Advance #1043	6/7	353,000,000.00	6/12/89	8.573%	
Advance #1044	6/22	100,000,000.00	6/26/89	8.541%	
Advance #1045	6/22	349,000,000.00	6/28/89	8.541%	
Advance #1046	6/26	93,000,000.00	7/7/89	8.449%	
Advance #1047	6/28	70,000,000.00	7/3/89	8.456%	
Advance #1048	6/28	281,000,000.00	7/5/89	8.456%	
Advance #1049	6/30	171,000,000.00	7/7/89	8.349%	
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Greece 17	6/7	23,337.01	2/25/13	8.523%	
Greece 17	6/9	9,198.80	2/25/13	8.425%	
Greece 17	6/20	400,591.00	8/26/13	8.469%	
Greece 17	6/22	10,647,198.83	8/26/13	8.459%	
Philippines 11	6/22	64,937.50	9/12/90	8.690%	
Greece 17	6/30	94,568.71	8/26/13	8.223%	
Morocco 9	6/30	462,182.40	3/31/94	8.217%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
*Florence, SC	6/2	821,529.22	7/2/90	8.990%	9.192% ann.
Florence, SC	6/6	13,026.18	7/2/90	8.578%	8.762% ann.
San Juan, PR	6/13	660,246.00	10/2/89	8.531%	
San Juan, PR	6/26	39,817.00	10/2/89	8.463%	

+rollover
*maturity extension

FEDERAL FINANCING BANK

JUNE 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION					
Oglethorpe Power #320	6/1	$ 5,283,000.00	7/1/91	8.942%	8.844% qtr.
Chugach Electric #257	6/2	6,796,000.00	1/2/24	8.734%	8.641% qtr.
Chugach Electric #321	6/2	5,129,000.00	12/31/19	8.736%	8.643% qtr.
*N.W. Electric #176	6/5	600,000.00	6/4/92	8.597%	8.507% qtr.
*Sho-Me Power #164	6/5	650,000.00	6/5/91	8.648%	8.556% qtr.
New Hampshire Electric #270	6/6	299,000.00	1/2/18	8.535%	8.446% qtr.
Basin Electric #232	6/12	449,000.00	6/12/91	8.400%	8.314% qtr.
S. Miss. Electric #330	6/12	918,000.00	7/1/91	8.398%	8.312% qtr.
*Wabash Valley Power #206	6/12	6,870,000.00	1/2/18	8.278%	8.194% qtr.
*Wolverine Power #233	6/12	7,793,000.00	1/2/18	8.278%	8.194% qtr.
*Wolverine Power #234	6/12	893,000.00	1/2/18	8.278%	8.194% qtr.
*Cajun Electric #263A	6/14	59,494,949.52	1/3/17	8.351%	8.266% qtr.
*Cajun Electric #263A	6/14	31,359,595.92	1/3/17	8.351%	8.266% qtr.
*Cajun Electric #263A	6/14	44,064,646.48	1/3/17	8.351%	8.266% qtr.
Plains Electric #330	6/16	1,245,000.00	1/3/17	8.438%	8.351% qtr.
*Wolverine Power #100A	6/16	179,754.88	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #100A	6/16	54,493,955.57	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #100A	6/16	1,210,750.00	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #100A	6/16	1,001,072.28	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #100A	6/16	1,446,405.57	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	69,641,783.29	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	1,600,416.71	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	63,333.31	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	1,334,144.43	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	1,796,177.72	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	1,825,866.71	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	1,208,894.43	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #101A	6/16	1,547,533.29	12/31/12	8.444%	8.357% qtr.
*Wolverine Power #182A	6/16	14,802,288.46	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	849,750.00	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	1,001,278.85	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	2,113,480.77	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	1,984,730.77	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	3,964,509.62	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	2,570,048.08	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	2,149,134.62	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	2,403,663.46	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	2,181,817.31	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	2,929,557.69	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	4,822,182.69	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	3,423,759.62	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	1,733,173.08	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	3,174,182.69	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #182A	6/16	454,586.54	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	21,562,653.85	12/31/14	8.441%	8.354% qtr.

*maturity extension

FEDERAL FINANCING BANK

JUNE 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Continued)					
*Wolverine Power #183A	6/16	$ 4,346,798.08	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	5,399,576.92	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	229,769.23	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	4,000,163.46	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	2,313,538.46	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	2,508,644.23	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	4,857,836.54	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	3,413,855.77	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	3,284,115.38	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	2,660,173.08	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	3,115,750.00	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	1,258,778.85	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	2,769,115.38	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	2,785,951.92	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	3,677,298.08	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	1,090,413.46	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #183A	6/16	577,394.23	12/31/14	8.441%	8.354% qtr.
*Wolverine Power #234	6/16	16,002,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	4,931,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	16,704,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	3,944,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	6,848,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	9,664,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	9,763,000.00	1/2/18	8.437%	8.350% qtr.
*Wolverine Power #234	6/16	1,343,000.00	12/31/19	8.434%	8.347% qtr.
*Wolverine Power #274	6/16	19,253,797.06	1/3/17	8.438%	8.351% qtr.
*Wolverine Power #274	6/16	355,198.04	1/3/17	8.438%	8.351% qtr.
*Wolverine Power #274	6/16	2,376,734.27	1/3/17	8.438%	8.351% qtr.
*Wolverine Power #274	6/16	640,106.24	1/3/17	8.438%	8.351% qtr.
*Wolverine Power #274	6/16	19,479,661.81	1/3/17	8.438%	8.351% qtr.
United Power Assoc. #159A	6/22	2,652,000.00	7/1/91	8.658%	8.566% qtr.
*W. Farmer Electric #196	6/22	589,000.00	12/31/19	8.465%	8.377% qtr.
*Wabash Valley Power #252	6/22	2,000,000.00	1/3/17	8.470%	8.382% qtr.
Old Dominion Electric #267	6/26	2,407,000.00	12/31/13	8.358%	8.272% qtr.
Brazos Electric #333	6/29	25,246,000.00	1/3/22	8.268%	8.184% qtr.
*Colorado-Ute Electric #168A	6/29	868,656.00	12/31/15	8.282%	8.198% qtr.
*Colorado-Ute Electric #203A	6/29	1,712,000.00	1/3/17	8.280%	8.196% qtr.
New Hampshire Electric #270	6/29	337,000.00	1/2/18	8.273%	8.189% qtr.
*Allegheny Electric #93A	6/30	513,860.84	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #93A	6/30	2,428,695.63	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #93A	6/30	2,305,982.69	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #93A	6/30	3,597,026.05	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #93A	6/30	7,669.58	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #175A	6/30	9,529,136.88	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #255A	6/30	3,988,000.00	7/1/91	8.289%	8.205% qtr.
*Allegheny Electric #255A	6/30	1,452,000.00	7/1/91	8.289%	8.205% qtr.

*maturity extension

FEDERAL FINANCING BANK

JUNE 1989 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Continued)					
*Colorado-Ute Electric #78A	6/30	$ 913,807.04	12/31/13	8.237%	8.154% qtr.
*Colorado-Ute Electric #276	6/30	668,181.85	1/3/17	8.234%	8.151% qtr.
*Colorado-Ute Electric #297	6/30	5,640,975.59	1/2/18	8.233%	8.150% qtr.
*Cornbelt Power Coop. #292	6/30	348,595.05	1/2/18	8.234%	8.151% qtr.
*Cornbelt Power Coop. #292	6/30	446,578.48	1/2/18	8.234%	8.151% qtr.
*Cornbelt Power Coop. #292	6/30	482,380.20	1/2/18	8.234%	8.151% qtr.
*Cooperative Power Assoc. #130A	6/30	14,975,454.52	7/1/91	8.289%	8.205% qtr.
*Cooperative Power Assoc. #130A	6/30	4,710,743.83	7/1/91	8.289%	8.205% qtr.
*Kamo Electric #148	6/30	548,000.00	7/1/91	8.289%	8.205% qtr.
*Kamo Electric #209	6/30	2,097,000.00	7/1/91	8.289%	8.205% qtr.
*Kamo Electric #266	6/30	1,592,672.27	7/1/91	8.289%	8.205% qtr.
*Kamo Electric #266	6/30	1,005,663.93	7/1/91	8.289%	8.205% qtr.
*Kamo Electric #266	6/30	3,134,571.41	7/1/91	8.289%	8.205% qtr.
*New Hampshire Electric #270	6/30	1,985,000.00	1/2/18	8.228%	8.145% qtr.
*New Hampshire Electric #270	6/30	780,000.00	1/2/18	8.228%	8.145% qtr.
*New Hampshire Electric #270	6/30	646,000.00	1/2/18	8.228%	8.145% qtr.
*New Hampshire Electric #270	6/30	456,000.00	1/2/18	8.228%	8.145% qtr.
*N.W. Electric #176	6/30	838,000.00	7/1/91	8.289%	8.205% qtr.
*N.W. Electric #176	6/30	220,000.00	7/1/91	8.289%	8.205% qtr.
*Northwest Iowa Power #279	6/30	92,113.80	1/3/17	8.229%	8.146% qtr.
*Old Dominion Electric #267	6/30	1,148,627.12	12/31/13	8.237%	8.154% qtr.
*Oglethorpe Power #320	6/30	12,215,000.00	12/31/19	8.226%	8.143% qtr.
*Oglethorpe Power #320	6/30	57,630,000.00	12/31/19	8.226%	8.143% qtr.
*Sho-Me Power #324	6/30	991,596.64	7/1/91	8.289%	8.205% qtr.
*Sho-Me Power #324	6/30	596,969.70	7/1/91	8.289%	8.205% qtr.
*Washington Electric #269	6/30	105,428.63	12/31/14	8.236%	8.153% qtr.
*Washington Electric #269	6/30	168,763.60	12/31/14	8.236%	8.153% qtr.
*Wolverine Power #100A	6/30	554,255.54	7/1/91	8.289%	8.205% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
Greater Metro Chicago Dev. Corp.	6/7	498,000.00	6/01/09	8.508%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-89-09	6/30	871,804,805.49	9/29/89	8.444%	

*maturity extension

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	June 30, 1989	May 31, 1989	Net Change 6/1/89-6/30/89	FY '89 Net Change 10/1/88-6/30/89
Agency Debt:				
Export-Import Bank	$ 11,007.6	$ 11,000.6	$ 7.0	$ 50.0
NCUA-Central Liquidity Facility	114.0	108.9	5.2	-4.1
Tennessee Valley Authority	17,340.0	17,240.0	100.0	209.0
U.S. Postal Service	6,195.0	6,195.0	-0-	602.8
sub-total*	34,656.6	34,544.5	112.1	857.7
Agency Assets:				
Farmers Home Administration	55,586.0	56,311.0	-725.0	-2,910.0
DHHS-Health Maintenance Org.	79.5	79.5	-0-	-0-
DHHS-Medical Facilities	93.8	93.8	-0-	-2.6
Overseas Private Investment Corp.	-0-	-0-	-0-	-0-
Rural Electrification Admin.-CBO	4,076.0	4,076.0	-0-	-63.2
Small Business Administration	12.4	12.4	-0.3	-2.9
sub-total*	59,847.8	60,573.1	-725.3	-2,978.7
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	11,552.3	11,604.8	-52.6	-4,459.4
DEd.-Student Loan Marketing Assn.	4,910.0	4,910.0	-0-	-0-
DOE-Geothermal Loan Guarantees	-0-	-0-	-0-	-50.0
DHUD-Community Dev. Block Grant	308.9	311.5	-2.6	-9.2
DHUD-New Communities	-0-	-0-	-0-	-0-
DHUD-Public Housing Notes +	1,995.3	1,995.3	-0-	-41.7
General Services Administration +	378.1	381.9	-3.9	-9.4
DOI-Guam Power Authority	31.5	31.5	-0-	-0.6
DOI-Virgin Islands	25.9	26.1	-0.2	-0.6
NASA-Space Communications Co. +	995.2	995.2	-0-	96.4
DON-Ship Lease Financing	1,720.5	1,720.5	-0-	-38.3
Rural Electrification Administration	19,236.4	19,236.3	0.1	31.1
SBA-Small Business Investment Cos.	582.2	583.2	-1.0	-50.5
SBA-State/Local Development Cos.	833.7	836.5	-2.8	-37.2
TVA-Seven States Energy Corp.	2,278.7	2,254.7	24.0	116.3
DOT-Section 511	37.5	37.6	-0.1	-8.7
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	45,063.3	45,102.2	-38.9	-4,461.8
grand total*	$ 139,567.7	$ 140,219.8	$ -652.1	$ -6,582.8

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

TREASURY NEWS

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DEPARTMENT OF THE TREASURY

FOR IMMEDIATE RELEASE
JULY 27, 1989

STATEMENT BY SECRETARY BRADY

We are pleased that the Conference Committee has finished work on the S&L legislation, which is generally an excellent product, however, the Administration's position on financing is perfectly clear and remains unchanged. We continue to actively oppose the House financing plan which requires a Gramm-Rudman waiver.

NB-395

TREASURY NEWS

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DEPARTMENT

Remarks by
Secretary of the Treasury
Nicholas F. Brady
at the Bicentennial Celebration of
the U.S. Customs Service
July 31, 1989

Senator DeConcini, Senator Domenici, Senator Helms, Congressman Rangel, Admiral Yost, Commissioner von Raab, Deputy Secretary Robson, other distinguished guests, ladies and gentlemen:

It is appropriate that we assemble today on the grounds of the Washington Monument to celebrate the bicentennial of the United States Customs Service.

Just as we remember George Washington as the Father of our country, today we pay tribute to the agency which played a key role in the growth and development of this great nation. And today the Customs Service continues to play an essential role in sustaining and safeguarding the nation's vital interests.

We at the Treasury Department never forget how closely linked are the histories of the United States and the Customs Service. As you know, our nation began its life under the Constitution in economic disarray and deeply in debt. One of the compelling forces in the creation of a strong federal system was the need for a rational, enforceable system of marshalling financial resources for the common good. Today, outside the entrance to the Treasury Department is a statue of Alexander Hamilton, on which is written, "He smote the rock of national resources and abundant streams of revenue gushed forth." The instrument of the transformation worked upon the young nation by Hamilton was the Customs Service.

From 1789 until 1913, when the Federal Income Tax Act was established, Customs collections were the chief source of income for the United States. It was through Customs revenues that the Revolutionary War debt was retired by 1835. Customs revenues financed the Louisiana purchase and the acquisition of the Oregon Territories, as well as Florida and Alaska.

Today Customs continues to perform a vital service to the American people by the most efficient system of moving and monitoring international trade and commerce in the world. And

today, Customs is preparing to take our commercial system into the 21st century with an arsenal of technologically advanced systems for monitoring trade. Its accomplishments in this realm make an indispensable contribution to our leadership in international commerce.

Yet the influence of the Customs Service has always been felt far beyond the boundaries of revenue collection. In providing a system of pension agents for Revolutionary War veterans, Customs functioned as the first Veterans Administration. When America needed to patrol her shores to guard against smugglers it was the Custom Service which provided this protection, for many years until the Coast Guard was created.

From the earliest days of our republic, members of the Customs Service have been in the forefront of our efforts to keep contraband and illegal products from infiltrating this country. It is a responsibility equally as important as Customs role in monitoring the flow of legal commerce across our borders. As we are all aware, today the most dangerous contraband is illegal drugs. President Bush has declared war on drug smugglers and sellers. And it is a war we are going to win.

In June I was with the President at Treasury's Federal Law Enforcement Training Center when he announced his comprehensive anti-crime program. A major purpose of this initiative is to combat drug- related crime and violence in this country.

As we celebrate the Bicentennial, let's remember those exceptional Customs employees who put their lives on the line in the national crusade against drugs. We especially honor today those like Richard Latham and Glenn Miles, who have given the last full measure of devotion -- their very lives -- to combat the scourge of drugs.

I commend the Customs Service for its part in President George Bush's campaign to combat illegal drugs. Customs undertakes important operations in a sophisticated federal effort that includes the Coast Guard, the Immigration & Naturalization Service, the Drug Enforcement Administration, the Department of Defense, and the FBI, as well as Treasury's Bureau of Alcohol, Tobacco and Firearms and Internal Revenue Service.

Close cooperation between members of the Bush Cabinet is and will continue to be a hallmark of our war against drugs. Those of us who head the older agencies have established a solid, cooperative working relationship with Director William Bennett's Office of National Drug Control Policy.

As the members of Congress here today will remember, the President pledged that the war against drugs will be "waged on

all fronts." That is why President Bush is asking Congress for a one billion dollar increase in federal funding to fight the drug war. We are proud that this Administration has recognized Customs' competence and central role in the drug war by increasing Customs' drug fighting manpower budget to its highest level ever.

As President Bush has stated, this is not a problem that can be solved solely within the borders of the United States. It requires international cooperation. At the International Drug Enforcement Conference in April the President called upon the leaders of the western hemisphere to join with him "to work together toward a hemispheric compact on drugs--a mutual commitment of resources and energy to ensure a brighter day for all the children of the Americas."

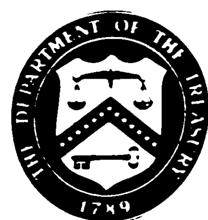
Underscoring the President's commitment to international cooperation, our partners at the recent Paris Economic Summit agreed to establish an international task force on drug money laundering.

Drug money laundering offers a unique opportunity in the war against drugs, because bringing drugs in to the United States is of no use to the drug lords if they can't get their money out. Over the past months we have been developing a new proposal for drug money laundering. And today we will send our proposal to Director Bennett.

Let me conclude by saying what can never be said enough by the grateful citizens of this country: We salute the men and women of the U.S. Customs Service. My congratulations, on this your bicentennial day, to the dedicated employees who perform the wide array of assignments that are part of the Customs' responsibilities and tradition.

As Willy von Raab has said, your job is not an easy one, but it is vital to our nation's independence and economic vitality. You guard nearly 100,000 miles of land, sea and air borders. Protect, secure, defend -- that is the U.S. Customs legacy. Thank you for making your heritage a commitment to our nation's future upon which all of our citizens can rely.

TREASURY NEWS



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FOR IMMEDIATE RELEASE
July 31, 1989

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DEPARTMENT OF THE TREASURY

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,403 million of 13-week bills and for $6,403 million of 26-week bills, both to be issued on August 3, 1989, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 2, 1989			:	26-week bills maturing February 1, 1990		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.64%	7.90%	98.069	:	7.34% a/	7.73%	96.289
High	7.65%	7.91%	98.066	:	7.37%	7.76%	96.274
Average	7.65%	7.91%	98.066	:	7.35%	7.74%	96.284

a/ Excepting 1 tender of $1,500,000.

Tenders at the high discount rate for the 13-week bills were allotted 68%.
Tenders at the high discount rate for the 26-week bills were allotted 3%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 35,845	$ 35,845	:	$ 29,300	$ 29,300
New York	24,234,760	5,382,530	:	19,686,925	5,363,535
Philadelphia	33,810	33,810	:	20,555	20,555
Cleveland	89,410	86,880	:	44,715	44,715
Richmond	46,180	41,180	:	41,265	41,265
Atlanta	42,600	42,600	:	30,765	30,765
Chicago	1,752,225	52,205	:	1,042,785	63,535
St. Louis	56,855	36,855	:	41,005	33,065
Minneapolis	12,765	12,765	:	9,330	9,330
Kansas City	57,365	54,300	:	41,935	40,820
Dallas	26,575	26,575	:	17,520	17,520
San Francisco	1,000,775	73,635	:	610,050	107,550
Treasury	524,115	524,115	:	601,250	601,250
TOTALS	$27,913,280	$6,403,295	:	$22,217,400	$6,403,205
Type					
Competitive	$24,377,615	$3,067,630	:	$17,653,005	$2,038,810
Noncompetitive	1,479,440	1,479,440	:	1,195,495	1,195,495
Subtotal, Public	$25,857,055	$4,547,070	:	$18,848,500	$3,234,305
Federal Reserve	1,955,425	1,755,425	:	1,800,000	1,600,000
Foreign Official Institutions	100,800	100,800	:	1,568,900	1,568,900
TOTALS	$27,913,280	$6,403,295	:	$22,217,400	$6,403,205

1/ Equivalent coupon-issue yield.

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