U.S. Department of the Treasury

PRESS RELEASES

TREASURY NEWS

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

OPENING STATEMENT OF

DEPUTY SECRETARY JOHN E. ROBSON

UNITED STATES DEPARTMENT OF THE TREASURY

BEFORE THE

HOUSE WAYS AND MEANS

OVERSIGHT AND TRADE SUBCOMMITTEES

UNITED STATES HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.

OCTOBER 16, 1991

THANK YOU CHAIRMAN GIBBONS, CHAIRMAN PICKLE, AND MEMBERS OF THE TRADE AND OVERSIGHT SUBCOMMITTEES FOR YOUR INVITATION TO DISCUSS THE UNITED STATES CUSTOMS SERVICE'S ENFORCEMENT OF THE U.S./CANADA FREE TRADE AGREEMENT (FTA). MORE SPECIFICALLY, I AM HERE TODAY TO DISCUSS THE TREASURY DEPARTMENT'S ROLE AND MY OWN WITH REGARD TO IMPLEMENTATION AND ENFORCEMENT OF THE DOMESTIC CONTENT REQUIREMENTS UNDER THE FTA FOR AUTOS AND TO A PENDING AUDIT OF THE HONDA MOTORS CORPORATION'S COMPLIANCE WITH THE FTA RULES OF ORIGIN.

I WISH TO STATE AT THE OUTSET THAT THE HONDA AUDIT IS NOT COMPLETE -- AND AS COMMISSIONER CAROL HALLETT HAS PREVIOUSLY INDICATED TO THE COMMITTEE, WILL NOT BE COMPLETE UNTIL FEBRUARY OF THIS COMING YEAR. THEREFORE, NEITHER I, NOR ANY OF THE OTHER WITNESSES, ARE IN A POSITION TO ADDRESS QUESTIONS PERTAINING TO INFORMATION THUS FAR ELICITED IN THAT AUDIT. NOR, AS THE COMMITTEE HAS BEEN INFORMED, WILL THE DEPARTMENT BE ABLE TO PROVIDE THE HONDA AUDIT "WHITE PAPER" WHICH HAS BEEN REQUESTED AS IT IS THE DEPARTMENT'S LONG ESTABLISHED POLICY NOT TO RELEASE MATERIALS THAT CONTAIN CONFIDENTIAL BUSINESS INFORMATION PROVIDED IN THE COURSE OF TAX AUDITS, INCLUDING CUSTOMS AUDITS.

I HAVE, HOWEVER, PROVIDED THE COMMITTEE WITH A COPY OF A MARCH 21 MEMORANDUM ON THIS SUBJECT FROM COMMISSIONER HALLETT TO ME -- WHICH I UNDERSTAND HAS BEEN SHOWN TO ALL INTERESTED MEMBERS OF THE COMMITTEE. FURTHER, WE WILL ATTEMPT TO ANSWER AS MANY QUESTIONS AS YOU MAY HAVE ON GENERAL ISSUES WHICH HAVE BEEN

RAISED IN THE COURSE OF THE AUDIT.

I. TREASURY OVERSIGHT ROLE

GOING BACK TO MAY 8TH, 1792, BY AN ACT INITIATED BY THIS COMMITTEE, THE SECRETARY OF THE TREASURY AND HIS DESIGNEES HAVE BEEN CHARGED WITH OVERSIGHT OF THE U.S. CUSTOMS SERVICE. IN FACT, WE HAVE TAKEN THIS CHARGE SERIOUSLY AT THE DEPARTMENT WITH THE STRONG ENCOURAGEMENT OF THIS COMMITTEE AS WELL AS THE SENATE FINANCE COMMITTEE. IN RECENT YEARS THIS ROLE HAS BEEN SUPPLEMENTED BY THE CONGRESS WITH THE STATUTORY CREATION OF AN ADVISORY COMMITTEE ON COMMERCIAL OPERATIONS WHICH HAS BEEN VERY USEFUL TO THE DEPARTMENT ON SUCH IMPORTANT MATTERS AS THE CUSTOMS MODERNIZATION ACT WHICH IS PRESENTLY PENDING BEFORE THE COMMITTEE.

WITH RESPECT TO SPECIFIC AUDITS, REGULATIONS, OR CLASSIFICATION RULINGS, I HAVE BEEN DIRECTLY INVOLVED IN A NUMBER OF SUCH CASES SINCE COMING INTO MY POSITION AS DEPUTY SECRETARY OF THE DEPARTMENT IN 1989. I HAVE, FOR EXAMPLE, BEEN INVOLVED WITH CUSTOMS CASES PERTAINING TO SPORT UTILITY VEHICLES, ATHLETIC SHOES, COMPUTER MOTHERBOARDS, TURBINE GENERATORS, AND INCLUSION OF CERTAIN INTEREST COSTS IN AUTOMOBILE IMPORTS UNDER THE CANADIAN FTA -- WHICH WAS OF PARTICULAR INTEREST TO MEMBERS OF THIS COMMITTEE, INCLUDING SOME OF WHOM I CONTACTED WHEN WE HAD

REACHED A DECISION. I HAVE SPOKEN AND CORRESPONDED WITH A NUMBER OF OTHER MEMBERS OF THE WAYS AND MEANS COMMITTEE AS WELL AS THE SENATE FINANCE COMMITTEE ON VARIOUS MATTERS WHICH I HAVE BEEN ASKED TO EXAMINE.

II. ROLE WITH HONDA

MY PERSONAL ROLE WITH RESPECT TO THE HONDA MATTER HAS BEEN A LIMITED ONE. COMMISSIONER HALLETT BROUGHT THE MATTER TO MY ATTENTION AND FOLLOWED UP WITH THE MARCH 21 MEMO WHICH YOU HAVE BEEN FURNISHED. FOLLOWING THE LEAK TO THE MEDIA OF CONFIDENTIAL BUSINESS DATA SUBMITTED BY HONDA IN THE COURSE OF THE AUDIT AND THE MARCH 21 MEMO, I WAS CONTACTED BY AND AGREED TO MEET WITH REPRESENTATIVES OF HONDA MOTORS. DURING THAT MEETING ON JUNE 21, WHICH LASTED APPROXIMATELY 45 MINUTES, I LISTENED TO HONDA'S PROTESTS ABOUT THE LEAK AND THEIR CONCERNS THAT IT HAD BEEN DAMAGING TO HONDA MOTORS. AT NO TIME DURING THAT MEETING DID ANY OF THE PARTICIPANTS DISCUSS THE SUBSTANCE OF THE AUDIT OR ATTEMPT TO INFLUENCE ITS OUTCOME.

I MADE ONLY THESE POINTS IN THE MEETING.

FIRST, I CONFIRMED THAT THE AUDIT WAS NOT COMPLETE AND, THEREFORE NO CONCLUSIONS HAD BEEN REACHED. SECOND, THAT HONDA WOULD GET A FAIR HEARING. THIRD, THAT IF EMPLOYEES OF TREASURY

OR ANY OF ITS BUREAUS WERE RESPONSIBLE FOR THE LEAK TO THE MEDIA OF CONFIDENTIAL BUSINESS DATA, IT WAS INCONSISTENT WITH OUR AGREEMENT WITH HONDA TO SAFEGUARD SUCH DATA SUBMITTED IN THE COURSE OF THE AUDIT, AND, IN MY VIEW, UNPROFESSIONAL. AND, FINALLY, THAT I HAD NO VIEWS ON THE SUBSTANCE OF THE AUDIT, AND THAT WHEN THE AUDIT WAS COMPLETE WE WOULD MAKE OUR FINDINGS AND CONCLUSIONS AS TO THE FACTS AND LAW AND LET THE CHIPS FALL WHERE THEY MAY.

THAT IS WHAT I SAID. AND LET ME EMPHASIZE AGAIN THAT AT NO POINT WAS THERE ANY DISCUSSION OF THE SUBSTANCE OF THE AUDIT.

III. LEGAL AND POLICY ISSUES RAISED BY FTA

AS IS FREQUENTLY THE CASE WITH THE IMPLEMENTATION OF COMPLICATED TRADE LAWS, PREVIOUSLY UNFORESEEN LEGAL AND POLICY ISSUES WILL ARISE DURING THE COURSE OF IMPLEMENTATION AND ENFORCEMENT OF SUCH LAWS. THIS HAS BEEN TRUE AS WELL IN THE CASE OF THE U.S.-CANADA FTA.

ALREADY WE HAVE ADDRESSED A RATHER COMPLICATED DETERMINATION ON THE INCLUSION OF CERTAIN INTEREST COSTS AS A DIRECT COST OF PROCESSING AND NOW WE ARE FACED WITH A NUMBER OF ADDITIONAL LEGAL AND POLICY ISSUES IN ORDER TO DETERMINE DOMESTIC CONTENT UNDER THE FTA. IT IS CLEAR THAT WE ARE WORKING WITH AN EVOLVING AREA

OF THE LAW -- AND AN AREA WHERE WE MOST CERTAINLY WILL BE SEEKING A GREATER DEGREE OF CLARITY IN THE CONTEXT OF THE UPCOMING NORTH AMERICAN FREE TRADE AGREEMENT. IT IS IMPORTANT THAT WE PROVIDE AS MUCH CLARITY AS POSSIBLE BEFORE MOVING FORWARD WITH THE AGREEMENT AND THAT WE LEARN FROM OUR EXPERIENCES WITH THE CANADIAN AGREEMENT.

AS HAS BEEN INDICATED, THE HONDA AUDIT IS NOT COMPLETE. VARIOUS LEGAL AND TECHNICAL ISSUES THAT WILL HAVE TO BE ADDRESSED UNDER THE FTA REMAIN UNDER REVIEW AND ARE NOT MATTERS ON WHICH I AM CONVERSANT AT THIS POINT. THEREFORE, I WILL BE LEAVING DISCUSSION OF THESE MATTERS TO COMMISSIONER HALLETT, DEPUTY ASSISTANT SECRETARY FOR ENFORCEMENT JOHN SIMPSON, AND THE TREASURY'S GENERAL COUNSEL JEANNE ARCHIBALD. I WOULD, HOWEVER, BE HAPPY TO ADDRESS ANY QUESTIONS I CAN ON MY OVERSIGHT ROLE AT THE TREASURY AND MY INVOLVEMENT TO DATE WITH RESPECT TO HONDA.

THANK YOU. THIS CONCLUDES MY INTRODUCTORY REMARKS.

TREASURY NEWS

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

Remarks by
Secretary of the Treasury
Nicholas F. Brady
(Presented by Assistant Secretary Olin Wethington)
at the Morning Session of
the Interim Committee
of the International Monetary Fund
Bangkok, Thailand
October 13, 1991

World Economic Outlook

We last met six months ago at a time of remarkable change, challenge, and opportunity in the global political economy. Since then, the rate of political and economic change has accelerated even further, and the opportunities and challenges have grown even larger.

The seeds of economic reform are germinating in Eastern Europe, but will need careful cultivation for years to come. After years of drift, the Soviet Union and its republics are beginning to make the fundamental changes that are so urgently needed to create a basis for healthy and balanced economic growth. Latin America has embraced market mechanisms more quietly, but with impressive determination. And here in Asia, there is growing appreciation of the larger benefits that come with more open and accessible markets and financial systems.

Of course, the key to success in any of these efforts is sound and consistent policy choices by the reforming countries themselves. Only they are masters of their own future.

But we also recognize our own responsibilities to support and accelerate the transition process. First and foremost, the industrial countries must promote a favorable global economic environment. We and the developing countries share a need for solid, sustained growth, expanding trade and capital flows, low inflation, and reasonable exchange market stability.

The global economy, however, remains characterized by widespread weaknesses, including inadequate overall growth of output and trade. We believe that the basic concerns we raised at the Spring meeting remain valid, and that the task of achieving a durable global expansion remains to be completed.

NB-1503

The picture is mixed in the industrial countries. Aided by a modest recovery in housing activity and a slowing of inventory liquidation, the U.S. economy appears to be recovering after three quarters of contraction. But there are still weaknesses in key sectors and regions. The other major economies in recession are also sending mixed signals and on current estimates will bring only limited strength into 1992. Meanwhile, growth in Japan and Germany has already cooled substantially, and will likely slow even further in the months ahead. And the wider effects of slower German growth are clearly being seen throughout the rest of Europe, where growth and growth expectations have been reduced considerably.

For the industrial countries as a group the outlook is for growth of only around 1 percent this year, picking up to perhaps the 2-1/2 percent range in 1992. Yet we should recall that our recent forecasts, and those of the IMF staff, have erred fairly consistently on the side of optimism, and we must remain alert to signs of greater-than-expected weakness in the recovery.

We believe that a few elements of this overall picture merit our special attention.

First, on current projections the industrial countries will likely have averaged only about 2 percent annual growth between 1990 and 1992. This is well below the nearly 3-1/2 percent average growth performance of the 1980s, and weaker even than average growth in the 1970s which was widely regarded as inadequate. The prospect of West European growth of only about 2 percent next year is a particular concern, given the special reliance of our new Eastern partners on growing export markets there.

The basic point is simple. We are currently operating in a global economic environment characterized by inadequate growth, high unemployment and unused capacity. We are foregoing trade and investment at a time when the world arguably needs them most.

Second, impressive progress has been made toward the price stability we need for long-term sustainable growth. But we have seen once again that unemployment is a costly and only partially effective route to low inflation. Experience shows that underlying pressures reflect structural rigidities that are best dealt with directly by marshalling the political will to change the status quo.

Third, projected trends raise the prospect of backsliding on some of the important progress that has been made in reducing key external imbalances in recent years.

Fourth, substantial exchange market stability has been achieved over the past few years, despite a number of market disruptions. On the whole, this has been a positive development.

And finally, I would note that the current situation of idle resources and capacity gives us the opportunity to raise both saving and investment and better meet legitimate capital needs as they emerge.

The current circumstances -- and medium-term prospects -- would therefore seem to give us fairly clear policy guidance. Our shared priority should be to return as rapidly as we can to a path of solid, durable growth -- by which I mean growth that does not reignite inflation pressure but that does make the most of available resources. Fiscal and monetary policies should therefore be directed to achieving sustained medium-term growth, with price stability and lower real interest rates.

Individual circumstances and policies will differ. That is inevitable. For our part, we are committed to a medium-term fiscal program which, temporary setbacks notwithstanding, will substantially improve our national saving without sacrificing the growth we need to achieve both domestic and external objectives.

Our strong hope is that, together, we can maintain a policy course that gives adequate weight to the unique and compelling global challenges that lie ahead.

The task is not an easy one. But the rewards will be great. Let's make the most of our unique opportunities.

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
October 16, 1991

CONTACT: Office of Financing
202/219-3350

TREASURY TO AUCTION 2-YEAR AND 5-YEAR NOTES TOTALING $22,500 MILLION

The Treasury will auction $13,500 million of 2-year notes and $9,000 million of 5-year notes to refund $10,636 million of securities maturing October 31, 1991, and to raise about $11,875 million new cash. The $10,636 million of maturing securities are those held by the public, including $465 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $22,500 million is being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average prices of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks, for their own accounts, hold $1,686 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.

The reductions in weekly bills announced yesterday and in today's 5-year notes reflect improvement in Treasury's cash, largely as a result of reduced spending for financial institution resolutions. The 2-year notes announced today include an amount that is sufficient to hedge the call, announced October 9, 1991, of the $0.9 billion held by private investors of 7-1/2% Bonds of 1988-93. The Treasury offered $13.0 billion of 2-year notes in September.

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-1504

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
OF 2-YEAR AND 5-YEAR NOTES TO BE ISSUED OCTOBER 31, 1991

October 16, 1991

<u>Amount Offered to the Public</u> ...	$13,500 million	$9,000 million
<u>Description of Security</u>:		
Term and type of security	2-year notes	5-year notes
Series and CUSIP designation ...	Series AG-1993 (CUSIP No. 912827 C7 5)	Series U-1996 (CUSIP No. 912827 C8 3)
Maturity date	October 31, 1993	October 31, 1996
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	April 30 and October 31	April 30 and October 31
Minimum denomination available .	$5,000	$1,000
<u>Terms of Sale</u>:		
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
<u>Payment Terms</u>:		
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender
Deposit guarantee by designated institutions	Acceptable	Acceptable
<u>Key Dates</u>:		
Receipt of tenders	Wednesday, October 23, 1991	Thursday, October 24, 1991
a) noncompetitive	prior to 12:00 noon, EDST	prior to 12:00 noon, EDST
b) competitive	prior to 1:00 p.m., EDST	prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):		
a) funds immediately available to the Treasury ...	Thursday, October 31, 1991	Thursday, October 31, 1991
b) readily-collectible check ...	Tuesday, October 29, 1991	Tuesday, October 29, 1991

AUCTION RESULTS
PUBLIC DEBT NEWS
Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 17, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $12,531 million of 52-week bills to be issued October 24, 1991 and to mature October 22, 1992 were accepted today (CUSIP: 912794YZ1).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.11%	5.41%	94.833
High	5.12%	5.42%	94.823
Average	5.12%	5.42%	94.823

Tenders at the high discount rate were allotted 34%. The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	16,500	16,500
New York	34,423,335	11,985,995
Philadelphia	9,495	9,495
Cleveland	13,300	13,300
Richmond	20,050	16,750
Atlanta	14,385	10,725
Chicago	1,200,655	124,355
St. Louis	19,010	13,690
Minneapolis	10,110	6,150
Kansas City	19,245	18,585
Dallas	8,810	8,810
San Francisco	484,315	44,715
Treasury	262,160	262,160
TOTALS	$36,501,370	$12,531,230
Type		
Competitive	$33,153,450	$9,183,310
Noncompetitive	497,920	497,920
Subtotal, Public	$33,651,370	$9,681,230
Federal Reserve	2,850,000	2,850,000
Foreign Official Institutions	0	0
TOTALS	$36,501,370	$12,531,230

An additional $530,000 thousand of bills will be issued to foreign official institutions for new cash.

NB-1505

MULFORD, ARCHIBALD, WETHINGTON, DOWNING, MCLOUGHLIN, E. NEWMAN, TEMPLEMAN,
SOBEL, ROMEY, DIGIULIO, HALSTEAD

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RUFHLO/AMEMBASSY LONDON 7032
RUEHMO/AMEMBASSY MOSCOW 0137
RUEHOT/AMEMBASSY OTTAWA 4451
RUFHFR/AMEMBASSY PARIS 5355
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UNCLAS SECTION 01 OF 05 BANGKOK 50626
USIA
EO 12356: N/A
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SUBJECT: FASTPRESS: BRADY/GREENSPAN PRESS CONFERENCE

1. TREASURY SECRETARY NICHOLAS BRADY AND CHAIRMAN OF THE FEDERAL RESERVE BOARD ALAN GREENSPAN GAVE A PRESS CONFERENCE OCTOBER 13, 1991, IN BANGKOK AT THE CONCLUSION OF G-7 MEETINGS. FOLLOWING IS A

TRANSCRIPT OF THEIR ON THE RECORD REMARKS.
2. BEGIN TRANSCRIPT.
3. (SECRETARY BRADY). AS I'M SURE YOU'RE ALL FAMILIAR WITH THE ACTIVITIES OF THE LAST SEVERAL DAYS, THE FINANCE MINISTERS AND CENTRAL BANK GOVERNORS OF THE G-7 COUNTRIES HAVE HAD A SERIES OF MEETINGS. LAST NIGHT AT DINNER WE WERE JOINED BY REPRESENTATIVES FROM THE SOVIET UNION. THEIR WHOLE DELEGATION WAS NOT ABLE TO BE PRESENT LAST NIGHT DUE TO TRAVEL ARRANGEMENTS, SO WE HAD ANOTHER MEETING THIS MORNING WHERE THOSE PEOPLE WHO WEREN'T THERE LAST NIGHT WERE ABLE TO JOIN.
FINANCE MINISTERS AND GOVERNORS MET AFTER THE COMPLETION OF THOSE MEETINGS, AND HAVE ISSUED A COMMUNIQUE WHICH I'M SURE YOU ALL HAVE BEFORE YOU. I WON'T TAKE ANY FURTHER TIME TO READ THE COMMUNIQUE AND I'LL BE GLAD TO ANSWER ANY QUESTION.
Q. (WHAT KIND OF DATA DID THE SOVIETS PROVIDE YOU?)
A. (SECRETARY BRADY). THEY DID NOT BRING A SERIES OF NEW FIGURES. THEY DID REAFFIRM THE FIGURES THAT HAD ALREADY BEEN PROVIDED. WE DID NOT DISCUSS WITH THEM ANY PARTICULAR FINANCING ARRANGEMENTS THAT MIGHT ULTIMATELY BE FORTHCOMING.
I SAY 'ULTIMATELY BE FORTHCOMING' BECAUSE, AS YOU KNOW, FROM READING THIS COMMUNIQUE, THE G-7 DEPUTIES ARE TO MEET IN MOSCOW WITH SOVIET REPRESENTATIVES IN WHAT IS DESCRIBED HERE AS "SHORTLY;" THERE ISN'T A SPECIFIC SCHEDULE AT THIS POINT THAT'S BEEN AGREED TO.
Q. (WHERE YOU "SATISFIED" WITH THE FIGURES THE SOVIETS PROVIDED?)
A. (SECRETARY BRADY). WHEN YOU USE THE WORD "SATISFIED" I DON'T WANT YOU TO ASSUME THAT WE THOUGHT THAT THEY HADN'T PROVIDED WHAT THEY TRIED TO PROVIDE. THERE'S A LOT OF INFORMATION THAT HAS TO BE FILLED OUT. AS YOU KNOW, THE SOVIETS ARE IN THE PROCESS NOW OF CREATING A WHOLE NEW ECONOMIC ORDER INSIDE THE SOVIET UNION AND THE FIGURES THEY ARE PUTTING TOGETHER ARE NOT ONES THAT THEY KEPT UNDER THE PREVIOUS ARRANGEMENTS AND REGIMES, SO THERE'S A LOT OF WORK TO BE DONE.
AS YOU WELL KNOW, THE IMF HAS A MISSION OF SOME 20-30 PEOPLE OVER THERE RIGHT NOW, TO BE JOINED BY PEOPLE FROM THE WORLD BANK; IT'S HOPED THAT THAT GROUPING OF PEOPLE WHO KNOW HOW TO HANDLE THESE KINDS OF PROBLEMS WILL MAKE A BIG DIFFERENCE IN THE KIND OF INFORMATION

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UNCLASSIFIED

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E GE T.
. (CAN YOU BE MORE SPECIFIC ABOUT POSSIBLE STEPS THE
-7 MAY TAKE TO ALLEVIATE SOVIET PROBLEMS?)
. (SECRETARY BRADY). WELL, IT'S QUITE CLEAR THAT
HE U.S. IS GOING TO JOIN WITH THE OTHER G-7
OUNTRIES TO TRY TO COME UP WITH A PROGRAM THAT WILL
E OF ASSISTANCE TO THE SOVIET UNION. THERE IS NO
LUEPRINT IN THE SENSE OF A DETAILED ARTICULATION OF
HAT THAT PROGRAM MIGHT BE. WE HEARD OUT THE SOVIET
EPRESENTATIVES TODAY; THEY WERE VERY FORTHCOMING IN
HEIR DESIRE TO HAVE THE G-7 MINISTERS AND THEIR
EPUTIES BE PART OF THE ONGOING STRUCTURE. WHAT THEY
EALLY ASKED US TO DO WAS TO COME HELP ARTICULATE
HAT THE PROGRAM MIGHT BE. THEY SAID YOUR HELP WILL
E OF INESTIMABLE VALUE TO US.
. (REGARDING THE FRAMEWORK OUTLINED IN THE
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EO 12356: N/A
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SUBJECT: FASTPRESS: BRADY/GREENSPAN PRESS CONFERENCE

COMMUNIQUE, IS IT A FAIR UNDERSTANDING THAT, IF THE SOVIETS STUMBLE ALONG THE WAY IN THE FRAMEWORK OF REFORM THAT THE G-7 WILL HELP THEM?)
A. (SECRETARY BRADY). I WOULDN'T CHARACTERIZE IT THAT WAY. I WOULD SAY THAT THESE CONDITIONS, WHICH ARE ONES THAT YOU ARE ALL FAMILIAR WITH, ARE ONES WHICH ARE AGREED TO BY THE SOVIET UNION AND BY THE G-7 FINANCE MINISTERS AND GOVERNORS. AND THAT THOSE ARE IN MY MIND VERY POSITIVE STEPS AND ARRANGEMENTS THAT HAVE TO TAKE PLACE FOR THIS PROBLEM TO BE ADEQUATELY ADDRESSED. "STUMBLED ALONG THE WAY" WOULDN'T BE MY IDEA; I THINK WHAT WE HAVE PROVIDED IS A PRESCRIPTION FOR PROGRESS.
Q. IS THERE AN AGREEMENT IN PRINCIPLE, IF THE DETAILS CAN BE WORKED OUT, THAT THE G-7 IS PREPARED TO PROVIDE LIQUIDITY ASSISTANCE TO THE SOVIET UNION?
A. (SECRETARY BRADY). NO, THERE IS NO AGREEMENT IN PRINCIPLE. BUT THAT DOESN'T MEAN THERE WON'T BE. WHAT THIS COMMUNIQUE INDICATES IS THAT YOU CAN'T, BASED ON A MEETING LAST NIGHT AND A MEETING THIS MORNING, ARRIVE AT SUCH AN AGREEMENT. WE ARE OBVIOUSLY, THE G-7 MINISTERS AND CENTRAL GOVERNORS, IN THE BUSINESS OF TRYING TO HELP THE SOVIETS FACE THE ECONOMIC PROBLEMS THAT THEY HAVE. I DON'T WANT, BY ANSWERING THAT QUESTION "NO," WHICH IS THE CORRECT ANSWER, TO INDICATE THAT THAT'S NOT WHAT WE'RE TRYING TO DO; IT IS WHAT WE'RE TRYING TO DO.
Q. WHAT IS THE MOST SIGNIFICANT THING THAT HAS TRANSPIRED HERE IN YOUR VIEW?
A. (SECRETARY BRADY). THE MOST SIGNIFICANT THING IS THAT THE SOVIETS FEEL THAT THE SOLVING OF THIS PROBLEM WILL BE MOST AGGRESSIVELY MOVED FORWARD IF

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UNCLASSIFIED

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THE G-7 REPRESENTATIVES ARE INVOLVED IN THIS
PROCESS. I THINK IT'S QUITE CLEAR FROM THE
REPRESENTATIVES WE TALKED TO TODAY AND FROM THE TRIPS
WE'VE TAKEN BEFORE, THAT THE G-7 GROUP HAS ENORMOUS
STANDING INSIDE THE SOVIET UNION IN TERMS OF WHAT
COMES NEXT WITH REGARD TO ECONOMIC ARRANGEMENTS.
I DON'T MEAN THAT IMPLIES WE ARE GOING TO GET INTO
ANY KIND OF ARTICULATION OF WHAT SHOULD BE THE
ARRANGEMENT BETWEEN THE CENTER AND THE REPUBLICS;
THAT'S THEIR BUSINESS. BUT I THINK QUITE CLEARLY THE
MOST IMPORTANT THING ABOUT THIS AND PREVIOUS MEETINGS
IS THE G-7 PROCESS IS ONE THAT THEY HAVE GREAT
CONFIDENCE IN. THEY FEEL IT HAS GREAT STANDING IN
THEIR OWN COUNTRY. IT'S HELP THEY WANT AND SEEK ON A
FIRST HAND BASIS AND THE SOONER THE BETTER.
Q. (INAUDIBLE).
A. (SECRETARY BRADY). I THINK THERE IS AN
UNDERSTANDING AMONG THE G-7 THAT WHAT WE'VE GOT HERE
IS WHAT'S BEEN DESCRIBED IN THE COMMUNIQUE:
FINANCIAL AND ECONOMIC PROBLEMS WHICH HAVE TO BE
ADDRESSED. CERTAINLY, THE ARRANGEMENTS BY WHICH THE
SOVIETS PUT TOGETHER A MARKET BASED ECONOMIC REFORM
IS A VERY IMPORTANT PART OF THAT. OBVIOUSLY, AS THAT
GOES FORWARD AND THOSE THINGS GET FLESHED OUT, WE'LL
GET INTO THE OTHER DETAILS.
Q. (INAUDIBLE).
A. (SECRETARY BRADY). YOU ARE NOW, I THINK, MIXING
UP TWO DIFFERENT THINGS. THE CIRCUMSTANCE THAT
YOU'RE REFERRING TO IS THE COMBINATION OF
HUMANITARIAN AID, MEDICAL AND FOOD SUPPLIES, THAT MAY
BE FORTHCOMING. YOU KNOW, THE U.S. HAS COMMITTED TWO
AND A HALF BILLION DOLLARS OF CCC CREDITS WHICH WE
ARE IN THE PROCESS OF FINALIZING AND DELIVERING. THE
EC, I'M LED TO BELIEVE IN THIS PAST WEEK, IS TALKING
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UNCLAS SECTION 03 OF 05 BANGKOK 50626
USIA
EO 12356: N/A
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SUBJECT: FASTPRESS: BRADY/GREENSPAN PRESS CONFERENCE

THEIR RESOURCES AND THE JAPANESE HAVE COME FORWARD
WITH A PLAN WHICH INCLUDES NOT ONLY SOME AGRICULTURAL
HELP, BUT ALSO GUARANTEES OF ONE KIND OR ANOTHER
WHICH ADD UP TO BE TWO AND A HALF BILLION DOLLARS.
I DON'T WANT TO MONOPOLIZE THE ANSWERS TO THESE
QUESTIONS; IF YOU HAVE ANY QUESTIONS FOR CHAIRMAN
GREENSPAN HE'S HERE AND WILLING TO JOIN IN.
Q. (IT SEEMS TO ME THAT WHAT THE G-7 HAS DONE HERE IS
TO HAVE PUT TOGETHER A FRAMEWORK FOR THE SOVIET UNION
LIKE THE MARSHALL PLAN. IS THIS A FAIR ASSESSMENT?)
A. (SECRETARY BRADY). WELL, I THINK, OF COURSE, WHAT
WE'RE TALKING ABOUT HERE IS TRYING TO BE RESPONSIVE
TO WHAT THEIR NEEDS ARE; WE DON'T KNOW WHAT THOSE

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NEEDS ARE. WHAT WE DO KNOW IS THAT THE SYSTEM THAT THEY HAVE HAD IN YEARS GONE BY IS ONE ON WHICH YOU CANNOT BUILD A CATHEDRAL. WE NEED A NEW SYSTEM AND WE HAVE AGREED WITH THEIR INTERPRETATION OF WHAT THAT NEW SYSTEM OUGHT TO BE AND I THINK IT'S EVERYBODY'S INTENTION TO PLAY AS BIG A PART IN THAT AS THEY CAN, AS THEIR OWN RESOURCES WILL ALLOW, BUT BASED SURELY, AND THE MOST IMPORTANT PART, WHICH IS THAT THEY HAVE A LOT OF WORK TO DO THEMSELVES.

Q. (FOR MR. GREENSPAN, WHAT IS YOUR FEELING ABOUT HAVING ONE CENTRAL BANK IN THE SOVIET UNION?)

A. (CHAIRMAN GREENSPAN). THE QUESTION, AS YOU CORRECTLY PHRASE IT, IS A DECISION THAT WILL BE MADE BY THE SOVIET PEOPLE. THERE ARE NUMEROUS WAYS IT COULD COME OUT, BUT OBVIOUSLY, THE ISSUE OF A SINGLE CURRENCY AND A SINGLE CENTRAL BANK WOULD MAKE THE TRANSITION EASIER. I'M NOT SAYING THAT, WERE THERE TO BE INDEPENDENT CURRENCIES AND INDEPENDENT CENTRAL BANKS, THAT IT WOULD BE UNFUNCTIONAL, I'M MERELY SAYING THAT IT WOULD BE FAR MORE DIFFICULT. MOREOVER, THE BASIC PROBLEM THAT THEY HAVE NOW IS AN INFLATING CURRENCY. AND AN INFLATING CURRENCY OCCURS AS A CONSEQUENCE OF THE FACT THAT THEY HAVE VERY SUBSTANTIAL AND ESCALATING BUDGET DEFICITS, WHICH EXIST BOTH ON THE REPUBLICS' SIDE AND ON THE CENTER'S SIDE. UNLESS THAT ISSUE IS RESOLVED, PARTICULAR CHOICES THEY ARE MAKING WITH RESPECT TO CURRENCIES AND CENTRAL BANKS BECOME LESS IMPORTANT. SO I WOULD SUGGEST THAT THE CRUCIAL DECISIONS THAT HAVE TO BE MADE ARE A COMBINATION OF FISCAL AND MONETARY POLICIES. YOU CANNOT, AT THIS STAGE, SEPARATE THE TWO ISSUES.

Q. (INAUDIBLE).

A. (SECRETARY BRADY). I THINK THAT STATEMENT, WHICH I'M NOT TOTALLY FAMILIAR WITH, INDICATES WHAT COULD BE ONE OF THE PROBLEMS (LONG TERM DEBT) THAT HAS TO BE ADDRESSED. BUT I THINK THAT THE FACT THAT THE DEPUTIES ARE GOING TO THE SOVIET UNION AS SOON AS THEY CAN GET ORGANIZED TO DO SO INDICATES THAT THERE'S MORE WORK TO BE DONE. WE DON'T HAVE FIRM FIGURES. IF WE HAD FIRM FIGURES WE'D BE GIVING THEM TO YOU. THE PROBLEM IS THE SYSTEM THEY'VE HAD OVER THE YEARS DOESN'T SPIT OUT STATISTICS THE WAY THEY DO IN THE WESTERN DEMOCRACIES. THAT'S PART OF THE PROBLEM AND WE HAVE TO ADDRESS IT.

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Q. HOW WOULD YOU SAY THE SOVIETS ASSESS THEIR NEED
FOR SO-CALLED EMERGENCY HUMANITARIAN AID?
A. (SECRETARY BRADY). THEY DIDN'T BRING IT UP IN
THIS MEETING. BUT I DON'T WANT TO LEAD YOU OFF THE
TRACK. AGRICULTURE SECRETARY MADIGAN IS IN THE
SOVIET UNION RIGHT NOW, VARIOUS OTHER SECRETARIES OF
AGRICULTURE AND THOSE WHO DEAL WITH THE PROBLEMS OF
MEDICAL SUPPLIES HAVE BEEN OVER THERE, SO THAT IS A
HIGH PRIORITY. YOU ASKED ME IF IT CAME UP IN THIS
MEETING AND IT DIDN'T, BECAUSE IT DIDN'T. BUT THAT
PROCESS IS GOING ON IN OTHER CHANNELS.
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RUEHOT/AMEMBASSY OTTAWA 4454
RUFHFR/AMEMBASSY PARIS 5358
RUEHRO/AMEMBASSY ROME 5198
RUEHKO/AMEMBASSY TOKYO 4844

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BT
UNCLAS SECTION 04 OF 05 BANGKOK 50626
USIA
EO 12356: N/A
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SUBJECT: FASTPRESS: BRADY/GREENSPAN PRESS CONFERENCE

Q. ABOUT THE USE OF THE WORD "INTEGRATION;" IT SEEMS THAT BOTH SIDES ARE SAYING WE HAVE BEGUN THE PROCESS OF INTEGRATION BETWEEN THE SOVIET AND WORLD ECONOMIES. CAN YOU COMMENT IF THAT IS SO?

A. (SECRETARY BRADY). I THINK IT'S ENORMOUSLY IMPORTANT. I THINK CHAIRMAN GREENSPAN SAID IT BEST THE OTHER DAY WHEN HE SAID THEY ARE ANSWERING QUESTIONS THE NEVER ANSWERED BEFORE. IT'S CLEAR THAT A YEAR AGO THIS WAS A STAND OFF DISCUSSION WHERE PEOPLE WERE ACROSS THE DESK ON OPPOSITE SIDES AND NOT ENGAGING THE PROBLEM, LITERALLY PASSING EACH OTHER AT DIFFERENT ALTITUDES.

THE VERY IMPORTANT DIFFERENCE NOW IS THE FACT THAT THE SOVIET UNION'S REPRESENTATIVES, AND THIS WAS TRUE OF PRESIDENT GORBACHEV WHEN I MET WITH HIM AS WELL AS THE OTHER HIGH OFFICIALS OF THE REPUBLICS, WANT THE HELP OF THE WESTERN WORLD AND THEY ARE WILLING TO SIT DOWN AT THE TABLE AND PROVIDE FIGURES THAT THEY NEVER PROVIDED BEFORE.

LET'S JUST START WITH THE FIGURES ON GOLD; THOSE ARE THINGS WHICH NEVER BEFORE WOULD HAVE BEEN COMING FORWARD. SO THE VERY, VERY IMPORTANT DIFFERENCE THAT YOU'VE TALKED ABOUT HERE IS ONE THAT IS ENORMOUSLY SIGNIFICANT.

A. (CHAIRMAN GREENSPAN). I THINK THAT'S A REALLY IMPORTANT ISSUE. WHAT WE ARE SEEING HERE IS REALLY FOR THE FIRST TIME THE SOVIET UNION ENGAGING THE WEST AT A LEVEL OF DETAIL THAT IS UNPRECEDENTED. WE ARE ACTIVELY ENGAGED IN DISCUSSIONS WITH THEM ON AN EXTRAORDINARY RANGE OF ISSUES WHICH RELATE TO THE SHIFT FROM A CENTRALLY PLANNED ECONOMY TO A MARKET ECONOMY. IRONICALLY, ONE OF THE ISSUES THAT IS SURFACING IS THE AMOUNT OF INFORMATION WE ARE LEARNING ABOUT HOW COMPLEX OUR SYSTEM IS. WHEN ONE SEES THE ACTUAL SYSTEMS SIDE BY SIDE AND LOOKS AT THE PROCESS OF TRANSITION, IT'S REALLY AN EXTRAORDINARILY COMPLEX PROBLEM.

NONETHELESS, THERE IS AN AWARENESS ON THE PART OF

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CTH SIDES OF THE ADVANTAGE CF ACTIVE ENGAGEMENT AT
ERY DETAILED LEVELS CF TRYING TC SET UP INSTITUTIONS
N THE SCVIET UNICN THAT WILL HELP ENABLE THEM TC
OVE TO A MARKET ECONCMY. THAT'S GCING TC BE AN
N-GCING PROCESS. AS I SAID THE CTHER DAY, BANGKCK
S NCT A WATERSHED IN THIS PRCCESS. IT'S THE
EGINNING OF WHAT INEVITABLY IS GCING TO BE A VERY
CNG AND VERY DETAILED PRCCESS, AND HCPEFULLY A VERY
RCDUCTIVE ONE.
. (IS THERE SC MUCH FCCUS ON THE SOVIET UNICN IN
HESE MEETINGS THAT PRCBLEMS IN CTHER PARTS CF THE
CRLD ARE BEING LCST SIGHT OF?)
. (SECRETARY BRADY). I THINK IT'S AN UNDERSTANDABLE
CNCERN. BUT THESE MEETINGS INEVITABLY ALWAYS FCCUS
N THE MOST IMPORTANT EVENT THAT'S GCING CN AND NC
NE WOULD DISGUISE THE FACT THAT THE ENORMOUS CHANGE
CING ON IN THE SCVIET IS A VERY IMPORTANT FACT AT
HIS PCINT IN TIME. I'D CNLY SAY TO THE PEOPLE WHC
CRRY ABOUT THAT PROBLEM THAT THERE HASN'T BEEN AN
NORMOUS FINANCIAL CCMMITMENT MADE UP TO THIS POINT
N TIME. THERE'S BEEN WHAT WE THINK ARE VERY
ENEROUS GRAIN CREDITS FRCM THE UNITED STATES AND
LSEWHERE. BUT JUST BECAUSE THE MEETING FOCUSES ON
HE MOST IMPORTANT EVENT SHOULDN'T BE AN INDICATICN
HAT ALL CTHER AVENUES ARE BEING DROPPED. I THINK
OU PRESTCN AND MICHEL CAMDESSUS HAVE REFERRED TC
HAT RATHER COPIOUSLY.
. (INAUDIBLE).
. (SECRETARY BRADY). I COULDN'T POSSIBLY GIVE YOU
T
C626
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ET
NCLAS SECTION 05 OF 05 BANGKOK 50626
SIA
O 12356: N/A
SUBJECT>
UBJECT: FASTPRESS: BRADY/GREENSPAN PRESS CONFERENCE

AN ANSWER TO THAT. I THINK PART OF YOUR QUESTION, HICH I WOULD SLIGHTLY QUARREL WITH, IS "GO OVER AND ET SOME MORE INFORMATION." I WOULD REFER YOU TO HAT WE HAVE SAID EARLIER. THEY HAVE ASKED US TO OME BE PART OF THE PROCESS THAT SETS UP A NEW SYSTEM NSIDE THE SOVIET UNION WHICH WILL, HOPEFULLY, ROVIDE THE BASIS FOR THE ECONOMIC REFORMS AND NORMOUS CHANGE THAT THEY HAVE CALLED FOR.
HAT'S A VERY IMPORTANT STATEMENT ON THEIR PART. HEY HAVE SAID ANY NUMBER OF TIMES YOU CANNOT OSSIBLY UNDERSTAND HOW IMPORTANT YOUR FEELINGS ARE, OUR PARTICULAR OBSERVATIONS ARE, IN THIS PROCESS. SO OME HELP US PUT THIS THING TOGETHER. THIS ISN'T UST A MISSION TO GO GET A FEW MORE STATISTICS. A EALLY IMPORTANT PART OF IT IS THEY SAY WE WANT TO NOW WHAT YOU THINK. WE WANT TO HAVE THE BENEFIT OF HE WAY YOU HAVE DONE THINGS IN THE WESTERN WORLD. E MAY DO THEM A LITTLE DIFFERENTLY OURSELVES, BUT HIS IS WHAT WE WANT.
O IT ISN'T JUST A QUESTION OF GOING THERE FOR DATA.

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THEY WANT THE FOUNDATION STONES THAT WE SPENT SO MANY
YEARS CREATING IN THE WESTERN WORLD.
Q. (CAN YOU BE ANY MORE SPECIFIC ABOUT WHEN THOSE
MEETINGS IN THE SOVIET UNION WILL CONTINUE?)
A. (SECRETARY BRADY). WE USE THE WORD SHORTLY IN THE
COMMUNIQUE BUT I WOULD ASSUME SOME TIME IN THE VERY
NEAR FUTURE THE DEPUTIES WOULD GO OVER THERE AND THIS
DISCUSSION WOULD GO ON. I CAN'T GIVE YOU A PRECISE
TIME TABLE, BUT I CAN GIVE YOU AN ESTIMATION OF THE
INTENT, AND THAT'S TO BE AS RESPONSIVE AS WE POSSIBLY
CAN IN THE SHORTEST PERIOD OF TIME.
Q. (ON THE IDA PROCESS).
A. (UNDER SECRETARY OF THE TREASURY DAVID C.
MULFORD). THE IDA PROCESS IS A WELL DEFINED PROCESS
AND WE'LL LOOK AT THAT AS WE DO EVERY TIME. THERE'S
ALWAYS BEEN AN ADEQUATE RESPONSE TO THAT AND WHEN THE
TIME COMES WE'LL LOOK AT THAT ISSUE.
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SOBEL, ROMEY, DIGIULIO, HALSTEAD

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

STATEMENT OF THE HONORABLE
DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE OF
DEFICITS, DEBT MANAGEMENT, AND INTERNATIONAL DEBT
SENATE FINANCE COMMITTEE
OCTOBER 21, 1991

Introduction

Thank you Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to review the economic implications of change and decentralization in the Soviet Union. These developments will have far-reaching global economic implications. The Soviet Union is now joining the global shift toward market-based economies. We can now envision a new era for the world economy, an era of unprecedented integration, cooperation, and prosperity.

The Soviets understand that the success of the effort to transform the Soviet economy to a market system rests primarily with them. Nevertheless, there is a clear recognition in industrial nations and the international institutions of the importance of a supportive response to this historic challenge.

During the recently concluded Annual Meetings of the IMF and the World Bank in Bangkok, the Finance Ministers and Central Bank Governors of the Group of Seven met with Soviet representatives to discuss the challenges faced by the central authorities and republics of the Soviet Union. This meeting provided a substantial opportunity for a direct exchange with the Soviets on: current economic conditions, their planned approach to defining political and economic relations among the republics and with the center, their external indebtedness problems, their thinking on longer-term economic reform priorities and the need for economic assistance. I would like to review these discussions today.

NB -1506

The Nature of the Challenge

It would be hard to overstate the magnitude and scope of change sweeping the Soviet Union today. The center and the republics are literally demolishing one political and economic system and seeking to build another. This effort encompasses four difficult and overlapping challenges:

(1) reaching agreement on new center/republic economic and political relations;

(2) easing the immediate economic crisis;

(3) building a market economy; and

(4) avoiding a politically and economically destructive disintegration of the country.

Unfortunately, the Soviets do not have the luxury of addressing these four issues separately. They cannot institute a comprehensive economic reform program without resolving the division of economic policy responsibilities between the center and the republics, and they cannot rejuvenate production without beginning a broad program of market reform.

By the same token, we in the West do not have the luxury of standing idly on the sidelines until the uncertainties in the current Soviet situation are resolved. The stakes are too high. We have a chance, probably of limited duration, to help anchor the Soviet Union firmly and permanently in the global market system.

The challenge for the industrial democracies and the multilateral institutions is how to provide constructive and effective assistance in such a chaotic environment. We cannot and will not control developments in the Soviet Union, but we might be able to exert some influence on certain aspects of the situation.

As President Bush has repeatedly stressed, in addition to providing humanitarian aid, our first priority must be to support Soviet economic reform efforts, that is, the comprehensive effort to shift from a command economy to a market-based system. It will be essential to pursue this effort to a large extent at the republic level, where much of the policymaking authority is likely to reside. In the wake of immediate problems facing Soviet consumers and enterprises, which tend to be the focus of the media, it is easy to lose sight of this crucial long-term goal. We can take discrete measures to help address current shortages and liquidity problems. But the transformation to a market system is the only lasting way to strengthen economic performance in the republics.

As to the relationship between the center and the republics, this is a matter for resolution by the Soviet people and their leaders at all levels of society. Economic reform itself, however, will require changes at the republic level that go beyond the agreement on economic relations.

Center/Republic Relations

As you know, the Soviets are attempting to define center/republic relations despite formidable and complex differences among the republics. Prior to the IMF/World Bank annual meetings, Secretary Brady welcomed the initialing of a treaty for an economic community by the twelve republics. The fate of this agreement is still uncertain, but we feel it would lay some of the groundwork for a viable economic union. The treaty provides a general framework, allocating responsibilities for monetary and fiscal policy and outlining the legal and regulatory principles which are to govern economic activity. Much work remains to be done before the general principles set forth in the treaty can be translated into specific, binding commitments. A number of separate, detailed agreements on such difficult issues as responsibility for Soviet debt and ownership of Soviet assets will have to be concluded.

From the perspective of accelerating the transformation of the Soviet economy, we would hope that the treaty and detailed agreements produce a politically stable arrangement with a workable division of economic responsibilities. Clear authority must be established, at some level of government, over fiscal and monetary policy if macroeconomic stabilization is to be achieved. In the fiscal case, this means that those who must control budget balances must also have the authority to tax and spend. In the monetary case, it means that there must be a workable system for limiting the supply of credit. And, as in the case of any economic community, the greater the degree of clarity and uniformity in legal and regulatory systems, and the fewer the restrictions on market forces, the greater the capacity to conduct mutually beneficial, unimpeded commerce among the constituent parts of the market.

Current Soviet Economic Situation

Negotiations to establish a new political and economic union are, of course, severely complicated by the sharply deteriorating economic environment. Our discussions with the Soviets, both in Moscow and in Bangkok, have revealed wide recognition that the command system is in collapse. After a decade of mediocre growth in the 1980s, Soviet output fell by around 5 percent in 1990, and is expected to drop 15 percent or more in 1991.

The gravity of the budget situation cannot be overstated. Fed by massive subsidies to consumers and enterprises, the budget deficit will probably run as high as 25 percent of GNP for 1991, and is being financed almost entirely by the printing of money. Soviet efforts to issue public debt instruments to the public have failed. As a result, prices are rising dramatically: consumer price inflation has accelerated from 25 percent in the first quarter of this year to 95 percent in the second quarter. The classic symptoms of hyperinflation are becoming apparent.

The balance of payments has also deteriorated sharply, due both to declining oil and arms exports. Hard currency debt has risen to $65-70 billion, large in absolute terms although relatively small compared to the size of the economy and Soviet export potential. Foreign exchange reserves available to service centrally held obligations and access to short-term credit lines from Western banks are shrinking rapidly.

The breakdown in center/republic relations is contributing directly to the budget deficit and to debt service difficulties. Some republic governments have been unwilling to transfer planned tax revenues to the central government. And foreign exchange earnings are no longer flowing at previous levels to the central monetary authorities who are responsible for servicing debt obligations.

Obviously, the conclusion and subsequent implementation of the new economic agreement will have significant benefits for addressing the current economic crisis, as well as for implementing longer-term comprehensive economic reforms.

Crisis Assistance

During the G-7 Ministerial meeting in Bangkok, the Ministers and Governors and the Soviet representatives discussed the Soviet external payments situation in great detail. Several key considerations were emphasized during this exchange:

-- the importance of working with the international financial institutions on comprehensive economic reforms;

-- the necessity to honor external financial obligations and fulfill any understandings with external creditors in order to maintain access to new credits;

-- in the context of the evolving center/republic relations, the need for a framework to govern the ongoing financial relations between the Soviet Union and its many creditors; and

-- the further need for full disclosure of Soviet economic and financial data.

The Soviet representatives reiterated their request for assistance in addressing their immediate external payments difficulties. In recognition of this problem, Ministers and Governors indicated their willingness to consider appropriate measures in support of the political and economic transformation now taking place. The G-7 Ministers and Governors accepted the invitation by Soviet representatives to send the G-7 Deputies to Moscow in order to explore specific approaches to the Soviet external payments problem as well as to discuss broader financial and economic concerns in the overall context of economic reform.

The industrial countries are also demonstrating their commitment, bilaterally and multilaterally, to addressing Soviet humanitarian needs and to lowering barriers inhibiting trade and investment links with the Soviets.

The United States has substantially increased its assistance to the Soviets in the form of support for food and medical needs. In fiscal years 1991 and 1992, the U.S. has already committed a total of $2.5 billion in CCC credits. Medical assistance through Project Hope will also increase in the year ahead.

In addition, the Administration is continuing to work on removing restrictions on economic relations through: urging Congress to ratify the U.S.-Soviet trade agreement, resuming negotiations on tax and investment treaties, waiving restrictions on OPIC activity, and working with Congress to remove restrictions on Eximbank activities in the Soviet Union and on the importation of Soviet gold coins into the United States.

Economic Transformation

The external assistance effort, however, will have to extend well beyond short-term measures to address shortages and liquidity problems.

This does not mean large-scale official financing of the kind which has been given priority in the media. I believe the Soviets understand that the private sector, both domestic and foreign, must be the principal source of financing to build a market economy. They also know that the best way to mobilize and utilize private financing is to establish a market-based economic environment conducive to building investor confidence. During Secretary Brady's trip to the Soviet Union in September, and again in Bangkok, the Soviets themselves acknowledged the futility of seeking large sums of Western money at this juncture, which, as they put it, would be like pouring water on the sands of Arabia.

What is desperately needed is assistance in the formulation of a comprehensive program for the transformation to a market economy. The Soviets will partly address this task in the context of negotiating the specifics of the agreed-upon policies within their economic agreement. The republics, as well as whatever center emerges, will also need to be prepared to address problems that emerge as new institutions and economic relationships begin to be put in place. Once the republics establish the basic economic relationships, they will have to implement a broad range of reforms to achieve economic stabilization and structural transformation. These programs must encompass the following areas.

First, stability must be achieved through a program for reducing the budget deficit and reliance on money creation.

Second, there must be a market system that permits buyers and sellers to determine prices for goods and services, as well as for labor and capital.

Third, a legal and regulatory framework is required which permits private ownership of property and diminishes the role of state-owned enterprises.

Fourth, the economy must be opened domestically and internationally to the free flow of goods and investment. There should be emphasis here on industries that generate substantial foreign exchange revenues.

Moreover, in the Soviet case, the systematic destruction of private enterprise over seventy years has created even more fundamental needs.

- They need help in building basic economic institutions, such as a commercial banking system and bond markets.
- They need basic training on how to run profitable private businesses.
- They need practical advice on the operation of a sound fiscal system: a tax code and collection system, a budget mechanism, a customs operation, and a data collection system.
- They also need assistance on establishing a legal system which ensures the enforceability of private contracts and facilitates the functioning of private enterprise.

In a word, there has to be a complete change in orientation toward private initiative and competition. The items noted above should be addressed by private individuals and companies in groups, not just by governments. Attitudes toward the creation of wealth need to be changed to release the dynamism of the private sector. Free enterprise and entrepreneurship mean that businesses and individuals are free to succeed. In such an environment, private economic players can function productively and profitably, and growth and economic transformation will follow.

Soviet Relations with the International Financial Institutions

From the start, this Administration has sought to tap the expertise of the IMF and the World Bank in helping the Soviet Union chart a course to a market economy. The Bretton Woods institutions can provide detailed, tested policy and technical advice, based on practical experience in many countries, including Eastern Europe. Such advice is crucial in an effort as complex and broad in scope as the transformation of an economic system. In December 1990, President Bush proposed a Special Association of the Fund and the Bank with the Soviet Union as a means to initiate the relationship and get the advisory process moving. The basic components of Special Association with the IMF are:

-- reviews of the Soviet economy similar to those conducted in consultations with IMF members;

-- technical assistance on policy reform to the center and republics;

-- access to Fund documents and training courses;

-- attendance at Fund meetings; and

-- establishment of a Fund resident office in the Soviet Union.

For the World Bank, a trust fund of $30 million has been approved to finance technical assistance for the Soviet Union and its republics on a wide range of economic reform issues. The Bank has subsequently developed a work program of activities for the next three months which focuses on such key areas as basic social services, private sector development, and the energy, agricultural, and financial sectors.

After the coup, the President and Secretary Brady pushed hard for the IMF to initiate Special Association to meet the pressing Soviet need. On October 5, an agreement for a Special Association was finally signed by the Soviet Union and the IMF, and consultations have begun. We do not view Special Association as an end in itself, but we think it is the best way forward for now. We welcome this agreement and urge that no effort be spared to work intensively in the days ahead. Special Association will help clear the way for full membership in both the IMF and the World Bank.

In the immediate future, the two institutions will provide policy and technical assistance to further the process of reform. In his speech at the Annual Meetings, the Secretary urged the IMF and the World Bank to take on a new role in the Soviet Union and Eastern Europe to address some of the more fundamental needs of economies which must create the basic institutions, attitudes, and skills necessary for a successful market economy. The Fund and the Bank must help to build a real understanding of what free enterprise and entrepreneurship mean. The Secretary urged the financial institutions to pay much greater attention to the human capital component of their programs, to place knowledgeable people in-country capable of providing advice and training on a broad range of issues, and to expand in-country contacts beyond central government officials.

Other Technical Assistance

The IMF and the World Bank are expected to work closely with other institutions, such as the EBRD and the OECD, in coordinating their efforts. The EBRD itself has already established a short-term program of technical assistance and project financing for the Soviet Union which will concentrate on private sector development, privatization, and assistance for private sector activities in agricultural distribution and energy. It is already engaged in providing advice to the cities of Moscow and St. Petersburg on privatization.

We in the U.S. government are also engaged in an extensive technical assistance effort to advise Soviet officials about policymaking and regulation. Treasury has sent a team to several republics to advise on setting up new tax laws. The Federal Reserve, the Justice Department, the FTC, and Census have conducted seminars for Soviet officials on banking and reserve systems, competition and monopoly policy, and statistics. Other technical assistance is being provided in the areas of energy, food distribution, and defense conversion.

Secretary Brady has also proposed tapping the expertise of the U.S. private sector through a professional corps to train Soviet entrepreneurs to run successful businesses in a market environment. This would complement the Department of Commerce's ongoing Soviet-American Business Intern Training Program, under which Soviet entrepreneurs work in American corporations. During President Gorbachev's discussion with Secretary Brady in September, he expressed particular interest in the idea of setting up a business training center in Moscow. The Mayor of Moscow, in fact, has already agreed to provide land and infrastructure.

Conclusion

In closing, I would restate the overriding objective of our economic relations with the Soviet Union: to encourage a complete transformation to a market system and to integrate the Soviet Union firmly with the world economy.

The transition to a market economy cannot be accomplished through a simple government declaration or by a quick infusion of Western financial assistance. It will take perseverance and many years of work for the Soviet people.

We now have the mechanisms in place -- Special Association with the IMF and the World Bank, the G-7 coordinated effort, other multilateral efforts, and bilateral assistance -- to provide crucial support. But we must guard against unfocused schemes for throwing money at the problem, particularly in an era of competing demands for scarce global resources. All of our efforts, financial and non-financial, must be carefully structured and targeted to promote the goal of transformation and sound economic policies in the Soviet Union.

Thank you.

AUCTION RESULTS
PUBLIC DEBT NEWS
Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 21, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,648 million of 13-week bills to be issued October 24, 1991 and to mature January 23, 1992 were accepted today (CUSIP: 912794XW9).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.02%	5.17%	98.731
High	5.04%	5.19%	98.726
Average	5.04%	5.19%	98.726

Tenders at the high discount rate were allotted 86%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	31,705	31,705
New York	28,734,820	9,101,770
Philadelphia	27,925	27,925
Cleveland	44,430	44,110
Richmond	188,675	74,475
Atlanta	27,555	26,275
Chicago	1,896,020	131,600
St. Louis	54,070	14,070
Minneapolis	6,090	6,090
Kansas City	29,905	29,905
Dallas	22,200	22,200
San Francisco	1,107,950	228,670
Treasury	909,640	909,640
TOTALS	$33,080,985	$10,648,435
Type		
Competitive	$28,979,015	$6,546,465
Noncompetitive	1,572,310	1,572,310
Subtotal, Public	$30,551,325	$8,118,775
Federal Reserve	2,288,660	2,288,660
Foreign Official Institutions	241,000	241,000
TOTALS	$33,080,985	$10,648,435

NB-1507

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 21, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,649 million of 26-week bills to be issued October 24, 1991 and to mature April 23, 1992 were accepted today (CUSIP: 912794YK4).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.08%	5.30%	97.432
High	5.11%	5.33%	97.417
Average	5.11%	5.33%	97.417

Tenders at the high discount rate were allotted 63%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	23,495	23,495
New York	24,994,810	9,593,310
Philadelphia	14,790	14,790
Cleveland	31,545	31,545
Richmond	43,355	41,505
Atlanta	24,460	24,090
Chicago	1,266,580	120,330
St. Louis	29,405	9,405
Minneapolis	5,645	5,645
Kansas City	29,650	29,650
Dallas	15,550	15,550
San Francisco	696,395	87,145
Treasury	652,435	652,435
TOTALS	$27,828,115	$10,648,895
Type		
Competitive	$23,828,580	$6,649,360
Noncompetitive	1,110,035	1,110,035
Subtotal, Public	$24,938,615	$7,759,395
Federal Reserve	2,000,000	2,000,000
Foreign Official Institutions	889,500	889,500
TOTALS	$27,828,115	$10,648,895

NB-1508

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

For Release Upon Delivery
Expected at 2:30 p.m.
October 22, 1991

STATEMENT OF
MICHAEL J.GRAETZ
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXES
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to be here today to present the Administration's position with respect to S. 1787, a bill to provide a new tax credit to purchasers of real property held by the Resolution Trust Corporation (RTC). Although the Administration fully supports efforts to minimize the costs of the savings and loan cleanup, we object to the RTC property credit for a number of reasons. Before discussing our objections, I shall describe the provisions of the bill.

Summary of S. 1787

S. 1787 would grant purchasers of real property held by the RTC a tax credit to be claimed over a five-year period. The credit may have a present value of as much as 80 percent of the purchase price of the property. The exact percentage for any particular property would be set by the RTC in an amount that the RTC concludes is necessary to sell the property, but the aggregate amount of credits would be limited to $1 billion. If the purchased property requires rehabilitation or is not fully constructed, the credit could also apply to the estimated rehabilitation or construction costs, as agreed to by the RTC and the purchaser. A taxpayer's basis in purchased property would not be reduced by the amount of the credit allowed. As a result, a purchaser receiving a tax credit for as much as 80 percent of the property's cost would nevertheless be entitled to depreciation deductions for the full purchase price of the

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property. Upon a resale of the property by a recipient of the credit, the RTC would be entitled to receive 20 percent of the difference between the amount realized from the sale and the amount the recipient paid for the property.

The RTC property credit would be added to a list of business tax credits under the Code.[1] However, certain restrictions currently applicable to other business tax credits would not apply to the RTC property credit. First, the RTC credit would not serve to reduce the maximum benefit otherwise available to corporations for other business tax credits. The RTC credit, however, generally would not be allowed to reduce by more than 50 percent the tax liability due after application of the other credits. Unlike other business tax credits, the RTC property credit also could be used by all taxpayers to offset up to 50 percent of their alternative minimum tax liability.

In addition, individual taxpayers would be exempt from the limitations under the passive activity loss rules enacted under the Tax Reform Act of 1986 for up to $50,000 of RTC credits. Finally, any loan extended by the RTC in connection with the purchase of property to which the credit applies would be exempt from the original issue discount rules.

Administration Position

The Administration opposes S. 1787. The idea of using tax incentives in the context of the savings and loan problem is not a new one. In 1981, the Congress coupled substantial tax incentives with direct financial incentives for savings and loan associations. During 1988 and 1989, the Federal Savings and Loan Insurance Corporation (FSLIC) resolved 199 insolvent financial institutions in 96 assisted transactions, which combined direct federal financial benefits and tax savings. The tax benefits were considered necessary because FSLIC did not have the financial resources to liquidate insolvent institutions even where liquidation would have minimized the cost of resolving the institutions.

The nation's experience in combining tax and direct financial benefits in these transactions has not been a happy one. Indeed, the combination of tax and direct financial benefits in the 1988/89 transactions has created perverse incentives for institutions to hold assets and to minimize their value when sold, as well as incentives to maximize expenses, when institutions believe that both direct reimbursement from the

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[1]The business tax credit provisions coordinate the use of most business credits, such as the research credit and the low-income housing credit.

Federal Deposit Insurance Corporation (FDIC) and tax deductions for the reimbursed expenses are available. In enacting the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Congress repealed the special tax benefits available in the 1988/89 transactions, making the judgment -- which remains sound today -- that the creation or maintenance of artificial tax-driven transactions should be avoided because they ultimately will increase overall costs to the federal government. Although S. 1787 contains limitations on the total amount of tax credits that could be claimed and thereby avoids the unlimited blank check aspects of some prior tax incentives, it presents major difficulties.

S. 1787 empowers a federal agency, the RTC, to deliver tax reductions in amounts it selects to taxpayers it chooses in circumstances where others who purchase similar assets -- whether from the RTC or from private sellers -- will not enjoy such tax relief. This legislation inevitably will produce different tax burdens for similarly situated taxpayers and will foster a perception that the tax system is unfair. This seems particularly likely to occur in circumstances such as these where the RTC can best reduce its own costs by channeling these tax credits to taxpayers with sufficient taxable income to make the tax benefits readily usable without delay.

Moreover, the tax credit provided in this legislation is not the most efficient means to achieve the legislation's goal of expediting the RTC's sales of real property that is expected to have significant management, maintenance and other holding costs. Analytically, it is clear, for example, that, in circumstances where savings to the government are possible from the RTC selling property sooner and reducing its holding costs, the proposed tax credit would be more costly for the government than a reduction in the RTC's minimum price for accepting bids. Buyers, who face higher borrowing costs than the Treasury, would value the tax credit, which is spread over five years, using a higher discount rate than the Treasury. Buyers might also discount the value of the tax credit to reflect the risks that the full credit might not be used. This could occur, for example, if subsequent legislation were to restrict the use of the tax credits, if a buyer were to sell the property within five years of the purchase date or if the taxpayer has insufficient taxable income to fully use the credit in one or more of the taxable years of the relevant five-year period.[2] There is no economic rationale for offering buyers a tax credit in lieu of explicit price reductions

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[2]Any increased taxes resulting from the actual occurrence of the events being discounted by buyers would only partially mitigate the loss to the government from the discounting of those events.

or rebates. As a result, the credit proposed in this legislation would add unnecessarily to the government's cost of the savings and loan cleanup.

Some proponents of a tax credit approach have claimed that, because a tax credit would support higher prices for RTC real properties, nearby real estate would benefit. Such a claim is not correct. The value that current and potential owners place on property depends upon the net present value of future income they expect to receive from owning and managing the property. A tax credit for RTC property would not affect the expected future income of properties located in the same area as the RTC property, and therefore would not affect their appraised value. While potential buyers of commercial property not owned by the RTC would observe nominally higher prices on RTC sales of property that qualified for the tax credit, they could be expected to understand and take into account the effect of the tax credit on the actual purchase price.

Proponents of the tax credit approach also claim that the tax credit would expand the number of potential buyers who have sufficient equity to buy RTC property. The tax credit, however, would be of value only to potential buyers with sufficient taxable income. Accordingly, tax-exempt entities (such as pension funds and foundations), nonprofit organizations, which have been important purchasers of multi-family affordable housing properties, and other potential buyers lacking an adequate tax base would not value a tax credit. The bill does not even require that the RTC use the least costly method of disposing of its property -- a minimum protection for the taxpayer.

In addition to our fundamental objection to the RTC's using tax credits to stimulate sales of property, S. 1787 also raises other tax policy and administrative concerns. For example, although a purchaser of a property would be entitled to a tax credit equal to as much as 80 percent of the property's purchase price (as well as its completion and rehabilitation costs), the purchaser also would be entitled to claim depreciation with respect to the entire purchase price of the property. This could result in a purchaser receiving total tax savings that exceed the property's purchase price.

S. 1787 also provides exemptions for the RTC property credit from the generally applicable provisions of the alternative minimum tax and the passive activity loss rules. The minimum tax and passive loss rules were cornerstones in implementing a principal goal of the Tax Reform Act of 1986: elimination of tax shelters and their destructive effect on our nation's economy. The proposed exceptions in this legislation to the minimum tax and passive loss rules would not only limit the scope of these important rules but also would invite their further future erosion.

Finally, this legislation would lead to increased transaction costs for both the government and purchasers of RTC property. And the government's costs would not end with its disposition of the property. The Internal Revenue Service would be burdened with the cost of monitoring compliance with the detailed credit provisions for many years following the property's disposition by the RTC.

Revenue Implications

Over the period 1992-1996, Treasury estimates the revenue loss of S. 1787 to exceed $1 billion. The cumulative revenue loss exceeds the $1 billion aggregate cap on tax credits principally because S. 1787 does not require that basis in credit property be adjusted for the credit, and therefore would serve to increase depreciation allowances.

No provision to offset the revenue loss from S. 1787 has been proposed. As a result of preliminary discussion with OMB, we believe that this revenue loss is included under paygo provisions of the 1990 Act. Our preliminary view is also that this provision is not exempt from paygo under the deposit insurance provisions of the 1990 Act.

This concludes my prepared remarks. I will be pleased to answer any questions that you may have.

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
October 22, 1991

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $20,800 million, to be issued October 31, 1991. This offering will provide about $2,350 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $18,446 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, October 28, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Standard time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 10,400 million, representing an additional amount of bills dated August 1, 1991 and to mature January 30, 1992 (CUSIP No. 912794 XX 7), currently outstanding in the amount of $ 10,482 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 10,400 million, to be dated October 31, 1991 and to mature April 30, 1992 (CUSIP No. 912794 YL 2).

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

The bills will be issued for cash and in exchange for Treasury bills maturing October 31, 1991. 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 $ 1,189 million as agents for foreign and international monetary authorities, and $ 4,648 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 competitive 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.

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.

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.

8/89

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
October 22, 1991

CONTACT: Bob Levine
(202) 566-2041

TAX INFORMATION EXCHANGE AGREEMENT BETWEEN UNITED STATES AND THE REPUBLIC OF HONDURAS ENTERS INTO FORCE

The Treasury Department announced today that the United States and Honduras have exchanged diplomatic notes that activate an agreement to exchange tax information (the "Agreement") that satisfies the criteria set forth in the Caribbean Basin Economic Recovery Act of 1983. The Agreement was signed in Washington, D.C. on September 27, 1990 and is effective October 11, 1991.

With the Agreement in effect, Honduras qualifies as a jurisdiction in which Puerto Rican financial institutions may make certain investments of funds derived from U.S. section 936 companies. Such funds may be used to finance investments in qualifying development projects in Honduras.

Another benefit of the Agreement is that Honduras will now be considered part of the "North American Area" for purposes of determining whether U.S. taxpayers may deduct expenses incurred in attending conventions, business meetings, and seminars. Therefore, convention expenses incurred by U.S. taxpayers for meetings in Honduras that are otherwise deductible as ordinary and necessary business expenses will be allowed without regard to the additional limitations applicable to foreign convention deductions.

Finally, Honduras will now qualify as a foreign country in which a foreign sales corporation may incorporate and maintain an office as provided in the foreign sales corporation provisions of the Tax Reform Act of 1984.

The United States also has Tax Information Exchange Agreements in effect with Barbados, Dominica, The Dominican Republic, Grenada, Jamaica, Trinidad and Tobago, Saint Lucia, Costa Rica, Mexico, the Marshall Islands and Bermuda. All but the final three are Caribbean Basin Initiative countries.

A limited number of copies of the Agreement are available from the Treasury Public Affairs Office, Treasury Department, Room 2315, Washington, D.C. 20220.

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NB-1511

TREASURY NEWS

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

EMBARGOED UNTIL GIVEN
EXPECTED AT 10:00 A.M.
OCTOBER 23, 1991

STATEMENT OF THE HONORABLE JOHN E. ROBSON
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON CONSUMER AND REGULATORY AFFAIRS
OCTOBER 23, 1991, 10:00 A.M.
538 DIRKSEN SENATE OFFICE BUILDING

Chairman Dixon and members of the Subcommittee, I am pleased to respond to your request to discuss the Administration's proposal to restructure the RTC. Accompanying me is Peter Monroe, President of the Oversight Board.

The Administration's restructuring proposal is contained in the RTC Refinancing and Restructuring Act of 1991, which Secretary Brady submitted on behalf of the Administration to the Speaker of the House and President of the Senate on September 27, with a request for its prompt consideration. It has been introduced in the House as H.R. 3435. It has not been introduced in the Senate.

The RTC Refinancing and Restructuring Act of 1991 would provide $80 billion in loss funds, which we estimate will be sufficient to complete the unprecedented jobs of the savings and loan cleanup and the protection of insured depositors. It would provide additional working capital by raising the obligation limitation to $160 billion, and it would extend to September 30, 1993, the Office of Thrift Supervision's authority to transfer insolvent thrifts to the RTC for closure.

To create the framework for our discussion of restructuring, I think it important to review the RTC's progress to date - where it stands in an effort that must, by law, end in 1996.

At September 30 this year the RTC had saved the accounts of over 18 million depositors in thrifts in 44 states. The average balance of those 18 million accounts is just over $9,000. Because it has kept depositors' accounts whole and done so without delay RTC has helped avert a crisis of confidence in our banking system.

At September 30 the RTC had seized 660 thrifts and had resolved 563 of them - one every 33 hours. It plans during fiscal year 1992 to resolve a total of 233 institutions, if it promptly receives the funds it needs to continue its work.

My point is that the RTC is within sight of completing the task of closing insolvent institutions and removing them from the thrift industry.

The great task now confronting the RTC is the disposition of a huge amount of hard-to-sell assets - the investments of hundreds of defunct S&Ls. Even here there is progress to report. As of August 31, 1991, the RTC had seized $341 billion of assets. The net book value of sales and principal collections totaled $182 billion, leaving $159 billion of assets in inventory.

Recognizing that the RTC has ended the phase during which its mission has mainly been resolution of institutions, and entered the phase of its short life during which it must concentrate on the disposition of assets, the Oversight Board in June began with former FDIC Chairman Seidman a search for a new full-time Chief Executive Officer to run the RTC.

We were able to recruit a highly qualified individual, and last Thursday the FDIC, in its capacity under FIRREA as exclusive manager of the RTC, appointed as RTC CEO a seasoned business executive with a record of outstanding achievement in managing complex organizations. I am delighted that Albert V. Casey will appear here today in this new capacity.

With the appointment of Mr. Casey as CEO and the delegation to him of sufficient powers to run the RTC effectively, the Administration believes it has taken the most important single action necessary to solve the operational problems that have plagued the RTC's asset disposition efforts.

Some argue, however, that the RTC's problems stem not from operations or management but from its structure, notably the dual board structure created by FIRREA. We do not agree, neither does the Chairman of the RTC National Advisory Board, Philip Searle, who stated before this Subcommittee on June 19 that the structure is not the cause of RTC's operational problems.

Simply put, the current structure makes the RTC Board responsible for operations, and the Oversight Board responsible for funding, policy, and evaluation. The Administration believes that the logic of this division of responsibility remains valid for several reasons:

First is the RTC's control over a tremendous expenditure of public funds. An operational agency that can spend up to $160 billion in taxpayer dollars, and borrow as much as $160 billion more, should have independent oversight by the Administration which is responsible for the national budget. This need was recognized in the cases of the Chrysler and Lockheed loan guarantees. In both instances Congress created an oversight board to monitor the use of public monies.

- Second is the need to permit the RTC - its CEO and Board - to focus wholly on their giant operational task, while permitting the separate Oversight Board to monitor overall policy, performance and financial matters.

- Third is the need for political accountability. To entrust the cleanup to an independent board dominated by private sector members would be bad public policy. Retaining a separate Oversight Board maintains the linkage of the cleanup to the Administration.

The necessity of an independent oversight entity has been consistently stated by the General Accounting Office. Before the House Banking Committee on February 20, the Comptroller General said:

> "I think you need an oversight board to monitor how the operation is going...I don't think just having GAO and auditors coming in [is enough], I think you need an oversight board with...staff monitoring that."

Most recently, in letters to Senator Garn and Congressman Wylie on October 8, the GAO reiterated its views on the structure of the cleanup. I have attached a copy of this letter and ask that it be included in the record. It should be useful to the Subcommittee because it makes three important points that are directly relevant to today's discussion: first, it calls for a strong CEO; second, it calls for "strong oversight by an entity independent of the day-to-day operations of the RTC;" third, it asks that any restructuring be done in such a manner as to minimize disruption.

The restructuring contained in the Administration's proposed RTC Refinancing Act of 1991, in combination with the appointment of a new Chief Executive Office for the RTC, fulfills each of these objectives. It creates a strong CEO with statutory powers to manage the RTC; it provides for independent oversight by retaining the Oversight Board and more sharply defining its powers to cover essential oversight actions and to keep it out of operations; and by building on the existing structure and providing protection for RTC employees, it will not result in disruption in an effort that is now in mid-course and making substantial progress.

The proposal is the result of a collaboration between the Oversight Board and Chairman Seidman. Both believe that it makes useful changes in the current structure without impeding the growing momentum of the cleanup effort. Mr. Casey is of course familiar with the current structure and with our proposal and feels confident he can work within either.

Against this background let me now review the main elements of the proposal.

First, it places political accountability for the cleanup squarely in the Oversight Board. Mr. Chairman, at the full Committee's June 11 hearing you expressed frustration with an apparent lack of accountability when you asked the Comptroller General "can you not get someone in here we can blame later?" I would observe that Congress has so far had no trouble blaming the Administration and the Oversight Board. But this proposal makes it clear that political responsibility for the cleanup rests with the Board. That is partly because under the proposal the CEO is hired and fired by the Board.

As Bill Seidman has pointed out, the Oversight Board in this proposal becomes much more like a corporate board with the power to remove the CEO, and the power to review and modify, but not to establish, policies for the RTC. This last point is important. The Oversight Board now has the power to initiate policies for the RTC. Under our proposal, the Board may only review and modify RTC policies. And such Board review is after-the-fact. It does not slow RTC or require advance approval of its policies.

Second, it creates, as I said earlier, a strong CEO giving him full powers in law to operate the RTC. This, Mr. Chairman should respond to your bill, S. 1425, requiring appointment of a strong CEO, and your letter to the Washington Post on August 1 in which you call for RTC leadership by an experienced CEO. As you asked, our proposal gives him the authority to make decisions and make the RTC work.

In addition to the grant of managerial powers, our proposal gives the CEO more authority than currently by making him Chairman of the RTC Board. You may well ask why it is necessary to retain the RTC Board. As Bill Seidman has pointed out, the structure we propose retains the RTC Board as the body responsible for management of operations, much like the operating committees that exist in many corporations. When you consider the magnitude of the decisions the RTC CEO must regularly make, you can understand the desirability for a group of experienced individuals to help with them. This operational role is similar to that which the RTC Board now plays.

Our proposal does not call for Senate confirmation of the CEO. We do not believe this is necessary because he reports to the Oversight Board which consists of five officers confirmed by the Senate. We do not believe it is desirable because it would create delay. We now have a fully qualified CEO in place. Under our proposal he can continue to serve in the new structure without interruption but with enhanced powers. To require confirmation would almost certainly have the effect of inhibiting his decision-making.

Third, the proposal improves coordination and communication between the operating and oversight function by making the CEO a member of the Oversight Board. In addition the FDIC Chairman is made a member of the Board in recognition of the fact that the FDIC will continue to supply personnel and support for the RTC, a temporary agency.

Fourth, our proposal will free the FDIC from the FIRREA-mandated responsibility of exclusive manager of the RTC and permit it to concentrate on the banking industry.

However, the proposal retains a relationship between FDIC and RTC in which all RTC personnel are maintained as FDIC employees. This arrangement avoids the creation of a permanent RTC bureaucracy and looks forward to the termination of the RTC in 1996 by providing for the return of non-temporary RTC employees to the FDIC. Thus the proposal avoids creating a situation in which FDIC employees currently detailed to the RTC will want to leave the RTC now.

Fifth, the proposal avoids disruption. It builds on the current structure. It makes a real improvement in RTC's operations but avoids creating havoc in an enterprise that is well under way.

Finally, the proposal retains the oversight function that the Administration strongly believes must continue to be an essential component of the cleanup structure.

Mr. Chairman, we believe we have fashioned, in cooperation with Bill Seidman, a proposal which responds, in the ways I have outlined above, to the concerns you and other members of Congress have expressed. It is a proposal that at the same time meets the criteria we and the General Accounting Office have established.

As Senator Garn and others have acknowledged, it would be counterproductive to enact a structure neither the Administration nor RTC want or believe is suitable to the task.

There will be other witnesses today who have had considerable experience in government organization. So have I, and with major private sector organizations as well. These witnesses, based on past statements, may make the point that the current structure seems clumsy and that our proposal does not go far enough. I have watched this organization closely since its inception. Certainly there have been problems: not to have expected problems in an undertaking of this magnitude and complexity would have been unrealistic. But organizational structures which perhaps meet academic criteria may not fill the real needs of an organization in the political context in which it operates, an organization that is moreover well down the path toward fulfilling its mission within a relatively short time frame. As the GAO points out in the attached letter, "careful attention must be given to avoiding changes or delays that would be counterproductive to the progress RTC is making in improving both its operations and asset disposition strategies."

In conclusion, Mr. Chairman and subcommittee members, I ask for your support for a restructuring proposal which we believe improves RTC operations and responds to Congressional concerns. On behalf of the Administration I express the earnest hope that the Committee will move quickly to report our refunding request and with it, our reorganization proposal. I look forward to responding to your questions.

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

FOR IMMEDIATE RELEASE

October 23, 1991

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of September 1991.

As indicated in this table, U.S. reserve assets amounted to $74,731 million at the end of September 1991, up from $73,514 million in August 1991.

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/
1991					
August	73,514	11,062	10,479	43,247	8,726
September	74,731	11,062	10,722	43,853	9,094

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-1513

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 23, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Tenders for $13,504 million of 2-year notes, Series AG-1993, to be issued October 31, 1991 and to mature October 31, 1993 were accepted today (CUSIP: 912827C75).

The interest rate on the notes will be 6 %. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	6.00%	100.000
High	6.01%	99.981
Average	6.01%	99.981

Tenders at the high yield were allotted 89%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	44,065	44,065
New York	31,364,525	12,606,750
Philadelphia	26,100	26,100
Cleveland	34,575	34,575
Richmond	60,395	59,515
Atlanta	51,405	40,305
Chicago	952,030	176,630
St. Louis	61,510	50,490
Minneapolis	23,140	23,110
Kansas City	59,175	59,175
Dallas	11,435	11,435
San Francisco	495,730	133,630
Treasury	238,615	238,615
TOTALS	$33,422,700	$13,504,395

The $13,504 million of accepted tenders includes $872 million of noncompetitive tenders and $12,632 million of competitive tenders from the public.

In addition, $678 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,486 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1514

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
October 24, 1991

CONTACT: BOB LEVINE
(202) 566-2041

UNITED STATES AND CHILE TO DISCUSS AN INCOME TAX TREATY

The Treasury Department announced today that representatives of the United States and Chile will meet in Washington, January 13-17, 1992 to discuss a possible bilateral income tax treaty. There is no income tax treaty now in effect between the two countries.

The negotiations will take into account the current income tax laws of the two countries and will be based on the model income tax treaties published by the Organization for Economic Cooperation and Development, the United Nations, and the U.S. Treasury Department, as well as recent U.S. tax treaties with other countries.

Income tax treaties provide rules for the taxation of income derived in one of the countries (the "source" country) by residents of the other. They establish when the source country may tax various classes of income and specify maximum rates of tax at source on certain items, such as dividends, interest and royalties. They also provide for administrative cooperation between the tax authorities of the two countries and guarantee non-discriminatory taxation. Treaty benefits are limited to residents of the two countries.

Persons wishing to offer comments or suggestions on the negotiations are invited to write to Philip D. Morrison, International Tax Counsel, Treasury Department, Washington, DC 20220.

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AUCTION RESULTS
PUBLIC DEBT NEWS
Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 24, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Tenders for $9,029 million of 5-year notes, Series U-1996, to be issued October 31, 1991 and to mature October 31, 1996 were accepted today (CUSIP: 912827C83).

The interest rate on the notes will be 6 7/8%. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	6.91%	99.854
High	6.93%	99.771
Average	6.92%	99.812

$5,000 was accepted at lower yields.
Tenders at the high yield were allotted 13%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	21,334	21,334
New York	22,524,215	8,342,163
Philadelphia	14,834	14,834
Cleveland	20,047	20,047
Richmond	74,764	31,244
Atlanta	35,716	20,684
Chicago	930,035	390,585
St. Louis	32,361	25,751
Minneapolis	11,434	11,434
Kansas City	37,567	28,867
Dallas	7,284	7,282
San Francisco	299,684	71,124
Treasury	43,496	43,496
TOTALS	$24,052,771	$9,028,845

The $9,029 million of accepted tenders includes $432 million of noncompetitive tenders and $8,597 million of competitive tenders from the public.

In addition, $100 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.

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE
October 24, 1991

CONTACT: CHERYL CRISPEN
202-566-2041

STATEMENT BY TREASURY SECRETARY NICHOLAS F. BRADY

Today, an outline was released of a proposed compromise on banking legislation. The U.S. needs a comprehensive overhaul of its banking system that will strengthen our economy and allow us to compete effectively internationally. Today's proposed "compromise" does the opposite. It turns back the clock, restricts competition, and protects special interests. It will weaken the banking system and impede the economic recovery.

If enacted, the so-called "compromise" would restrict the flow of voluntary private capital necessary to create a strong banking system. A strong banking industry is our best protection against using taxpayer funds to bail out the banks.

We will strongly oppose this so-called "compromise" on Title IV of the banking legislation.

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NB-1517

TREASURY NEWS

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

For Release Upon Delivery
Expected at 9:30 AM
October 25, 1991

STATEMENT OF THE HONORABLE
JEROME H. POWELL
ASSISTANT SECRETARY OF THE TREASURY
FOR DOMESTIC FINANCE
BEFORE THE
SUBCOMMITTEE ON
TELECOMMUNICATIONS AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES
OCTOBER 25, 1991

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before this Subcommittee to discuss the regulation of the government securities market in light of concerns that have arisen over recent developments in that market.

In my statement today, I will discuss the issues raised in your letter of invitation concerning regulation of the government securities market. However, before doing so I would again urge the Subcommittee to act without further delay to extend the Treasury's rulemaking authority under the Government Securities Act of 1986 ("GSA"). On September 4, the Treasury Department, the Federal Reserve, and the SEC appeared before this Subcommittee and urged that the Treasury's authority be extended and that consideration of further reforms be deferred until the completion of our interagency review in December. The same institutions also made such a request in testimony before the Securities Subcommittee of the Senate Banking Committee on September 11, and the Senate responded by passing a one-year extension of Treasury's rulemaking authority on September 25.

Unfortunately, this Subcommittee has not acted, and has instead allowed Treasury's rulemaking authority to lapse on October 1. As a result, the principal rulemaker in this marketplace is left without rulemaking authority during this important period. Already, several important regulatory initiatives have been put on hold. In addition, Treasury does not have the authority to issue emergency regulations if market conditions were to make this necessary. This is an unnecessary

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and dangerous state of affairs, and I urge the Subcommittee to correct it by promptly reauthorizing Treasury's rulemaking authority for an interim period while Congress and the regulators consider the need for additional reforms.

At the outset, a clear distinction should be made between primary market and secondary market regulation. The Treasury's rulemaking authority for the auction of Treasury securities stems from the public debt statutes, while Treasury's rulemaking authority for the secondary market is derived from Section 15C of the Securities Exchange Act of 1934. While Salomon Brothers' admissions make clear that wrongdoing in the primary market for Treasury securities can lead to problems in the secondary market, there are, between the two markets, differences in the legal frameworks, in the issues raised by wrongdoing, and in the potential types of solutions for problems.

In my statement, I will first discuss secondary market regulatory issues, which are the main concern of this Subcommittee, and then make some comments concerning the primary market.

Secondary Market Regulation

We believe that the regulatory structure of the GSA is fundamentally sound. The GSA assigns rulemaking authority over all brokers and dealers in government securities to the Treasury Department, with the enforcement responsibilities assigned to the appropriate regulatory agencies -- the Securities and Exchange Commission ("SEC") and the various federal financial institution regulators.

This balanced approach makes sense because of the importance of the government securities market for the borrowing requirements of the U.S. government and for the financial system, and because of the different types of entities that act as government securities brokers and dealers. The judgment Congress made in 1986, which remains valid today, was that the Treasury Department is best suited to formulate rules that ensure both the integrity of the secondary market for government securities and the continuing ability of the government to meet its borrowing requirements in a cost-effective manner for the taxpayer. In addition, Congress made the judgment that rules pertaining to government securities transactions by brokers and dealers should not favor a particular subset of government securities brokers or dealers and that the Treasury Department is the appropriate government agency to ensure the harmonization of regulation among the otherwise differently regulated entities that are government securities brokers and dealers.

The regulatory structure established by the GSA has worked well. The regulatory agencies, the General Accounting Office ("GAO"), market participants, and industry representatives all agree that Treasury has done a good job of rulemaking for the government securities market. During the rulemaking process, Treasury consulted extensively with the other regulatory agencies and self-regulatory organizations, a process that was invaluable in formulating appropriate rules for this market. The actions taken by Treasury, the federal regulatory agencies, and the self-regulatory organizations in implementing the GSA regulations have successfully met the objectives established by Congress in enacting the GSA. The rules have been timely and fairly implemented and have improved and strengthened investor safety in the market. At the same time, the rules have not imposed excessive and overly burdensome requirements, nor have they impaired the liquidity or efficiency of the government securities market. No customers have lost any funds or securities in those instances where government securities brokers or dealers have failed or discontinued business since the inception of the GSA regulations.

The underlying basis for our comments concerning the draft of this Subcommittee's proposed legislative package is our view that the Congress made the correct judgment in 1986 concerning the basic regulatory structure of the secondary market for government securities. However, we have, since the outset of the legislative process to extend Treasury's rulemaking authority under the GSA, taken the position that additional regulatory authority over this market is needed.

Extension of Treasury's rulemaking authority. We believe that Treasury's rulemaking authority under the GSA should be extended. The GAO, the SEC, the Federal Reserve, and numerous other regulatory agencies and industry associations concur in this opinion.

Because the government securities market encompasses the activities of both registered brokers and dealers and financial institutions, a single rulemaker must be empowered to ensure that appropriate government securities regulations are in place for all market participants.

Treasury is in the best position of any federal agency to oversee the government securities market because it has a comprehensive understanding of the market and, as the largest issuer, is concerned with maintaining market integrity and efficiency in order to minimize the cost of government borrowing. In addition, the Treasury as the single rulemaker can assure that appropriate regulations are in place for all market participants.

Moreover, we believe that Treasury's rulemaking authority should be made permanent, as it is in S.1247, which the Senate passed on July 30, 1991. The sunset provision contained in the GSA made sense in 1986, because of its novel and untested structure. However, we believe that the structure has worked well.

Finally, we reiterate that Treasury's rulemaking authority, which lapsed on October 1, should at a minimum be temporarily extended as soon as possible. The Senate has already passed a bill, S.1699, which extends Treasury rulemaking authority until October 1, 1992.

Treasury is unable to act with respect to several regulatory initiatives to strengthen the market because of the lapse of Treasury's rulemaking authority. These regulations involve (1) risk assessment rules pursuant to the Market Reform Act of 1990 to be proposed for affiliates of government securities brokers and dealers registered under Section 15C of the Securities Exchange Act of 1934, (2) modifications to be proposed to Treasury capital rules raising certain minimum requirements and requiring notification for large capital withdrawals, and (3) final buy-in rules for mortgage-backed securities.

Furthermore, extension of Treasury's rulemaking authority is necessary so that Treasury can respond to and correct serious abuses or problems that may arise in the government securities market. The current lapse of Treasury's rulemaking authority would preclude Treasury from taking action in response to a market crisis through the issuance of emergency rules.

Broader recordkeeping and reporting requirements and large trader reporting. The Treasury believes that the GSA provides substantial authority in the area of recordkeeping and reporting. Under the GSA, Treasury could, for example, require large position reporting of government securities brokers and dealers for both their accounts and the customer accounts they maintain. However, we are actively examining this issue and will report to Congress in early December, as part of our study, our conclusion as to whether Treasury needs more authority in this area in order to require reports of non-dealers that maintain government securities accounts at institutions that are not subject to the reporting requirements of the GSA.

We do not believe that requiring reporting of large trades is a cost-effective tool for conducting surveillance of the government securities markets. Information concerning large positions in government securities, rather than large transactions that may offset each other, is more useful for determining the causes of a market squeeze.

We would oppose the language in the draft bill that the Subcommittee has provided us concerning this issue. To a large extent, the authority that would be granted to the SEC in

Section 3 of the draft bill overlaps with Treasury authority under the GSA. This could only cause confusion concerning which agency is responsible for such rules. Also, we believe that, in keeping with the proven structure of the GSA, it should be the Treasury that makes rules for all government securities brokers and dealers, including financial institutions, not the SEC.

Sales practice rules. Of the three agencies that prepared the October 1990 report to Congress on the GSA, only the Treasury supported sales practice rules for all government securities brokers and dealers. This remained true at the hearings held by the Subcommittee on Securities of the Senate Banking Committee last June.

The government securities market is the only regulated securities market in which not all brokers and dealers are subject to sales practice rules. Treasury's concern in this area is not for the large, institutional investors, who should be expected to have the ability to judge the suitability of particular securities, but for the smaller, less sophisticated customers who are attracted to the government securities market because of their desire for safe and secure investments. Adding to this concern is the proliferation in the government securities market of instruments that can pose greater risk of adverse price movements than traditional Treasury and agency securities. These instruments, some of which are very complex, include mortgage-backed securities and real estate mortgage investment conduits ("REMICS") issued or guaranteed by government agencies or Government-sponsored enterprises, zero-coupon instruments such as STRIPS, agency mortgage-backed securities stripped into interest-only ("IOs") and principal-only ("POs") pieces, and over-the-counter options on government securities. Even though many of these securities are backed by a U.S. government guarantee or are highly rated by nationally recognized statistical rating organizations and are attractive due to their apparent higher returns, unsophisticated investors may not fully understand their complexity, risks, and speculative nature. In addition, we need to prevent unscrupulous persons, who may have operated in other markets, from gravitating to the government securities market.

Treasury supports the regulatory structure for sales practice rules set out in S.1247, which reflects a balanced and appropriate role for each of the regulatory agencies. The primary rulemaking powers pertaining to such rules for financial institution brokers and dealers and members of registered securities associations rest with the appropriate federal financial institution regulator and the National Association of Securities Dealers ("NASD"), respectively. This approach utilizes the expertise and experience of the bank regulatory agencies and the NASD in implementing and enforcing sales practice rules that are in place for other markets.

Additionally, the regulatory structure of S.1247 preserves the SEC's oversight role for self-regulatory organizations.

By permitting sales practice rules to become effective only if the Treasury has not determined that the rules would "adversely affect the liquidity and efficiency of the market for Government securities" or "impose any burden on competition not necessary or appropriate," this regulatory framework also ensures that Treasury retains an oversight role, consistent with the regulatory approach set out in the GSA. This structure is appropriate given Treasury's interest in minimizing the cost to the taxpayer of financing the public debt by maintaining the liquidity, efficiency, and integrity of the government securities market. A Treasury oversight role would also help to minimize disparities in sales practice rules for the various types of brokers and dealers.

Treasury would oppose the provisions in the Subcommittee's draft bill governing sales practice rules in order "to promote just and equitable principles of trade" or "to prevent fraudulent manipulative acts and practices." To some extent, the authority granted to the SEC in the draft bill overlaps with the authority the draft bill grants to the bank regulators. Further, it reduces Treasury's role to a consultative one, with no real authority in this area. In other words, the draft bill significantly alters the regulatory structure of the GSA. This change in the division of responsibilities among the agencies is not warranted.

Requirement for internal controls. The Treasury believes that it is appropriate to require that all government securities brokers and dealers be required to have internal controls designed to prevent and detect violations of the Securities Exchange Act and associated regulations. We would point out that the NASD and the New York Stock Exchange already have rules in place addressing internal controls. The language in the Subcommittee's draft bill should be clarified to say that it is the appropriate regulatory agency that has the responsibility for examining for the existence and the adequacy of these controls.

Market information. Treasury supports expanded disclosure of and access to government securities price and volume information. Expanded information access would serve to enhance customer protection, since customers would be in a better position to determine actual or potential prices for securities, especially for inactively traded issues, and to evaluate the fairness of trades proposed by a broker or dealer. Moreover, expanded availability of such information would serve the public interest because it would ensure that a broad spectrum of market participants could obtain current, accurate information concerning market conditions, thus improving the competitiveness, liquidity, and efficiency of the government securities market.

Greater access to price and volume information would also foster increased competition among dealers. Improvements in the derivative markets would also likely result due to the availability of more timely and accurate information on the underlying securities used for pricing and hedging strategies. Further, access to more accurate market information would enhance the ability of regulatory examiners and independent auditors to carry out their respective responsibilities to ensure that securities transactions and positions are valued appropriately.

Treasury originally proposed that it be granted rulemaking authority in this area in order to ensure that private sector initiatives, such as GOVPX, continue to take further steps in disseminating government securities price and volume information.

However, Treasury accepts the judgment of the Senate in passing S.1247 that adequate private sector solutions are likely to be found without the need for additional federal regulation. The commencement of operations by GOVPX in July was an important factor in our decision to support the Senate approach. The private sector initiatives already underway should be allowed additional time to develop before any new rulemaking authority is deemed necessary. Treasury supports S.1247, which calls for a joint Treasury/SEC/Federal Reserve Board evaluation of private sector initiatives regarding the dissemination of price and volume information.

Therefore, Treasury cannot support the provisions in the draft Subcommittee bill on this matter. Granting rulemaking authority in this area to the SEC is again contrary to the carefully balanced and sound regulatory structure of the GSA. Moreover, the federal rulemaking authority is too broad with respect to the provisions that would enable the SEC to require various entities to act jointly in planning, developing, or operating facilities for disseminating government securities price and volume information. No need has been demonstrated for such authority.

Issuance of Government Securities (The Primary Market)

The Treasury is currently evaluating the efficacy of its auction technique and auction rules and procedures. We expressed our concern over auctions that result in a concentration of awards in a letter to Chairman Markey in July of this year. Salomon Brother's admissions of wrongdoing in Treasury auctions are a further cause for concern.

On September 11, Treasury announced the following steps to ensure the continued integrity of the Treasury auction process:

-- The Treasury Department and the Federal Reserve Bank of New York are developing a system to require customers to provide written verification of large, winning bids prior to the settlement date and receipt of the security being purchased.

-- Data on Treasury's quarterly borrowing needs will be released two days prior to each quarterly refunding announcement and prior to the meeting of the Public Securities Association (PSA) Treasury Borrowing Advisory Committee.

-- A market surveillance group has been created, consisting of representatives of the Treasury, SEC, and the Federal Reserve System, to formalize and expand information sharing among government regulators.

-- The Treasury/Federal Reserve working group on auction automation has strengthened and accelerated its efforts to automate the auction process in order to improve efficiency and accuracy and to enhance supervision and ensure compliance with auction rules. This group has been expanded to include the SEC. Completion of the first phase of the automation project is expected in the first half of 1992.

In addition, the Federal Reserve Bank of New York has begun spot checking large customer winning bids to ensure their authenticity. Treasury has also made it a priority to clarify and make readily available in one place all its auction rules.

We are currently studying alternative auction techniques, such as so-called "Dutch" auctions, in order to ascertain whether any benefits would be likely to accrue from alternative selling techniques.

With respect to Treasury auctions, the Treasury has broad authority under current law to make necessary changes to rules and procedures. We do, however, support S.1699, which the Senate passed on September 25, which would make it unlawful to make false or misleading statements in writing in connection with a bid or a purchase of a government security at its original issuance. This provision also helps address the issue of false statements made in connection with the issuance of securities by certain government-sponsored enterprises.

Conclusion

As we have stated in recent appearances before this Subcommittee and other Congressional subcommittees, we are withholding judgment concerning whether changes, in addition to those embodied in S.1247 and S.1699, are necessary and appropriate. We have committed to report to Congress in early December our recommendations concerning additional legislation in light of the ongoing investigations by regulatory and law enforcement authorities into the primary and secondary markets for government securities.

In the meantime, it is important that the current lapse in Treasury rulemaking authority under the GSA not be allowed to continue. We urge this Subcommittee and the House of Representatives to act as soon as possible to pass legislation that would extend temporarily Treasury rulemaking authority, as the Senate has already done.

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

FOR IMMEDIATE RELEASE
October 25, 1991

CONTACT: Anne Kelly Williams
(202) 566-2041

TREASURY MODIFIES AUCTION RULES

The Treasury today announced changes in its auction rules designed to broaden participation in Treasury auctions.

Bidding for customers

All government securities brokers and dealers that have registered with the Securities and Exchange Commission will be eligible to submit bids for customers in Treasury auctions. Prior to this change, only primary dealers and depository institutions were permitted to do so.

This change is intended to increase the number of participants in Treasury auctions. The change will be effective beginning with the upcoming 3-year Treasury note auction, which is scheduled for Tuesday, November 5, 1991.

Payment mechanism

The Treasury is establishing a payment mechanism by which any bidder will be able to bid without making a deposit at a Federal Reserve Bank or without having an explicit payment guarantee. Prior to this change, only primary dealers and depository institutions could bid without a deposit or guarantee.

Treasury, in conjunction with the Federal Reserve, is developing a standard "autocharge" agreement which will permit auction participants without a funds account at a Federal Reserve Bank to pay for securities purchased at auction in a consistent and equitable manner. An autocharge agreement is a written arrangement between a bidder and a depository institution. This agreement, which is approved by a Federal Reserve Bank, authorizes the Federal Reserve Bank to charge the depository institution's funds account on the issue date for securities purchased by the bidder. Autocharge agreements will be available at Federal Reserve Banks.

The autocharge process will be available, at the option of the bidder, in addition to other existing payment methods.

NB-1519

Maximum awards on noncompetitive tenders

The Treasury will increase to $5 million from $1 million the maximum award to any single noncompetitive bidder in auctions of Treasury notes and bonds. Noncompetitive awards will continue to be at the yield (price) that reflects the average of accepted competitive tenders. The last change in the noncompetitive bidding limit for notes and bonds was in November 1976, when the maximum was increased to $1 million per bidder from $500,000.

This change is designed to encourage bidding by the smaller investors in the government securities market. The change will be effective beginning with the upcoming 3-year Treasury note auction, which is scheduled for Tuesday, November 5, 1991.

The noncompetitive award limit for Treasury bills remains at $1 million for each bidder.

Information dissemination

The Treasury also announced that the Department has suggested to the Board of Director of GOVPX, a government securities market quotation and trading volume information service, to expand the coverage of its product, to help increase the liquidity and depth of the market by attracting additional participants.

Reports of the PSA Advisory Committee

The Treasury also announced that the Department will make the reports of the Public Securities Association Treasury Borrowing Advisory Committee available to the public four weeks after each meeting of the Committee, instead of waiting until the end of the year to do so. The Committee will continue to advise the Treasury before each midquarter Treasury refunding operation.

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STATEMENT OF DAVID C. MULFORD

UNDER SECRETARY FOR INTERNATIONAL AFFAIRS

UNITED STATES TREASURY DEPARTMENT

U.S.-Japan Working Group on Financial Markets

October 17, 1991

Vice Minister Chino and I have just concluded frank and constructive talks on financial market issues in both our countries. We do so at a time of great change and tension in the financial world.

The Yen-Dollar talks have now been going on since 1983, and I wish to recognize that over that period some important progress has been made in liberalizing the Japanese market, internationalizing the yen, and improving access for foreign firms in Japan.

I have met with members of the press here many times, and you will recall that sometimes we made progress step by step, sometimes stride by stride, but more recently, as I said earlier today, I feel the progress has been inch by inch.

But now, Japan has come to something of a crossroads. Either it will recognize the need for taking decisive action to address the many adjustment issues and tensions in Japan's present financial system, or it will continue to conduct business as usual.

Decisive action is required, particularly in the aftermath of the recent financial irregularities, because these are symptomatic of the lack of transparency, anti-competitiveness, and market segmentation that characterize the Japanese market and put foreign firms at an unfair disadvantage.

I came here today to hear if the Ministry of Finance has a plan for reforming the system. And although I can see some beginnings of efforts by MOF to revise and restructure the system, it does appear that the same step-by-step, untransparent, and anti-competitive approach will be followed.

We believe that tinkering at the edges of financial reform in fact perpetuates a system that takes money from the pockets of Japanese savers and investors.

Among the issues we addressed today, which included the corporate securities market, new products, pension funds, investment trusts, foreign exchange controls, interest rate deregulation and money markets, I would stress that we were particularly concerned about pension funds and investment trusts business, where exclusionary practices limit equality of competitive opportunity.

For example, in the pension fund market of some 78 trillion yen, foreign firms account for only one quarter of one percent of the activity. And these are firms of outstanding world reputation.

The Ministry of Finance must take the lead in creating a credible, transparent and competitive financial system worthy of the world's respect and confidence. It is in Japan's best interest to do so -- not to please the United States, but to bring Japan fully into the world financial community and to allow Japan to resolve the many tensions now visible in the market.

###

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 28, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,429 million of 13-week bills to be issued October 31, 1991 and to mature January 30, 1992 were accepted today (CUSIP: 912794XX7).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.96%	5.11%	98.746
High	4.99%	5.14%	98.739
Average	4.99%	5.14%	98.739

$80,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 56%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	29,650	29,650
New York	28,583,025	8,852,860
Philadelphia	19,060	19,060
Cleveland	54,335	54,335
Richmond	58,965	54,565
Atlanta	27,790	25,910
Chicago	1,090,460	270,140
St. Louis	62,095	22,095
Minneapolis	12,715	12,715
Kansas City	42,030	42,030
Dallas	24,345	24,345
San Francisco	1,335,195	522,195
Treasury	498,945	498,945
TOTALS	$31,838,610	$10,428,845
Type		
Competitive	$28,041,580	$6,631,815
Noncompetitive	1,232,525	1,232,525
Subtotal, Public	$29,274,105	$7,864,340
Federal Reserve	2,247,600	2,247,600
Foreign Official Institutions	316,905	316,905
TOTALS	$31,838,610	$10,428,845

An additional $41,295 thousand of bills will be issued to foreign official institutions for new cash.

NB-1520

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
October 28, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,414 million of 26-week bills to be issued October 31, 1991 and to mature April 30, 1992 were accepted today (CUSIP: 912794YL2).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.02%	5.24%	97.462
High	5.04%	5.26%	97.452
Average	5.04%	5.26%	97.452

Tenders at the high discount rate were allotted 97%. The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	33,215	33,215
New York	30,915,915	9,599,025
Philadelphia	19,685	19,685
Cleveland	34,160	34,160
Richmond	45,960	35,960
Atlanta	25,280	25,280
Chicago	1,081,085	249,635
St. Louis	44,915	24,915
Minneapolis	9,230	9,230
Kansas City	33,425	33,425
Dallas	15,000	15,000
San Francisco	524,550	73,800
Treasury	261,055	261,055
TOTALS	$33,043,475	$10,414,385
Type		
Competitive	$29,042,170	$6,413,080
Noncompetitive	786,410	786,410
Subtotal, Public	$29,828,580	$7,199,490
Federal Reserve	2,400,000	2,400,000
Foreign Official Institutions	814,895	814,895
TOTALS	$33,043,475	$10,414,385

An additional $120,305 thousand of bills will be issued to foreign official institutions for new cash.

NB-1521

TREASURY NEWS

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

FOR RELEASE AT 3:00 p.m.
OCTOBER 28, 1991

CONTACT: Cheryl Crispen
(202)566-2041

TREASURY ANNOUNCES MARKET BORROWING NEEDS

The Treasury Department today announced that its estimated net market borrowing needs for the October-December 1991 quarter are expected to be $75.8 billion, with a $30 billion cash balance on December 31. The Treasury also announced that its estimated net market borrowing needs for the January-March 1992 quarter are expected to be in a range of $95 to $100 billion, with a $20 billion cash balance at the end of March 1992. The borrowing estimates include allowances for Resolution Trust Corporation activities.

In the quarterly refunding announcement on July 31, 1991, Treasury estimated net market borrowing during the October-December quarter to be in a range of $85 to $90 billion, with a $30 billion end-of-quarter balance. The reduction in market borrowing reflects the larger-than-anticipated cash balance at the end of September.

Actual market borrowing in the quarter ending September 30, 1991 was $103.5 billion, while the end-of-quarter cash balance was $41.5 billion. On July 31, Treasury had estimated market borrowing for the July-September quarter to be $107.5 billion, with a $30 billion cash balance on September 30. Larger receipts and reduced spending for financial institution resolution and for Agriculture and Health and Human Services programs, compared with the July 31 estimates, account for most of the improvement in the Treasury cash position during this period.

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NB-1522

REPORT ON
UNITED STATES PORTFOLIO INVESTMENT ABROAD
AS OF DECEMBER 31, 1990

as required by the
International Investment and Trade in Services Survey Act
Public Law 94-472 as Amended

United States Treasury Department

Office of Economic Policy

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Executive Summary

U.S. portfolio investments abroad decelerated sharply in 1990 to a 2.7% increase from an average increase of 9.8% during the 1980s. Developments in the major categories were as follows:

-- Banks' own claims, the largest category of portfolio investments, fell by 3.5% in 1990. This was a sharp break from the experience of the 1980s, when such claims increased by an annual average of 16.0%. The decline reflected:

  - Sharp decreases in claims on foreign official debtors, especially in Latin America, largely as a result of official U.S. debt-reduction initiatives.

  - Reduced inter-bank lending activity, partly growing out of the recession, the Persian Gulf crisis, and pressures to raise bank capital-asset ratios.

-- In contrast, two categories of trade-related and other business financing showed strong growth in 1990, perhaps largely reflecting the strong growth of U.S. exports of recent years:

  - U.S. banks' claims on nonbank businesses and individuals abroad showed an increase of 10.4% in 1991, after several years of decline or slow growth.

  - The total foreign claims of U.S. nonbank businesses and of bank-reported custody claims (mainly corporate) increased by 16.9% in 1990, as compared to an average of 6.1% for the 1980s.

-- The value of U.S. holdings of foreign long-term securities also increased sharply (16.9%) in 1990, well above the 12.8% average of the 1980s.

  - The value of U.S. holdings of foreign bonds rose by 31.1%, boosted both by large net purchases and a 6.9% increase in the dollar prices of the bonds.

  - The value of foreign stocks increased by only 1.7%, well below the 20.0% average of the 1980s, as moderate net purchases were offset by a 7.1% decline in foreign stock prices.

Introduction

The International Investment and Trade in Services Survey Act requires the President to compile currently available data on U.S. portfolio investment abroad and to submit a report and analysis of such data to Congress each year.[1] This requirement has been delegated to the Department of the Treasury by Executive Order 11961. This report is in response to this requirement. Much of the information required by the law is regularly compiled in a number of periodic reports published by various government agencies and other official bodies.[2] However, this report provides greater detail on the specific data required in the law (22 U.S.C. 3103(c)(2)) than is available in the statistical reports. It also highlights some of the more significant developments and trends in capital flows since the previous report. This report is confined mainly to discussion of U.S. portfolio investment abroad and does not seek to evaluate foreign investment in the U.S.

The data base created by the Treasury International Capital (TIC) Reporting System is the primary source of information for this survey. The TIC Reporting System follows balance of payments accounting definitions regarding domicile of holdings, so that U.S. holdings include holdings of U.S. residents (including some residents who are not U.S. citizens), as well as holdings reported by U.S. nominees, some of which may be beneficially owned by non-U.S. residents. While the reporting system does collect data by geographic region and country and by broad classes of asset forms, it does not yield detail on the diversification of holdings by economic sector.

For purposes of preparing international accounts, portfolio investments are distinguished from direct investments. The latter are those in which the investor has a controlling interest, which is defined in the Act as 10 percent or more of the voting equity

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[1] The International Investment Survey Act of 1976, Public Law 94-472 of October 11, 1976 (90 Stat. 2059)(22 U.S.C. 3101 et seq.) was amended by Public Law 97-33 of August 7, 1981 (95 Stat. 170) to require an annual compilation and analysis of currently available data on U.S. portfolio investment abroad. The amendment maintained the parameters noted below of the study outlined in the 1976 Act. Title III of the Trade and Tariff Act of October 30, 1984, Public Law 98-573 (98 Stat. 3009) changed the title of the law to the International Investment and Trade in Services Survey Act.

[2] The periodic sources include the following: (1) the Treasury Bulletin, published monthly before December 1982 and quarterly thereafter by the Treasury Department: the Capital Movements section contains most of the directly reported data available to the U.S. Government concerning the major classes of U.S. portfolio investment abroad (bank claims, nonbank business enterprise claims, and current purchases of long-term foreign securities reported by banks and brokers in the United States); (2) the Survey of Current Business, published by the Commerce Department: the annual article on the U.S. international investment position (published in either June or August) is the primary source for estimates over time of the outstanding foreign portfolio holdings of U.S. residents; (3) the Federal Reserve Board's Federal Reserve Bulletin, published monthly, includes most data reported under the Treasury International Capital Reporting System.

in an incorporated business enterprise or the equivalent in an unincorporated enterprise. All other investments are considered portfolio investments. They include financial instruments such as bank deposits, commercial paper, bonds, and corporate stocks, as well as trade-related debts and instruments such as bankers' acceptances (insofar as the investor's holdings comprise less than 10% of the voting equity). While data on direct investment are maintained and published by the Commerce Department, portfolio investment data are maintained by the Treasury Department in its TIC data bank.

The TIC data are based on a series of reports which are filed periodically by bank and nonbank enterprises located in the United States. Data on long-term securities (henceforth, "securities"), defined as equities and debt instruments with original contractual maturities of greater than one year, are collected on a transactions basis (i.e., purchases and sales rather than outstanding amounts). These data are used directly for reporting balance of payments flows. In order to obtain figures for the current value of outstanding securities in international portfolios, it is necessary to add the annual transactions figures for years starting from the previous compilation and then to make adjustment for estimated price changes. Rough adjustments of this sort based on overall indexes of securities prices are made by the Commerce Department and published annually in the Survey of Current Business, usually in the June or August issue.

For portfolio claims and liabilities other than securities, data are collected on the basis of the value of the amounts outstanding. Annual transactions are calculated for balance of payments flows by subtracting closing period values from those of the previous closing period. No adjustments are made for possible changes in market prices. (As these are mainly short-term items, market price changes generally would be less than for securities.) Current TIC data are published in the quarterly Treasury Bulletin. Except where otherwise noted, all data in this report come from the TIC database.

The organization of this report basically follows the categories of the TIC database. The largest category is bank-reported claims, which consists of banks' own claims and custody claims. Banks' own claims, conceptually distinct from the custody claims, are discussed from the standpoint of the geographic breakdown of the claims, their size relative to domestic claims, and the claims of the banking sub-group, the International Banking Facilities or IBFs. Bank-reported custody claims and the foreign claims of nonbank business are closely related to trade financing and other direct business finance and are discussed together as a separate category. U.S. holdings of foreign stocks and bonds comprise a third major category of the TIC database and the recent behavior of this aggregate makes up the final section of the report.

Overview of U.S. Portfolio Investment Holdings

The major components of U.S. portfolio investments abroad are provided in Chart 1 and Table 1. The total value of portfolio investments grew rapidly in the course of the 1980s, with an average annual increase of 9.8%. In 1990, however, the growth fell sharply, to 2.7% from 10.4% in 1989. The major factor in this deceleration was an absolute decline in banks' own claims abroad, which are the largest component in the total (accounting for almost half). This decline reflected sharp reductions in claims on foreign governments and a moderate decline in claims on foreign banks. The reduction in claims on foreign governments was strongly influenced by official U.S. debt-reduction initiatives. The weakening of claims on foreign banks was part of a general slackening in the growth of international banking business.

Excluding banks' own claims, the total value of portfolio assets increased by 9.6%, which was actually above the annual average of the 1980s (5.6%). Government claims abroad showed only minimal growth (1.2%), as a rise in U.S. official reserves (mainly the result of increased dollar values of German mark and Japanese yen holdings) was offset by a decline in other government holdings. Nonbank business claims and the conceptually-related category of bank custody claims showed strong gains, with a 16.9% increase for the

Chart 1. U.S. Claims on Foreigners

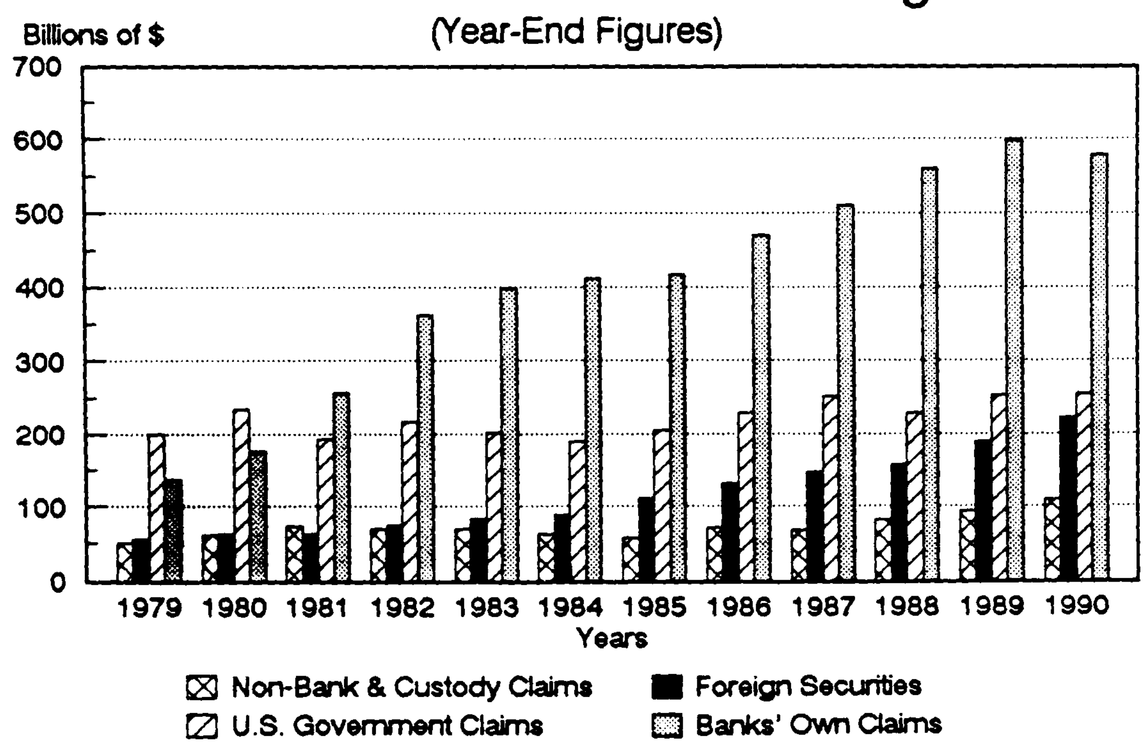

Table 1
U.S. Portfolio Investment Positions Abroad
Year-End Figures
(in billions of dollars)

	1979	1985	1986	1987	1988	1989	1990
U.S. Assets Abroad, Total	445.8	794.1	904.8	978.1	1028.7	1135.7	1166.1
U.S. Government Assets Abroad	200.7	205.7	229.5	251.0	229.8	252.9	255.9
U.S. Official Reserve Assets	143.3	117.9	139.9	162.4	144.2	168.7	174.7
Other U.S. Government Assets	57.4	87.8	89.6	88.6	85.6	84.2	81.2
Private Assets Abroad	245.1	588.4	675.3	727.1	798.9	882.8	910.2
Bank Reported Claims	157.0	447.4	507.3	549.5	608.0	661.7	654.3
Banks' Own Claims	136.4	417.9	470.9	511.1	560.1	599.6	578.4
Custody Claims	20.7	29.5	36.4	38.3	47.9	62.1	75.9
Nonbank Business Claims	31.3	28.9	36.3	31.0	34.0	31.4	33.5
Foreign Securities	56.8	112.2	131.7	146.7	156.8	189.6	222.4
Bonds	42.0	72.9	81.7	92.0	94.0	98.5	129.1
Corporate Stocks	14.8	39.3	50.0	54.7	62.7	91.7	93.3

Source: Department of Commerce, "U.S. Net International Investment Position, 1990," Release No. BEA 91-30, July 2, 1991, and TIC data.

sum of the two, as compared to only 6.1% for the annual average during the 1980s, which may reflect continuing growth in U.S. exports, especially to Latin America. Also showing a strong gain was U.S. holdings of foreign securities, with a 17.3% 1990 increase as compared to the 8.9% average during the 1980s. This increase, however, mainly reflected a very large (31.1%) increase in U.S. holdings of foreign bonds. The value of foreign stocks increased only slightly (1.7%), well down from the 20.0% average increase during the 1980s, as net U.S. purchases of foreign stocks in 1990 ($8.7 billion) were offset by a 7.1% decline in the imputed price index of those stocks.

Banks' Own Claims on Foreigners

The claims on foreigners by brokers, dealers, and banks and other depository institutions (hereafter, "banks") located in the U.S. declined in 1990 by 3.5% (Table 2).[3] This aggregate grew very rapidly in the early part of the 1980s. While it slowed somewhat in more recent years, the average for the 1980s was still a very strong average annual rate of 16.0%. The 1990 decline was the first since the series began to be reported in its current form in 1978. Very probably the major factors for the decline were a) increased regulatory pressures for banks to raise capital-to-asset ratios in connection with the implementation of BIS-agreed standards, b) loan write-offs and reduced lending to official borrowers, partly resulting from official debt-reduction initiatives, and c) increased concern with borrower creditworthiness due to the Gulf crisis, recession, and loan losses. The reduced pace of banking activity was also reflected in the foreign liabilities of U.S. banks, which were virtually unchanged in 1990 after growing at an average annual rate of 16.8% during the 1980s. The retrenchment in 1990 was part of a general pattern of slackening in international lending by banks in the BIS-reporting area, particularly inter-bank lending.[4]

As noted in previous reports, inter-bank lending, especially to affiliated banks abroad, was a principal growth component during the 1980s, while claims on nonbank sectors were stagnant or declining (see Chart 2). During the 1980s U.S. banks generally shifted their international lending away from nonbank borrowers in favor of lending to their own branches and to unaffiliated banks abroad. But in 1990, inter-bank claims as well as claims on nonbanks declined, though the latter fell much more than the former (13.6% vs. 1.9%). Foreign currency claims, which recorded very strong growth in the 1980s, reaching $65.1

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[3] Besides their own claims, banks report claims held in custody for their customers. As such claims are conceptually quite different and likely to be driven by different factors, they are discussed separately below along with claims reported by nonbanking enterprises.

[4] Besides uncertainties introduced by the rapid August rise in crude oil prices, the Gulf Crisis also caused a freeze-up of banking flows to the Middle East. See the Bank of England, Quarterly Bulletin, Vol. 30, No. 2 (May 1991), pp.235-236, and the Bank for International Settlements, Annual Report: 1990/91 (Basle: Bank for International Settlements, 1991), pp.119-126, for further discussion of international bank activity in the BIS-reporting area in 1990.

Table 2
U.S. Banks' Claims on Foreigners
Year-End Figures
(in billions of dollars)

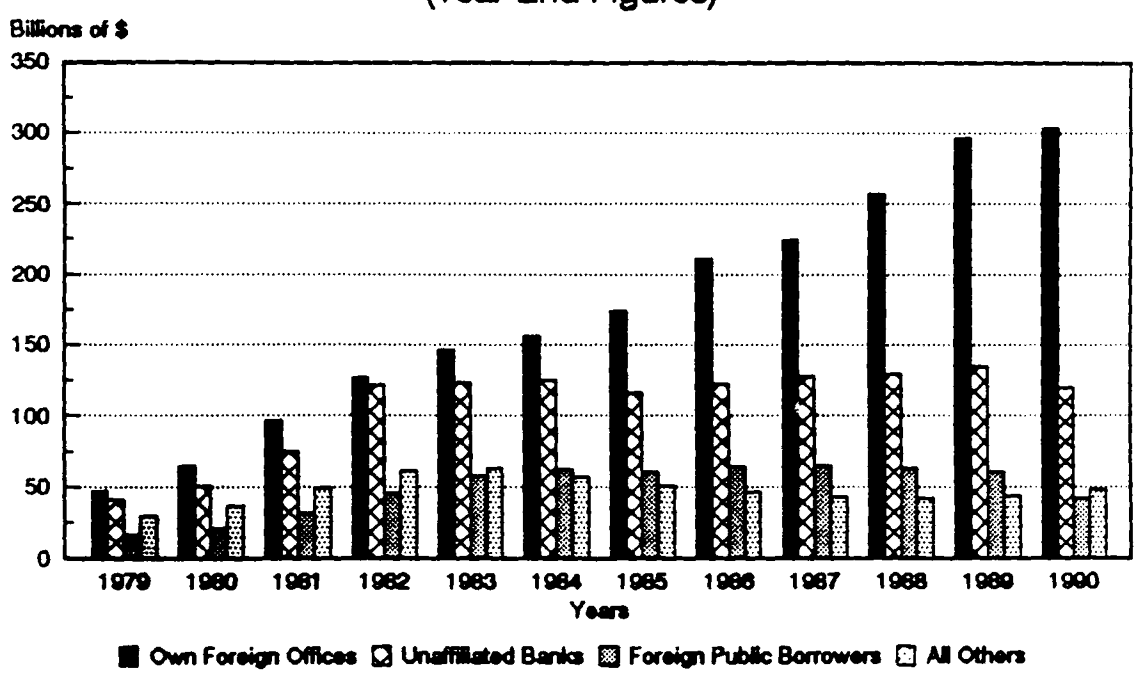
	1979	1985	1986	1987	1988	1989	1990
Total Banks' Own Claims	136.4	417.9	470.9	511.1	560.1	599.6	578.4
Dollar Denominated	133.9	401.6	444.7	459.9	491.2	534.5	512.3
of which: On Foreign Public Borrowers	15.9	60.5	64.1	64.6	62.7	60.5	41.9
On Unaffiliated Foreign Banks	40.9	116.7	122.9	127.6	129.4	134.9	119.7
On Own Foreign Offices	47.4	174.3	211.5	224.7	257.4	296.0	303.1
On All Other Foreigners	29.6	50.2	46.2	42.9	41.6	43.1	47.6
Foreign Currency Denominated	2.4	16.3	26.2	51.3	69.0	65.1	66.1
Memorandum: Claims By Banks' Domestic Customers[1]	20.7	29.5	36.4	38.3	47.9	62.1	75.9
Memorandum: Bank Claims on Other Banks Net of Liabilities to Other Banks[2]	5.1	38.2	24.2	-19.3	-22.6	-23.4	-35.2
Memorandum: Current Account Balance[3]	-1.0	-122.3	-145.4	-162.3	-128.9	-110.0	-99.3

[1] Custody account items reported by banks, borkers, and dealers in the U.S.
[2] Dollar claims and liabilities only netted against foreign affiliates as well as unaffiliated foreign banks.
[3] Flow balances for entire years. Source: Department of Commerce, Survey of Current Business.

billion in 1989 vs. only $2.4 billion at the end of 1979, also moderated, recording only a 1.5% increase in 1990. These claims are not broken out by borrower, but probably are overwhelmingly inter-bank.

Within the category of inter-bank lending, dollar claims on affiliated banks abroad continued to increase, though much less than in previous years (2.4% in 1990, vs. an average of 11.1% for the decade of the 1980s). But claims on unaffiliated banks abroad fell by $15.2 billion, or 12.3%, as compared to an average growth of 1.3% per annum during the 1980s. The BIS accords were probably an important factor in curtailing lending to unaffiliated banks relative to affiliated banks. The capital-asset ratios embodied in those accords, due to be fully implemented in March 1993 (but with interim targets for year-end 1990), are based on the consolidated accounts of each bank and hence are not applicable to lending to affiliated banks. The requirements do, however, apply to lending to other banks. While the capital-asset ratios required on inter-bank lending are generally lower than on some other types of lending, the profit margins are also very low. In addition to the pressures to boost capitalization, inter-bank lending activity was affected by substantially increased concerns on counter-party risks, especially toward the end of the year. These concerns reflected, besides the uncertainties regarding the Persian Gulf crisis and the decline in stock markets, the continuing loan quality problems of many banks.[5]

Chart 2. Components of Banks' Own Dollar Claims
(Year-End Figures)



[5] For further discussion, see the Bank for International Settlements, Annual Report: 1990/91 (Basle: Bank for International Settlements, 1991), pp.122-123.

It is important to note in connection with inter-bank lending that it can involve a multiple of the amount of lending to final borrowers. An increase in the amount of international inter-bank claims by U.S. banks is likely to reflect in part a general increase in the mobility of capital among banks, which probably will result in an increase in liabilities as well. For that reason changes in claims on other banks or bank offices should not automatically be taken as a measure of the amount of indirect lending to nonbank borrowers. A better measure of the extent to which the U.S. (or any other country) is providing funds to support "final borrowing" is its net lending or borrowing in inter-bank markets. A net borrower position for U.S. banks in international inter-bank markets would indicate net lending vis-a-vis nonbank markets (of which some portion may be cross-border).

As noted in the reports of prior years, the U.S. has in fact increasingly moved to a net borrowing position on its inter-bank dollar claims/liabilities (see memorandum item in Table 2). The extent of this negative swing amounted to almost $115 billion from end-1982 through end-1990. From a balance of payments standpoint this swing represents a large net capital inflow. It emerged simultaneously with the larger U.S. current account deficit and accounted for about 12.5% of the financing of the deficit during that period. In 1988 and 1989 the decline in the net inter-bank position was relatively minor, but more substantial ($11.9 billion) in 1990.[6]

U.S. bank claims on nonbank borrowers are broken down between public and "other" (mainly corporate) borrowers. Trends for these two components diverged substantially in 1990. Claims on foreign public borrowers, which peaked in 1987 and then fell modestly in 1988 and 1989, were down a sharp 30.3% in 1990. This brought the level back down below that of 1982 at the outset of the LDC debt crisis. Claims on other nonbank borrowers, on the other hand, showed the strongest growth since the early 1980s.

The reduction in claims on public borrowers was concentrated in Latin America ($18.8 billion; see Table 3), while claims on foreign public borrowers in all other areas actually increased slightly. The sharp 1990 decline in claims on public borrowers mainly reflects write-downs and debt conversions into securities. (As securities are not covered in the TIC bank claims data, such conversions result in a reduction in reported claims.) A large portion of the 1990 write-down is attributable to the Brady Initiative accords with Mexico, where claims fell by $7.5 billion. Claims on Brazil also declined sharply ($3.7 billion). Besides the write-downs, there may also have been some re-booking of such loans to the

[6] The data cited are for banks' dollar claims and liabilities only. Data are not available on inter-bank foreign currency positions. However, the net foreign currency position vis-a-vis both banks and nonbanks abroad showed a negative swing of about $5 billion, which mainly occurred from 1985 through 1988. Because most foreign currency claims and liabilities are held by IBFs (discussed further below), it is likely that this was mainly a swing on inter-bank positions.

Table 3
Geographic Distribution U.S. Banks' Own Dollar Claims
on Foreigners by Type of Debtor
Year-End Figures
(in billions of dollars)

	1979	1985	1986	1987	1988	1989	1990
WESTERN EUROPE, Total	28.4	106.4	107.8	102.3	116.9	119.0	113.7
UK	13.8	62.6	58.3	50.8	65.7	65.5	65.3
Other	14.6	43.8	49.5	51.5	51.2	53.5	48.4
by borrower:							
Foreign Public Borrowers	2.2	5.4	4.3	4.0	4.0	3.5	2.5
Unaffiliated Foreign Banks	13.6	52.0	56.7	56.8	50.4	48.7	42.5
Own Foreign Offices	9.0	42.3	39.0	36.3	56.3	61.0	60.2
All Other Foreigners	3.6	6.8	7.8	5.3	6.2	5.8	8.6
LATIN AMERICA, Total	68.0	202.7	208.8	214.8	214.3	230.4	230.0
Banking Centers[1]	35.0	105.1	112.1	120.4	126.7	150.3	173.0
Other	33.0	97.6	96.7	94.4	87.6	80.1	57.0
by borrower:							
Foreign Public Borrowers	11.3	48.3	52.2	52.2	51.4	47.4	28.6
Unaffiliated Foreign Banks	13.3	37.3	35.1	34.7	34.4	32.1	22.8
Own Foreign Offices	30.1	89.3	95.6	103.8	108.2	131.2	154.4
All Other Foreigners	13.3	27.8	25.9	24.1	20.2	19.7	24.2
ASIA, Total	30.7	66.2	96.1	106.1	130.9	157.5	140.2
Japan	16.9	31.2	59.7	68.7	90.1	111.3	92.0
Other	13.8	35.0	36.5	37.4	40.7	46.1	46.1
by borrower:							
Foreign Public Borrowers	1.3	4.2	3.5	3.6	3.2	4.0	4.5
Unaffiliated Foreign Banks	12.2	18.9	23.6	29.0	36.7	47.6	48.5
Own Foreign Offices	7.0	33.7	62.4	66.2	81.1	95.5	80.2
All Other Foreigners	10.2	9.4	6.7	7.3	9.9	10.4	7.0
CANADA, Total	4.1	16.5	21.0	25.4	18.9	15.5	16.1
by borrower:							
Foreign Public Borrowers	0.7	0.4	0.2	0.4	0.3	0.4	0.2
Unaffiliated Foreign Banks	1.1	5.0	4.3	3.9	4.7	3.2	3.0
Own Foreign Offices	1.0	8.2	13.1	17.0	10.7	7.2	7.4
All Other Foreigners	1.3	2.9	3.4	4.1	3.2	4.7	5.6
TOTAL, Above Areas	131.3	391.8	433.8	448.6	481.0	522.4	500.1
TOTAL, All Areas	133.9	401.6	444.7	459.9	491.2	534.5	512.3

[1] Includes Bahamas, British West Indies, Netherlands Antilles, and Panama.

offshore branches. Federal Reserve Board data covering the consolidated positions of U.S.-chartered banks (i.e., including foreign branches and subsidiaries, but excluding units of foreign banks located in the U.S. and covered in TIC data) also show a decline in claims on foreign public borrowers (Table 4), but substantially less than the TIC data.

The TIC data broken down by primary ownership indicate that the reductions in claims on public borrowers were much more concentrated in U.S.-owned banks. Banks with primary U.S. ownership showed a reduction of claims of $14.0 billion as compared to $4.6 billion for banks with primary foreign ownership. While this may partly reflect re-booking patterns, the traditionally strong orientation of U.S.-owned banks toward Latin America and the fact that much of the expansion of foreign-owned banks in the U.S. occurred after the emergence of the LDC debt crisis are probably the major factors explaining this divergence.

In contrast to the sharp decline in banks' claims on foreign public borrowers, claims on "other" nonbank borrowers, primarily corporate business, showed a considerable increase in 1990. Such claims rose sharply in the first half of the 1980s, hitting a peak in 1983, then declined steadily through 1988. A 3.5% rise in 1989 was followed by a more substantial 10.4% increase in 1990, though this still left the level over 25% below the 1983 peak. The 1990 increase was particularly strong vis-a-vis Latin America (Table 3). The improved business climate in Mexico and elsewhere in Latin America very probably was important in this expansion. Such claims on Europe also increased, but the levels in this case were relatively minor.

Another notable feature of the geographical distribution of banks' claims was the increased concentration in banking centers. As discussed in previous reports, the strong trend during the second half of the 1980s away from direct lending to nonbank borrowers in favor of inter-bank lending naturally led to a disproportional increase in claims on banking centers. This tendency was most marked in the case of Latin America, where the percentage of total dollar claims accounted for by claims on the four offshore banking centers (Bahamas, British West Indies, Netherlands Antilles, and Panama) rose from 51.5% at end-1979 to 65.2% at end-1989. The year 1990 saw another increase in this concentration, to 75.2% of all dollar claims on Latin America. This was partly the result of the sharp decline in claims on public borrowers (which are almost totally outside the banking centers), but also the result of a substantial further rise in claims on banks' own foreign offices, which are themselves heavily concentrated in the banking centers.

A similar but less extreme shift occurred in the case of claims on Europe, where the predominance of London as a banking center meant an increasing share of banks' claims on the UK. Such claims represented 48.6% of total claims on Europe at the end of 1979 and rose steadily to a share of 55.1% at the end of 1989. In 1990 total claims on Europe fell considerably (4.4%) in absolute terms, but those against the UK were almost constant, resulting in another increase in the UK share, to 57.4%.

Table 4
Bank Claims by Charter and by Primary Ownership
Year-End Figures
(in billions of dollars)

	1979	1985	1986	1987	1988	1989	1990
A. U.S.-Chartered Banks, Consolidated[1]							
Total	246.2	294.5	275.6	267.3	235.3	216.3	189.3
Banks	136.1	137.6	130.2	129.5	112.7	100.7	81.7
Public Borrowers	42.6	76.6	78.6	76.4	69.3	60.2	53.3
Other	67.5	80.3	66.9	61.5	53.3	55.4	54.2
Memorandum: Local Currency Claims of Foreign Branches	67.0	106.6	117.0	136.4	128.9	137.7	140.2
B. Banks Located in U.S.[2]	133.9	401.6	444.7	459.9	491.2	534.5	512.3
Primary U.S. Ownership							
Total	70.2	214.7	215.2	209.6	228.8	245.6	227.1
Affiliated Banks	24.3	95.2	96.7	101.8	121.9	140.4	140.7
Unaffiliated Banks	23.4	57.0	55.2	47.5	46.6	44.8	36.4
Public Borrowers	4.8	31.5	34.8	36.0	35.8	34.8	20.8
Other	17.8	31.0	28.4	24.2	24.5	25.5	29.2
Primary Foreign Ownership[3]							
Total	63.7	186.9	229.6	250.3	262.4	288.9	285.2
Affiliated Banks	23.1	79.0	114.8	123.0	135.6	155.6	162.4
Unaffiliated Banks	17.5	59.6	67.7	80.1	82.8	90.1	83.3
Public Borrowers	11.2	29.1	29.3	28.6	26.8	25.7	21.1
Other	11.9	19.2	17.7	18.7	17.1	17.6	18.4

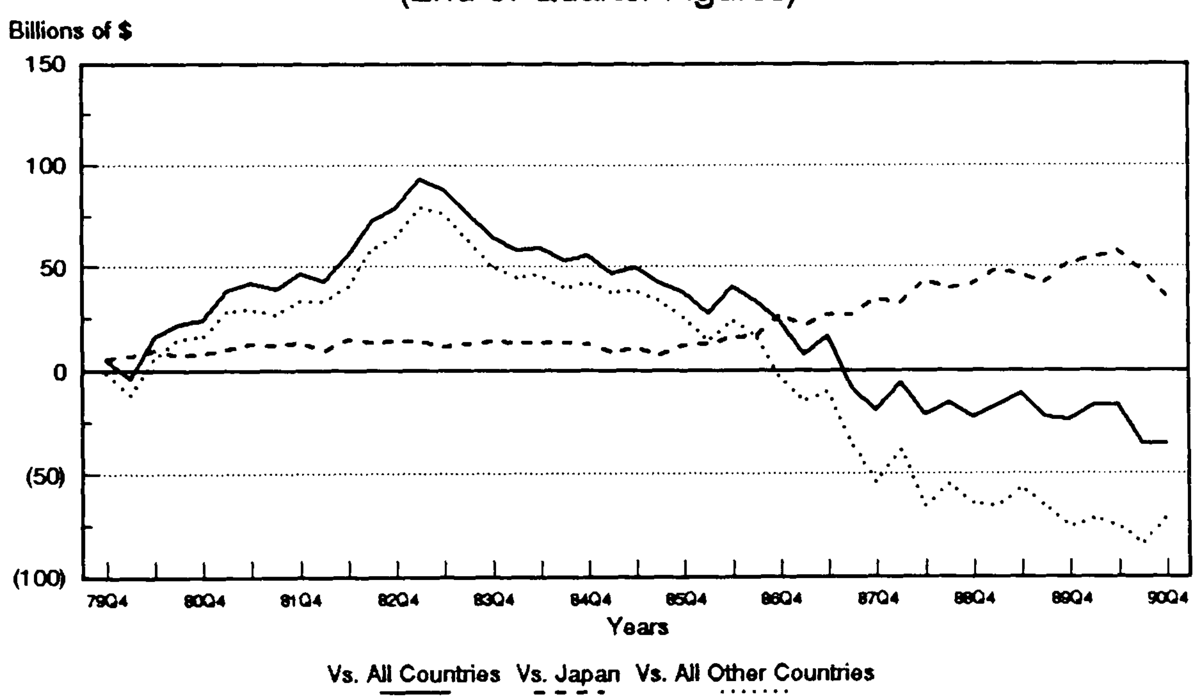
[1] U.S.-chartered banks consolidated: cross-border claims and claims denominated in a currency other than that of the borrower. Source: U.S. Board of Governors of the Federal Reserve System, Country Exposure Lending Survey, E.16 (126).
[2] TIC Data and categories. Dollar claims only.
[3] Includes some banks with U.S. charters.

Also interesting was the status of net U.S. bank claims against Japan. During the decade of the 1980s banks' liabilities against Japan grew rapidly ($57.2 billion), but claims even more ($94.4 billion), so that the net claims position against Japan actually increased in the course of the decade. This increase in net claims was more than accounted for by inter-bank claims (net claims against nonbank entities fell slightly) and was in sharp contrast to the major decline in the net position against other countries (Chart 3). As indicated in previous reports, to a large extent this net bank flow of funds to Japan apparently represented the counterpart to a large net Japanese purchase of U.S. nonbank financial instruments: nonbank sectors in Japan often found it more attractive to purchase offshore financial instruments rather than depositing funds domestically. This meant that Japanese banks became net takers of funds in some markets abroad, including the U.S. Thus, foreign capital markets were serving as an intermediary in the flow of funds between Japanese banks and nonbanks.

In 1990, however, this process went into reverse. Monetary conditions in Japan substantially tightened, partly due to the concerns of the Japanese authorities with perceived inflationary pressures, but also because of capital-adequacy pressures on many Japanese banks in the aftermath of the stock market decline and in preparation for the 1993 BIS capital-asset requirements. Consequently, Japanese banks restrained their banking activities

Chart 3. Net U.S. Inter-bank Dollar Claims

(End of Quarter Figures)



domestically and abroad. Reduced funding in U.S. banking markets meant that claims of U.S. banks vis-a-vis Japan fell by 15.1% in 1990. Liabilities, however, were virtually unchanged, resulting in a $18.8 billion decline in net U.S. bank claims against Japan.

Other than the fact, noted above, that the write-downs on foreign public borrowers were heavily concentrated on banks with primary U.S. ownership, the credit trends for U.S.-owned and foreign-owned banks were similar in 1990 (Table 4). During the early part of the 1980s both categories of banks showed very rapid growth. But after 1983 claims in most credit groups for banks with primary U.S.-ownership stabilized (with an average annual rate of increase in claims of 1.0% from end-1983 through end-1989) while banks with foreign ownership continued to grow rapidly (8.6% for the same time period). In 1990, however, the pressures for strengthening capital requirements and increased monetary stringency in Japan and elsewhere appear to have restrained claims growth among the foreign-owned banks. Excluding the claims on foreign public bodies, claims both of foreign-owned and U.S.-owned entities were almost unchanged in 1990 from 1989. For both categories, claims on unaffiliated banks declined while other claims showed modest increases.[7]

Domestic and International Bank Claims

The decline in foreign claims of U.S. banks has greatly reduced their international exposure relative to domestic exposure. This is confirmed on the basis of two different measures. One of them, using Federal Reserve figures, is based on the consolidated accounts of U.S.-chartered banks, including subsidiaries of U.S. banks abroad. On this basis, the total assets, domestic and foreign, of U.S. banks increased by an average of 6.6% during the 1980s. Foreign assets, including local lending abroad in foreign currencies, increased sharply from 1980 through 1982, then fell through most of the rest of the decade (Chart 4a and Table 5). The divergence was particularly marked in 1990, when total bank assets were almost unchanged from end-1989 (down 0.3%), while foreign assets fell by a sharp 6.9%. As a result, the share of foreign claims in the total fell from 35.3% at end-1981 to 20% at the end of 1989 and to only 18.7% at the end of 1990.

The TIC data, based on a geographical definition of U.S. banks, including U.S. units of foreign-owned banks and excluding foreign units of U.S.-owned banks, also indicate a declining share of foreign claims (Chart 4b and Table 5). Excluding inter-bank lending and all claims of brokers and dealers, foreign claims of U.S. banks increased rapidly from end-1979 to end-1983, then declined continuously, with the largest decline coming in 1990 (due to the precipitous fall in claims on public borrowers). On the other hand, domestic loans (also excluding inter-bank lending), grew rapidly almost throughout the 1980s (9.4% average

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[7] The 1990 retrenchment in lending particularly affected U.S.- and Japanese-owned banks. International lending by European banks, particularly to nonbank borrowers within the BIS-reporting area, showed considerable strength during the year. See the Bank for International Settlements, Annual Report: 1990/91, pp.124-126.

Table 5
Domestic and Foreign Claims of U.S. Banks
Year-End Figures
(in billions of dollars)

	1979	1985	1986	1987	1988	1989	1990
U.S. Banks' Domestic Loans[1]	817.7	1451.9	1616.2	1708.3	1867.2	2002.7	2089.6
U.S. Banks' Foreign Claims[2]	43.7	108.8	104.4	102.5	96.7	92.0	74.7
U.S. Banks' Foreign Claims as % of Total Lending	5.1	7.0	6.1	5.7	4.9	4.4	3.5
Memorandum: Foreign Assets as % of Total Assets of U.S.-Chartered Banking System[3]	33.4	26.2	24.3	24.7	21.8	20.0	18.7

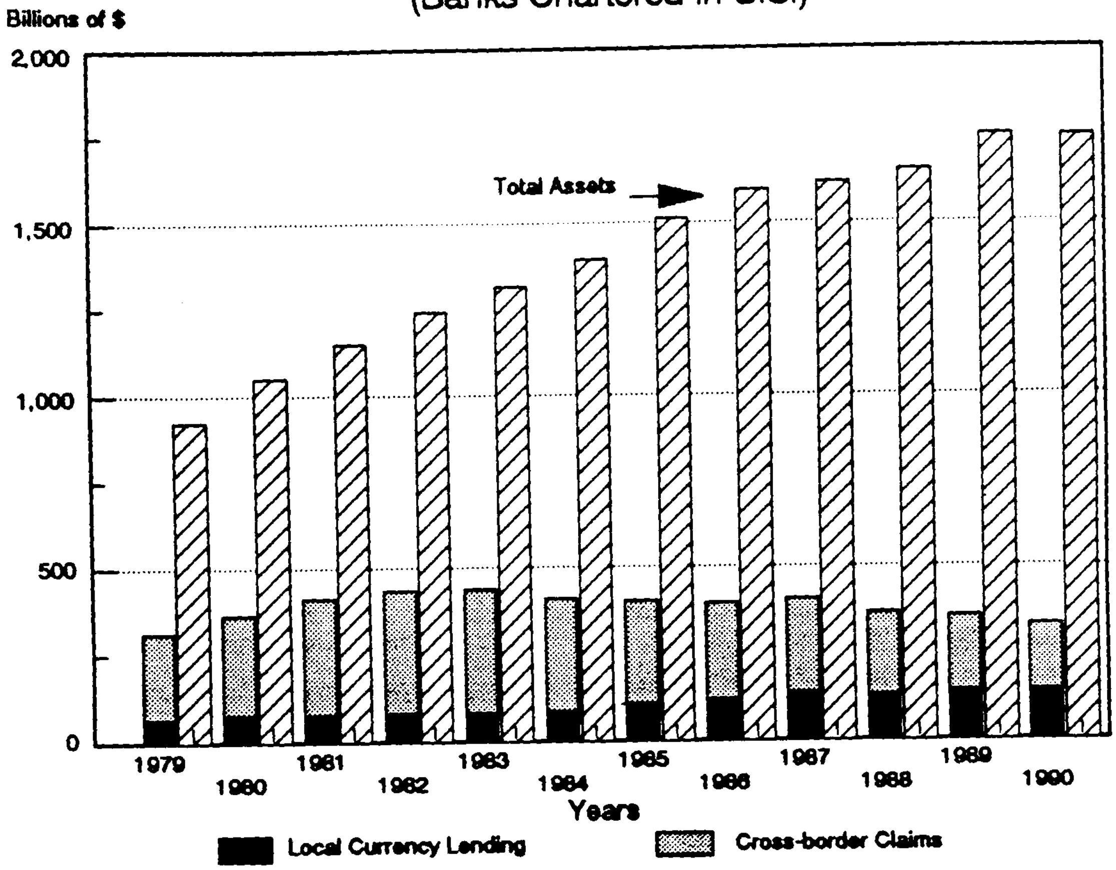
[1] Figures exclude inter-bank lending. Source: Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, Table 1.23 and Table 1.25.
[2] Banks' own dollar claims; excludes claims of securities brokers and dealers.
[3] Figures based on data contained in Board of Governors of the Federal Reserve System, Country Exposure Lending Survey (E.16).

annual growth rate). In 1990 growth was down substantially from that average but still substantial (4.3%). The result was that the relative share of foreign claims, after rising from 1980 through 1983, declined sharply in the succeeding years to only 3.5% at end-1990.

However, the exclusion of inter-bank lending results in an understatement of international exposure. As noted earlier, to an increasing degree in recent years the focus of international lending has been in fact inter-bank, rather than to final borrowers. While inter-bank lending is generally less risky than nonbank lending, a measure of international exposure inclusive of inter-bank lending certainly would be desirable. However, much of the inter-bank lending internationally is carried out through International Banking Facilities (IBFs, see below). While TIC data do cover this international lending, comparison data for domestic IBF lending, which is entirely inter-bank, are no longer gathered. Data available through 1989 (Federal Reserve Board G.14 release), covering about 60% of the IBFs, suggest that the inclusion of inter-bank lending would increase the share of international claims to about double that of the figures excluding inter-bank (i.e., to perhaps 7-8% at end-1990). Again, however, this share decreased sharply in the course of the 1980s.[8]

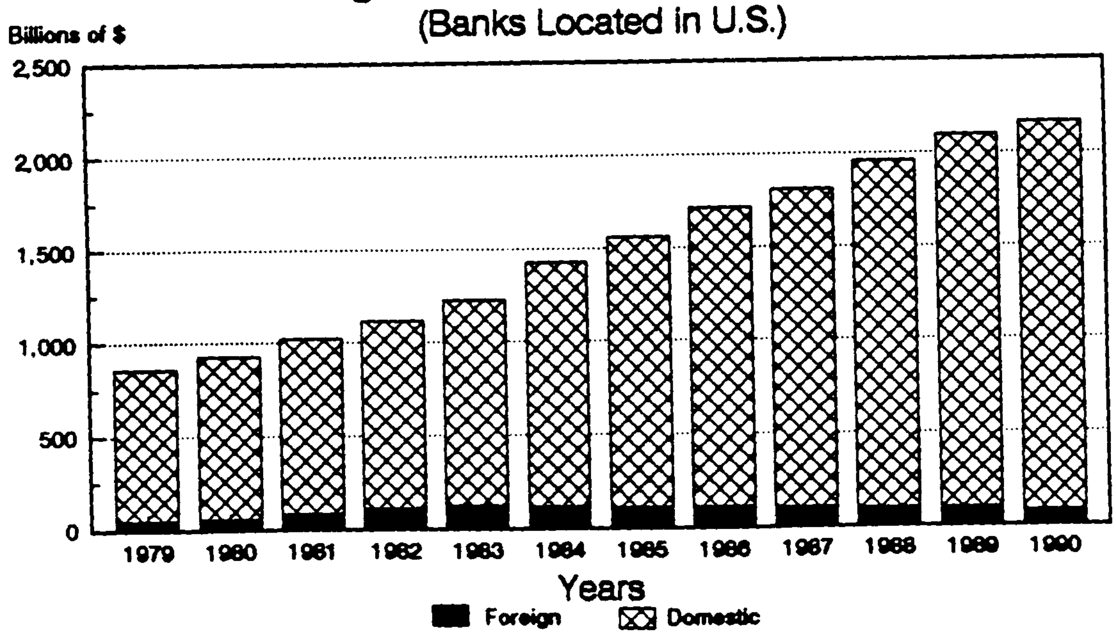
[8] As discussed earlier, the TIC data do not include foreign securities, but domestic securities figures are also excluded from the data used for comparison. As U.S. banks concentrate their holdings in Treasury securities (well over half of the total), the omission of securities probably results in an overstatement of the share of international exposure.

Chart 4a. Foreign and Domestic Claims of U.S. Banks
(Banks Chartered in U.S.)



Source: Federal Reserve Board

Chart 4b. Foreign and Domestic Claims of U.S. Banks
(Banks Located in U.S.)



International Banking Facilities

International Banking Facilities (IBFs) are segregated asset and liability accounts within existing U.S. bank offices (including branches and agencies of foreign-chartered banks) which are subject to special rules and provisions. They were authorized by the Federal Reserve Board at the end of 1981 in order to improve the competitiveness of U.S. banks by allowing them to carry on international banking without many of the regulations that apply to domestic operations. Thus the IBFs are not subject to reserve requirements, FDIC deposit insurance, and other restraints that would raise costs relative to international banks in offshore markets. However, fairly stringent limitations are placed on the activities of the IBFs in order to confine their activities to the international market and to prevent their impingement on domestic monetary conditions. Specifically, the IBFs may not make loans to, or take funds from, domestic entities other than the founding bank and other IBFs, may not issue CDs (since these might be purchased by domestic entities) and may not accept deposits with maturities of less than two days from nonbanks.[9]

The advantages of IBF operations were such that most major banks quickly established IBFs. This was particularly true of foreign banks. Federal regulations enacted prior to authorization of the IBFs increased the regulatory requirements on foreign banks to bring them more in line with those on U.S. banks. Since a large portion of the business of foreign banks was international, the establishment of IBFs essentially provided a means of maintaining "offshore" status for the foreign agencies and branches operating in the U.S. This was particularly important for Japanese banks, which at the time of the introduction of the IBFs were heavily restricted from establishing shell branches (though subsequent measures allowed the establishment of a Japanese counterpart to the IBFs, namely the "Japanese Offshore Markets" or JOM).

The consequence was a rapid increase in the claims of the newly-formed IBFs. Already by the end of 1982 IBF foreign claims amounted to $144.6 billion, or almost 40% of the total foreign claims, much of which represented the re-booking of existing assets to the newly-created IBFs. Partly because of the restrictions on IBF funding, IBF lending has generally been oriented largely to inter-bank business. However, since this was precisely the area in which U.S. banking became heavily focussed in the last half of the 1980s, the growth of IBF dollar claims on affiliated and unaffiliated banks abroad was particularly rapid, averaging 15.4% annually from end-1982 through end-1989 (Table 6 and Chart 5). Also showing very rapid growth were IBF foreign currency claims, which went from only $3.9 billion at end-1982 to $59.2 billion at end-1988 before declining to $53.1 billion at end-1989. (These foreign currency claims are not broken down by type of borrower, but because the

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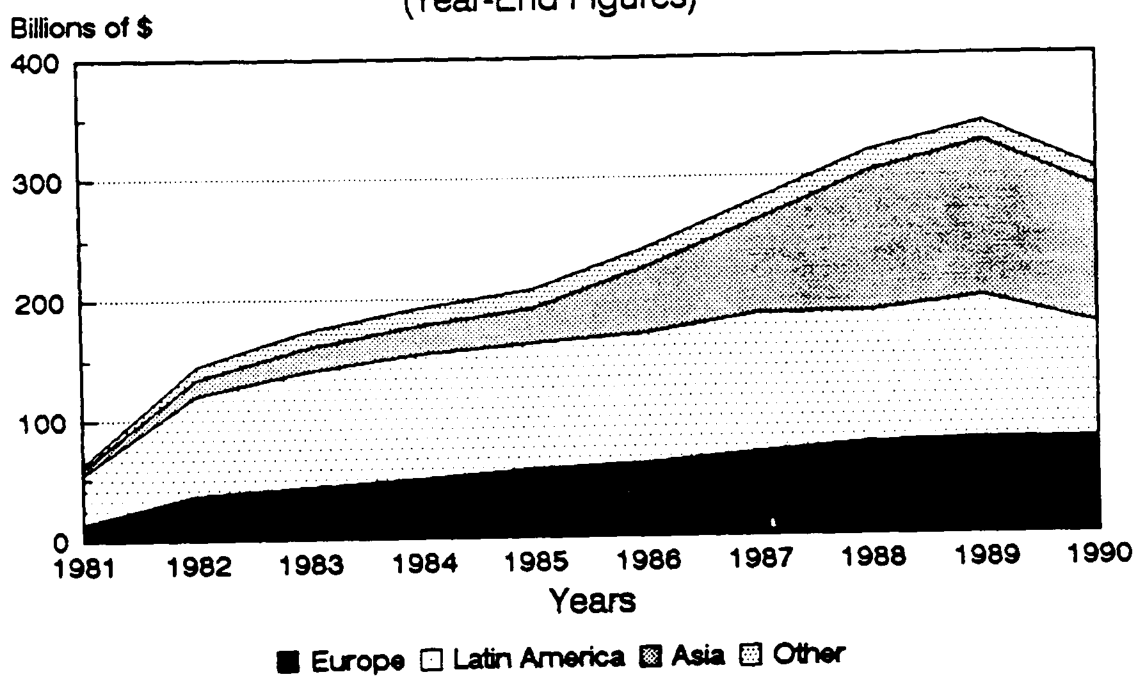
[9] For a detailed description of the establishment and operation of IBFs, see Sidney J. Key and Henry S. Terrell, "International Banking Facilities," International Finance Discussion Paper #333 (Board of Governors of the Federal Reserve System, 1988); and U.S. Department of the Treasury, Report on Foreign Portfolio Investment in the United States as of December 31, 1984, (Washington, D.C.: 1989), pp.79-85.

Table 6
Claims on Foreigners Reported by International Banking Facilities
by Geographical Area
Year-End Figures
(in billions of dollars)

	1981	1985	1986	1987	1988	1989	1990
Total Claims	63.4	207.4	241.5	280.9	320.1	343.2	302.9
Europe	13.8	56.8	60.6	68.8	76.9	78.9	79.1
Latin America	40.7	105.2	109.2	116.5	109.9	119.1	94.8
Asia	4.8	29.5	55.3	78.8	117.0	129.2	114.5
Other	4.1	15.9	16.4	16.9	16.2	16.0	14.6
Total Dollar Claims	62.2	198.4	223.2	239.9	260.9	290.1	251.3
Europe	13.3	52.7	52.3	58.0	65.9	66.8	61.1
Latin America	40.3	103.5	105.7	110.0	103.2	111.6	86.2
Asia	4.7	27.4	50.2	56.9	77.1	97.0	90.6
Other	3.9	14.8	15.0	15.0	14.7	14.7	13.5
On Foreign Public Borrowers	16.1	45.0	47.6	47.5	47.8	43.6	28.1
Europe	2.2	3.6	3.0	2.7	2.1	1.8	1.5
Latin America	12.7	37.9	41.8	41.2	41.6	37.1	21.8
Asia	0.4	2.2	1.9	2.4	2.4	3.2	3.6
Other	0.8	1.3	0.9	1.2	1.7	1.5	1.3
On Unaffiliated Foreign Banks	21.9	72.5	76.9	88.5	89.0	96.6	86.8
Europe	7.9	33.6	36.5	40.2	33.9	33.9	30.5
Latin America	11.7	26.7	25.5	26.1	25.1	23.5	15.1
Asia	1.1	6.7	10.0	17.4	24.7	35.4	37.9
Other	1.3	5.4	4.9	4.8	5.3	3.9	3.3
On Own Foreign Offices	8.2	54.0	73.9	78.6	102.2	128.2	117.7
Europe	1.3	12.9	11.0	13.1	27.2	28.4	26.1
Latin America	4.4	19.4	20.4	24.8	21.7	37.7	40.0
Asia	2.5	16.8	36.9	35.6	49.0	57.3	47.6
Other	0.1	4.9	5.6	5.0	4.3	4.8	4.0
On All Other Foreigners	15.9	26.9	24.9	25.3	21.9	21.6	18.7
Europe	2.0	2.6	1.9	2.0	2.7	2.7	3.0
Latin America	11.4	19.5	18.0	17.8	14.8	13.3	9.2
Asia	0.8	1.7	1.4	1.4	1.1	1.1	1.6
Other	1.7	3.2	3.6	4.1	3.3	4.5	5.0
Total Foreign Currency Claims	1.2	9.0	18.3	41.0	59.2	53.1	51.6
Europe	0.5	4.1	8.2	10.8	11.1	12.1	18.0
Latin America	0.4	1.7	3.5	6.5	6.7	7.5	8.6
Asia	0.1	2.1	5.1	21.9	39.9	32.2	23.9
Other	0.2	1.1	1.4	1.9	1.5	1.3	1.0

Chart 5. Foreign Claims of IBFs

(Year-End Figures)



IBFs are heavily oriented toward "wholesale" business, it seems very likely that the claims are predominantly against foreign banks.) The percentage share of the IBFs in total foreign claims of U.S. banks reached 57.2% by end-1989.

In 1990, however, the reduction of bank claims was particularly marked in the case of the IBFs. Total IBF claims were down 11.7%, as compared to the 3.5% decline in the foreign claims of all U.S. banks. The declines were spread over all four of the major borrower categories, but the largest decline ($15.5 billion) was on foreign public borrowers. The IBF accounts thus bore the major part of the total decline in banks' claims on foreign public borrowers in 1990. But there were also substantial declines in IBF claims on other banks, both affiliated and unaffiliated. The pressures to improve capital asset ratios and the more restrained monetary climate in Japan again were probably important factors. Thus, IBF claims on Asia showed a sharp decline of 11.4%, after growing at an average rate of 38.2% from 1982 through 1989.

The decline in claims on foreign public borrowers has had a major impact on the geographical distribution of IBF claims. Dollar claims on Latin America, which were well over half of the total in the years 1981-1983, fell sharply in subsequent years (see Chart 5). By end-1990 they were down to less than a third of the total. Much of the decline in the Latin American share was taken up by Asia, especially during the three-year period 1986-

1988. Because claims on Asia also declined sharply in 1990, the share of claims on Europe advanced moderately in 1990.

Foreign-owned banks were particularly aggressive in establishing IBFs and expanding the assets of those IBFs during the 1980s. As offshore business comprises a major share of the business of agencies and branches (of foreign banks), the provisions exempting IBF deposits from reserve requirements are of particular importance. In addition, the IBFs were a particular focus of Japanese banks, which were generally expanding rapidly their international business during the 1980s.

As a result, the share of foreign-owned IBFs in total IBF claims has grown substantially. Already comprising 58.7% of total dollar claims at year-end 1984, the share of agencies and branches increased to 68.5% at year-end 1989. In 1990, U.S.-owned IBFs showed substantial reductions in dollar claims in all major categories, whereas foreign-owned IBFs reported slight increases in claims on their own offices abroad and to the "other" category of lending (mainly non-financial corporate). As a result, the share of foreign-owned IBFs increased yet further, to 74.9% at year-end 1990. The share of the foreign-owned IBFs in the much smaller category of foreign currency claims is even more predominant, at over 90% in both 1988 and 1989, though it declined slightly to just below 88% in 1990.

Bank-Reported Custody Claims and Claims of Nonbank Enterprises

Foreign portfolio investments of nonbank enterprises and individuals are reported both directly and indirectly. Many such investments are held in custody accounts with banks, which are required to provide data on such accounts to the TIC. The assets covered are confined to short-term instruments, such as deposits in foreign banks, trade bills and foreign CDs. While including some accounts of individuals and public bodies, the bulk of these custody accounts are held for non-financial enterprises, especially those involved in international trade.

In addition, enterprises and other nonbanking entities holding assets abroad directly, rather than through custody accounts, are required to report those assets (if they exceed certain exemption levels) to TIC. Reportable assets are broken down into commercial and financial claims. Commercial claims are defined as those arising directly from the purchase and sale of goods and services as part of normal business operation and consist mainly of trade receivables. (Inter-company accounts are considered as part of direct investment and are not included in the TIC data.) Financial claims are those arising from investment and borrowing activities, such as foreign bank deposits and commercial paper.

As indicated in Chart 6 and Table 7, the total of the bank custody and nonbank claims, excluding special trust transactions (see note to Table 7), showed considerable yearly variation but little net increase from 1980 through 1988. Claims growth on Latin America was generally weak, particularly so in 1984, 1985 and 1987, while claims on Europe and

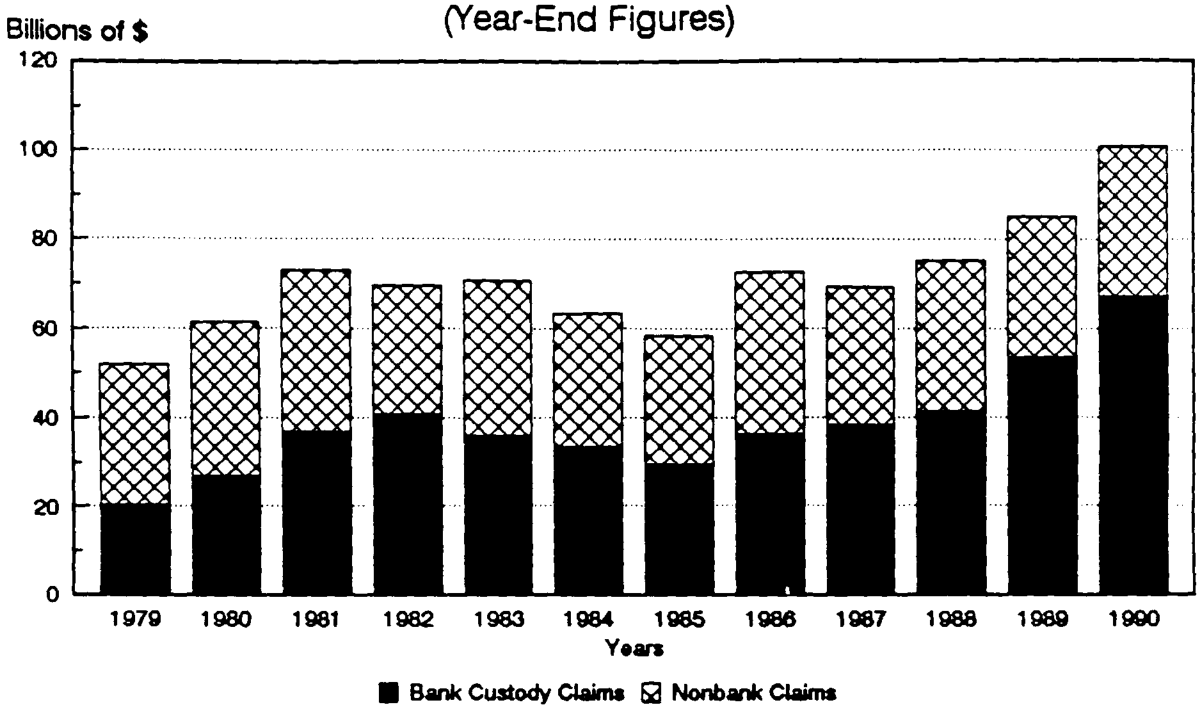
Table 7
Bank Custody Claims and Claims of Nonbank Enterprises
Year-End Figures
(in billions of dollars)

	1979	1985	1986	1987	1988	1989	1990
Bank Custody Claims	20.7	29.5	36.4	38.3	47.9	62.1	75.9
by Region:							
Europe	12.2	19.0	25.0	25.8	27.1	30.6	36.0
Latin America	2.2	3.5	3.2	2.7	4.1	9.0	14.0
Asia	2.1	3.0	3.8	5.2	11.6	16.0	20.9
Claims by Nonbanks	31.3	28.9	36.3	31.0	34.0	31.4	33.5
by Type:							
Financial	18.4	18.9	26.3	20.4	21.9	17.7	18.1
Commercial	12.9	10.0	10.0	10.6	12.2	13.7	15.4
by Region:							
Europe	11.1	10.5	14.5	13.7	15.5	13.2	15.1
Latin America	9.2	9.6	11.1	8.9	10.4	9.8	8.1
Asia	4.1	3.7	4.1	3.8	3.8	4.4	5.3
Total Claims							
by Region:	52.0	58.3	72.7	69.3	81.9	93.5	109.4
Europe	23.3	29.5	39.5	39.5	42.5	43.8	51.2
Latin America	11.4	13.1	14.3	11.6	14.5	18.8	22.1
Asia	6.2	6.7	7.9	9.0	15.4	20.4	26.1
Memorandum: Total Claims excluding special Trust Transactions[1]	52.0	58.3	72.7	69.3	75.4	85.1	101.0

[1] Beginning in 1988 special trusts were established to repay U.S. Defense Department loans to several Asian countries (the largest were for Israel). These Trusts issued bonds and lent the receipts to the debtor countries for the loan repayments. The trusts maintain accounts with reporting banks and their country claims are reported as custody claims. Essentially, the Defense Department loans were converted into loans held in custody accounts. The amounts so converted came to $6.5 billion in 1988 and $1.9 billion in 1989, but less than $0.1 billion in 1990.

Chart 6. Bank Custody Claims and Nonbank Claims

(Year-End Figures)



Note: Incorporated data exclude special trust transactions.

Asia were more robust. It seems likely that the debt crisis and the slide in the economies of many Latin American countries were major factors, as commercial claims were especially weak.

In 1989 and 1990, however, total bank custody and nonbank claims showed substantial increases (12.9% and 18.6% respectively), reaching levels well above those of previous years. The increases in claims on Europe, Latin America and Asia all showed large increases (claims on Asia almost doubled from two years earlier). Very probably the strong growth in U.S. exports in 1989 and 1990 was an important factor. It is noteworthy in this respect that, while financial claims on Latin America fell slightly over the two-year period, commercial claims were up by 26.5% and custody claims (which include trade receivables as an important category), more than tripled. U.S. exports of goods and services to Latin America increased by 55.2% from 1987 to 1990, with particularly large increases to Mexico.

U.S. Investments in Foreign Securities

U.S. holdings of foreign securities (Chart 7 and Table 8) enjoyed a rapid growth during the 1980s, increasing at an annual rate of 12.8%. Holdings of foreign stocks were particularly strong, averaging 20.0% growth per year, while the value of foreign bond portfolios increased by 8.9% per year. In the case of bonds, most of the annual increase was due to actual purchases, which averaged $5.3 billion per year on a net basis. While there were capital gains on these bonds, particularly during periods of dollar weakness such as 1985-1987, the average imputed price increase was only 1.1%. For stocks, however, capital gains were much more important, with imputed stock prices going up a hefty 10.5% per year on average. The years 1985, 1986, and 1989 showed particularly large increases of over 20% in each.

In 1990, however, these patterns changed sharply. Net purchases of foreign bonds were strong at $22.3 billion, but net purchases of foreign stocks fell to $8.7 billion, compared to $13.1 billion in 1989. Besides the continuing press of diversification, the net purchases of foreign bonds may have been spurred by the weakness of the dollar during much of the year. The considerable increase in the imputed prices of foreign bonds (6.9%) was probably also heavily influenced by the weak dollar. The decline in net purchases of foreign stocks,

Chart 7. U.S. Holdings of Foreign Securities
(Year-End Figures)

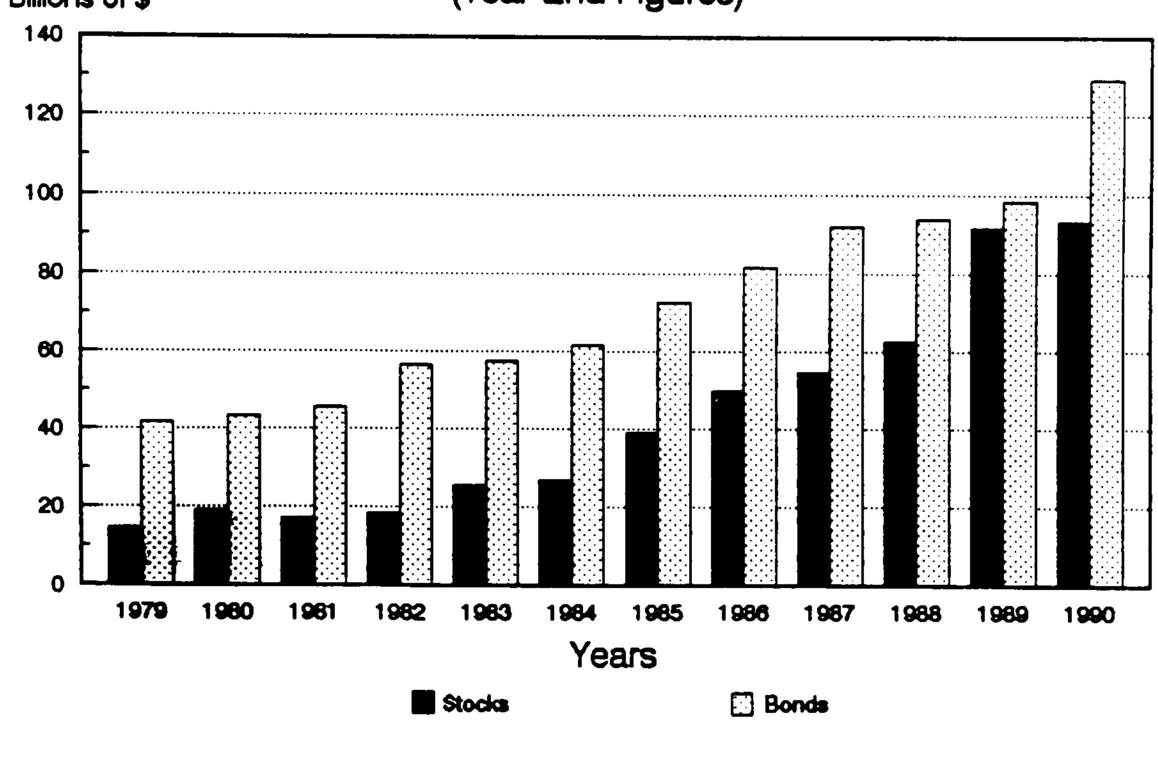


Table 8
U.S. Investment in Foreign Bonds and Stocks
(in billions of dollars)

	1979	1985	1986	1987	1988	1989	1990
U.S. Holdings of Foreign Securities[1]	56.8	112.2	131.7	146.7	156.8	190.2	222.4
Bonds	42.0	72.9	81.7	92.0	94.0	98.5	129.1
Stocks	14.8	39.3	50.0	54.7	62.7	91.7	93.3
Annual Change in the Value of U.S. Holdings[1]	3.5	23.3	19.5	15.0	10.1	33.4	32.2
Bonds	-0.1	11.0	8.8	10.3	2.0	4.5	30.6
Stocks	3.6	12.3	10.7	4.7	8.0	29.0	1.6
Net Outflows of Capital for the Purchase of Foreign Securities[2]	4.8	7.9	5.5	6.9	9.4	19.1	31.0
Bonds	4.0	4.0	3.7	7.9	7.4	5.9	22.3
Stocks	0.8	3.9	1.9	-1.1	2.0	13.1	8.7
Memorandum: Imputed Price Change on Securities	-2.2	15.9	11.9	5.9	0.4	8.1	0.5
Bonds	-8.9	10.6	6.7	2.6	-5.4	-1.4	6.9
Stocks	23.3	27.0	21.5	11.8	10.6	21.0	-7.1

[1] Based on year-end figures. Source: Department of Commerce, Survey of Current Business. Incorporates estimates of security price changes.
[2] Treasury basis: as reported under the TIC reporting system.

on the other hand, was probably a function of the Gulf crisis in the second half of the year and the ensuing weakness in world stock markets. Imputed prices of foreign stocks fell by 7.1% in 1990.

The data in Table 9 illustrate the very rapid increases in trading activity in foreign bonds and stocks that have occurred in recent years. Total volume of trades in foreign stocks in 1989 was over 23 times, and for foreign bonds over 16 times, as large as that of 10 years earlier, representing average annual rates of increase of 36.9% and 32.1% respectively. In 1990 the increase in trading in foreign bonds was again quite large (37.1%). Trading in foreign stocks, however, slowed substantially, to 9.1%. Again, the Gulf Crisis and the decline in world stock prices were probably factors in the reduced volume of stock trading, as monthly data indicate that trading in the second half of 1990 was down both on the first half and on the second half of 1989. On the basis of the trends of earlier years, however, the 1990 level is likely to represent only a temporary pause in the growth of equity trading volumes.

Table 9
U.S. Residents' Purchases and Sales of Foreign Bonds and Stocks, 1979-1990
(in billions of dollars)

	Foreign Bonds			Foreign Stocks			Total Foreign Securities		
Years	Purch-ases	Sales	Net	Purch-ases	Sales	Net	Purch-ases	Sales	Net
1979	16.7	12.7	4.0	5.4	4.6	0.8	22.1	17.3	4.8
1980	18.1	17.1	1.0	10.0	7.9	2.1	28.1	25.0	3.1
1981	23.0	17.6	5.5	9.6	9.3	0.2	32.6	26.9	5.7
1982	33.8	27.2	6.6	8.5	7.2	1.3	42.3	34.3	8.0
1983	39.6	36.3	3.2	17.0	13.3	3.8	56.6	49.6	7.0
1984	59.9	56.0	3.9	15.9	14.8	1.1	75.9	70.8	5.0
1985	85.2	81.2	4.0	24.8	20.9	3.9	110.0	102.1	7.9
1986	170.7	167.0	3.7	51.0	49.1	1.9	221.7	216.1	5.5
1987	207.0	199.1	7.9	94.4	95.5	-1.1	301.4	294.5	6.9
1988	226.0	218.5	7.4	77.3	75.4	2.0	303.3	293.9	9.4
1989	240.3	234.3	5.9	122.9	109.8	13.1	363.2	344.1	19.1
1990	336.5	314.2	22.3	131.3	122.5	8.7	467.8	436.8	31.0

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
October 29, 1991

CONTACT: Desiree Tucker-Sorini
(202)566-8191

Statement of Secretary Brady on GNP

Third quarter growth in GNP is encouraging. Although the economic recovery remains sluggish, consumer spending, residential construction and capital spending are up, and inflation is down.

These results are good news, but we should do more. Congress should act on the President's growth package, particularly the highway bill, which will create jobs immediately, and true reform of the banking industry, which will strengthen the economy and spur investment.

oOo

NB-1523

TREASURY NEWS

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

Contact: Cheryl Crispen (202) 566-2041
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FOR IMMEDIATE RELEASE
October 29, 1991

JOINT STATEMENT OF
NICHOLAS F. BRADY,
SECRETARY OF THE TREASURY,
AND
RICHARD G. DARMAN,
DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET
ON
BUDGET RESULTS FOR FISCAL YEAR 1991

SUMMARY

The Administration today released the September Monthly Treasury Statement of Receipts and Outlays of the United States Government. The statement shows the actual financial totals for the fiscal year that ended on September 30, 1991, as follows:

-- total receipts of $1,054.3 billion;

-- total outlays of $1,323.0 billion; and

-- a deficit of $268.7 billion.

NB-1524

Table 1. TOTAL RECEIPTS, OUTLAYS, AND DEFICITS
(in billions of dollars)

	Receipts	Outlays	Deficits
1990 Actual............................	1,031.3	1,251.8	-220.5
1991:			
February Budget Estimate..............	1,091.4	1,409.6	-318.1
July Mid-Session Review Estimate.....	1,068.7	1,350.9	-282.2
Actual................................	1,054.3	1,323.0	-268.7

DEFICIT

The actual FY 1991 deficit, $268.7 billion, is slightly above the OMB estimate associated with the 1990 Budget Summit Agreement. It is, however, $49.4 billion less than the Administration's February estimate, and $13.5 billion less than the deficit estimated in the July Mid-Session Review (MSR). The change from the MSR deficit estimate reflects the impact of:

-- a $17.1 billion decrease in deposit insurance outlays and

-- a $10.8 billion decrease in other outlays,

-- partially offset by a $14.4 billion decrease in receipts.

RECEIPTS

Actual receipts were $1,054.3 billion, $14.4 billion lower than July's MSR estimate. Estimated payments of liability by individuals and withholding on wages and salaries were both lower than anticipated, and accounted for most of the difference from the estimate.

Changes in Receipts According to Source

-- Individual Income Taxes were $467.8 billion, $14.1 billion lower than July's estimate of $481.9 billion. Withheld taxes and estimated payments of 1991 tax liabilities by individuals accounted for $7.6 billion and $6.8 billion, respectively, of the shortfall in individual income tax receipts. These shortfalls were partially offset by lower-than-anticipated tax refunds of $0.4 billion.

-- Corporation Income Taxes were $98.1 billion, $0.4 billion lower than the $98.5 billion estimated in July. Corporation estimated payments of 1991 tax liability were $1.2 billion lower than anticipated, but were partially offset by lower-than-estimated refunds of $0.7 billion.

-- Social Insurance Taxes and Contributions were $1.0 billion higher than the MSR estimate of $395.1 billion. This increase was the net effect of higher-than-estimated employment tax collections and contributions of $1.2 billion, partially offset by lower-than-estimated collections of unemployment insurance taxes and other retirement contributions.

-- Customs Duties were $15.9 billion, $1.1 billion below the July estimate. This shortfall apparently reflects lower levels of imports.

-- Other Receipts, which include excise taxes, estate and gift taxes, and miscellaneous receipts, totalled $76.4 billion, $0.2 billion above the MSR estimate.

OUTLAYS

Total outlays were $1,323.0 billion, $27.9 billion lower than the outlays estimated in the July MSR. The major reason for the difference from July is the decline of $17.1 billion in deposit insurance outlays, but spending also decreased by $4.2 billion in the Department of Health and Human Services, $1.7 billion in the Department of Agriculture, $1.1 billion in the Department of Energy, and smaller amounts in several other departments. Outlays of the Department of Defense, which include those for Desert Shield/Desert Storm, were only $0.3 billion lower than those estimated in the July MSR.

The major outlay changes since July are described below. Table 3 displays actual outlays and estimates from the February Budget and July MSR by agency and major program.

Deposit Insurance. Total outlays for deposit insurance were $66.4 billion, $17.1 billion below the forecast in the July MSR.

-- Bank Insurance Fund (BIF). Outlays for the Bank Insurance Fund were $4.7 billion lower than the July MSR. The difference is attributable to the timing of the resolution of banks in financial difficulty.

-- FSLIC Resolution Fund (FRF). Outlays of the FSLIC Resolution Fund were $0.6 billion below the MSR. The difference is attributable to a decrease of $0.2 billion in assistance agreement payments and an increase of $0.5 billion in asset recoveries.

-- Resolution Trust Corporation (RTC). Outlays for the RTC were $11.5 billion lower than the July MSR estimate. About $8.0 billion of this lower spending resulted from a reduction in the number of problem thrifts resolved during the year. Receipts from sales of failed thrift assets were about $3.0 billion higher than estimated.

-- Other Deposit Insurance Related Agencies. Net outlays for other deposit insurance related agencies, primarily the National Credit Union Administration (NCUA), account for $0.2 billion of the total change.

Other Outlay Changes

Department of Agriculture. Actual outlays of the Department of Agriculture were $54.1 billion, $1.7 billion below the July MSR estimate. Outlays for the Commodity Credit Corporation (CCC) accounted for the largest portion of this decrease, $0.5 billion below the MSR estimate. CCC outlays were reduced as a result of higher than anticipated prices for program crops. Outlays of the Foreign Assistance--P.L. 480 program were $0.3 billion below the July MSR estimate mostly because the Title III foreign food aid program was initiated late in FY 1991. A $0.3 billion decrease from the MSR estimate in Rural Electrification Administration outlays was the result of lower-than-expected demand for loans.

Department of Defense-Military. Net outlays of the Department of Defense were $261.9 billion, $0.3 billion lower than the MSR estimate of $262.2 billion. The change is the net result of lower-than-expected outlays for Desert Shield costs, offset by slower payment by allies of Desert Shield contributions, and increased outlays for procurement.

Department of Education. Actual outlays of the Department of Education were $0.7 billion higher than the MSR estimate of $24.6 billion. The largest single factor in the increase was higher-than-expected default claims in the Guaranteed Student Loan program.

Department of Energy. Actual outlays of the Department of Energy were $1.1 billion below the MSR estimate. The largest portion of the difference was in atomic energy defense activities, where spending was $0.5 billion under the MSR estimate. The change was due to slower-than-anticipated spending for nuclear materials and nuclear weapons production. The Department of Energy reported outlays for the Strategic Petroleum Reserve Petroleum account were $0.3 billion below the MSR estimate because of higher receipts.

Department of Health and Human Services. Actual outlays of the Department of Health and Human Services were $484.4 billion, $4.2 billion below the MSR estimate of $488.6 billion. The major components of this decrease are in Medicaid, Family Support Payments to States, the Public Health Service, and Supplemental Security Income programs. Actual FY 1991 outlays for Medicaid were $1.3 billion less than estimated in the MSR. Most of the difference is attributable to unexpected revenue shortfalls in many states during the last few months of FY 1991, which prevented states from having the necessary funds needed to draw Federal matching payments. It is expected that the decline will be made up in FY 1992 and later years.

Outlays in the Public Health Service were $1.0 billion below the MSR estimate. In part, this decrease reflects slower than anticipated grantee drawdowns of appropriations, which increased by more than 12 percent annually during FY 1990 and FY 1991. Health Resources and Services Administration (HRSA) spending was $0.4 billion below the MSR estimate, in part because vaccine claims adjudication was slower than expected. Indian Health Service (IHS) outlays were $0.2 billion lower as a result of delays on several large construction projects. Outlays by the National Institutes of Health and the Centers for Disease Control were also slightly below the MSR estimate.

The July MSR estimates assumed that $1.3 billion in Supplemental Security Income (SSI) benefits would be paid for retroactive payments resulting from the Supreme Court's decision in Zebley v. Sullivan. Because of District Court delays, these payments will not begin until FY 1992. Overall, SSI outlays were down from the MSR estimate by $1.0 billion.

Department of Housing and Urban Development. Outlays of the Department of Housing and Urban Development (HUD) were $0.8 billion below the MSR estimate. Spending for Housing Payments accounts fell from the MSR estimate as a result of lower-than-anticipated low-income rental subsidy payments. Government National Mortgage Association (GNMA) outlays were lower due to lower expenses in its mortgage-backed securities program. Outlays were above the MSR estimate in the Federal Housing Administration Fund (FHA) due to higher than expected multifamily insurance claims.

Department of Labor. The Department of Labor's actual outlays were $0.6 billion below the MSR estimate. Almost all the shortfall occurred in the Department's benefits programs. The largest single difference from the MSR was $0.2 billion in decreased spending for the Pension Benefit Guaranty Corporation (PBGC). The Corporation did not take over the number of plans anticipated at MSR and did not pay out as much in benefits as expected. Outlays for the Black Lung program were $0.1 billion below the MSR estimate due to a combination of lower benefit payments and fewer advances.

Department of the Treasury. Outlays for the Department of Treasury were $276.9 billion, $1.2 billion higher than the MSR estimate. Outlays for interest on the public debt were $286.0 billion, $1.3 billion higher than the MSR estimate. This difference is mainly in the interest paid on the holdings of Government accounts, where a combination of higher balances and slightly higher interest rates resulted in higher interest payments than estimated in the MSR.

Export-Import Bank. Export-Import Bank outlays were $0.6 billion lower than the MSR estimate. This was primarily because interest repayments on direct loans were $0.3 billion above projections. In addition, new direct loan disbursements were $0.2 billion below projections because of delays in the projects for which loans had been approved.

Federal Emergency Management Agency. Outlays for the Federal Emergency Management Agency were $0.8 billion below the MSR estimate. This is primarily because outlays from the disaster relief fund were $0.5 billion below the MSR estimate. Nearly $0.2 billion of this amount is attributable to a 1991 supplemental request that Congress did not enact, and $0.3 billion results from slower-than-expected drawdowns by grantees for disaster assistance.

Funds Appropriated to the President. Outlays of Funds Appropriated to the President were $11.7 billion, $0.4 billion lower than the $12.1 billion estimated in the MSR. Actual outlays for military sales programs, which include principally the Foreign Military Sales and Kuwait Civil Reconstruction Trust Funds, were $1.1 billion below the July MSR estimate. This change is primarily attributable to increased receipts from foreign governments for arms sales and reconstruction activity resulting from the events in the Persian Gulf. This decrease was partially offset by a $0.6 billion increase in International Security Assistance.

Postal Service. Postal Service outlays were $1.3 billion higher than the MSR estimate. The difference is the result of the establishment in FY 1991 of a 29-cent stamp rather than a 30-cent stamp.

Employer Share, Employee Retirement Fund. The Federal Government's contributions to its Employee Retirement Fund were $0.9 billion higher than the MSR estimate. Most of the change occurred in the

Military Retirement Fund because of the increased numbers of military personnel activated for operations in the Persian Gulf.

Table 4. Receipts of the U.S. Government ($ millions)

	This Month		Current Fiscal Year to Date	
	Gross Receipts	Receipts	Gross Receipts	Receipts
page 6				
Miscellaneous receipts:				
All other	382	382	3,270	3,261
should be	810	810	3,698	3,689
Total--Miscellaneous receipts	2,019	2,018	22,429	22,419
should be	2,447	2,446	22,857	22,847
Total--Receipts.................................	111,990	108,917	1,151,470	1,053,832
should be	112,418	109,345	1,151,897	1,054,260
Total--On-budget...............................	85,776	82,703	856,915	759,946
should be	86,204	83,131	857,343	760,375

Table 5. Outlays of the U.S. Government ($ millions)

	This month		Current Fiscal Year to Date	
	Gross Outlays	Outlays	Gross Outlays	Outlays
page 11				
Social Security Administration:				
Supplemental security income program	172	172	15,498	15,498
should be	600	600	15,926	15,926
Total--Social Security Administration.	242	242	22,320	22,320
should be	670	670	22,748	22,748
page 12				
Total--Department of Health and Human Services Except Social Security	18,002	16,978	229,757	217,541
should be	18,430	17,406	230,185	217,969
page 19				
Total--Outlays	130,841	115,746	1,542,110	1,322,561
should be	131,269	116,174	1,542,538	1,322,989
Total--On-budget...............................	102,473	91,089	1,255,723	1,080,874
should be	102,901	91,517	1,256,150	1,081,302

Table 9. Summary of Receipts by Source, and Outlays byFunction of the U.S. Government ($ millions)

	This month	Fiscal Year to Date
page 29		
RECEIPTS:		
Miscellaneous....................................	2,018	22,419
should be	2,446	22,847
Total...	108,917	1,053,832
should be	109,345	1,054,260
NET OUTLAYS:		
Income security..................................	11,761	171,190
should be	12,189	171,618
Total...	115,746	1,322,561
should be	116,174	1,322,989

Note: Changes noted in the above tables are also reflected in Table 7, pages 26 & 27; and in Table 8, page 28.

ERRATA

Final Monthly Treasury Statement

of Receipts and Outlays
of the United States Government

For Fiscal Year 1991 Through **September 30, 1991**, and Other Periods

Attention is called to the following corrections on the pages and columns indicated:

Table 1. Summary of Receipts, Outlays, and the Deficit/Surplus of the U.S.Government ($ millions)

	Receipts	Outlays
page 2		
FY 1991		
September	108,917	115,746
should be	109,345	116,174
Year-to-Date	1,053,832	1,322,561
should be	1,054,260	1,322,989

Table 2. Summary of Budget and Off-Budget Results and Financing of the U.S. Government ($ millions)

	This month	Current Fiscal Year to Date
page 3		
Total on-budget and off-budget results:		
Total receipts	108,917	1,053,832
should be	109,345	1,054,260
On-budget receipts	82,703	759,948
should be	83,131	760,375
Total outlays	115,746	1,322,561
should be	116,174	1,322,989
On-budget outlays	91,089	1,080,874
should be	91,517	1,081,302

Table 3. Summary of Receipts and Outlays of the U.S. Government ($ millions)

	This month	Fiscal Year to Date
page 5		
Budget Receipts:		
Miscellaneous receipts	2,018	22,419
should be	2,446	22,847
Total Receipts	108,917	1,053,832
should be	109,345	1,054,260
(On-budget)	82,703	759,948
should be	83,131	760,376
Budget Outlays:		
Department of Health and Human Services, except Social Security	16,978	217,541
should be	17,406	217,969
Total Outlays	115,746	1,322,561
should be	116,174	1,322,989
(On-budget)	91,089	1,080,874
should be	91,517	1,081,302

Table 3.--1991 BUDGET OUTLAYS BY AGENCY
(fiscal years, in millions of dollars)

	1990	1991				Actual less
		Estimate				
	Actual	February	July		Actual	July Est.
TOTAL, outlays	1,251,777	1,409,563	1,350,891		1,322,988	-27,903
On-budget	(+1,026,711)	(+1,171,658)	(+1,111,103)		(+1,081,302)	(-29,801)
Off-budget	(+225,066)	(+237,905)	(+239,788)		(+241,686)	(-1,898)
Deficit (-)	-220,470	-318,122	-282,213		-268,728	13,485
On-budget	(-277,059)	(-378,505)	(-335,388)	\2	(-320,926)	(+14,462)
Off-budget	(+56,590)	(+60,382)	(+53,175)	\2	(+52,198)	(-977)

NOTE: Detail may not add to totals due to rounding.

\1 A placeholder for FY 1991 Desert Shield contributions and incremental costs was included in Allowances.

\2 Reflects a change in the accounting treatment for the quinquennial transfers to the general fund for adjustments for military service credits. Under the revised treatment, outlays for Social Security and Medicare are increased by $2,889 million and $1,100 million respectively. This change is fully offset by a decrease an outlays in other HHS of $3,989 million.

Table 3.--1991 BUDGET OUTLAYS BY AGENCY
(fiscal years, in millions of dollars)

	1990 Actual	1991 Estimate February	1991 Estimate July	1991 Actual	Actual less July Est.
Federal Emergency Management Agency	2,183	1,397	1,640	870	-770
Postal Service:					
On-budget	490	511	511	511	0
Off-budget	1,626	59	59	1,317	1,258
Railroad Retirement Board	4,477	4,313	4,444	4,358	-86
Resolution Trust Corporation	46,547	84,578	62,249	50,751	-11,498
Tennessee Valley Authority	-312	54	54	-22	-76
Other (net)	6,021	6,753	6,765	6,240	-525
Subtotal, other independent agencies	73,666	125,708	98,197	80,456	-17,741
Allowances	0	8,200	0	0	0
Undistributed offsetting receipts:					
Employer share, employee retirement (on-budget)	-28,044	-29,537	-29,539	-30,402	-863
Employer share, employee retirement (off-budget)	-5,567	-5,827	-5,805	-5,804	1
Interest received by on-budget trust funds	-46,416	-50,179	-50,179	-50,977	-798
Interest received by off-budget trust funds	-15,991	-20,164	-20,663	-20,222	441
Rents and royalties on the OCS lands	-3,004	-3,729	-3,629	-3,150	479
Subtotal, undistributed offsetting receipts	-99,025	-109,436	-109,815	-110,555	-740

Table 3.--1991 BUDGET OUTLAYS BY AGENCY
(fiscal years, in millions of dollars)

	1990	1991			
		Estimate			Actual less
	Actual	February	July	Actual	July Est.
Treasury:					
Exchange stabilization fund	-2,947	-1,800	-1,800	-2,206	-406
Interest on the Public Debt	264,853	286,290	284,697	286,022	1,325
Offsetting receipts	-22,716	-26,868	-26,618	-26,567	51
Other	16,074	19,425	19,434	19,645	211
Subtotal, Treasury	255,264	277,047	275,713	276,894	1,181
Department of Veterans Affairs	28,998	31,338	31,614	31,214	-400
Environmental Protection Agency	5,108	5,776	5,776	5,770	-6
General Services Administration	-123	756	756	487	-269
National Aeronautics and Space Administration	12,429	13,499	13,499	13,878	379
Office of Personnal Management	31,949	35,161	35,161	34,808	-353
Small Business Administration	692	529	544	613	69
Other independent agencies:					
District of Columbia	548	540	644	636	-8
Export-Import Bank	357	542	542	-88	-630
Federal Deposit Insurance Corporation:					
Bank insurance fund	6,429	15,881	12,111	7,363	-4,748
FSLIC resolution fund	5,213	11,067	9,165	8,556	-609
Other FDIC	87	13	13	-36	-49
Subtotal, Federal Deposit Insurance Corporation	11,729	26,961	21,289	15,883	-5,406

Table 3.--1991 BUDGET OUTLAYS BY AGENCY
(fiscal years, in millions of dollars)

	1990 Actual	1991 Estimate February	1991 Estimate July	1991 Actual	Actual less July Est.
Housing and Urban Development:					
Housing payments	13,875	15,912	15,895	15,159	-736
Federal Housing Administration fund	988	1,533	1,533	1,892	359
Government National Mortgage Association	-468	-145	-145	-280	-135
Community development grants	2,770	3,073	3,073	2,941	-132
Other	3,002	3,100	3,145	3,039	-106
Subtotal, HUD	20,167	23,473	23,501	22,751	-750
Interior	5,794	6,386	6,407	6,094	-313
Justice	6,507	8,689	8,697	8,244	-453
Labor:					
Training and employment services	3,837	3,897	3,897	3,808	-89
Unemployment trust fund	20,250	28,400	28,504	28,434	-70
Other	1,230	2,206	2,203	1,807	-396
Subtotal, Labor	25,317	34,503	34,604	34,049	-555
State	3,979	4,306	4,461	4,252	-209
Transportation:					
Federal Highway Administration	14,293	14,436	14,436	14,539	103
Urban Mass Transportation Administration	3,770	4,048	4,048	3,857	-191
Federal Aviation Administration	6,391	7,419	7,419	7,241	-178
Other	4,183	4,865	4,898	4,866	-32
Subtotal, Transportation	28,637	30,768	30,801	30,503	-298

Table 3.--1991 BUDGET OUTLAYS BY AGENCY
(fiscal years, in millions of dollars)

	1990	1991				
		Estimate				Actual less
	Actual	February	July		Actual	July Est.
Defense-Military:						
Contributions	0	0 \1	48,214		43,618	-4,596
Other	289,755	287,451	310,402		305,543	-4,859
Subtotal, Defense-Military	289,755	287,451	262,188		261,925	-263
Defense-Civil	24,975	26,415	26,415		26,538	123
Education	23,109	24,839	24,638		25,339	701
Energy	12,028	13,539	13,539		12,459	-1,080
Health and Human Services - except Social Security:						
Medicare	109,709	116,267	118,036	\2	117,763	-273
Medicaid	41,103	51,555	53,798		52,533	-1,265
Public Health Service	14,007	16,288	16,303		15,348	-955
Family Support Payments to States	12,246	14,110	14,110		13,520	-590
Supplemental Security Income	12,568	16,881	16,881		15,925	-956
Other	4,046	7,334	3,228	\2	2,880	-348
Subtotal, HHS - except Social Security	193,679	222,435	222,356		217,969	-4,387
Health and Human Services - Social Security	244,998	263,837	266,197	\2	266,395	198
Subtotal, Health and Human Services	438,677	486,272	488,553		484,364	-4,189

Table 3.--1991 BUDGET OUTLAYS BY AGENCY
(fiscal years, in millions of dollars)

Outlays by Major Agency	1990 Actual	1991 Estimate February	1991 Estimate July	1991 Actual	Actual less July Est.
Legislative branch and the Judiciary	3,885	4,604	4,611	4,284	-327
Executive Office of the President	157	258	258	193	-65
Funds Appropriated to the President:					
International Security Assistance:					
Military assistance	5,030	5,357	5,357	5,643	286
Economic Support Fund	3,769	3,263	4,113	4,321	208
Other	-447	-531	-531	-433	98
International development assistance	3,528	3,487	3,510	3,444	-66
International monetary programs	-738	5	5	179	174
Military sales programs	-1,116	-343	-343	-1,438	-1,095
Other	60	16	16	8	-8
Subtotal, Funds Appropriated to the President	10,086	11,254	12,127	11,724	-403
Agriculture:					
Commodity Credit Corporation	6,380	10,844	10,591	10,069	-522
Foreign assistance - P.L. 480	978	1,120	1,120	820	-300
Federal Crop Insurance Corporation	979	884	884	769	-115
Rural Electrification Administration	278	405	405	100	-305
Farmers Home Administration	6,713	6,412	6,412	6,629	217
Food and Nutrition Service	23,620	27,865	28,486	28,065	-421
Forest Service	2,934	3,236	3,236	3,001	-235
Other	4,130	4,666	4,721	4,666	-55
Subtotal, Agriculture	46,012	55,432	55,855	54,119	-1,736
Commerce	3,734	2,796	2,791	2,585	-206

Table 2.--1991 BUDGET RECEIPTS BY SOURCE
(fiscal years, in millions of dollars)

Receipts by Source	1990 Actual	1991 Estimate February	1991 Estimate July	1991 Actual	Actual less July Est.
Individual income taxes	466,884	492,635	481,901	467,827	-14,074
Corporation income taxes	93,507	95,866	98,508	98,086	-422
Social insurance taxes and contributions:					
Employment taxes and contributions	353,891	376,175	369,354	370,526	1,172
On-budget	(72,235)	(77,888)	(76,391)	(76,641)	250
Off-budget	(281,656)	(298,287)	(292,963)	(293,885)	922
Unemployment insurance	21,635	21,194	21,112	20,922	-190
Other retirement contributions	4,522	4,586	4,586	4,563	-23
Subtotal, Social insurance taxes and contributions	380,048	401,955	395,052	396,011	959
Excise taxes	35,345	44,810	42,333	42,430	97
Estate and gift taxes	11,500	12,241	11,493	11,138	-355
Customs duties	16,707	17,698	16,999	15,921	-1,078
Miscellaneous receipts	27,316	26,236	22,392	22,847	455
Total, Receipts	1,031,307	1,091,441	1,068,678	1,054,260	-14,418
On-budget	(749,652)	(793,153)	(775,715)	(760,376)	-15,339
Off-budget	(281,656)	(298,287)	(292,963)	(293,885)	922

NOTE: Detail may not add to totals due to rounding.

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
October 29, 1991

CONTACT: Office of Financing
202-219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 20,800 million, to be issued November 7, 1991. This offering will provide about $ 1,725 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 19,078 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, November 4, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Standard time, for competitive tenders. The two series offered are as follows:

91 -day bills (to maturity date) for approximately $ 10,400 million, representing an additional amount of bills dated August 8, 1991 and to mature February 6, 1992 (CUSIP No. 912794 XY 5), currently outstanding in the amount of $ 10,455 million, the additional and original bills to be freely interchangeable.

182 -day bills (to maturity date) for approximately $ 10,400 million, representing an additional amount of bills dated May 9, 1991 and to mature May 7, 1992 (CUSIP No. 912794 YM 0), currently outstanding in the amount of $ 11,854 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 November 7, 1991. 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 $ 955 million as agents for foreign and international monetary authorities, and $ 5,141 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 competitive 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.

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.

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.

8/89

TREASURY NEWS

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

Embargoed Until Release
October 30, 1991
9:00 am

The Honorable John E. Robson
Deputy Secretary of the Treasury
Before the Committee on Small Business
United States Senate

October 30, 1991

Mr. Chairman, members of the Committee, I am pleased to appear before you today to address issues relating to the availability of bank credit.

Today, I would like to describe the steps the Administration has taken, with the collaboration and cooperation of the bank and thrift regulatory agencies -- the Federal Reserve Board, the FDIC, the Comptroller of the Currency and the Office of Thrift Supervision, to address the regulatory aspects of this credit crunch. Also, I would like to discuss how the passage of the President's growth initiatives and comprehensive banking reform could contribute to a healthier economy and stronger, more competitive banks which can better handle future periods of tight credit.

Factors Contributing to the Credit Crunch

During the last year there has been considerable discussion about the so-called "credit crunch" and its impact on the economy.

Let me say first, that despite some assertions in the media that the credit crunch is illusory, we believe that a real credit crunch exists for certain types of borrowers and in certain regions of the country and that it is having a negative effect on the economic recovery. By "credit crunch" I mean that loans which could reasonably and responsibly be made are not available. These are loans that in normal times would be made -- not go-go credits -- and loans which could be extended under traditional standards. A banker in a recent meeting we had put it succinctly when he said, "We are not making loans that we could make". So we do not concur in the thesis that the current credit situation is simply a matter of weak demand for loans. This problem has a supply side.

The credit crunch has multiple causes which I will discuss in more detail, but which I will enumerate on here to indicate its complexity. These causes include:

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-- The recession, which has sapped consumer, business and banker confidence;

-- Lender caution induced by the savings and loan catastrophe;

-- Lenders' effort to build capital to meet international standards and satisfy stock market and credit agency concern about financial institution capital levels;

-- Severe overbuilding in the real estate sector, especially commercial real estate;

-- Reduced lending and tougher collateral requirements caused by the perception that borrowers have easier access to bankruptcy protection;

-- Bank management uncertainty about what future structure and laws will govern the industry;

-- Increased risk aversity, due to greater exposure to liability on the part of bank directors and officers and various professionals such as appraisers and accountants; and

-- The influence of bank regulatory policy and examiner overreaction.

Let me also add that we are, as is the Committee, aware of the severe consequences a credit crunch has on small and medium businesses which do not have access to the capital markets and must rely primarily on bank credit for growth, expansion, and in some cases, survival.

Recession

From roughly July of 1990 until mid-year 1991, our country experienced a recession -- a recession somewhat less severe than average, but a very real one nevertheless. This declining level of economic activity, combined with the uncertainty resulting from fighting in the Persian Gulf War, negatively impacted consumer and business confidence. During recessions, people buy less, so demands for credit soften. Likewise, real estate markets have experienced increasing vacancy rates and falling rents. Commercial banks have seen a rise in non-performing assets and the need for greater loan loss reserves -- while at the same time they are working to raise capital.

Recognizing these trends, the Federal Reserve Board lowered short-term interest rates and reduced the reserves that banks are required to maintain on deposit at the Federal Reserve. While these steps were helpful, it is my view that the Federal Reserve actions came too slowly. Money supply, as measured by M2, is still growing well below the rate set by the Federal Reserve's own target ranges.

The Commerce Department reported yesterday that real GNP rose at an annual rate of 2.4 percent in the third quarter, so that while not robust, the economy has moved out of recession. These are macroeconomic statistics and we realize that there are regions and economic sectors which are struggling.

Regulation's Impact on the Supply of Credit

Many businesses and borrowers have reported a significantly more stringent bank regulatory approach. It must be said first that this approach was in substantial measure due to the banking agencies' application of prudent regulation in more severe economic conditions, where the creditworthiness of borrowers and the values of collateral had in fact deteriorated, necessitating larger loan loss reserves. Praise, not criticism, should be given to the bank regulators for vigilance in difficult economic conditions. No one wants to return to the dangerous regulatory laxity that marked the savings and loan collapse.

However, it is this same savings and loan collapse that many believe has generated an overcorrection -- or some would call overzealousness -- in the application of regulatory policy. Nearly every day, an examiner can turn on CSPAN or read in the local newspaper about a Congressional Committee attacking a regulator for being too lax -- rarely, if ever, for being too strict. Thus, the nearly 7,000 examiners in the field are subjected to a "mixed message." This mixed message makes the job of achieving our goal -- balanced, common sense regulation -- especially difficult. This hearing is an important step in examining how to achieve a more direct and balanced message from both the legislative and the executive branches of government.

Likewise, prompt confirmation of Bob Clarke and Alan Greenspan, as well as the President's nominees to the Board of Governors of the Federal Reserve, would reduce uncertainty about the direction of regulatory policy.

There are banks, borrowers, and economic sectors experiencing temporary difficulties which need flexibility to work through their problems, and, regulatory judgment should and can be quite responsibly exercised in these situations.

In these areas of appropriate regulatory judgment the perception has been created among banks and businesses that examiners are inflexible and overly harsh. This perception has contributed to create an atmosphere of risk-aversity, apprehension and hesitation among lenders, and has resulted in the constraint of bank credit even to sound borrowers.

Lender's Contribution to the Credit Crunch

Bankers too have become more cautious. This is due in part to the perceived increase in regulatory scrutiny. But, bankers have on their own, tightened loan standards in response to their bad experiences with the loan loss lessons of the last decade: farm credit, third world debt, real estate, and highly leveraged transactions. These previous difficulties have increased the risk aversity of many loan officers.

It is also reported to us that bank directors, concerned about increased personal liability due to the provisions contained in FIRREA and the 1990 Crime Control Act, have instructed officers to be ultra-conservative in their lending. Wall Street stock analysts consider real estate "high risk lending" and thus, publicly traded banking companies are attempting to please analysts and boost their stock prices by rapidly reducing their real estate exposure. Banks hurt by loan losses in real estate may limit new lending to even credit worthy small businesses, as they attempt to shrink loan portfolios in order to build capital reserves.

The result is a banking system that is not functioning properly and that has retreated from its role as a taker of reasonable risks to fuel the establishment of new enterprises and the expansion of economic activity. It is my opinion that it is a poorer America where the old fashioned character loan is no longer available.

The Credit Crunch and Small Business

The impact of this credit crunch on small business, like the rest of the country, has not been uniform. New England continues to report more problems than elsewhere.

The National Federation of Independent Business (NFIB) quarterly publishes a survey of 2,000 small businesses. In both the March and July 1991 surveys, those small businesses who regularly borrow did not cite a material difficulty in obtaining credit. The study did note that there was a weak demand for short-term loans, particularly in light of earnings performance.

Credit availability for small business in the second quarter was unchanged from what it has been over the last year. However, borrowing frequency held at comparatively low levels and we continue to hear anecdotal evidence of small business not getting credit. One percent of those polled by the NFIB reported credit easier to obtain in the last three months compared to the prior three; 12 percent reported it harder to get. These numbers indicated that credit has been more difficult to obtain in the last quarter than it has been historically, but not more so than in the three prior recessions.

One area we have followed closely is residential housing. Many single family home builders have pointed to a dramatic decrease in credit available for new construction -- even in areas where there is identifiable demand for new starts. These borrowers could be victims of both overly cautious bankers and regulators, and also of a failure to distinguish properly among credit requests for commercial real estate in overbuilt markets and needed residential real estate credit. Another area of difficulty are those small businesses attempting to borrow and operate in regions of the country where there have been a large number of local banks in financial difficulty, such as New England or here in the Washington, D.C. metropolitan area.

Improving the Climate for Lending

Since the summer of 1990, President Bush and other Administration officials have been meeting with bankers, businesses, and the regulators to identify specific steps that could be taken to improve the climate for lending. These meetings led to regulatory policy changes and clarifications that were released in March, July, and October of 1991. Each of these steps is aimed at achieving balance and common sense in the application of regulatory policy, and raising the level of confidence in the lending environment. These changes are permanent changes to improve bank regulation. They are not simply quick-fix changes which will be abandoned when the credit crunch is over.

Some of these policy changes provided specific guidelines for the handling of troubled real estate loans, methods for working with troubled borrowers and improving the banker-examiner relationship. Specific changes and clarifications include:

- Directives that bankers should work constructively with borrowers experiencing temporary difficulties and facilitate the orderly restructuring of credits;

- Prudent refinancing of economically sound commercial real estate loans;

- Improved verification by regulatory supervisors that recent policy changes and clarifications are appropriately applied in each examination;

- Enhancements in the process for appeals of alleged misapplication of regulatory standards;

- Harmonization of the treatment of preferred stock in U.S. capital standards with other signatory countries under the Basle capital accord;

- Appropriate application of valuation standards especially in real estate credits so as to avoid a liquidation approach to valuation;

- Improved guidance in the appraisal process and steps to reduce excessive appraisal costs for lenders; and

- Legislative action to make permanent a recent EPA proposed regulation to limit lender liability for environmental cleanup of loan collateral properties, and to address related issues.

Long-Term Solutions to Future Credit Crunches

Addressing the credit crunch is a battle which must be waged in the short term to accelerate and sustain the economic recovery. To encourage long term economic growth, Congress should act immediately to pass the President's initiatives for economic growth which were submitted in our 1992 budget request but on which Congress had yet to act. Our program would:

-- Reduce the capital gains tax rate to promote jobs and business formation;

-- Enhance personal savings through an expanded Individual Retirement Account (IRA) and the Family Savings Account;

-- Make permanent the Research and Experimentation tax credit;

-- Increase federal investment in science, technology and infrastructure;

-- And keep the pay-as-you-go system in the budget process to ensure that any new spending must be offset by decreased spending elsewhere in the budget. This restraint on federal spending must be kept in place to contain the deficit.

Next, in order to ensure that our country has a competitive and strong financial services industry, the Congress should pass the President's comprehensive banking reform measures. As Treasury Secretary Brady said on March 18, 1991, "the state of banking in the U.S. leaves taxpayers overexposed, consumers and business underserved, and the industry increasingly uncompetitive.

Comprehensive reform is essential because strong banks and financial service firms are a key to the economic health of our country. Strong banks will keep credit available in good times and bad, fueling economic growth and new jobs. Competitive, well capitalized financial institutions are a sure way to avoid future credit crunches. If you want stronger banks, banks that will return to the business of lending money to sound customers for sound projects, work with your colleagues to pass this package.

Conclusion

Mr. Chairman, in the past, I have served as the head of a federal regulatory agency and as the chief executive officer of a company operating in a regulated industry. Thus, I believe that I can speak with some perspective on the dynamics of the regulatory process and what it takes to achieve the desired result.

It takes constant and consistent communication of the policies and procedures that one wants followed in order to achieve balanced and consistent regulation. Regulation should be consistent in boom times as well as times of economic hardship. We need the help of you and your colleagues, Mr. Chairman, to accomplish our mutual goal of safe and sound banks and available credit for America's entrepreneurs and businesses.

I would now be pleased to respond to the Committee's questions.

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

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE
October 30, 1991

CONTACT: Office of Financing
202/219-3350

TREASURY NOVEMBER QUARTERLY FINANCING

The Treasury will raise about $17,800 million of new cash and refund $20,189 million of securities maturing November 15, 1991, by issuing $14,000 million of 3-year notes, $12,000 million of 10-year notes, and $12,000 million of 30-year bonds. The $20,189 million of maturing securities are those held by the public, including $1,447 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The three issues totaling $38,000 million are being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average prices of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks hold $2,585 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

The 10-year note and 30-year bond being offered today will be eligible for the STRIPS program.

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

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Attachment

NB-1527

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC

NOVEMBER 1991 QUARTERLY FINANCING

October 30, 1991

Amount Offered to the Public	$14,000 million	$12,000 million	$12,000 million
Description of Security:			
Term and type of security	3-year notes	10-year notes	30-year bonds
Series and CUSIP designation	Series U-1994 (CUSIP No. 912827 C9 1)	Series D-2001 (CUSIP No. 912827 D2 5)	Bonds of November 2021 (CUSIP No. 912810 EL 8)
CUSIP Nos. for STRIPS Components	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Issue date	November 15, 1991	November 15, 1991	November 15, 1991
Maturity date	November 15, 1994	November 15, 2001	November 15, 2021
Interest rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates	May 15 and November 15	May 15 and November 15	May 15 and November 15
Minimum denomination available	$5,000	$1,000	$1,000
Amount required for STRIPS	Not applicable	To be determined after auction	To be determined after auction
Terms of Sale:			
Method of sale	Yield auction	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $5,000,000	Accepted in full at the average price up to $5,000,000	Accepted in full at the average price up to $5,000,000
Accrued interest payable by investor	None	None	None
Key Dates:			
Receipt of tenders	Tuesday, November 5, 1991	Wednesday, November 6, 1991	Thursday, November 7, 1991
a) noncompetitive	prior to 12:00 noon, EST	prior to 12:00 noon, EST	prior to 12:00 noon, EST
b) competitive	prior to 1:00 p.m., EST	prior to 1:00 p.m., EST	prior to 1:00 p.m., EST
Settlement (final payment due from institutions):			
a) funds immediately available to the Treasury	Friday, November 15, 1991	Friday, November 15, 1991	Friday, November 15, 1991
b) readily-collectible check	Wednesday; November 13, 1991	Wednesday, November 13, 1991	Wednesday, November 13, 1991

TREASURY NEWS

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

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October 30, 1991

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TREASURY NOVEMBER QUARTERLY FINANCING

The Treasury will raise about $17,800 million of new cash and refund $20,189 million of securities maturing November 15, 1991, by issuing $14,000 million of 3-year notes, $12,000 million of 10-year notes, and $12,000 million of 30-year bonds. The $20,189 million of maturing securities are those held by the public, including $1,447 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The three issues totaling $38,000 million are being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average prices of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks hold $2,585 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

The 10-year note and 30-year bond being offered today will be eligible for the STRIPS program.

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

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Attachment

NB-1527

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC

NOVEMBER 1991 QUARTERLY FINANCING

October 30, 1991

Amount Offered to the Public	$14,000 million	$12,000 million	$12,000 million
Description of Security:			
Term and type of security	3-year notes	10-year notes	30-year bonds
Series and CUSIP designation	Series U-1994 (CUSIP No. 912827 C9 1)	Series D-2001 (CUSIP No. 912827 D2 5)	Bonds of November 2021 (CUSIP No. 912810 EL 8)
CUSIP Nos. for STRIPS Components ..	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Issue date	November 15, 1991	November 15, 1991	November 15, 1991
Maturity date	November 15, 1994	November 15, 2001	November 15, 2021
Interest rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates	May 15 and November 15	May 15 and November 15	May 15 and November 15
Minimum denomination available ...	$5,000	$1,000	$1,000
Amount required for STRIPS	Not applicable	To be determined after auction	To be determined after auction
Terms of Sale:			
Method of sale	Yield auction	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $5,000,000	Accepted in full at the average price up to $5,000,000	Accepted in full at the average price up to $5,000,000
Accrued interest payable by investor	None	None	None
Key Dates:			
Receipt of tenders	Tuesday, November 5, 1991	Wednesday, November 6, 1991	Thursday, November 7, 1991
a) noncompetitive	prior to 12:00 noon, EST	prior to 12:00 noon, EST	prior to 12:00 noon, EST
b) competitive	prior to 1:00 p.m., EST	prior to 1:00 p.m., EST	prior to 1:00 p.m., EST
Settlement (final payment due from institutions):			
a) funds immediately available to the Treasury	Friday, November 15, 1991	Friday, November 15, 1991	Friday, November 15, 1991
b) readily-collectible check	Wednesday, November 13, 1991	Wednesday, November 13, 1991	Wednesday, November 13, 1991

TALKING POINTS
FOR THE
FINANCING PRESS CONFERENCE
October 30, 1991

Today, we are announcing the terms of Treasury's regular November midquarter refunding. I will also discuss the Treasury's financing requirements for the balance of the current calendar quarter and our estimated cash needs for the January-March 1992 quarter.

1. We are offering $38.0 billion of notes and bonds to refund $20.2 billion of privately-held notes maturing on November 15 and to raise approximately $17.8 billion of cash. The three securities are:

- -- First, a 3-year note in the amount of $14.0 billion, maturing on November 15, 1994. This note is scheduled to be auctioned on a yield basis on Tuesday, November 5. The minimum denomination will be $5,000. Purchases may be made in any higher multiples of $5,000.
- -- Second, a 10-year note in the amount of $12.0 billion, maturing on November 15, 2001. This note is scheduled to be auctioned on a yield basis on Wednesday, November 6. The minimum denomination will be $1,000.
- -- Third, a 30-year bond in the amount of $12.0 billion, maturing November 15, 2021. This bond is scheduled to be auctioned on a yield basis on Thursday, November 7. The minimum denomination will be $1000.

2. We will accept noncompetitive tenders up to $5,000,000 for each of the note and bond auctions. This represents an increase in the maximum noncompetitive award from the $1,000,000 level that has been in place for notes and bonds since November 1976. The $1,000,000 noncompetitive award in Treasury bill auctions is unchanged.

3. As announced on October 28, 1991, we estimate a net market borrowing need of $75.8 billion for the October-December quarter including an allowance for Resolution Trust Corporation operations. The estimate assumes a $30 billion cash balance at the end of December. We may want to have a higher balance, depending upon our assessment of cash needs at the time.

Including this refunding we will have raised $58.0 billion of the $75.8 billion in net market borrowing needed this October-December quarter. This net borrowing was accomplished as follows:

-- $4.5 billion of cash from the 7-year note that settled October 15;

-- $3.5 billion of cash from the 2-year notes which settled October 31;

-- $9.1 billion of cash from the 5-year notes which settled October 31;

-- $20.2 billion of cash from the sale of the regular weekly bills, including the bills announced yesterday;

-- $2.9 billion of cash in 52-week bills;

-- $17.8 billion of cash from the refunding issues announced today.

The $17.8 billion to be raised in the rest of the October-December quarter could be accomplished through sales of regular 13-, 26-, and 52-week bills, and 2-year and 5-year notes at the end of November and December.

4. We estimate Treasury net market borrowing needs to be in the range of $95 to $100 billion for the January-March 1992 quarter, assuming a $20 billion cash balance on March 31. The Treasury's January-March borrowing estimate includes an allowance for Resolution Trust Corporation operations.

5. The 10-year notes and 30-year bonds being announced today are eligible for conversion to STRIPS (Separate Trading of Registered Interest and Principal of Securities) and, accordingly, may be divided into separate interest and principal components.

6. The February midquarter refunding announcement will be on February 5, 1992.

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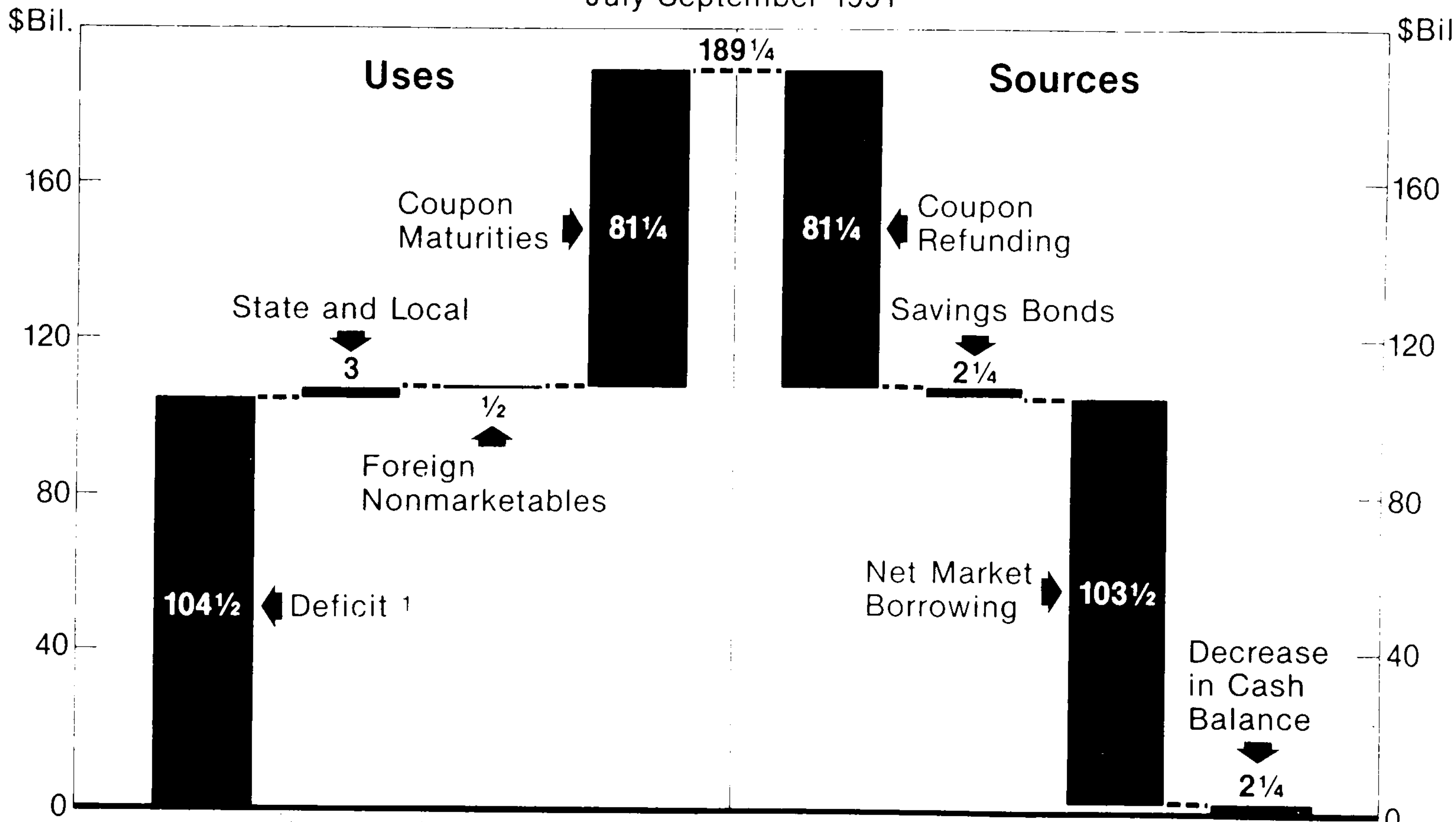
TREASURY FINANCING REQUIREMENTS

July-September 1991

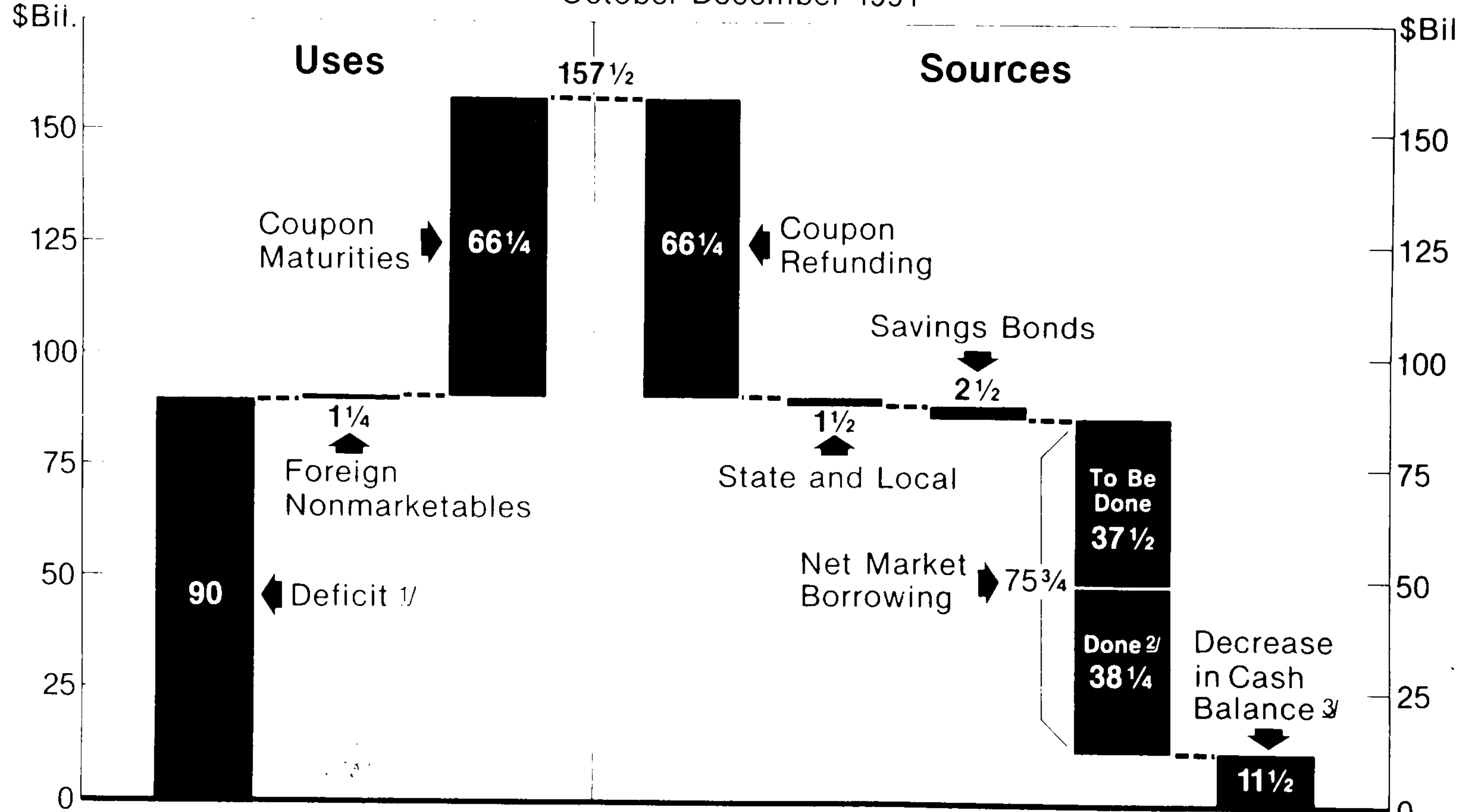


1/ Includes budget deficit, changes in accrued interest and checks outstanding and minor miscellaneous debt transactions.

Department of the Treasury,
Office of Market Finance

TREASURY FINANCING REQUIREMENTS

October-December 1991



1/ Includes budget deficit, changes in accured interest and checks outstanding and minor miscellaneous debt transactions.

2/ Issued or announced through October 25, 1991.

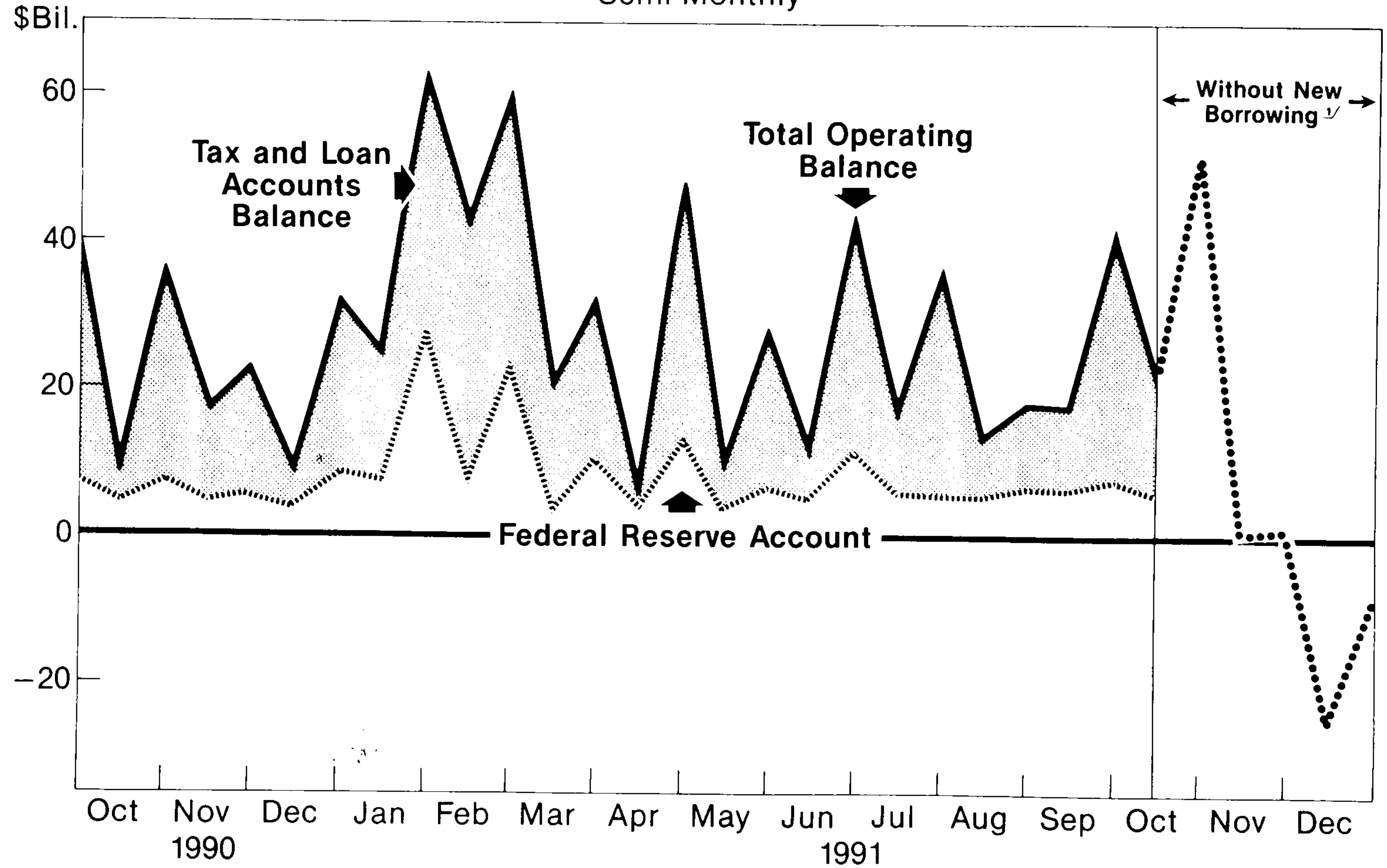
3/ Assumes a $30 billion cash balance December 31, 1991.

Department of the Treasury
Office of Market Finance

October 28, 1991-24

TREASURY OPERATING CASH BALANCE

Semi-Monthly

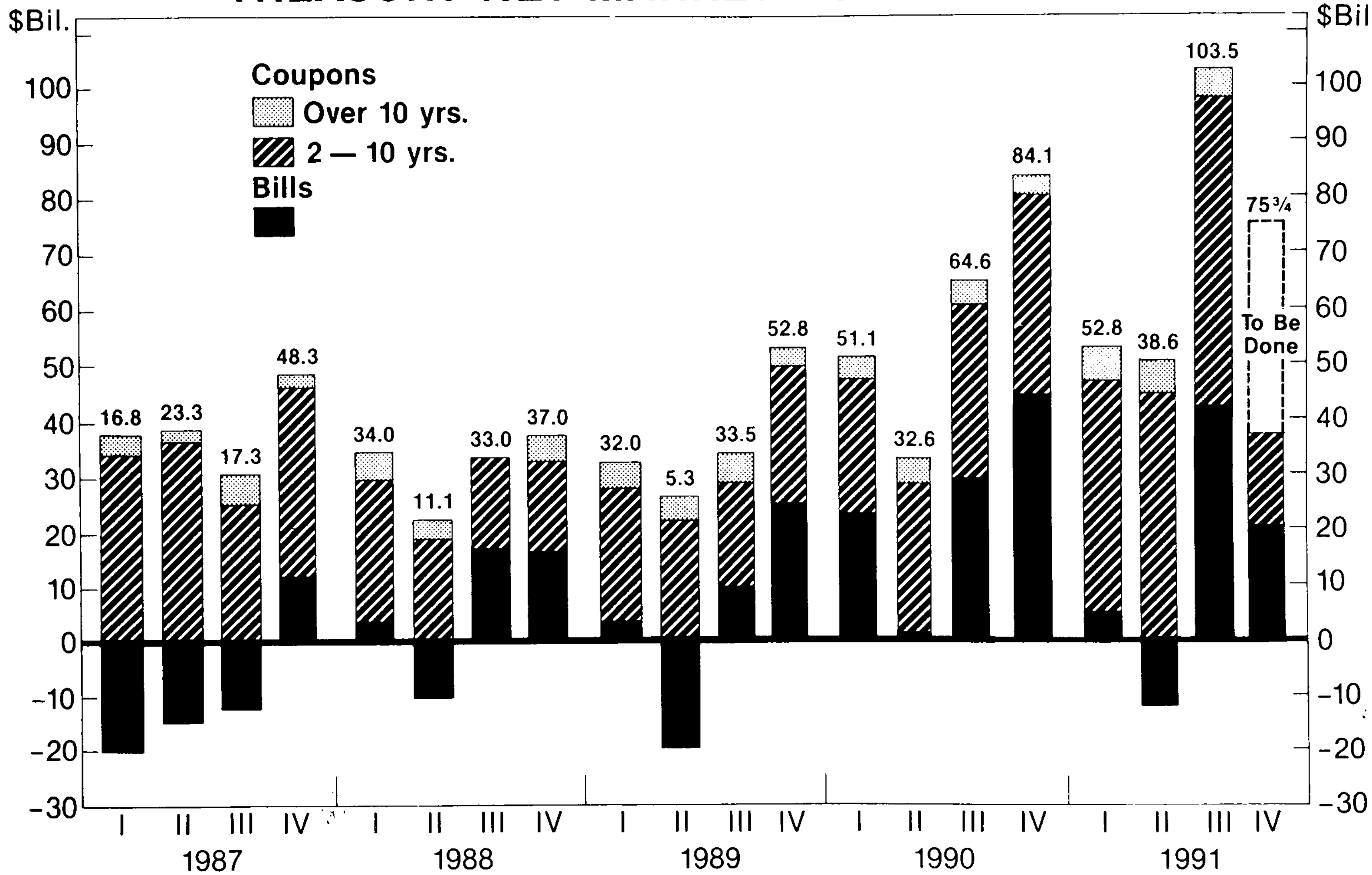


1/ Assumes refunding of maturing issues.

Department of the Treasury
Office of Market Finance

October 28, 1991-19

TREASURY NET MARKET BORROWING[1]

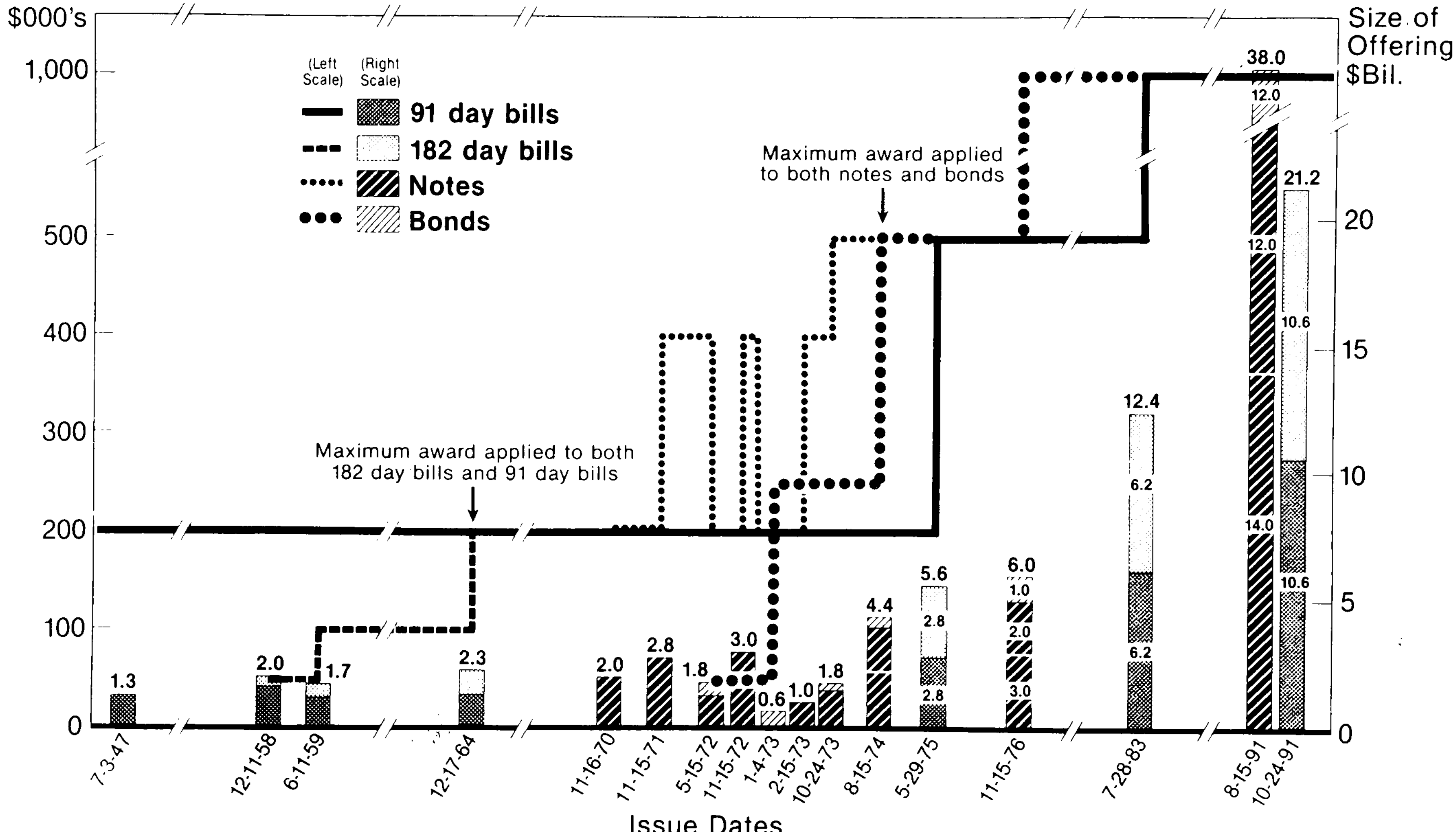


1/Excludes Federal Reserve and Government Account Transactions.

Department of the Treasury
Office of Market Finance

October 28, 1991-6

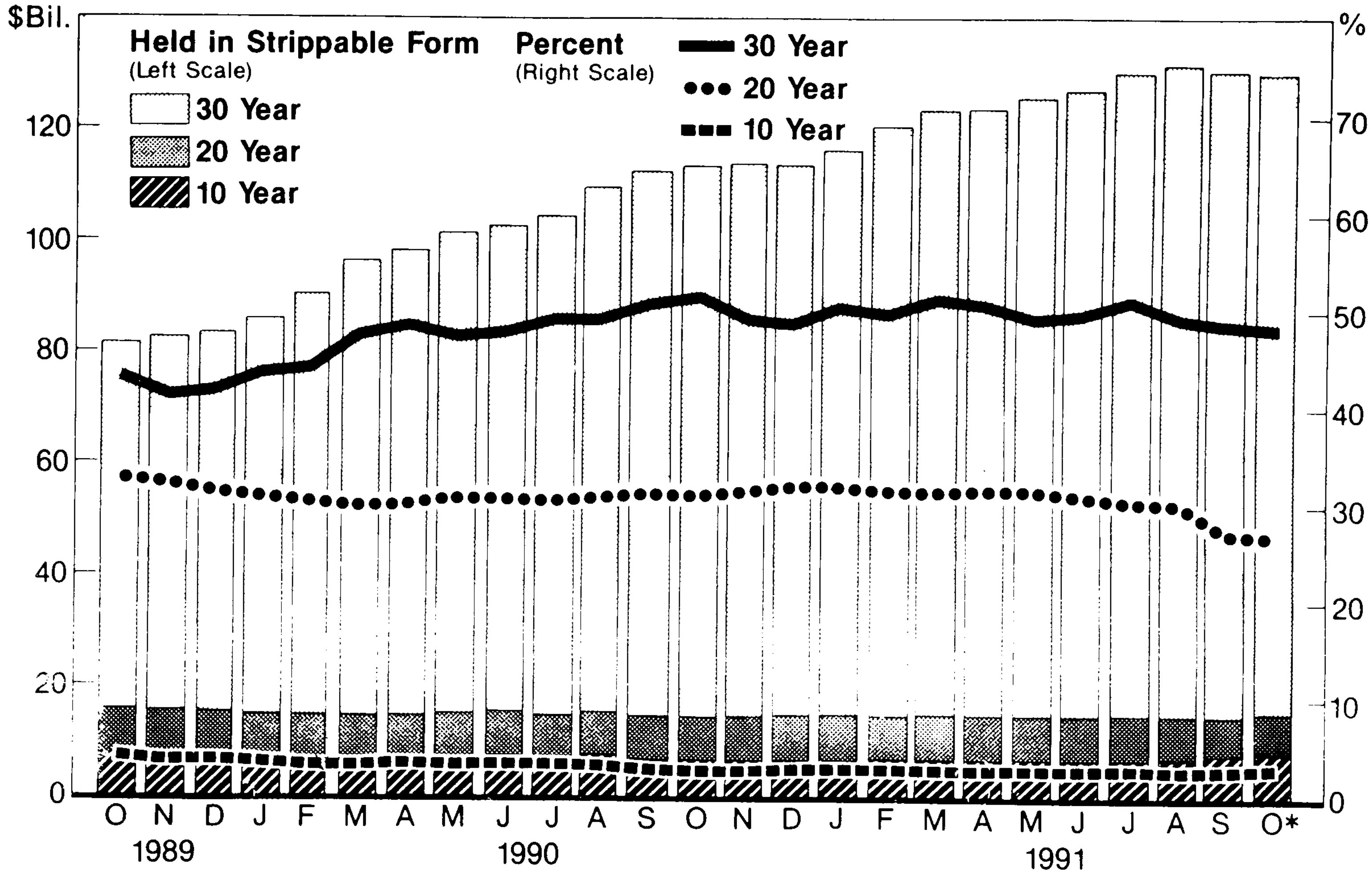
CHANGES IN SIZES OF MAXIMUM NONCOMPETITIVE AWARDS



Department of the Treasury
Office of Market Finance

October 28, 1991-5

NET STRIPS AS A PERCENT OF PRIVATELY HELD STRIPPABLE SECURITIES

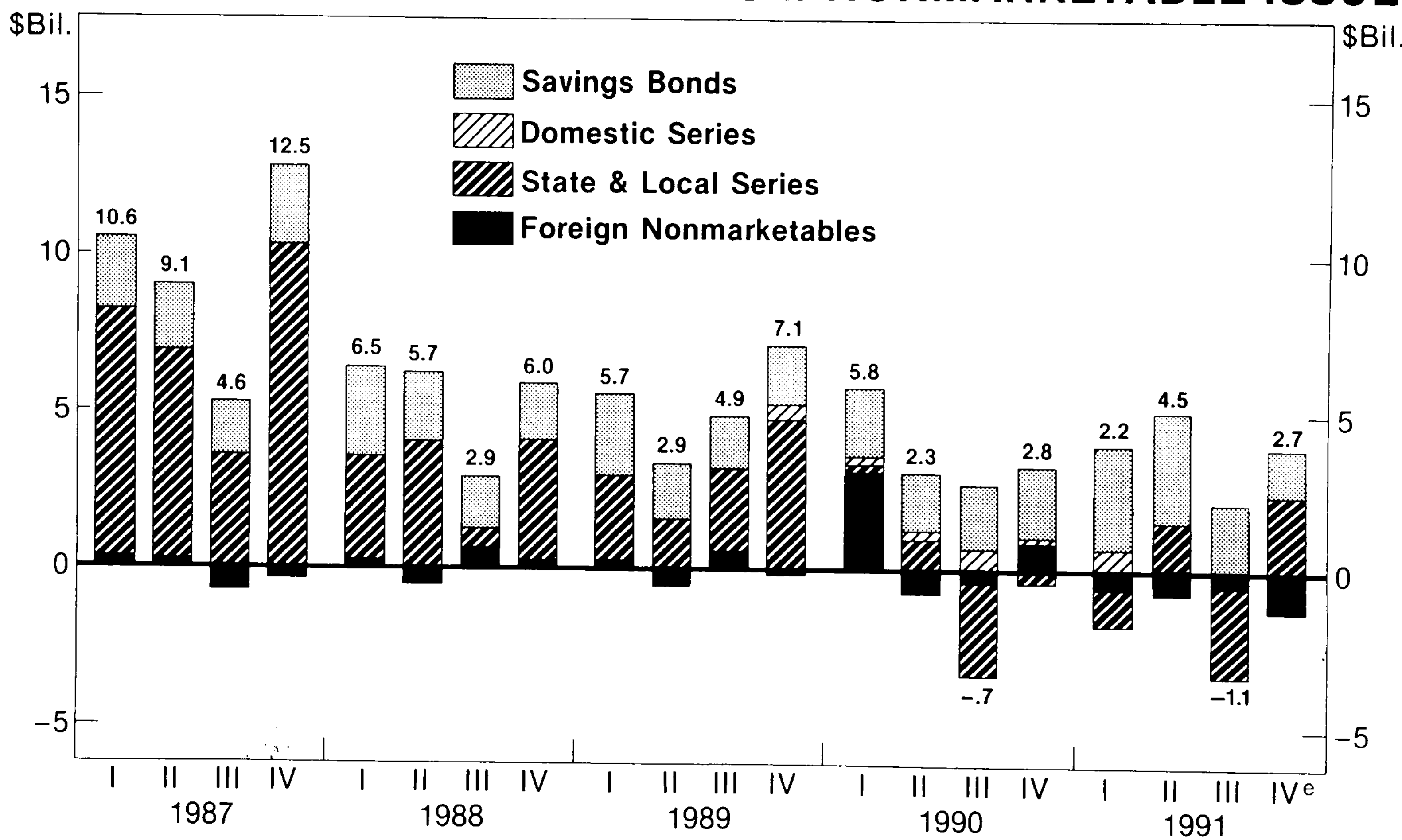


*Through October 18, 1991.
Note: Reconstitution began May 1, 1987

Department of the Treasury
Office of Market Finance

October 28, 1991-11

TREASURY NET BORROWING FROM NONMARKETABLE ISSUES

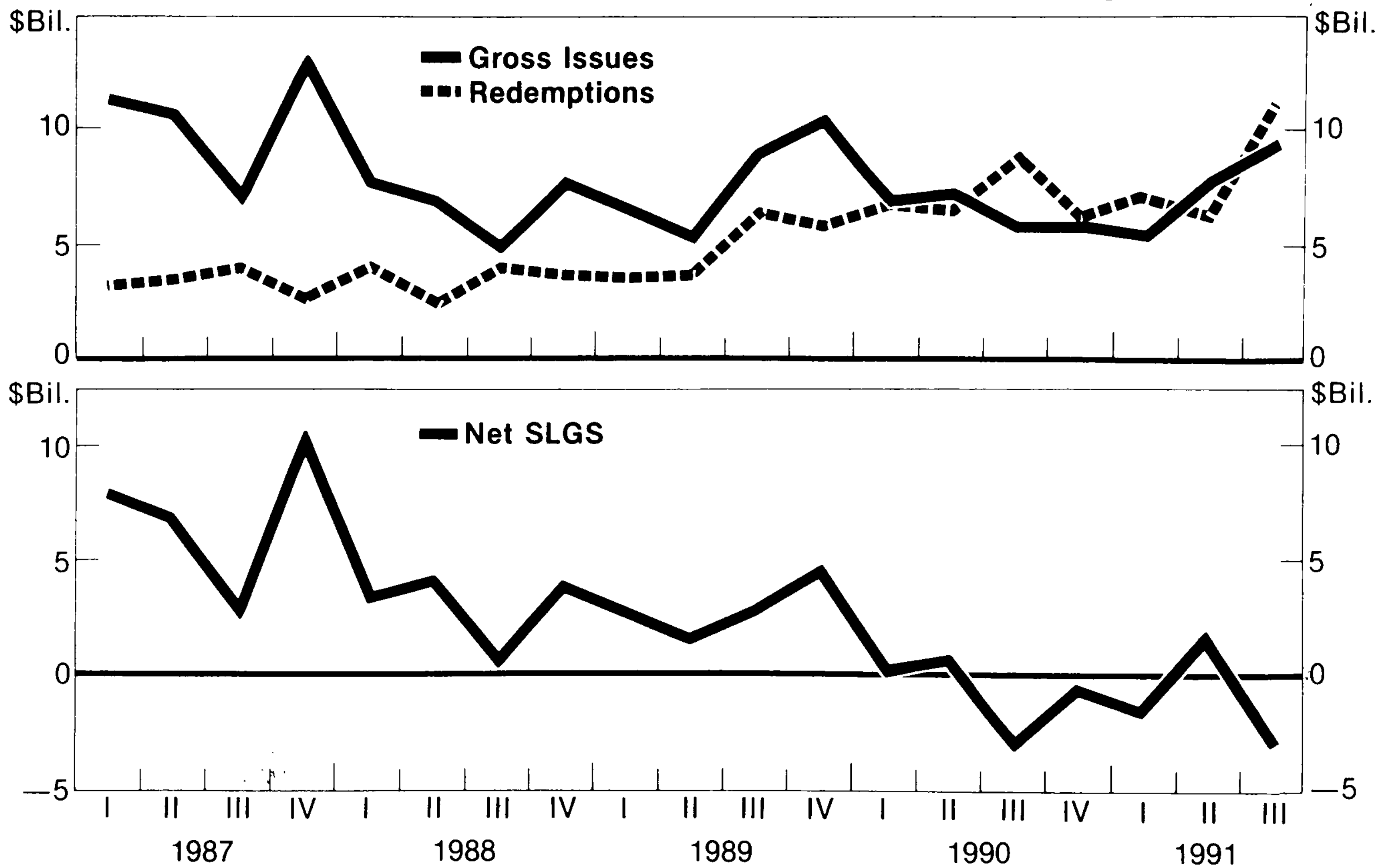


e estimate

Department of the Treasury
Office of Market Finance

October 28 1991 21

STATE & LOCAL GOVERNMENT SERIES



Department of the Treasury
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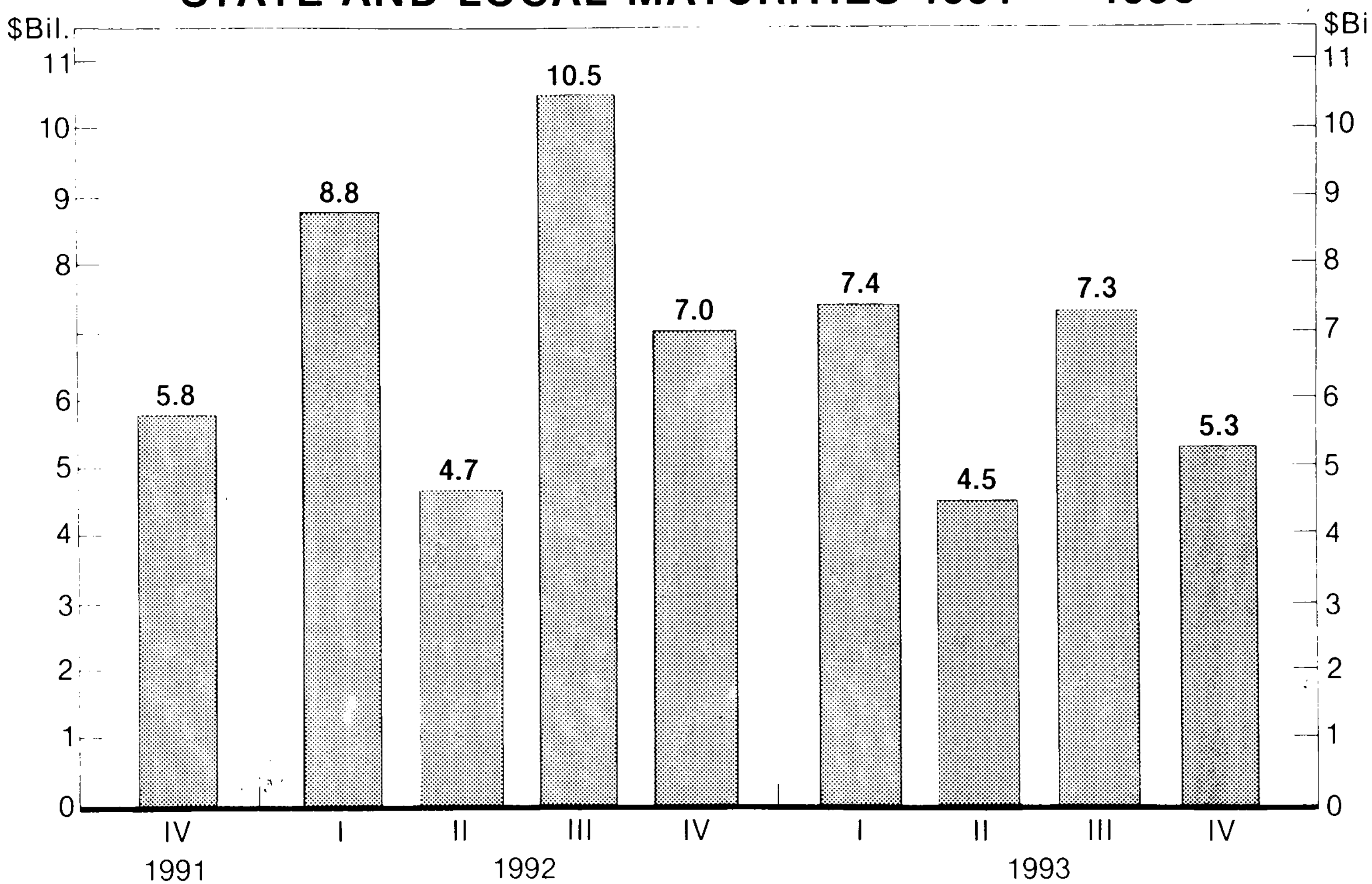
October 28, 1991-22

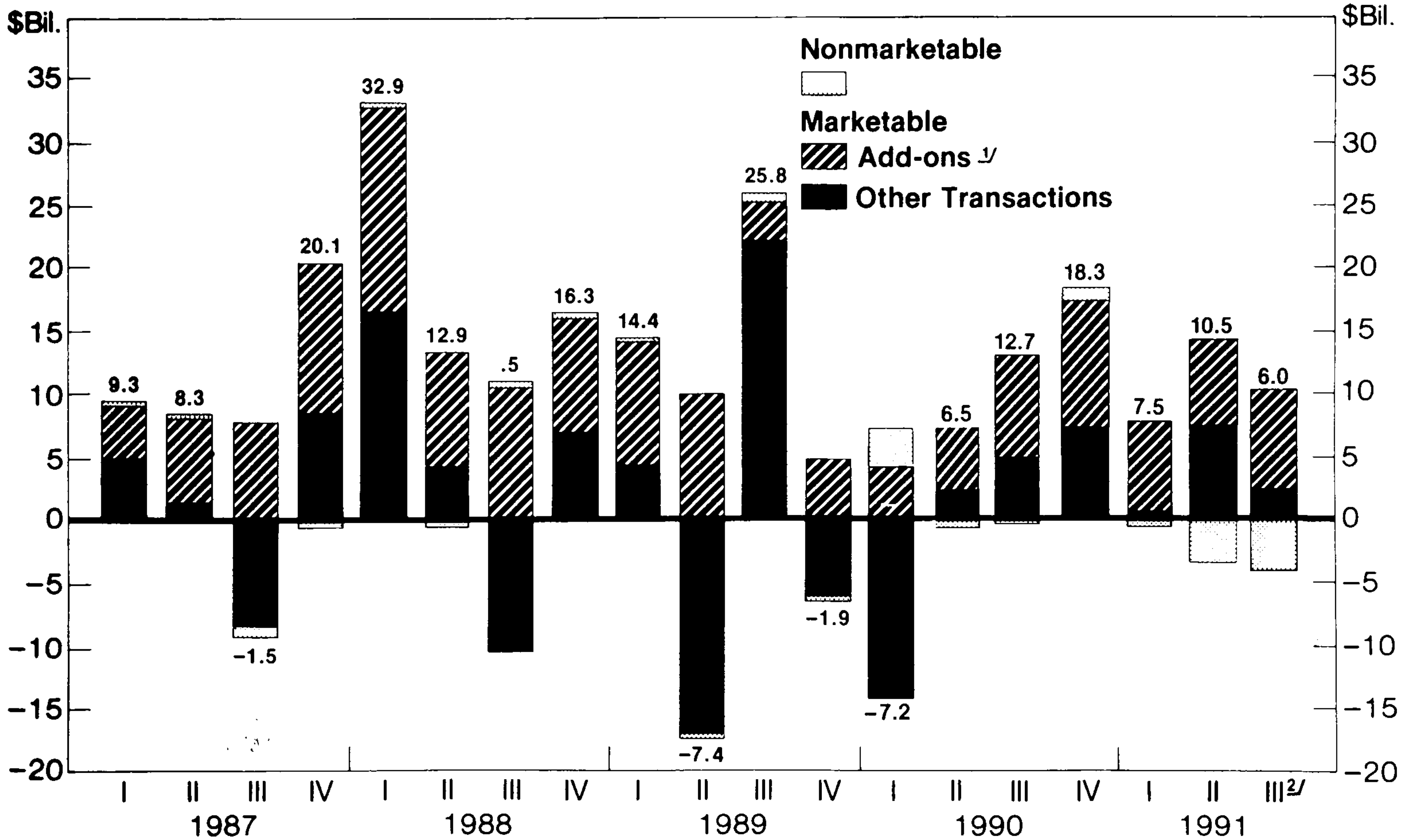
STATE AND LOCAL MATURITIES 1991 — 1993



Department of the Treasury
Office of Market Finance

October 28, 1991-18

QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES

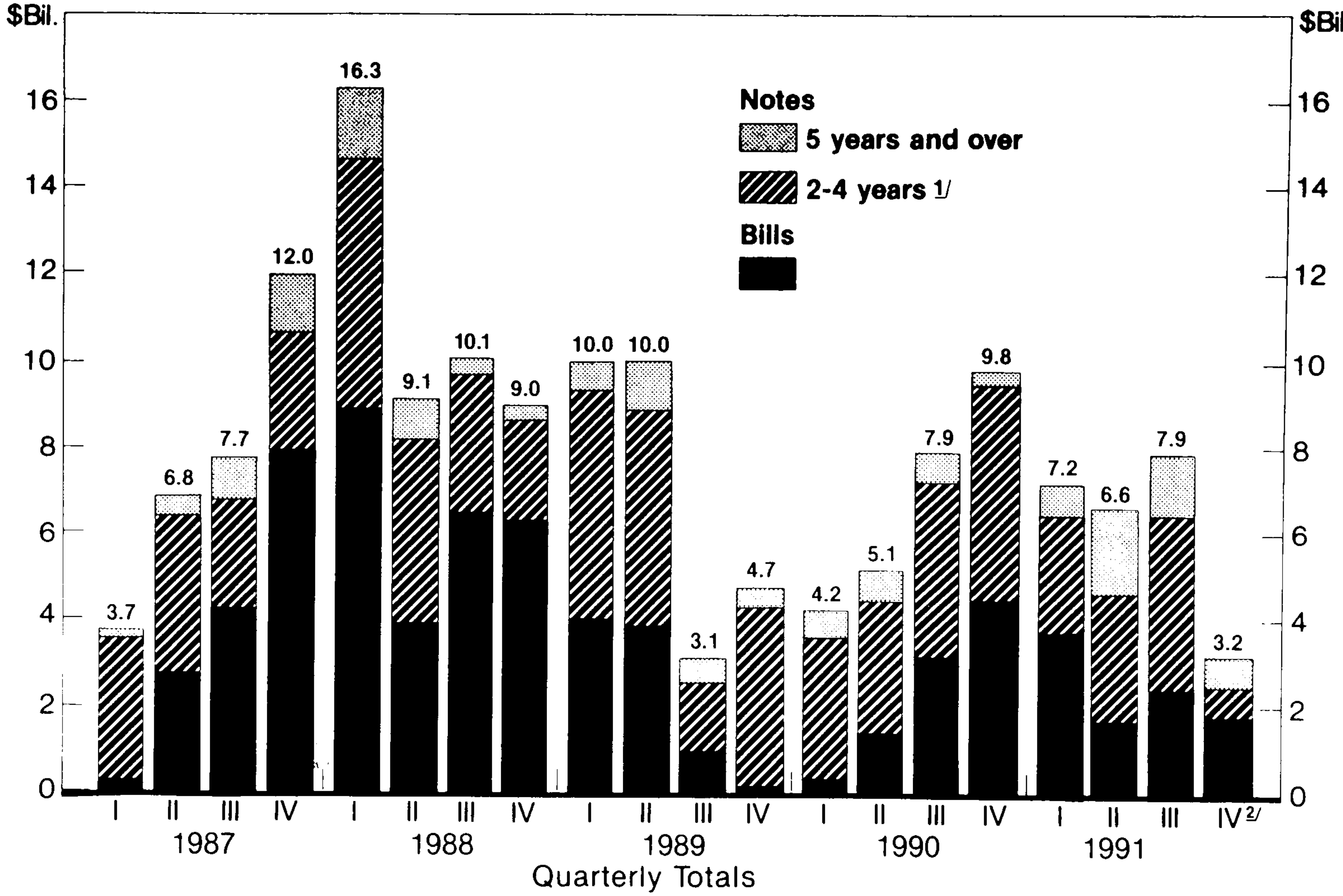


1/ F.R.B. purchases of marketable issues as agents for foreign and international monetary authorities which are added to the announced amount of the issue.
2/ Preliminary.

Department of the Treasury
Office of Market Finance

October 28, 1991 20

FOREIGN ADD-ONS IN TREASURY BILL AND NOTE AUCTIONS



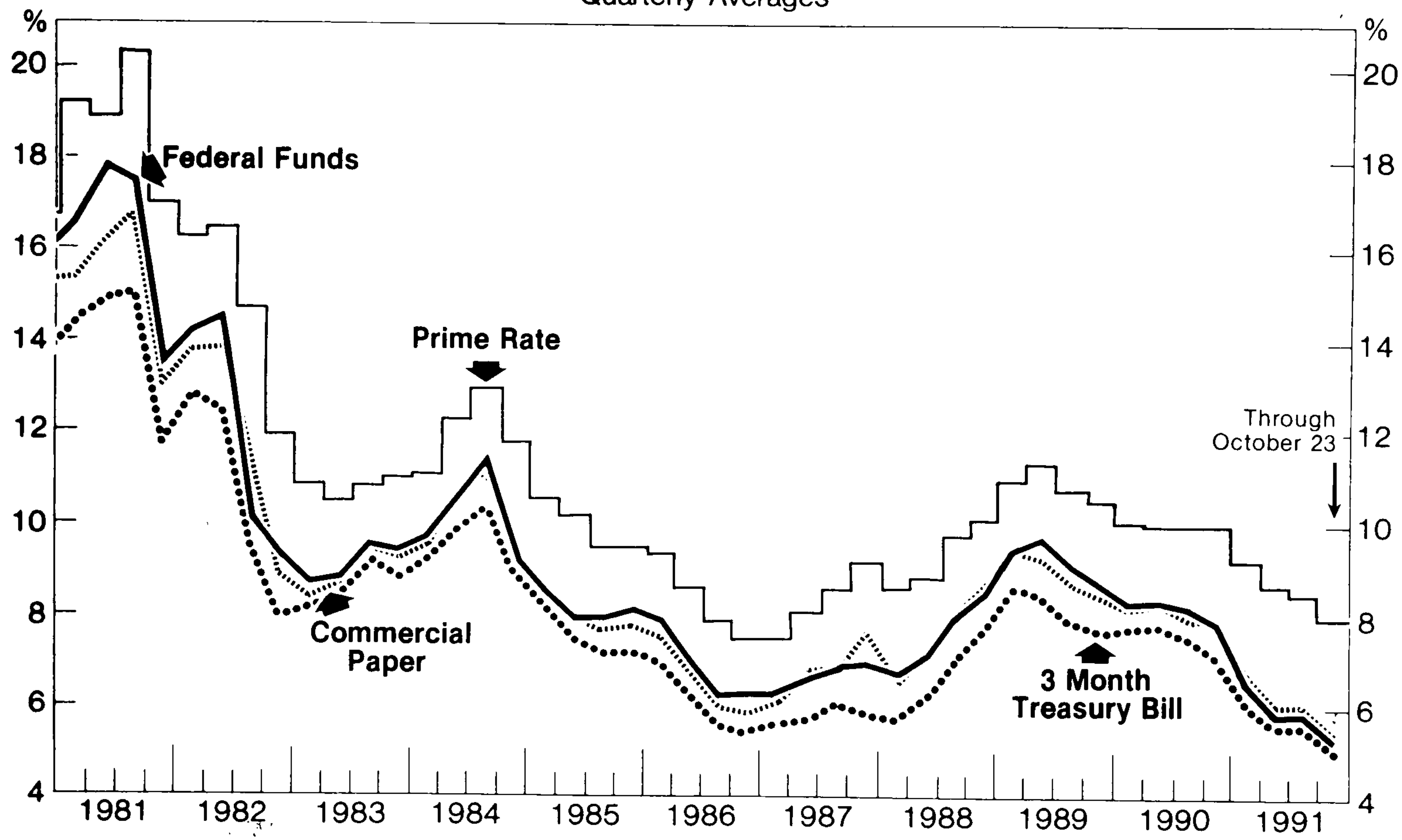
Department of the Treasury
Office of Market Finance

1/ 4 year notes not issued after December 31, 1990.
2/ Through October 24, 1991.

October 28, 1991-4

SHORT TERM INTEREST RATES

Quarterly Averages



Department of the Treasury
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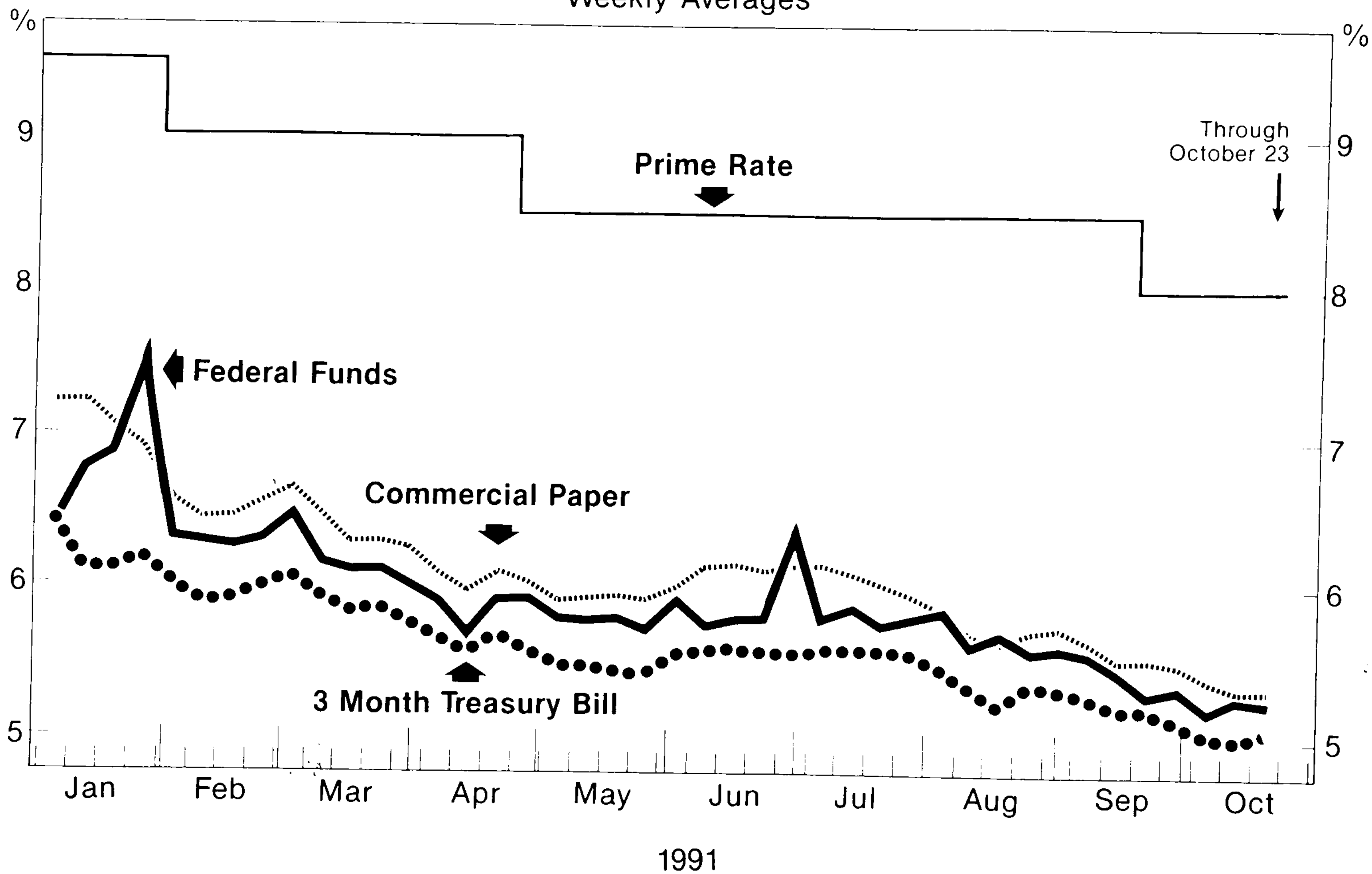
October 28, 1991 25

SHORT TERM INTEREST RATES

Weekly Averages



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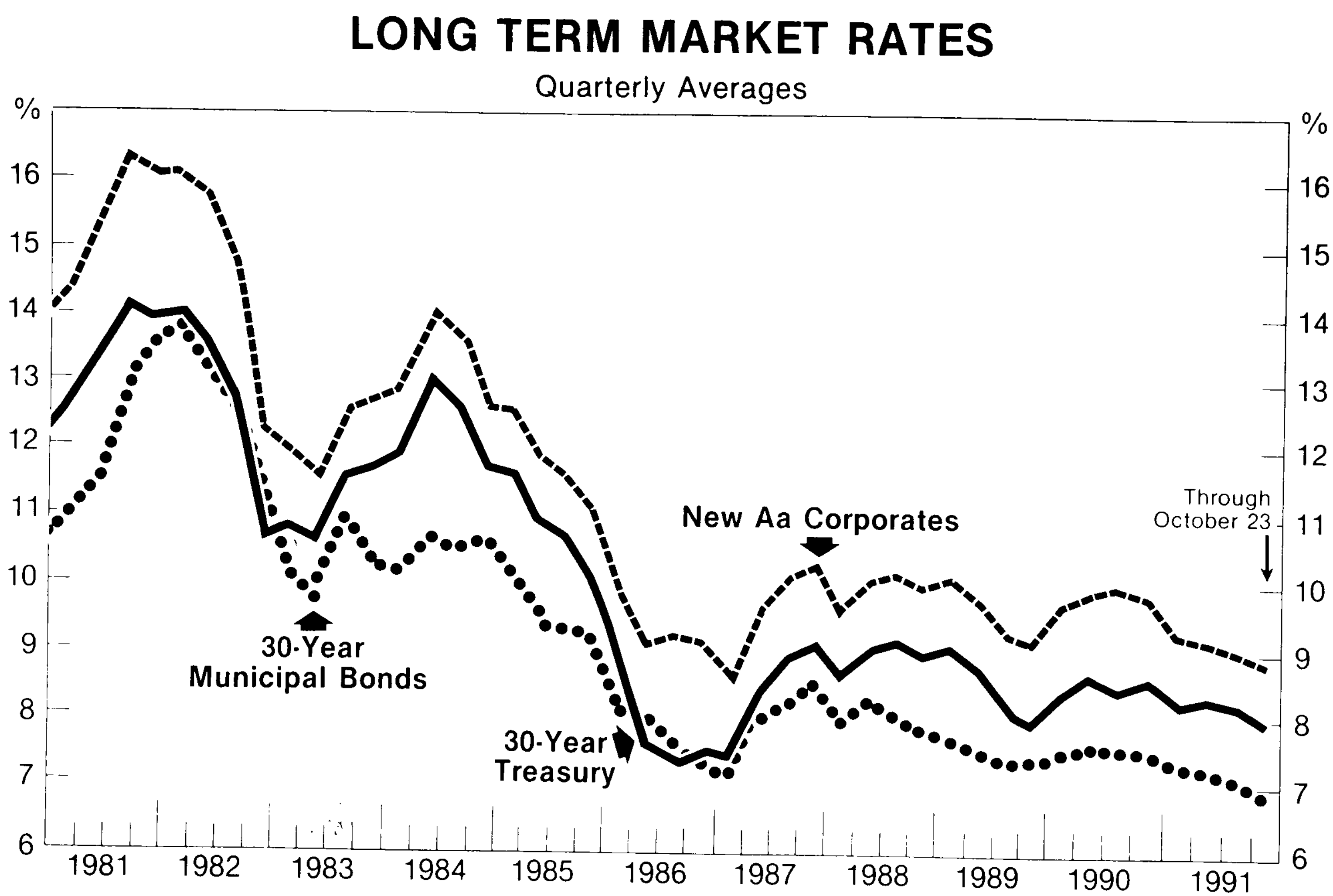
October 28, 1991-15



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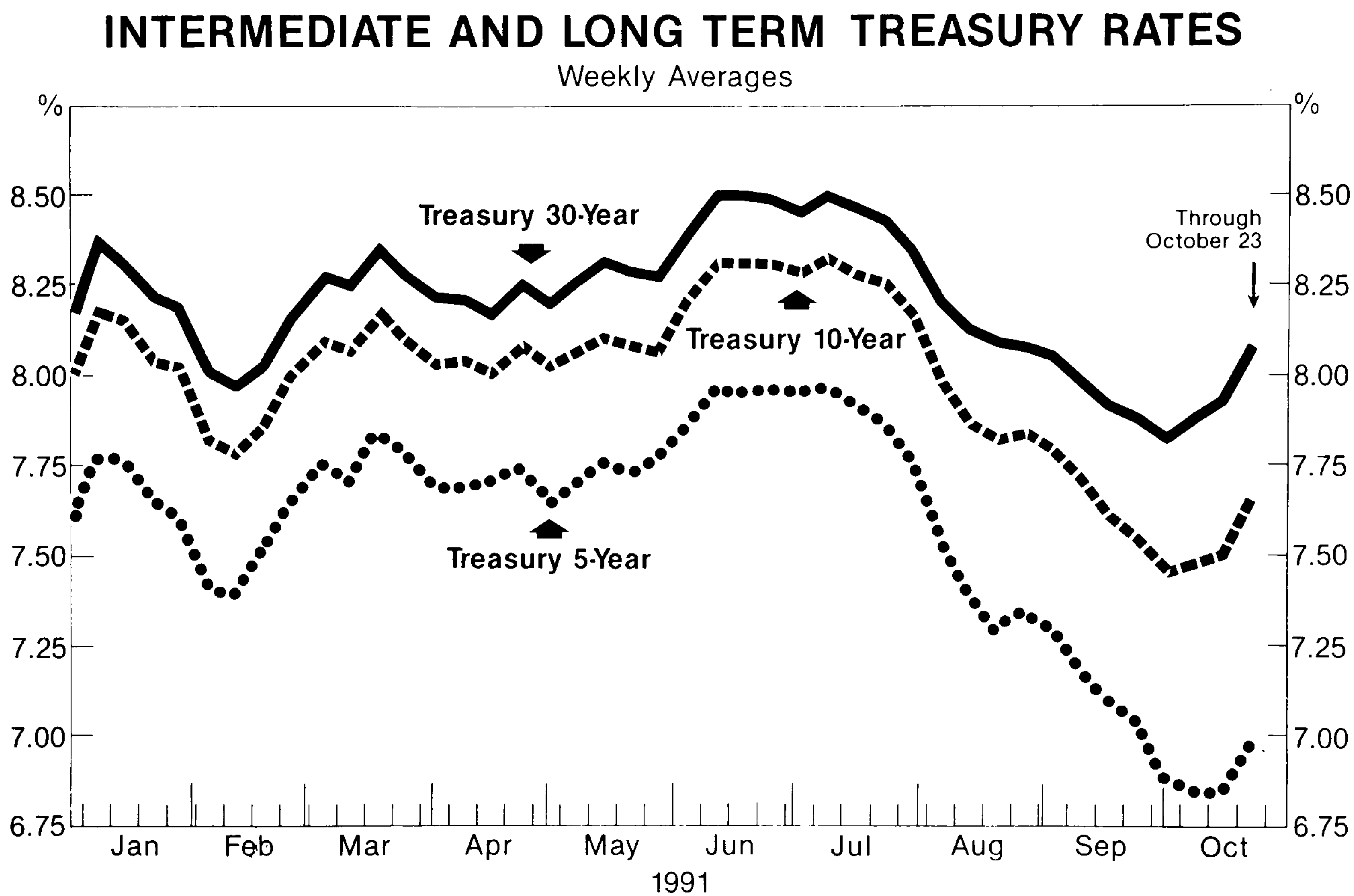
October 28, 1991-26



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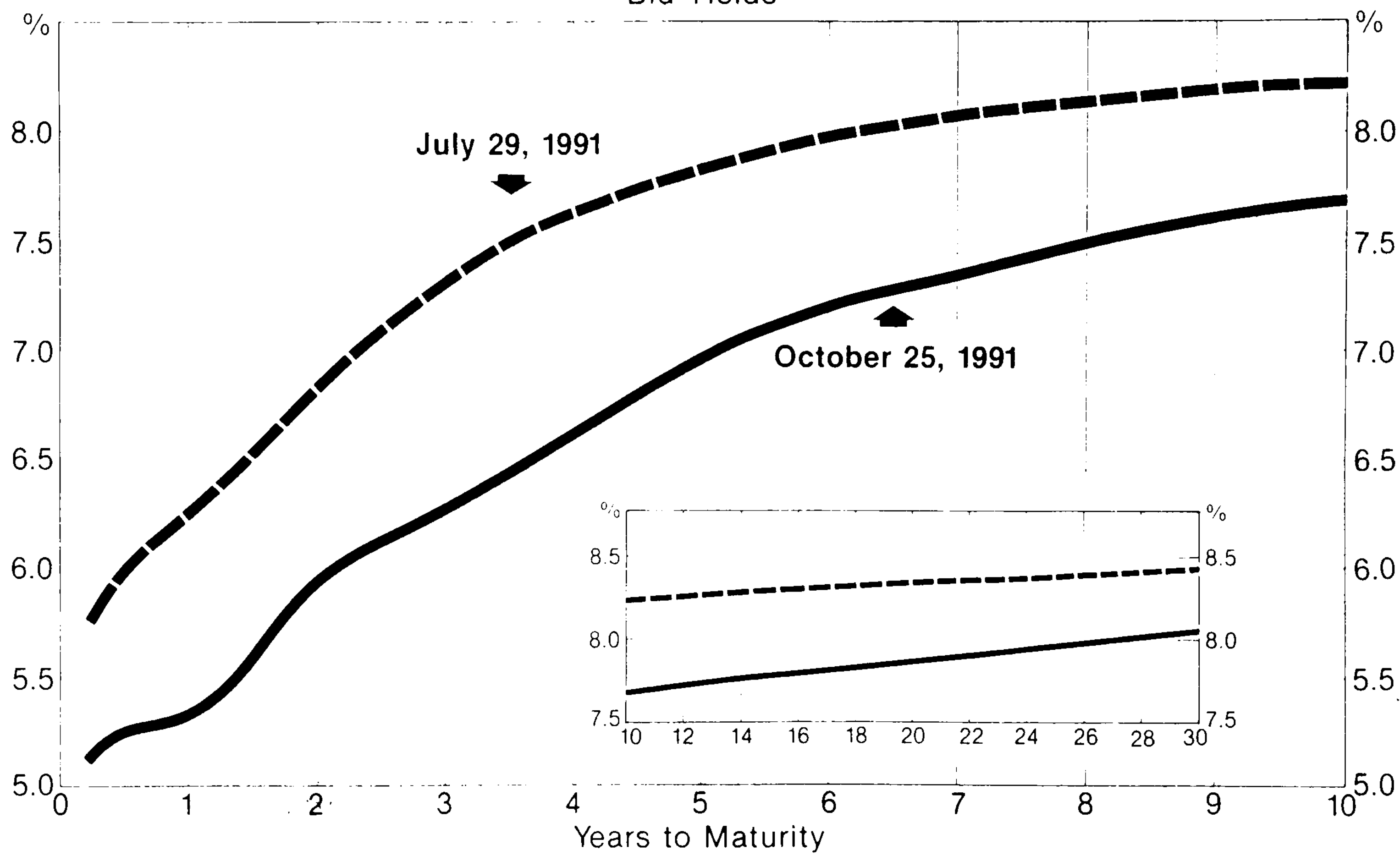
October 28, 1991 16

MARKET YIELDS ON GOVERNMENTS

Bid Yields



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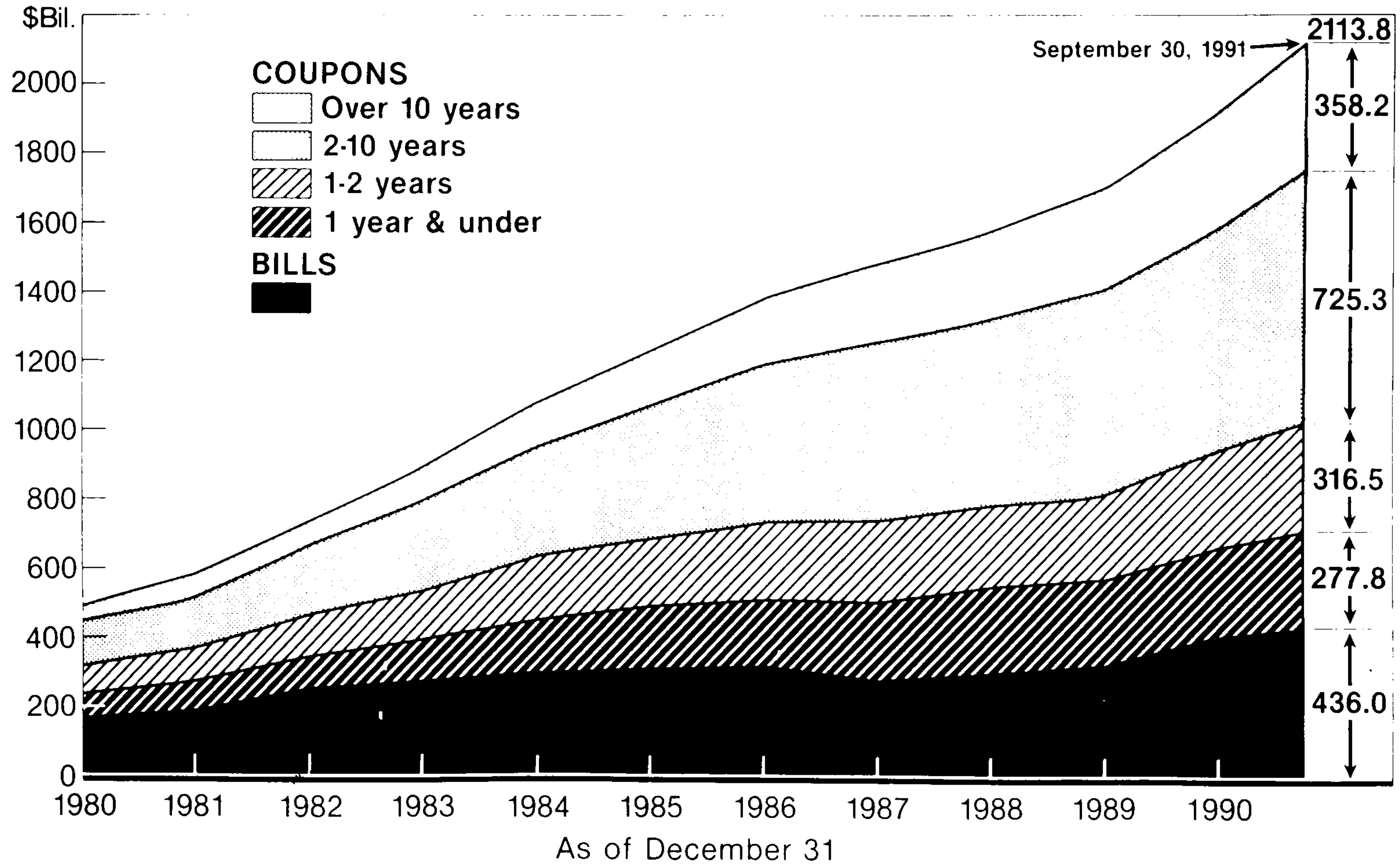
PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY



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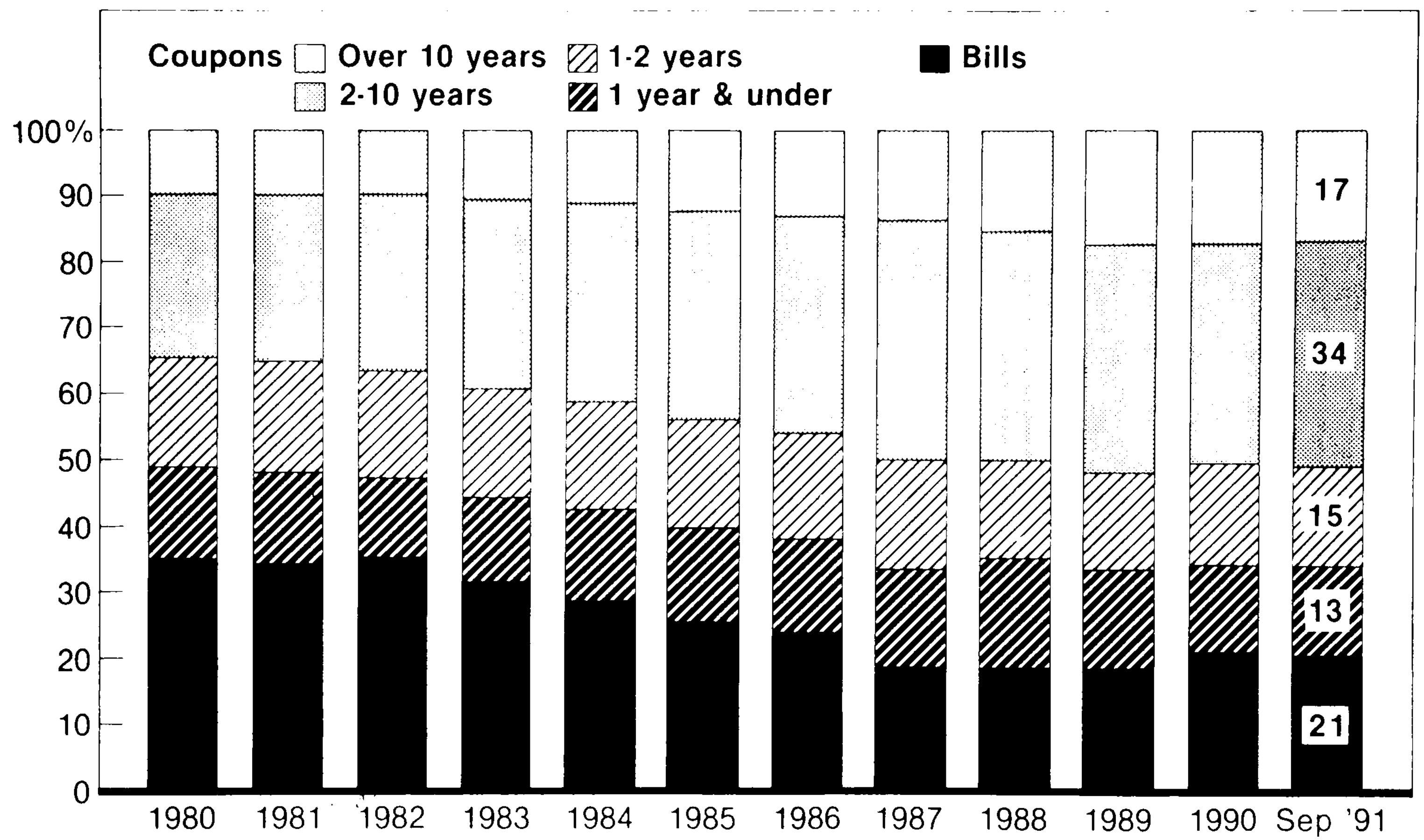
October 28, 1991-2

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT

Percent Distribution by Maturity



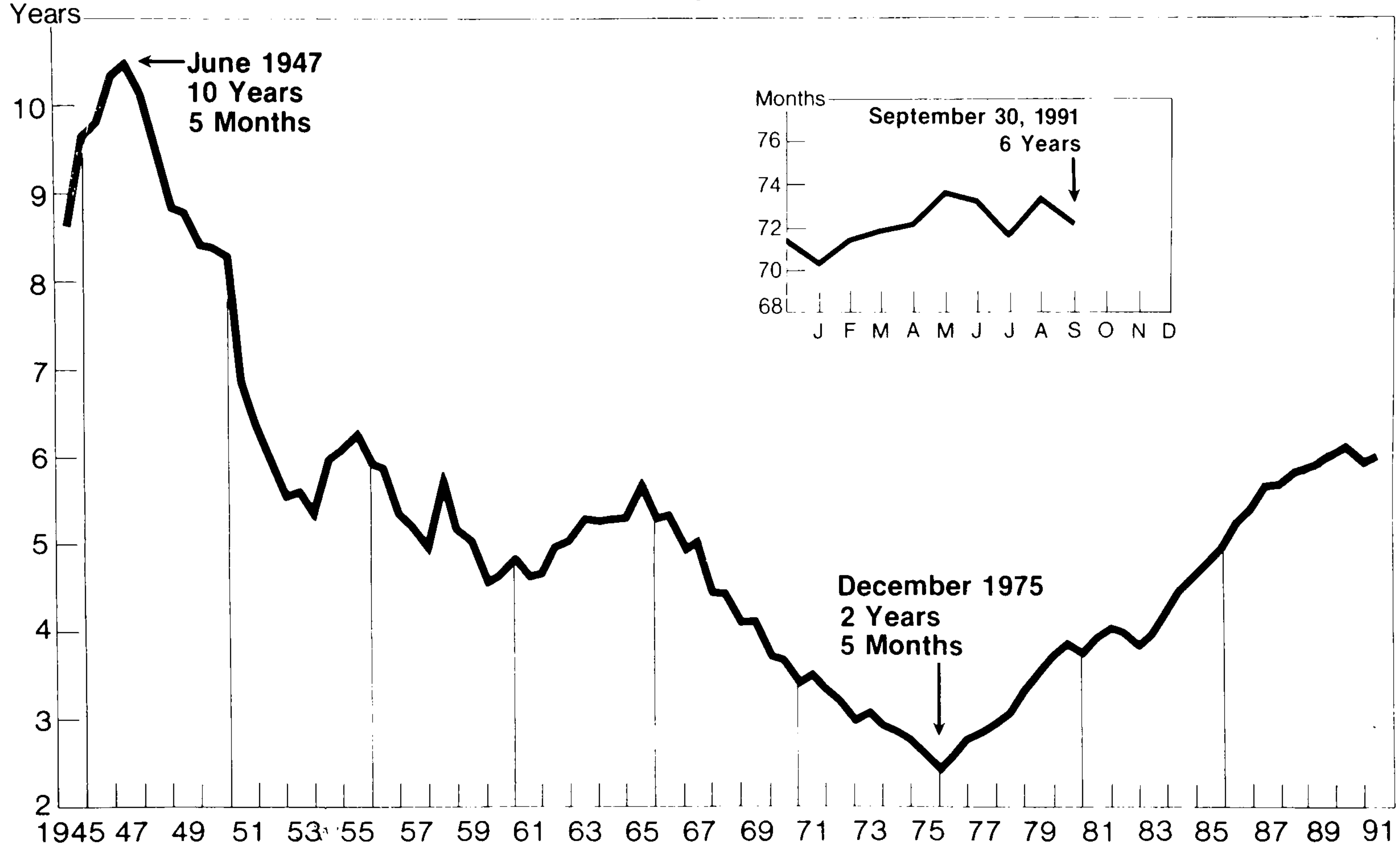
As of December 31

Department of the Treasury
Office of Market Finance

October 28, 1991 3

AVERAGE LENGTH OF THE MARKETABLE DEBT

Privately Held



Department of the Treasury
Office of Market Finance

October 28, 1991

MATURING COUPON ISSUES

November 1991 - March 1992

(in millions of dollars)

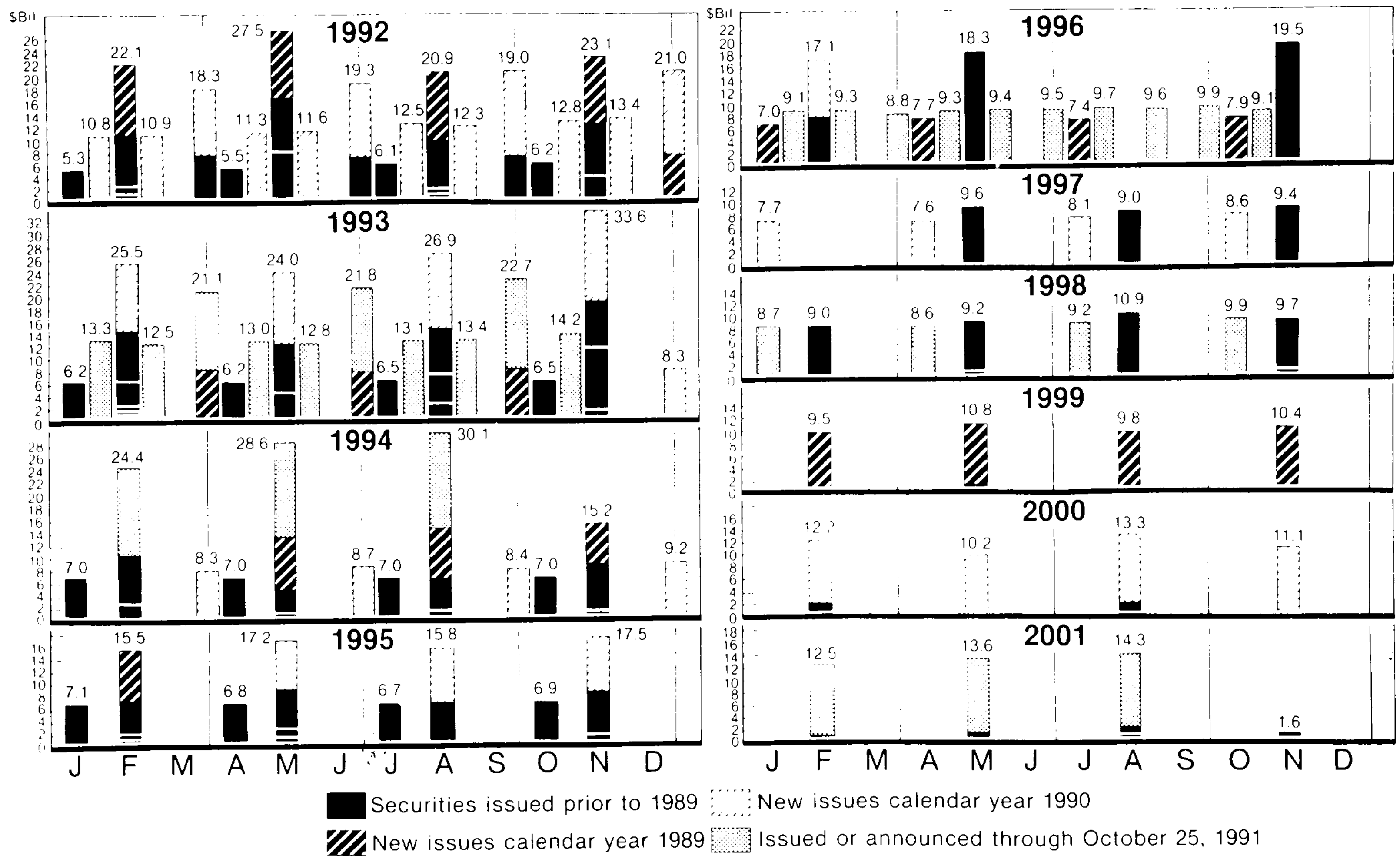
Maturing Coupons			September 30, 1991			
			Total	Held by		
				Federal Reserve & Government Accounts	Private Investors	Foreign Investors 1/
14 1/4%	Note	11/15/91	2,886	635	2,251	30
8 1/2%	Note	11/15/91	11,542	1,721	9,821	505
6 1/2%	Note	11/15/91	8,346	229	8,117	441
7 3/4%	Note	11/30/91	12,583	1,272	11,311	844
8 1/4%	Note	12/31/91	8,083	1,091	6,992	294
7 5/8%	Note	12/31/91	12,002	1,200	10,802	715
11 5/8%	Note	1/15/92	5,759	450	5,309	813
8 1/8%	Note	1/31/92	11,311	539	10,772	659
14 5/8%	Note	2/15/92	2,813	215	2,598	40
6 5/8%	Note	2/15/92	8,537	454	8,083	314
9 1/8%	Note	2/15/92	11,512	1,011	10,501	1,130
7 1/2%	Bond	2/15/92 2/	1,814	891	923	3
8 1/2%	Note	2/29/92	11,841	912	10,929	1,782
7 7/8%	Note	3/31/92	8,140	762	7,378	740
8 1/2%	Note	3/31/92	12,626	1,750	10,876	1,320
Totals			129,795	13,132	116,663	9,630

1/ F.R.B. custody accounts for foreign official institutions; included in Private Investors.

2/ Treasury announced on October 9, 1991 that the 7 1/2% Treasury Bond of 1988-93 will be called for redemption at par on February 15, 1992.

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills



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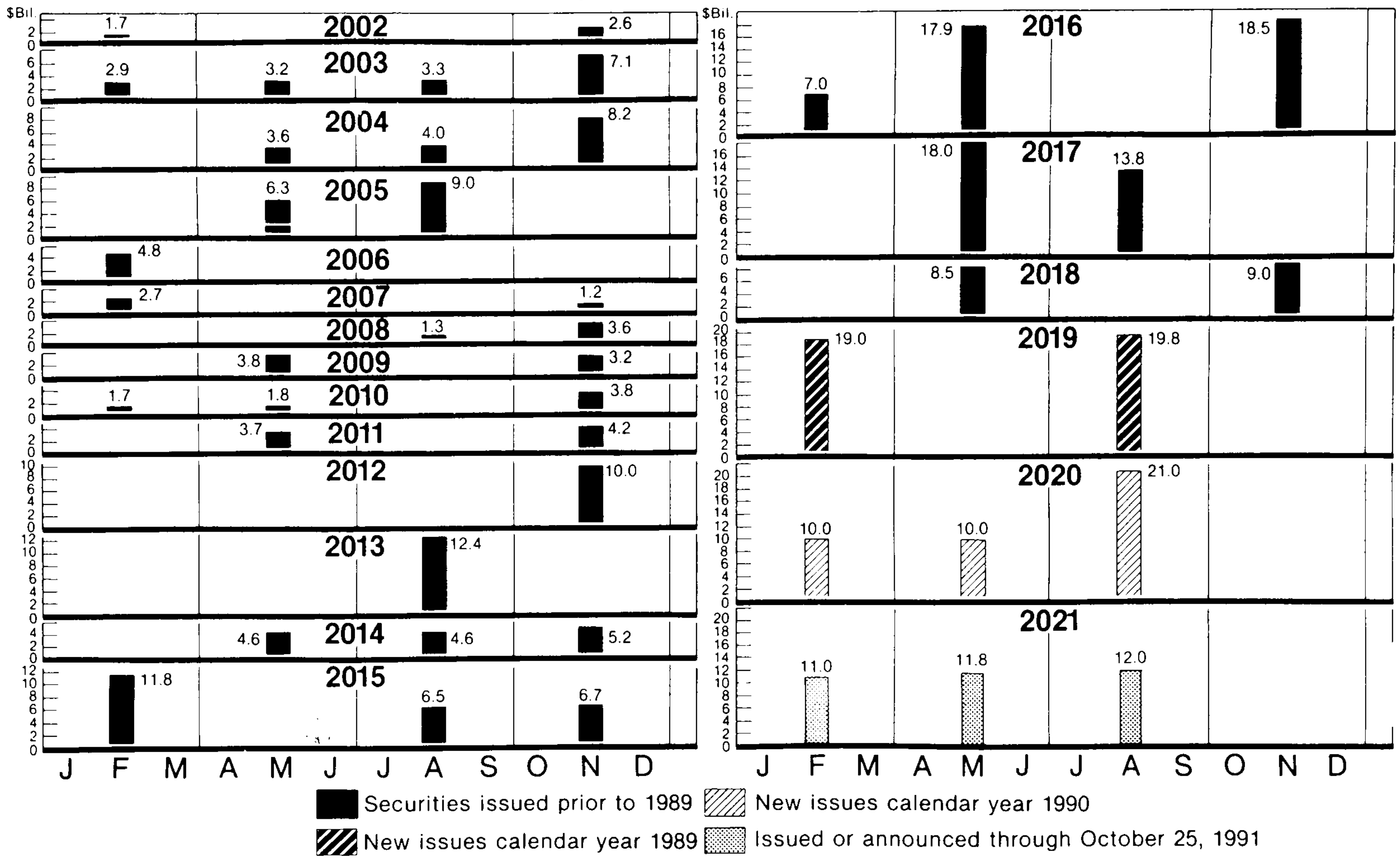
TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills



Department of the Treasury
Office of Market Finance

October 28, 1991 14

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN NOVEMBER 1991 1/

Monday	Tuesday	Wednesday	Thursday	Friday
4	5 Auction 3 year 2/	6 Auction 10 year 2/	7 Auction 30 year 2/	8 Announce 52 week
11 Holiday	12	13 Announce 2 year 5 year	14 Auction 52 week 3/	15
18	19	20 Auction 2 year 4/	21 Auction 5 year 4/	22
25	26	27	28 Holiday	29

1/ Does not include weekly bills
2/ For settlement November 15
3/ For settlement November 21
4/ For settlement December 2

Department of the Treasury
Office of Market Finance

October 28, 1991-8

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN DECEMBER 1991 1/

Monday	Tuesday	Wednesday	Thursday	Friday
2	3	4	5	6 Announce 52 week
9	10	11 Announce 2 year 5 year	12 Auction 52 week 2/	13
16	17	18 Auction 2 year 3/	19 Auction 5 year 3/	20
23	24	25 Holiday	26	27
30	31 Announce 7 year 4/			

1/ Does not include weekly bills
2/ For settlement December 19
3/ For settlement December 31
4/ For auction January 8 and settlement January 15

Department of the Treasury
Office of Market Finance

October 28, 1991-9

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN JANUARY 1992 1/

Monday	Tuesday	Wednesday	Thursday	Friday
		1 Holiday	2	3 Announce 52 week
6	7	8 Auction 7 year 2/	9 Auction 52 week 3/	10
13	14	15 Announce 2 year 5 year	16	17
20 Holiday	21	22 Auction 2 year 4/	23 Auction 5 year 3/	24
27	28	29	30	31

1/ Does not include weekly bills
2/ For settlement January 15
3/ For settlement January 16
4/ For settlement January 31

Department of the Treasury
Office of Market Finance

October 28 1991 10

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
October 31, 1991

CONTACT: BOB LEVINE
(202)566-2041

UNITED STATES AND DENMARK TO RENEGOTIATE INCOME TAX TREATY

The Treasury Department announced today that representatives of the United States and Denmark will meet in Copenhagen during the week of November 18, 1991 to renegotiate the proposed income tax treaty. The proposed treaty, which was signed in 1980 and amended by a protocol in 1983, has not been approved for ratification by the U.S. Senate, due to certain objections.

The negotiations in November will draw on the proposed treaty and protocol as appropriate, but will also take into account subsequent changes in the income tax laws of the two countries and their recent treaties with other countries.

Income tax treaties provide rules for the taxation of income derived in one of the countries (the "source" country) by residents of the other. They establish when the source country may tax various classes of income and specify maximum rates of tax at source on certain items, such as dividends, interest and royalties. They also provide for administrative cooperation between the tax authorities of the two countries and guarantee non-discriminatory taxation. Treaty benefits are limited to residents of the two countries.

Persons wishing to offer comments or suggestions on the negotiations are invited to write to Philip D. Morrison, International Tax Counsel, Treasury Department, Washington, D.C. 20220.

o 0 o

NB-1528

TREASURY NEWS

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

STATEMENT OF
SECRETARY OF THE TREASURY
THE HONORABLE NICHOLAS F. BRADY
(PRESENTED BY DEPUTY ASSISTANT SECRETARY GEORGE A. FOLSOM)
AT THE MEETING OF THE DEVELOPMENT COMMITTEE
OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND
BANGKOK, THAILAND
OCTOBER 14, 1991

Mr. Chairman, fellow Governors and distinguished guests.

First, I enthusiastically thank our Thai hosts for making us feel so warmly welcome in this dynamic city. The decade ahead promises to be both exciting and challenging for developing countries, and our gathering in Bangkok is a proper backdrop for our deliberations.

In the years ahead, a country's progress will depend primarily on the quality of its economic management and its ability to use resources effectively. The international community also shares in the responsibility to promote polices which contribute to a supportive external economic environment.

The development priorities of the 1990s set out in the Bank's excellent background paper underscore the interdependence of a functioning and vigorous private sector, poverty reduction, and protection of the environment. It is essential, then, for the Bank to bring its organizational resources to bear in assisting member countries develop purposeful strategies and proper policies.

Such sound policies require good implementation capacity in an environment of good governance. Experience has shown that human resource and institutional weaknesses can be major barriers to both policy and project implementation. Good governance in such areas as financial accountability and transparency, and predictable legal frameworks must be strongly encouraged. We agree that the problem of human resource development must be accorded the highest priority. Not only is this a key issue for established member countries, but also it emerges again as historic reforms and economic growth are pursued in countries transitioning from socialist to market economies.

The sharp focus on the clear and important role of women in development is particularly welcome. We cannot and should not undervalue this important human resource.

To remain on the cutting edge, however, the Bank will have to actively seek out opportunities to strengthen its effectiveness. In too many cases countries are losing ground and per capita incomes are declining. Frank policy and strategy dialogue with member governments improves country performance, and must be the centerpiece of Bank assistance. It will also entail close collaboration with the IMF, the donor community, and non-governmental organizations.

We also believe more attention will have to be placed on improving lending effectiveness, especially in areas where experience shows that previous approaches are falling below expectations. Project evaluation needs greater attention. The IFC capital increase and associated World Bank policy reforms on private sector development will place the Bank Group in a strong position to support the increasing market orientation of its borrowing member countries.

Collaborative efforts are needed to ensure a healthy global economy and to enhance the development prospects for the 1990s. In this regard, industrial and developing countries will continue to be well served by more open trade policies. The conclusion of a successful Uruguay Round must remain a common priority. We also welcome the continued progress in dealing with the debt problems of both low- and middle-income countries, and urge continued collaborative support for those debtors pursuing appropriate policies.

We are regularly reminded of the importance of efficient energy use in the development process. The Bank should make special efforts to assist countries in developing sound policies, market pricing, good management, and a comprehensive approach to energy efficiency, both on the supply and demand side. I hope we can see tangible progress in this area evidenced by policy development, technical assistance, and lending programs.

We are confident that the collaborative spirit so evident in this Committee can help drive a dynamic and innovative development process as we face the challenges of the 1990s. We commend the work of the World Bank Group and the IMF to date, and we fully expect these institutions to be at the forefront of economic and social advances in the years ahead.

Barber Conable left us a strong and vital Bank, and I know I can count on the new President, Lew Preston, to pursue the development priorities we are discussing today in a strong and purposeful way.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 4, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,444 million of 13-week bills to be issued November 7, 1991 and to mature February 6, 1992 were accepted today (CUSIP: 912794XY5).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.73%	4.87%	98.804
High	4.75%	4.89%	98.799
Average	4.74%	4.88%	98.802

Tenders at the high discount rate were allotted 17%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	37,230	37,230
New York	27,722,175	8,973,185
Philadelphia	15,745	15,745
Cleveland	47,260	47,260
Richmond	153,535	53,735
Atlanta	27,915	25,935
Chicago	1,061,575	160,385
St. Louis	52,965	14,665
Minneapolis	10,270	10,270
Kansas City	33,345	32,100
Dallas	20,755	20,755
San Francisco	781,885	140,735
Treasury	912,080	912,080
TOTALS	$30,876,735	$10,444,080
Type		
Competitive	$26,430,950	$5,998,295
Noncompetitive	1,628,895	1,628,895
Subtotal, Public	$28,059,845	$7,627,190
Federal Reserve	2,682,315	2,682,315
Foreign Official Institutions	134,575	134,575
TOTALS	$30,876,735	$10,444,080

An additional $135,325 thousand of bills will be issued to foreign official institutions for new cash.

NB-1529

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY PUBLIC DEBT

FOR IMMEDIATE RELEASE
November 4, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,474 million of 26-week bills to be issued November 7, 1991 and to mature May 7, 1992 were accepted today (CUSIP: 912794YM0).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.78%	4.98%	97.583
High	4.80%	5.00%	97.573
Average	4.80%	5.00%	97.573

Tenders at the high discount rate were allotted 61%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	28,105	28,105
New York	27,834,720	9,227,650
Philadelphia	15,355	15,355
Cleveland	38,505	38,505
Richmond	57,515	48,615
Atlanta	30,540	29,540
Chicago	978,765	187,505
St. Louis	10,255	10,255
Minneapolis	6,325	6,325
Kansas City	38,155	37,420
Dallas	18,860	18,860
San Francisco	426,040	134,040
Treasury	691,710	691,710
TOTALS	$30,174,850	$10,473,885
Type		
Competitive	$26,067,555	$6,366,590
Noncompetitive	1,203,570	1,203,570
Subtotal, Public	$27,271,125	$7,570,160
Federal Reserve	2,500,000	2,500,000
Foreign Official Institutions	403,725	403,725
TOTALS	$30,174,850	$10,473,885

An additional $415,375 thousand of bills will be issued to foreign official institutions for new cash.

NB-1530

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

FOR IMMEDIATE RELEASE

November 4, 1991

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank, announced the following activity for the month of September 1991.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $194.2 billion on September 30, 1991, posting an increase of $5.3 billion from the level on August 31, 1991. This net change was the result of an increase in holdings of agency debt of $6,075.1 million, and decreases in holdings of agency assets of $440.5 million and in holdings of agency-guaranteed loans of $321.0 million. FFB made 26 disbursements during September.

During fiscal year 1991, FFB holdings of obligations issued, sold or guaranteed by other Federal agencies posted a net increase of $20,915.3 million from the level on September 30, 1990. This change was the result of an increase in holdings of agency debt of $28,670.6 million, and decreases in holdings of agency assets of $1,115.8 million and in holdings of agency-guaranteed loans of $6,639.6 million.

The Appropriations Act for 1989 authorized FFB borrowers with Rural Electrification Administration guarantees to prepay at par up to $500 million of loans. Pursuant to this Act, FFB received prepayments of $203.8 million in FY 1991. FFB suffered an associated loss of $62.1 million.

The Continuing Appropriations Resolution for 1988 authorized FFB borrowers with foreign military sales guarantees to prepay at par their debt with interest rates of 10 percent or higher. The Foreign Operations Appropriations Act of 1990 amended this Resolution to lower the interest rate threshold to 8 percent. Pursuant to the Resolution, FFB received prepayments of $490.5 million in FY 1991. FFB suffered an associated loss of $78.4 million. The authority allowing par prepayments of foreign military sales loans expired on September 30th.

During fiscal year 1991, the FFB began lending to the Federal Deposit Insurance Corporation. On September 30, 1991, FFB holdings of FDIC obligations totaled $8,296.0 million.

FFB holdings on September 30, 1991 were the highest in the bank's history.

Attached to this release are tables presenting FFB September loan activity and FFB holdings as of September 30, 1991.

NB-1537

FEDERAL FINANCING BANK

SEPTEMBER 1991 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY ASSETS					
RURAL ELECTRIFICATION ADMINISTRATION					
Certificates of Beneficial Ownership					
CBO #34	9/30	$ 65,000,000.00	3/31/92	5.489%	
CBO #35	9/30	135,000,000.00	9/30/21	7.951%	
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note #101	9/3	134,000,000.00	12/1/00	7.382%	7.315% qtr.
Note #102	9/3	10,400,000.00	9/4/07	7.990%	8.150% ann.
Note #103	9/3	973,000,000.00	3/2/92	5.725%	
FEDERAL DEPOSIT INSURANCE CORPORATION					
Note No. FDIC 0002					
Advance #6	9/23	650,000,000.00	10/1/91	5.469%	
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #574	9/20	5,000,000.00	11/8/91	5.481%	
+Note #575	9/23	8,000,000.00	11/8/91	5.469%	
+Note #576	9/27	1,580,000.00	12/26/91	5.408%	
+Note #577	9/27	13,000,000.00	11/26/91	5.408%	
+Note #578	9/27	5,000,000.00	12/26/91	5.408%	
RESOLUTION TRUST CORPORATION					
Note No. 0010					
Advance #5	9/16	4,100,000,000.00	10/1/91	5.437%	
UNITED STATES POSTAL SERVICE					
Note #35	9/5	450,000,000.00	9/30/21	8.183%	
Note #36	9/5	450,000,000.00	10/1/01	7.933%	
Note #37	9/5	450,000,000.00	9/30/98	7.786%	
Note #38	9/5	450,000,000.00	9/30/93	6.470%	

+rollover

FEDERAL FINANCING BANK

SEPTEMBER 1991 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					
Kenya 12	9/13	$ 7,654,284.00	7/25/96	6.609%	
Kenya 12	9/30	520,237.78	7/25/96	7.018%	
GENERAL SERVICES ADMINISTRATION					
Foley Square Courthouse	9/12	1,018,833.20	12/11/95	7.187%	
Foley Square Office Building	9/20	2,307,932.00	12/11/95	7.069%	
U.S. Trust Company of New York					
Advance #18	9/5	1,416,205.75	11/15/91	5.618%	
RURAL ELECTRIFICATION ADMINISTRATION					
Allegheny Electric #255A	9/4	2,036,000.00	9/30/93	6.469%	6.418% qtr.
*Oglethorpe Power #246A	9/30	54,208,284.31	1/3/17	7.733%	7.660% qtr.
*Oglethorpe Power #320	9/30	2,817,528.96	12/31/19	7.781%	7.707% qtr.
*Oglethorpe Power #320	9/30	518,305.76	12/31/19	7.781%	7.707% qtr.
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-91-11	9/30	656,742,717.20	12/31/91	5.416%	

*maturity extension

FEDERAL FINANCING BANK
(in millions)

Program	September 30, 1991	August 31, 1991	Net Change 9/1/91-9/30/91	FY '91 Net Change 10/1/90-9/30/91
Agency Debt:				
Export-Import Bank	$ 11,261.0	$ 11,238.0	$ 23.0	$ -78.8
Federal Deposit Insurance Corporation	8,296.0	7,646.0	650.0	8,296.0
NCUA-Central Liquidity Fund	113.6	113.5	0.1	57.0
Resolution Trust Corporation	62,882.4	58,782.4	4,100.0	21,400.7
Tennessee Valley Authority	11,875.0	12,373.0	-498.0	-2,507.0
U.S. Postal Service	8,200.6	6,400.6	1,800.0	1,502.8
sub-total*	102,628.5	96,553.4	6,075.1	28,670.6
Agency Assets:				
Farmers Home Administration	50,694.0	51,334.0	-640.0	-1,355.0
DHHS-Health Maintenance Org.	61.2	61.2	-0-	-8.3
DHHS-Medical Facilities	75.8	76.1	-0.3	-6.9
Rural Electrification Admin.-CBO	4,663.9	4,463.9	200.0	256.7
Small Business Administration	6.2	6.4	-0.2	-2.2
sub-total*	55,501.1	55,941.6	-440.5	-1,115.8
Government-Guaranteed Loans:				
DOD-Foreign Military Sales	4,600.0	4,680.0	-80.1	-5,155.6
DEd.-Student Loan Marketing Assn.	4,850.0	4,850.0	-0-	-30.0
DHUD-Community Dev. Block Grant	204.5	208.1	-3.5	-39.4
DHUD-Public Housing Notes +	1,903.4	1,903.4	-0-	-47.4
General Services Administration +	660.6	655.8	4.7	293.3
DOI-Guam Power Authority	28.4	29.1	-0.7	-1.3
DOI-Virgin Islands	24.5	24.5	-0-	-0.7
NASA-Space Communications Co. +	32.7	32.7	-0-	-1,063.2
DON-Ship Lease Financing	1,624.4	1,624.4	-0-	-47.9
Rural Electrification Administration	18,596.9	18,846.4	-249.5	-445.3
SBA-Small Business Investment Cos.	245.0	265.5	-20.4	-137.5
SBA-State/Local Development Cos.	688.3	693.0	-4.7	-53.3
TVA-Seven States Energy Corp.	2,447.1	2,413.8	33.2	91.0
DOT-Section 511	21.3	21.4	-0.1	-2.0
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	36,104.1	36,425.2	-321.0	-6,639.6
grand total*	$ 194,233.8	$ 188,920.2	$ 5,313.6	$ 20,915.3

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

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

November 4, 1991

Contact: Desiree Tucker-Sorini
202-566-8191

STATEMENT BY SECRETARY BRADY

The House of Representatives has rejected the amended version of H.R. 6, the banking legislation. This action indicates that the House will not replenish the Bank Insurance Fund without true, comprehensive reform.

The House must now craft new comprehensive legislation to address the real problems of the banking system. The minimum elements of such a package are clear -- the House floor votes showed consensus on nearly every part of comprehensive legislation other than Title IV, including a positive compromise on interstate branching. We believe there can be an equally positive approach to Title IV, including an appropriate balancing of interests between the insurance, securities and banking industries. As we have indicated to the House leadership, we stand ready to work to achieve this goal.

We will also continue to work for genuine comprehensive reform in the Senate, which begins action this week on a banking bill.

Before Congress adjourns they need to pass true reform; a narrow recapitalization of the Bank Insurance Fund will only delay the day of reckoning.

NB-1532

BRADY/BAKER PLAN

For Third World Debt Plan

TREASURY NEWS
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Remarks By
Secretary of the Treasury
Nicholas F. Brady
Before The
International Monetary Conference
San Francisco, California
June 4, 1990

Thank you. Last year you were kind enough to invite me to address your annual meeting in Madrid. I had the impression that my visit was not necessarily the high point of the week.

At any rate, it is always an honor to address the International Monetary Conference, and particularly so when asked to return for a second straight year. As Mae West often said, "Too much of a good thing is wonderful."

This brings to mind the debt strategy. Last year at this time, we were preoccupied with fleshing out the debt strategy. Uncertainty abounded. We had disagreements which I hope you will agree were ones of viewpoint, not end goals. And we shared the goal that true economic reform was the fundamental necessity for debtor countries. We also shared the objective of a strong world banking system.

A fair appraisal of what has transpired since that time would say that "business is being done," that there is movement in a process that not long ago was stalled, and that a sense of order prevails over uncertainty. At the same time, dramatic changes throughout the world pose new challenges.

Who would have predicted even a year ago that fundamental political changes and economic reform would sweep so quickly through Eastern Europe and the Soviet Union? Who would have predicted that these countries would be looking to the West for advice in developing free market institutions? By the same token, who would have anticipated the quiet revolution that is taking place in Latin America, where democratic governments are discarding statist economic models?

Seemingly unconnected events, thousands of miles apart in countries with separate political heritages and different languages, are linked by a powerful force. Striking political changes are being driven not only by a desire for political freedom, but also by the evidence that free-market economies are the way societies function best and most fairly. In addition, there is a growing realization that in a world short of resources, countries with market-based systems are most likely to attract the capital that is essential to their growth and prosperity.

In Poland, a Communist government that could not offer a plausible plan for economic revival was ousted in favor of a government committed to sweeping political and market reform.

In Czechoslovakia, people took peacefully to the streets to win back their political and economic independence.

The East Germans voted overwhelmingly, first with their feet and then with their ballots, to scrap their entire system and quite literally join the market-based system that has brought prosperity to West Germans.

Deep-seated economic problems in the Soviet Union have triggered a searching reassessment of the political structure that fostered them. In meetings with President Bush last week, President Gorbachev reemphasized that market reforms are necessary if the Soviet Union is to overcome its deepening economic crisis.

These are all developments of the highest importance, full of promise for the future, and richly deserving the attention the world has given them.

And yet, we should also pause to consider the other revolution, less noticed, but no less dramatic, that is underway in Latin America. Here, too, economic forces are driving a basic shift in political leadership.

Democratic elections in many Latin American nations have produced a new generation of leaders committed to market-based economic reforms. The new faces of Salinas of Mexico, Callejas of Honduras, Collor of Brazil, LaCalle of Uruguay and Aylwine of Chile personify the dynamism that has taken hold. Other leaders such as Perez of Venezuela and Manley of Jamaica have assembled new economic teams that are implementing reforms.

But what are the essential elements in the march to free markets driving political changes on two different continents?

-- The establishment of competitive prices to allocate resources;

-- The elimination of fiscal deficits and rampant inflation;

-- The reduction of excessive government interference which stifles private initiative;

-- The allocation of credit by market forces rather than by political objectives;

-- And, the creation of a more receptive environment for private investment, both domestic and foreign.

If you look for the root cause of change, both in Eastern Europe and in Latin America, there is a common theme -- a theme expressed by President Bush in his inaugural address when he said, "Freedom Works." Free people and free markets liberate the energy and vitality that produce a rising standard of living. This energy and vitality -- extra effort, if you will -- is an essential part of democratic capitalism's secret of success. At the same time, it is also extraordinarily hard to communicate to societies making the change from command economies. With no frame of reference, they find it hard to believe and hard to visualize.

With this in mind, the developed countries must stand with Eastern Europe and Latin America at this historic juncture. Our challenge in the developed countries is to encourage and nurture these impulses for economic freedom, so that their transformation can be completed and economic progress sustained. We are committed to providing maximum possible support for market-oriented reforms in both regions. But let's face it, the world is short of capital, and governments are shorter still. In the United States, a recent poll confirmed eight out of ten Americans favor cuts in foreign aid. Fortunately, foreign aid, though necessary, itself is not sufficient to the resolution of this problem.

So what is our response in a resource-short world? How can we help at a time of urgent need?

The U.S. helps in two ways. One is our direct bilateral support -- both financial and technical. The other is our large and continuing commitment to the family of international financial institutions which have served us all so effectively for more than 40 years.

In Poland and Hungary, for example, the U.S. has committed nearly $1 billion over three years for multiple uses, including enterprise funds for private sector development. In December, the U.S. led an international effort to provide a $1 billion stabilization fund to launch Poland's new economic program and to support its move to a convertible currency. And the President recently signalled the attention he attaches to the Western Hemisphere by signing legislation providing almost $800 million to Panama and Nicaragua for economic reconstruction.

However, our largest commitments, and those of our major allies, take the form of regular contributions of capital to the IMF, World Bank, Inter-American Development Bank, Asian Development Bank and African Development Bank. In addition, the U.S. will be the largest shareholder in the new European Bank for Reconstruction and Development, whose charter was signed in Paris last week and whose lending capacity over the next five years will be $12 billion for Eastern Europe, of which at least $7 billion must be for the development of the private sector. These institutions provide perhaps the most essential ingredient beyond finance, and that is the economic policy advice so necessary to reform.

The U.S. continues to provide the largest share of the World Bank's $75 billion capital increase and, together with other members of the IMF, we have just approved a $70 billion quota increase, of which approximately $12 billion will come from the U.S. These resources are important in both Eastern Europe and Latin America and, of course, one of the most important uses of these funds is to support the debt strategy.

Since your annual meeting last year, agreements have been reached with several debtor countries, including Mexico, Venezuela, Costa Rica, Morocco, the Philippines and Chile. In developing these arrangements, you have demonstrated that different perspectives and diverse interests have not stopped the search for common ground, both among yourselves and with the debtors. Building on experience has allowed us to go beyond the original agreement with Mexico to more varied and innovative options, tailored to the circumstances of each transaction. Despite the difficulties along the way, genuine progress has been made. The spirit of cooperation that is so vital to enduring success has been preserved. In a number of countries the manifestation of this progress is there for all to see. A year ago, how many of you would have thought that Mexico would be privatizing its banking system?

I would like to address the question of arrears to commercial banks which I know is a matter of concern. We do not support or condone the accumulation of arrears by debtor countries. When countries follow this course, to close financing gaps or to gain leverage over the banks, the result will be to exacerbate their own economic problems and undermine progress in negotiations with commercial banks.

At the same time, we must face the fact that when countries embark on the difficult path of economic reform, timely IMF and World Bank support is critical to the reform effort. So is an early agreement with the commercial banks on medium-term financing arrangements.

Thus, as countries seek to carry out their economic reforms and to secure medium-term financing, we believe an element of case-by-case judgement is essential. The genesis of most arrears problems pre-date the strengthened debt strategy. Such arrears have not been caused by early IMF and World Bank disbursements. Indeed, under a case-by-case approach there may be instances where strong reform programs exist side by side with temporary arrears, especially if protracted negotiations with the banks delay the completion of medium-term bank programs.

Difficult cases demand our special efforts. Commercial banks have shown imagination in dealing with arrears as a part of larger financing packages. Most countries also recognize that arrears are inconsistent with the contractual arrangements entered into with creditors.

As important as debt reduction and new money may be, no amount of creative financial engineering can substitute for credible economic reform that commands the confidence of all sources of finance, including new money, direct investment, and returning flight capital.

The incentive for the developing countries to move ahead vigorously with reform efforts has taken on additional urgency since the emergence of Eastern Europe. In the aggressive worldwide competition for foreign investment, countries which fail to create an attractive investment environment run a real risk of lost opportunities and falling behind. The countries that move forcefully to privatize state-owned operations, to open trading and investment regimes and to withdraw the government from the marketplace will be the ones that attract the capital to fuel growth. In a resource-short world, there is no other answer.

Mexico, Chile and Venezuela have demonstrated their determination to face this challenge squarely. A number of other countries are also moving in this direction. But much more remains to be done. Many years of statist, inward-looking policies have left these countries saddled with protectionist trade and investment regimes and excessive public sectors. Reform efforts are still in their infancy in many cases.

Privatization and deregulation will need to become more than just the watchwords of a few select leaders. They must become the order of the day.

As more countries embrace the principles of economic freedom, creditors will need to stand ready to lend their support. You in this room cannot simply be bystanders to this process. The world's commercial banks are daily participants in the financing of world trade and commerce. The globalization of our economy points to continued involvement in cross-border finance.

Finally, the developed countries, in addition to providing support for the debt strategy through the international financial institutions and direct aid to the new democracies in Eastern Europe and the developing countries in Latin America, also have a responsibility to foster an economic environment in which all nations can grow and prosper. We must maintain steady, non-inflationary growth, resist protectionism, open markets further, and reduce both fiscal and external imbalances in our own economies.

This is why the U.S. continues to take the lead in promoting the G7 policy coordination process. In recent years, this process has contributed importantly to the strength and durability of the global economic expansion, now into its eighth consecutive year, and to its resilience in the face of periodic financial market instability. It also has provided the basis for coordinating our efforts on a wide range of related policy issues such as our response to Eastern Europe and the international debt strategy.

Let me conclude where we began: We are in a world of dynamic change -- a world that is transforming nations without war, and drawing its energy from a positive view of human nature.

There is much to be accomplished in individual countries. There is also much to be accomplished between countries. We must bend our efforts to this task and use our resources effectively. I recognize that the international banking community will always have a vital role to play in this process. Together we can make a difference.

Thank you very much.

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STATEMENT OF
SECRETARY OF THE TREASURY
NICHOLAS F. BRADY
AT THE MORNING SESSION
OF THE DEVELOPMENT COMMITTEE
OF THE WORLD BANK AND
THE INTERNATIONAL MONETARY FUND
WASHINGTON, D.C.
MAY 8, 1990

This morning, I want to review three topics:

1) progress under the strengthened debt strategy, including the importance of foreign investment and the return of flight capital;

2) the role of the private sector in development; and

3) the treatment of environmental issues within the World Bank.

<u>The Strengthened Debt Strategy</u>

I welcome the progress that has been made under the strengthened debt strategy. Six heavily-indebted countries have reached agreements with the commercial banks. The international institutions, creditor governments and commercial banks have all contributed to support debtor reform efforts under the new approach.

Debtor countries, are already gaining benefits. Debt burdens have been reduced, flight capital is returning and investor confidence is growing. However, to ensure that these benefits are lasting, reform efforts must be sustained. Policies for promoting foreign investment and capital repatriation, privatizing public enterprises, and developing competitive economies are an essential part of these reforms.

NB-796

Debtors need to liberalize regulations relating to investment and create efficient domestic capital markets in order to develop competitive economies and attract foreign capital. The international financial institutions should complement those efforts and assume a more active role in the reform of investment regimes. They should, for example, develop investment sector loans and incorporate measures to liberalize direct investment policies in both structural and sectoral adjustment loans. Debt/equity swap programs can also be an important element of adjustment programs while also contributing to overall debt reduction.

The Role of the Private Sector

A related and broader issue is the importance of enhancing the contribution of the private sector to development. Developing countries have begun to recognize that a dynamic private sector is the key to sustainable development and economic well-being. The United States welcomes this change and is working through many channels to support and encourage it.

The World Bank Group is well positioned to promote private sector growth in its borrowing members. The Bank, should pay greater attention to the role of the private sector in the development process.

Since the World Bank is a key source of adjustment lending, it is able to help developing countries implement needed macroeconomic, structural and institutional changes. The Bank should give higher priority to private sector development and institutionalize this priority across the entire range of Bank operations. Failure to stimulate private sector growth and mobilize private capital could undermine sustainable growth.

We will be discussing this issue this afternoon. However, given its critical importance, and the presence of other issues on the afternoon agenda, I suggest that the Committee revisit the issue of private sector development, including the mobilization of private capital, as a primary topic of discussion at the next meeting in September.

The Environment

I would like to conclude with a few remarks on the environment. This is an issue of great importance to the United States. At last September's annual meeting of the World Bank, President Bush called for more emphasis on the environment in national policy making, especially in promoting energy efficiency and conservation and greater protection of tropical forests. With respect to the World Bank, the United States has sought to promote the integration of environmental considerations into its lending programs and has encouraged the use of environmental impact assessments and environmental action plans.

The United States has supported the use of debt-for-nature swaps to help preserve forests and wetlands. In the recent past, such swaps have been signed in a number of countries. While the dollar amounts involved in these swaps have been small, an important principle has been established. We believe this mechanism can be used more innovatively and encourage the World Bank to play a more active role in facilitating swaps. For example, a portion of either project or sector loans could be used by the Bank to help finance debt-for-nature swaps.

An environmental report has been prepared by the Bank for our meeting today. However, it focuses on the proposed Green Fund and does not address a number of important issues relating to the Bank's existing environmental programs as was requested at the meeting of this Committee last September. Significant progress has been made by the Bank in the environmental area, but a great deal more needs to be done. We suggest that the information requested last Fall be provided to the Committee for our next meeting in September so that the Bank's progress can be reviewed, and further progress encouraged.

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Statement of the Honorable
David C. Mulford
Under Secretary of the Treasury for International Affairs
before the Subcommittee on
International Finance and Monetary Policy
of the
Committee on Banking, Housing, and Urban Affairs
U.S. Senate

Last spring Secretary Brady launched the Administration's initiative to strengthen the international debt strategy. In the past year, these concepts have been forged into far-reaching country reform programs, concrete actions by the IMF, World Bank and creditor governments, and financing packages between debtor countries and their creditor banks which include substantial reduction of debt and debt service burdens.

The watershed agreement between Mexico and its commercial banks was formally completed last month with the signing ceremony in Mexico City. Costa Rica and its creditors have reached an agreement in principle on a comprehensive debt and debt service reduction package. Chile's buyback of commercial bank debt in November was financed by resources made available under the strengthened debt strategy. Last month, the Philippines completed its new financing package with commercial banks, which included a highly successful direct buyback of commercial bank debt. Earlier this week Venezuela and its creditor banks announced an agreement in principle on a financing package which includes a broad range of options for debt and debt service reduction.

I am thus pleased to inform the Subcommittee that the strengthened debt strategy is very much alive and well. My progress report today will reiterate the objectives of the strategy, outline creditor government actions, detail the reform efforts in some of the debtor countries, and focus on the design and benefits of the financing agreements in Mexico, Costa Rica, and the Philippines. I will also summarize the elements of the recent Venezuelan package, as we understand them, and touch on the prospects for Argentina and Brazil.

NB-723

Objectives of the Debt Strategy

The major tenet of the debt strategy can be summarized in one sentence: Highly indebted countries must successfully implement market-oriented macroeconomic and structural policy reforms in order to achieve sustained growth and ultimately resolve their debt servicing problems. In advancing the strengthened debt strategy, our key objectives are to:

- Reinvigorate the policy reform efforts in the highly indebted countries. While a number of the major debtors initiated vital macroeconomic and structural reform programs, by the end of 1988 efforts to sustain these programs in several countries were stalled by debtor fatigue and pessimism. The strengthened debt strategy, by offering the prospect of significant debt and debt service reduction by the commercial banks, has provided important incentives for many debtor countries to maintain difficult but essential reform efforts. The strategy reaffirms the role of the IMF and the World Bank in encouraging strong debtor reforms, in particular measures to encourage repatriation of flight capital and investment.

- To mobilize financial resources from the private sector more effectively in support of debtor reforms. By the end of 1988, new lending from commercial banks had virtually dried up, banks were disposing of their LDC exposure in the secondary market, and low investment and continued capital flight hobbled economic growth in debtor countries. The strengthened debt strategy is designed to harness commercial bank willingness to engage in debt and debt service reduction for the benefit of debtor countries, as a complement to new lending by a smaller group of banks, and to develop measures to promote new investment and capital repatriation.

- To redirect IMF and World Bank resources to back debt and debt service reduction for commercial banks. In order to strengthen the capacity of the IMF and World Bank to promote meaningful reform programs in debtor countries, the strengthened debt strategy permits debtor countries to use resources from the international financial institutions (IFIs) to back the reduction of debt and debt service by commercial banks. IFI resources can be used to finance cash buybacks of bank debt, to purchase collateral for debt and debt service reduction instruments, and to provide limited interest support for such instruments.

- To provide continued creditor government support. Creditor governments continue to play an important role under the strengthened debt strategy through their contributions to the international financial institutions, rescheduling of official debt in the Paris Club, ongoing export finance, and efforts to reduce (where appropriate) impediments to debt and debt service reduction stemming from tax, regulatory, and accounting regimes.

The strengthened debt strategy has been broadly endorsed by the international community. Last May, the IMF and the World Bank moved expeditiously to adopt guidelines governing their support for debt and debt service reduction. Several debtor countries have subsequently adopted medium-term, market-oriented economic reform programs, with greater recognition of the importance of measures to promote investment and capital repatriation. This is the first essential step in the process.

The second step for most countries has been the negotiation of multiyear rescheduling agreements with official creditors in the Paris Club. The final step -- negotiations with commercial bank creditors -- has now been completed for four countries -- Mexico, the Philippines, Costa Rica, and now Venezuela. Morocco is now actively negotiating with its banks. Other countries are moving to avail themselves of similar support within the next year as they adopt strong medium-term economic reform programs with the IMF and World Bank. These countries include Bolivia, Nigeria, Ecuador, and Uruguay. The new president of Brazil is putting together his program after his inauguration last week.

Role of Creditor Governments

Creditor governments have moved rapidly to support the strengthened debt strategy. At their urging, the IMF and the World Bank developed and put into place guidelines for IFI support for debt and debt service reduction. A number of creditor countries have pledged financial support to enhance specific financing packages. The Government of Japan is in the process of providing $10 billion to support the strengthened debt strategy with specific commitments so far for Mexico, the Philippines, Costa Rica, and Venezuela. The United States, through USAID, has provided concessional resources to both the Philippines and Costa Rica to back debt and debt service reduction. In addition, official export credit agencies continue to provide critical trade finance to many of the major debtor countries.

Creditor governments have also made substantial contributions through Paris Club reschedulings. Reflecting the medium-term horizon of the debt strategy, the focus of the Paris Club is now on multi-year rescheduling agreements (MYRAs) for the debtor countries. Since in many cases creditor governments have been willing to reschedule interest as well as principal on official loans, the official reschedulings have continued to provide "new money" and therefore more relief than bank reschedulings. Official relief continues to be available only for countries with an IMF adjustment program.

The U.S. Government and other official creditors are also providing special treatment ("Toronto terms") to the least developed countries which are pursuing sound economic reform programs. In addition, the U.S. government has announced a willingness to forgive up to $1 billion in economic assistance loans to Sub-Saharan African countries pursuing economic reform programs. Congress has provided for this purpose in an appropriations act, nine countries have signed agreements, and four more countries have been declared eligible for the program.

Creditor governments have also initiated efforts to identify and, where appropriate, remove any impediments to debt and debt service reduction in their tax, regulatory, and accounting regimes. In the United States, the Securities and Exchange Commission has clarified the accounting treatment for the debt reduction bonds and debt service reduction bonds held by banks as a result of the Mexican financing package. In addition, the Department of the Treasury has clarified the tax treatment of the new bonds, in particular the determination of the amount of the tax loss. Neither the SEC clarification nor the Treasury clarifications break new ground, but instead rely on longstanding standards and rules to remove uncertainties as to how these financial instruments would be treated.

I would now like to touch on specific developments in individual debtor countries.

<u>Mexico</u>

Mexico has maintained a strong record of implementing macroeconomic and structural reforms in its efforts to resolve its debt problem. Mexico's past adjustment performance -- exchange rate reform, tax reform, liberalization of its trade regime, industrial diversification, and measures to reduce the fiscal deficit and curb inflation -- has provided the backdrop for economic recovery. However, the fall in oil prices in 1986, following on the 1985 earthquake, disrupted Mexico's economic progress. While the Mexican economy has been recovering from these shocks, growth has been sluggish, key debt ratios have remained high, and substantial financing gaps have persisted even after significant adjustment in the trade balance.

The Administration of President Salinas has pressed forward with reform efforts, including efforts to reduce the size and scope of the public sector. Recently, Mexico has taken measures to privatize the state airline, its major copper mine, and the state telephone company (one of the five largest companies in Mexico). Deregulation has been pressed in the trucking industry and the financial sector. New regulations have significantly liberalized Mexico's foreign investment regime. These regulations streamline and expedite registration requirements, increase the transparency of Mexico's foreign investment laws, reduce performance requirements, and open up areas formerly excluded from foreign participation.

Mexico's agreements with its key creditor groups incorporate all elements of the strengthened debt strategy:

- Strong macroeconomic and structural reforms as conditions for drawing IMF and World Bank resources;
- Meaningful debt reduction;
- Substantial debt service reduction;
- New money;
- Bank waivers to permit subsequent debt buybacks;
- Full participation by commercial banks;
- IMF and World Bank enhancements in support of debt and debt service reduction;
- Substantial debt/equity swaps;
- Capital repatriation; and
- Multiyear Paris Club rescheduling.

Mexico and its creditor banks completed negotiations on a comprehensive medium-term financing package in July 1989. Signature of the final agreement started last month, with the actual exchange of debt instruments expected by the end of March. The financing package provided commercial banks with a choice of vehicles to participate:

- **Debt Reduction Bonds** that replace existing medium-term debt at a discount of 35% with full repayment occurring in 30 years.

- **Debt Service Reduction Bonds** that carry a fixed interest rate of 6.25% with full repayment occurring in 30 years.

- **New financing** during 1989-92 equal to a total of 25% of existing exposure that has not been converted into debt and debt service reduction instruments.

The debt reduction and debt service reduction bonds are supported by enhancements totaling $7.1 billion from the IMF, World Bank, Japan, and Mexico's own resources. The principal of both bonds will be fully secured by collateral in the form of 30-year zero coupon bonds. Interest payments will be enhanced by 18 months of rolling interest support.

The United States Department of the Treasury will sell Mexico sufficient non-marketable 30-year zero-coupon Treasury bonds to be used as collateral for these transactions. Pricing zero-coupon bonds is complicated by a number of factors. At the time of the pricing Treasury had only issued non-marketable zero coupon bonds on two other occasions -- the Morgan/Mexican debt reduction deal in 1987-88 and the initial issue of zeros to REFCORP in October, 1989. Furthermore, Treasury has not itself issued zero coupon bonds directly in the public market. The Treasury STRIPS market, a derivative market resulting from the stripping of Treasury coupon instruments by market participants, remains smaller than the coupon market and somewhat volatile. As a result, there were few pricing precedents and no easy or obvious market guidance since a number of possible pricing benchmarks exist.

The Treasury pricing decision for the zero-coupon bond for Mexico was based on principles reflecting both the size of the Mexican transaction and the precedent of the 1987-88 Mexican purchase of zeros. The earlier Mexican deal was priced off the coupon rate because the STRIPS market was deemed to lack sufficient depth and the size of the transaction was large relative to the then outstanding STRIPS market. The current transaction size of approximately $35 billion face amount is even larger relative to the STRIPS market today. Treasury judged that the STRIPS quotation would again be inappropriate for pricing a transaction of this size and scope. The existing STRIPS yields would be severely affected if a transaction the size of the $35 billion face amount of Treasuries for Mexico were issued in the public market. It is likely that the STRIPS yields would be driven toward the coupon yields.

The specific pricing formula for the Mexican transaction involved the average 30-year U.S. Treasury coupon borrowing rate for the 3-day period ending January 5, 1990 of 8.05%. A fee was charged by Treasury in the form of an adjustment of the annual yield by 1/8%, which is identical to the fees charged for Treasury special issues over many years. The Treasury's final borrowing rate from Mexico was 7.925%.

Benefits to Mexico of its Agreement with Commercial Banks:

The commercial bank package will generate substantial debt and debt service reduction benefits for Mexico:

- Over 85% of Mexico's bank debt will undergo substantial cuts in interest or principal.

- Mexico's debt obligations to commercial banks will be slashed significantly:

  -- The debt reduction bonds cut bank debt immediately by about $7 billion.
  -- The debt service reduction bonds are the economic equivalent of a further implicit reduction in the stock of debt of $7.75 billion.
  -- Up to an additional $3.5 billion of debt will be retired in the debt/equity swap program by 1992.

- o Debt service savings total over $12 billion during the 1989-92 period.

  - -- Annual interest payments to commercial banks will be cut by $1.5 billion (nearly one-third).
  - -- Principal amortization payments will be reduced by $6.7 billion over this period.

- o Of even greater importance, the burden of principal payments on $42 billion of Mexico's bank debt are lifted from the shoulders of the Mexican people; this is because Treasury 30-year zero-coupon bonds provided as collateral up front will assure full repayment of the remaining principal amounts of both the debt and debt-service reduction instruments in 2019.

- o Overall, the Mexican Government estimates that the <u>net effect</u> is that Mexico's <u>total</u> external debt will decline from $95 billion at the end of 1989 to the equivalent of $80 billion in March 1990. Furthermore, external net transfers will be reduced by more than $4 billion annually, which is equivalent to 4% of GDP.

However, these positive results do not convey the full importance of the Mexican Agreement. To complete the assessment, it is necessary to compare these positive results with the results that would have flowed from the type of all new money solution that characterized the previous debt strategy:

- o Mexico's total debt in 1992 would have been some $24 billion higher than will now be the case, if we include the implicit effect of debt service reduction.

- o Rather than perpetually rescheduling principal, the new agreement's defeasance arrangement removes from Mexicans the burden of future principal payments on $42 billion of Mexico's bank debt.

- o The medium-term time horizon of this package (four years) increases the stability of Mexico's economic and investment climate, as compared to the traditional 12-18 month financing pact, which we found could take most of that time to put together. Furthermore, the annual benefits of reduced interest payments, debt reduction, and defeasance extend well beyond the 1989-92 period of the package.

- o The new agreement frees up substantial Mexican resources for productive investment (about 4% of GDP), which otherwise would be used to service ever-growing debt.

- The fact that virtually all of Mexico's commercial banks participated in this package contrasts sharply with the growing free rider problem under the old strategy. Finally, there is no doubt that if the old strategy of concerted new lending had been tried for Mexico, the equivalent of $7.5 billion in new money would not have been forthcoming. It was clear by the end of 1988 that most banks had decided to withdraw from providing fresh money to debtor countries. This was one of the key reasons for changing the old debt strategy.

The final and perhaps most notable benefit of the agreement is the growing confidence in Mexico's economy. Since the agreement was announced last summer, domestic interest rates have fallen, resulting in savings on servicing the government's domestic debt and a reduced fiscal deficit equivalent to 4-5% of GDP. In addition, net private capital inflows in 1989 totalled about $3 billion, indicating increased investor confidence. These positive developments, combined with Mexican reform efforts, have contributed to an expansion in the Mexican economy. Growth has increased from 1.1% in 1988 to an anticipated 2.5% in 1989. The economy is expanding at a fairly rapid pace, with substantially lower inflation.

These early indicators bode well for Mexico's capacity to achieve sustainable growth in the future. Current projections are that these benefits will help produce growth of 5-6 percent by 1994 and will halve Mexico's debt service and interest service ratios. For these benefits to crystallize, it will be vital for Mexico to sustain its reform efforts.

<u>Other Financing Packages</u>

The strengthened debt strategy is designed to be flexible and responsive to individual debtor country needs. As a result of the case-by-case approach, the financing packages which emerged from debtor/bank negotiations in the Philippines, Costa Rica and Venezuela differ markedly from the Mexican package.

The agreement between the Philippines and its commercial banks places greater emphasis on new money and direct cash buybacks because Philippine conditions are materially different from those in Mexico. The Philippine economy has realized steady growth for a number of years and its debt burden is not as heavy as Mexico's. The Philippines also is the beneficiary of substantial foreign assistance commitments for the period ahead. The impact of debt and debt service reduction would have been small relative to Philippine financing needs because medium-term bank debt only accounts for about 25% of total Philippine indebtedness.

These factors are reflected in the agreement reached between the Philippines and its commercial banks. New lending was necessary to fill projected financing gaps, while direct cash buybacks were an efficient means of enlisting the support of banks prepared to exit the Philippines at a steep discount. The elements of this agreement include the following:

- The Philippines completed a direct buyback of $1.3 billion in early January at a 50% discount. This is equivalent to a 20% reduction in its stock of medium-term commercial bank debt. The buyback was funded by IMF, World Bank, Philippine and official support totaling $667 million (including $95 million from the U.S. Agency for International Development).

- Banks rescheduled remaining outstanding debt.

- Voluntary new lending from commercial banks amounted to about $700 million.

- Commercial banks have rescheduled the remaining debt and have granted waivers to permit the Philippines to launch additional debt and debt service reduction arrangements.

This agreement offers substantial benefits to the Philippines. It fills the projected financing gaps for 1989-90 while achieving net debt reduction. After taking into account the substantial new lending contemplated, we estimate that the <u>net debt reduction</u> and the <u>net debt service reduction</u> on bank debt will still amount to 10%. Because the net debt reduction is permanent, these benefits will extend well beyond 1990. Further reduction of commercial bank debt is contemplated since the Philippines has committed to reopen its debt/equity swap program and expects additional debt and debt service reduction operations as a result of broad commercial bank waivers. These longer-term benefits should help to stabilize the medium-term economic and investment climate in the Philippines, provided of course that the Philippine government successfully implements needed reforms in its investment policies.

The debt strategy is not only flexible enough to accommodate different debtor profiles, but is also designed to apply to smaller debtor countries such as Costa Rica. Costa Rica has a heavy debt burden and has significant projected financing gaps for several years. Negotiations with commercial banks were also complicated by Costa Rica's arrears problem, accounting for $325 million of $1.8 billion owed commercial banks.

In October 1989, Costa Rica reached agreement with its Bank Advisory Committee on a package we expect will be completed by spring 1990. The financing agreement deals effectively and stringently with the arrears problem, while realistically recognizing the limits on Costa Rica's capability to service its bank debt. Elements of the agreement include:

- o A projected cash buyback of outstanding debt, including arrears, at an 80% discount.

- o An exchange of the remaining principal for a par bond with a reduced interest rate of 6.25%.

- o Substantially less favorable treatment for the remaining arrears, which requires a 20% downpayment on the outstanding balance by Costa Rica, rescheduling of the balance for 15 years in a mortgage-style bond, and a market rate of interest.

- o IMF, World Bank and official support to fund the buyback and provide interest support for the par bond.

- o Principal is not collateralized in this transaction.

Given the depth of Costa Rica's discount, the direct benefits of the financing package to Costa Rica are very substantial. We estimate that the arrangement, when implemented, would retire about 60% of Costa Rica's bank debt and reduce interest payments by about 60% annually. The agreement will put the troublesome arrears problem behind Costa Rica, and reduce Costa Rica's debt service burden to a level which reflects more realistically its ability to pay.

Venezuela and its creditor banks reached an agreement in principle earlier this week on a comprehensive financing agreement which included both a significant new money feature as well as several debt and debt service reduction options. During the past year, the Government of Venezuela has been implementing the most comprehensive economic adjustment program in its history. The purpose of the program is to eliminate distortions in the Venezuelan economy and to open the economy for international trade and investment. The bank financing package provides financial support for this adjustment effort. Elements of the agreement include:

- o A cash buyback program at a price to be set by Venezuela, taking into account the secondary market price of Venezuelan debt.

- o Principal reduction bonds at a discount of 30% and interest reduction bonds at an interest rate of 6.75%. Both of these options would be in the form of 30-year bonds, with principal collateralized by zero-coupon bonds and 14 months of interest support. Warrants would be included with each bond giving the holder the right to value recovery payments after 6 years if Venezuelan crude oil prices exceed a specified price, up to a ceiling specified in the warrants.

- Temporary interest reduction. Under this option, banks would exchange their debt for a 17-year bond with reduced interest rates of 5% for the first two years, 6% for the third and fourth years, 7% for the fifth year, and a market rate thereafter.

- New financing during the period 1990-92. Banks would exchange existing debt obligations and provide new money in the form of bearer bonds, resulting in a 20% increase in exposure for those banks selecting this option.

It is too early to assess the specific benefits of this financing package to Venezuela because we can not at this time estimate the likely bank response to the options available under this package. I would note, however, that this financing package contains the broadest range of options yet offered under the debt strategy.

The new debt strategy was also used by Chile to implement its direct cash buyback in November. Chile chose not to enter into broad debt reduction negotiations with commercial banks because it is close to recovering voluntary access to financial markets and its earlier debt conversion programs were very successful in reducing its commercial bank debt. Instead, Chile completed a limited direct buyback, using resources from the international financial institutions to purchase $140 million in commercial bank debt at a discount of 41%. The buyback should be viewed as the latest stage of the Chilean debt reduction program. Since 1985, Chilean debt/equity swap and buyback programs have retired $7.8 billion in debt, equivalent to over half of its medium- and long-term commercial bank debt at end-1985. In many ways, Chile could be viewed as the laboratory for the strengthened debt strategy. The Chilean experiment indicates that a strong commitment to reform combined with reduction in bank debt can result in normalization of debt service and sustainable growth.

Prospects for Argentina and Brazil

Among the major debtor nations, Brazil and Argentina are the largest countries that have yet to make significant progress under the strengthened debt strategy. This lack of progress does not reflect adversely on the debt strategy, but instead stems from protracted delays by both countries in implementing appropriate economic adjustment policies.

The IMF will need to play a crucial central role in providing a framework for economic adjustment in both these countries. Resources from the World Bank and the Inter-American Development Bank will also help promote structural and sectoral adjustment.

Argentina and Brazil remain candidates for the strengthened debt strategy, once they have established credible domestic economic policies with the help of an IMF-supported adjustment program. A full range of options for debt and debt-service reduction could then be exercised for both nations.

Argentina. The government of Argentina has been preoccupied for the last eight months with stabilizing the nation's economy, a process that remains elusive. While the government has held preliminary discussions with its commercial bank creditors, it cannot focus on serious negotiations as long as the domestic situation remains unstable. Negotiations with the commercial banks, once they begin, will also be complicated by the existence of some $6 billion in arrears to banks since April 1988. We do not expect progress in negotiations with commercial banks until Argentina can show progress in implementing far-reaching economic reforms.

Brazil. Since falling out of compliance with its IMF standby arrangement in late 1988, Brazil's economy and its relations with the international financial community have deteriorated. In February 1990, inflation reached a monthly record of 73% and the 1989 budget deficit stood at about 7% of GDP. Brazil's inability to revive its standby led to the withholding of a $600 million new money tranche from creditor banks and to a halt in policy-based lending from the World Bank. Most bilateral credits have also been frozen.

The Brazilian government imposed a de facto moratorium on interest payments to creditor banks last September to conserve liquid reserves prior to the Presidential election. Interest arrears to creditor banks now exceed $5 billion.

Last week the President of Brazil launched a new program for economic reform. We are now studying this program and look forward to discussing it with the Brazilian authorities. We also understand that they are developing a number of ideas for handling their debt situation. Any financing package would need to address as a matter of priority Brazil's interest arrears. In our view, Brazil will need a comprehensive, medium-term financing package, including a wide-ranging menu of options for debt and debt-service reduction. The first priority, however, is the successful implementation of Brazil's economic program.

Assessment of the Debt Strategy

The financing agreements to date feature the new mechanisms for commercial bank support anticipated by the strengthened debt strategy and furnish new incentives for sustaining sound policies in debtor economies. The Mexican, Costa Rican, and Venezuelan packages assured comprehensive support by the full banking community, while the Philippine and Chilean arrangements focus on selective debt reduction. Good performance deserves such support by the commercial banking community. Debtor nations cannot resolve their external debt problems through their own efforts alone.

Practical implementation of the strategy has required an adjustment of expectations by both the debtor nations and commercial banks. Initial debtor country expectations of debt relief were high, while the extent of acceptable debt reduction varied from bank-to-bank.

My own sense is that many debtor countries and commercial banks have been coming to terms with the new reality. Debtor countries are recognizing that debt relief alone is not a panacea for their economic problems. Sound policies are the essential prerequisite for success. In the agreements negotiated thus far, commercial banks have acknowledged that their diversified interests can only be reconciled through diversified options, that innovative forms of new lending are still possible, and that debt and debt service reduction for performing countries can support adjustment and improve the quality of their remaining claims.

Looking ahead, I would offer a note of caution to debtor nations and commercial banks alike:

- Debtor nations can not afford to relax their adjustment programs simply because they may be able to obtain a measure of debt relief. If the reform process is not sustained, these countries will have squandered their best opportunity to put their debt problems behind.

- The strong reserve position of commercial banks, which we commend as financially prudent and conducive to debt reduction, should not be used as a screen for failing to negotiate solutions with the debtor countries. Perpetual reschedulings, with minimal debt reduction, debt service reduction or new lending, can only contribute to future arrears and undermine the reforms needed for sustained growth.

- Both debtor nations and commercial banks must avoid the temptation of funding medium-term gaps through arrears. Such a temporary and illusory solution can only undermine the reform effort, dissipate market and investor confidence, and replace cooperation with confrontation.

- Finally, no matter how overpowering the debt problem appears in its totality, we must continue to focus our efforts on a case-by-case basis on those elements of the problem which can be solved and then expand on our successes. We must continue to recognize that there are no easy, all encompassing global solutions.

Conclusion

The international community has made significant progress in transforming the strengthened debt strategy from general concepts to practical results in the financing packages that have emerged thus far. While it is still too early to assess the strategy fully, a number of important developments have already occurred:

- The strengthened debt strategy has already renewed resolve in a number of debtor countries to complete the adjustment process. These countries are making significant strides in reforming their economies.

- The strategy is flexible. It can respond to specific country circumstances, whether the debtor is large or small, or close to returning to voluntary lending. It can offer commercial banks a wide range of options to suit their particular needs.

- The agreements in Mexico, the Philippines, and Venezuela indicate that new bank lending and debt reduction can coexist in the same financing packages.

- The reduction in domestic interest rates and capital reflows in Mexico resulting from the bank package are evidence that an important contribution of the strategy may be the restoration of confidence in the debtor country's economy.

- The strategy has the potential to extract debtor countries from the spiral of constantly escalating debt. This not only frees up resources for productive investment, but also boosts optimism in the debtor countries that sustained economic development and improved living standards are still achievable targets not just etherial goals.

- Finally, by combining fundamental economic reform in the debtor countries with substantial debt and debt service reduction by commercial banks, there is now a realistic hope that flows of capital in the form of repatriated flight capital and direct investment will be provided as the "new finance" needed by debtor countries to sustain their recovery. Such a result offers a far more credible solution for long-term growth than a perpetual dependence on new rounds of concerted lending by unwilling commercial banks.

TREASURY NEWS

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Remarks by
The Secretary of the Treasury
Nicholas F. Brady
to the
Brookings Institution and
The Bretton Woods Committee
Conference On Third World Debt

More than 40 years ago, the representatives of 44 nations met at Bretton Woods, New Hampshire to build a new international economic and financial system. The lessons learned from a devastating world depression and global conflict guided their efforts. At the concluding session, the President of the conference, Treasury Secretary Henry Morgenthau, described this lesson in the following manner:

> We have come to recognize that the wisest and most effective way to protect our national interests is through international cooperation -- this is to say, through united effort for the attainment of common goals. This has been the great lesson of contemporary life -- that the peoples of the earth are inseparably linked to one another by a deep, underlying community of purpose.

The enduring legacy provided by the Bretton Woods institutions is lasting testament to the success of their efforts. This community of purpose still resides in these institutions today. We must once again draw on this special sense of purpose as we renew our efforts to create and foster world growth.

These past seven years we have faced a major challenge in the international debt problem. This situation is, in fact, a complex accumulation of a myriad of interwoven problems. It contains economic, political and social elements. Taken together, they represent a truly international problem, for which no one set of actions or circumstances is responsible. And for which no one nation can provide the solution. Ultimately, resolution depends on a great cooperative effort by the international community. It requires the mobilization of the world's resources and the dedication of its goodwill.

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Since 1982 the world community has endeavored to come to terms with international debt. In 1985 we paused and took stock of our progress in addressing the problem. As a result of that review, together we brought forth a new strategy, centered on economic growth. This still makes sense. However, it is appropriate that now, almost four years later, we again take stock. Thus in recent months we have undertaken to look afresh at the international debt situation. The purpose was to discover what progress has been made: to see where we as a community of nations have succeeded and where we have not. And, where our success has not met our expectations, to understand why we have not achieved our goals. We have studied in depth, we have consulted widely -- seeking and taking into account the views of debtor nations, multilateral institutions, commercial banks and legislatures. We have also consulted closely with Japan and other industrial countries in order to begin to lay the basis for a common approach to the debt problem by the creditor countries.

Let me share with you the results of our reassessment as part of the ongoing process of international collaboration. I would hope that the ideas and suggestions I put forth here will provide a basis for a concerted effort by the international community to reinvigorate a process that has become debt-weary. However, we must strengthen the process without stopping it. As we move ahead with these ideas in the weeks ahead, it is important to continue working on individual debt problems.

Recent Progress

Our review confirmed that we have accomplished much, but much remains to be done.

The experience of the past four years demonstrates that the fundamental principles of the current strategy remain sound:

- Growth is essential to the resolution of debt problems;
- Debtor nations will not achieve sufficient levels of growth without reform;
- Debtor nations have a continuing need for external resources;
- Solutions must be undertaken on a case-by-case basis.

In recent years, we have seen positive growth occur in many debtor nations. Last year six major debtor nations realized more than four percent positive growth. This is primarily due to the debtors' own efforts. The political leadership of many of these nations has demonstrated their commitment to implement vital macroeconomic and structural reforms. In many countries this has been reflected in the privatization of nationalized industries. In some countries there has also been a move towards opening their shores to greater foreign trade and investment. Current account deficits have been sharply reduced, and the portion of export earnings going to pay interest on external debt has declined. These are significant achievements. All the more so, since in parallel progress, a number of debtor nations have advanced towards more democratic regimes. This has required great courage and persistence. The people of these countries have made substantial sacrifices for which they've earned our admiration. We must work together to transform these sacrifices into tangible and lasting benefits.

In another positive development, we have avoided a major disruption to the global payments system. Commercial banks have strengthened their capital and built reserves, placing them in a stronger position to contribute to a more rapid resolution of debt problems. The "menu" approach of the current strategy has helped to sustain new financial support while also encouraging debt reduction efforts. The banks have provided loans in support of debtor country economic programs. The stock of debt in the major debtor countries has been reduced by some $24 billion in the past two years through various voluntary debt reduction techniques.

However, despite the accomplishments to date, we must acknowledge that serious problems and impediments to a successful resolution of the debt crisis remain. Clearly, in many of the major debtor nations, growth has not been sufficient. Nor has the level of economic policy reform been adequate. Capital flight has drained resources from debtor nations' economies. Meanwhile, neither investment nor domestic savings has shown much improvement. In many cases, inflation has not been brought under control. Commercial bank lending has not always been timely. The force of these circumstances has overshadowed the progress achieved. Despite progress, prosperity remains, but for many, out of reach.

Other pressures also exist. The multilateral institutions and the Paris Club have made up a portion of the shortfall in finance. Commercial bank exposure to the major debtors since 1985 has declined slightly, while the exposure of the international institutions has increased sharply. If this trend were to continue, it could lead to a situation in which the debt problem would be transferred largely to the international institutions, weakening their financial position.

These are realities that we cannot deny. They are problems we must address if we are to renew progress on the international debt crisis.

Let me reiterate that we believe that the fundamental principles of the current strategy remain valid. However, we believe that the time has come for all members of the international community to consider new ways that they may contribute to the common effort.

In considering next steps, a few key points should be kept in mind:

- First, obviously financial resources are scarce. Can they be used more effectively?
- Second, we must recognize that reversing capital flight offers a major opportunity, since in many cases flight capital is larger than outstanding debt.
- Third, there is no substitute for sound policies.
- Fourth, we must maintain the important role of the international financial institutions and preserve their financial integrity.
- Fifth, we should encourage debt and debt service reduction on a voluntary basis, while recognizing the importance of continued new lending. This should provide an important step back to the free markets, where funds abound and transactions are enacted in days not months.
- Finally, we must draw together these elements to provide debtor countries with greater hope for the future.

Strengthening the Current Strategy

Any new approach must continue to emphasize the importance of stronger growth in debtor nations, as well as the need for debtor reforms and adequate financial support to achieve that growth. We will have success only if our efforts are truly cooperative. And, to succeed we must have the commitment and involvement of all parties.

First and foremost, debtor nations must focus particular attention on the adoption of policies which can better encourage new investment flows, strengthen domestic savings, and promote the return of flight capital. This requires sound growth policies which foster confidence in both domestic and foreign investors. These are essential ingredients for reducing the future stock of debt and sustaining strong growth. Specific policy measures in these areas should be part of any new IMF and World Bank programs. It is worth noting that total capital flight for most major debtors is roughly comparable to their total debt.

Second, the creditor community -- the commercial banks, international financial institutions, and creditor governments -- should provide more effective and timely financial support. A number of steps are needed in this area.

Commercial banks need to work with debtor nations to provide a broader range of alternatives for financial support, including greater efforts to achieve both debt and debt service reduction and to provide new lending. The approach to this problem must be realistic. The path towards greater creditworthiness and a return to the markets for many debtor countries needs to involve debt reduction. Diversified forms of financial support need to flourish and constraints should be relaxed. To be specific, the sharing and negative pledge clauses included in existing loan agreements are a substantial barrier to debt reduction. In addition, the banking community's interests have become more diverse in recent years. This needs to be recognized by both banks and debtors to take advantage of various preferences.

A key element of this approach, therefore, would be the negotiation of a general waiver of the sharing and negative pledge clauses for each performing debtor, to permit an orderly process whereby banks which wish to do so, negotiate debt or debt service reduction transactions. Such waivers might have a three year life, to stimulate activity within a short but measurable timeframe. We expect these waivers to accelerate sharply the pace of debt reduction and pass the benefits directly to the debtor nations. We would expect debtor nations also to maintain viable debt/equity swap programs for the duration of this endeavor, and would encourage them to permit domestic nationals to engage in such transactions.

Of course, banks will remain interested in providing new money, especially if creditworthiness improves over the three year period. They should be encouraged to do so, for new financing will still be required. In this connection, consideration could be given in some cases to ways of differentiating new from old debt.

The international financial institutions will need to continue to play central roles. The heart of their effort would be to promote sound policies in the debtor countries through advice and financial support. With steady performance under IMF and

World Bank programs, these institutions can catalyze new financing. In addition, to support and encourage debtor and commercial bank efforts to reduce debt and debt service burdens, the IMF and World Bank could provide funding, as part of their policy-based lending programs, for debt or debt service reduction purposes. This financial support would be available to countries which elect to undertake a debt reduction program. A portion of their policy based loans could be used to finance specific debt reduction plans. These funds could support collateralized debt for bond exchanges involving a significant discount on outstanding debt. They could also be used to replenish reserves following a cash buyback.

Moreover, both institutions could offer new, additional financial support to collateralize a portion of interest payments for debt or debt service reduction transactions. By offering direct financial support for debt and debt service operations, the IMF and the World Bank could provide new incentives, which would act simultaneously to strengthen prospects for greater creditworthiness and to restore voluntary private financing in the future. This could lead to considerable improvements in the cash flow positions of the debtor countries.

While the IMF and World Bank will want to set guidelines on how their funds are used, the negotiation of transactions will remain in the market place -- encouraged and supported but not managed by the international institutions.

It will be important that the Fund and the Bank both be in a strong financial position to fulfill effectively their roles in the strengthened strategy. The Bretton Woods Committee has provided an important public service in mobilizing capital resources for these institutions. The capital of the World Bank has recently been replenished with the implementation of the recent general capital increase providing approximately $75 billion in new resources to the Bank. With respect to the Fund, the implementation of these new efforts to strengthen the debt strategy could help lay the basis for an increase in IMF quotas. There are, of course, other important issues that have to be addressed in the quota review, including the IMF arrears problem and a need for clear vision of the IMF's role in the 1990's. It is our hope that a consensus can be reached on the quota question before the end of the year.

Creditor governments should continue to reschedule or restructure their own exposure through the Paris Club, and to maintain export credit cover for countries with sound reform programs. In addition, creditor countries which are in a position to provide additional financing in support of this effort may wish to consider doing so. This could contribute significantly to the overall success of this effort. We believe that creditor governments should also consider how to reduce regulatory, accounting, or tax impediments to debt reduction, where these exist.

The third key element of our thinking involves more timely and flexible financial support. The current manner in which "financial gaps" are estimated and filled is cumbersome and rigid. We should seek to change this mentality and make the process work better. At the same time, we must maintain the close association between economic performance and external financial support.

While we believe the IMF should continue to estimate debtor financing needs, we question whether the international financial institutions should delay their initial disbursements until firm, detailed commitments have been provided by all other creditors to fill the financing "gap." In many instances, this has served to provide a false sense of security rather than meaningful financial support. The banks will themselves need to provide diverse, active, and timely support in order to facilitate servicing of the commercial debt remaining after debt reduction. Debtor nations should set goals for both new investment and the repatriation of flight capital, and to adopt policy measures designed to achieve those targets. Debtor nations and commercial banks should determine through negotiations the portion of financing needs to be met via concerted or voluntary lending, and the contribution to be made by voluntary debt or debt service reduction.

Finally, sound policies and open, growing markets within the industrial nations will continue to be an essential foundation for efforts to make progress on the debt problem. We cannot reasonably expect the debtor nations to increase their exports and strengthen their economies without access to industrial country markets. The Uruguay Round of trade negotiations provides an important opportunity to advance an open trading system. We must all strive to make this a success.

<u>Conclusion</u>

Taken together, the ideas I have discussed today represent a basis on which we can work to revitalize the current debt strategy. We believe that through our efforts we can provide substantial benefits for debtor nations in the form of more manageable debt service obligations, smaller and more realistic financing needs, stronger economic growth, and higher standards of living for their people.

If we work together, we can make important progress towards our key objectives:

- o to assure that benefits are available to any debtor nation which demonstrates a commitment to sound policies;
- o to minimize the cost or contingent shift in risk to creditor governments and taxpayers;
- o to provide maximum opportunities for voluntary, market-based transactions rather than mandatory centralization of debt restructurings;
- o and to better tap the potential for alternative sources of private capital.

In the final analysis, our objective is to rekindle the hope of the people and leaders of debtor nations that their sacrifices will lead to greater prosperity in the present and the prospect of a future unclouded by the burden of debt.

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In the final analysis, our objective is to rekindle the hope of the people and leaders of debtor nations that their sacrifices will lead to greater prosperity in the present and the prospect of a future unclouded by the burden of debt.

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

For Release Upon Delivery
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Statement by the Honorable David C. Mulford
Assistant Secretary of the U.S. Treasury
for International Affairs
before the
Subcommittee on International Finance and Monetary Policy
United States Senate

Mr. Chairman and members of the Subcommittee:

I welcome this opportunity to discuss the two reports that have been transmitted to your full Committee, the Administration's review of the international debt strategy, and our suggestions for strengthening international efforts to alleviate the debt burden in developing countries.

In mid-December, then President-elect Bush called for a thorough reassessment of current public policy on this issue. At that time, the Treasury Department was in the midst of preparing reports, as required by law, that have had a direct bearing on the policy recommendations that we have developed. Therefore, I will open my remarks with a summary and conclusions of the reports.

International Discussions on an International Debt Management Authority

Turning to the report on the negotiation of an International Debt Management Authority, the Treasury Department has reviewed many international debt facility proposals. Most of these proposals have several common elements, including a significant, up-front injection of capital and the assumption of full risk on principal and interest.

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As required by the legislation, the report assesses the use of IMF gold stock and World Bank uncommitted liquid assets to establish an Authority. With regard to use of IMF gold stock, the report notes that mobilization of gold for the Authority could only be accomplished through the sale of gold, with proceeds made available to the authority. Such sales would reduce the IMF's basic reserves, which serve as backing for creditor claims on the IMF. They could have an adverse impact on gold prices and international gold reserves of the U.S. and other countries. Since only a small segment of IMF membership would benefit directly from this use of gold stocks, it would be extremely difficult to obtain the 85 percent majority vote necessary to authorize IMF gold sales for the authority.

The use of World Bank resources to establish such an authority would also be constrained by financial and legal obstacles. The Bank's liquid assets are earmarked to fund contractual lending commitments. These assets afford the Bank a margin of flexibility in raising funds in the international capital markets. Pledging Bank assets to a debt authority could affect the Bank's creditworthiness and increase its cost of funding. On the legal side, the Bank's Articles of Agreement do not cover the pledging of liquid assets. Moreover, pledging of the Bank's assets could raise questions concerning negative pledge clauses in agreements under which the Bank is the borrower. Each such clause typically provides that the Bank cannot pledge its assets to secure its obligations unless the benefits of the pledge are shared equally by the lenders which are parties to the agreement.

Our assessment concluded that negotiation of an Authority could materially increase the likelihood of payment interruptions and a further decline in secondary market prices. We believe that the suggested, market-oriented approach outlined by Secretary Brady on March 10 addresses Congressional concerns with less risk to taxpayers.

Voluntary debt reduction techniques have been developed by the commercial banks and debtor countries in response to both the banks' strategies and goals, and debtor nations' appetite for capturing the discount on their debt. All of the 15 heavily indebted middle income countries, with the exception of Colombia, Ivory Coast and Morocco, have participated in voluntary, market-driven debt reduction operations totaling $28 billion since 1985.

We have concluded after months of study that debt reduction and debt service reduction can be successful

We have reviewed numerous debt facility proposals in preparing the report at hand and, I would stress, not with jaundiced eyes but with a fresh view. In the final analysis, however, we have reaffirmed a market-oriented approach that would encompass both voluntary reduction in debt and access to private capital, while minimizing the expense and risk to the public sector.

The Report on Special Purpose Allocation of SDRs

Pursuant to the 1988 Trade Act, we have studied the feasibility of a special purpose allocation by the IMF of Special Drawing Rights (SDRs) to the poorest countries for use in repaying their debt to foreign governments and international financial institutions. The report concludes that the use of SDRs would undermine adjustment incentives, contribute to inflationary pressures, weaken the liquidity of the SDR and its usefulness as a monetary asset, and undermine the ability of the United States to mobilize its SDR holdings.

The report determined that the IMF's Enhanced Structural Adjustment Facility (ESAF) is a preferred alternative for helping the poorest countries. It suggests that the Administration's request for a $150 million contribution to the ESAF represents a more effective means of providing U.S. support for efforts to deal with the balance of payments and debt problems of the poorest countries.

The Report on the World Bank's Strategy in Debtor Countries

I would like to take a moment to review the conclusions of the report transmitted yesterday to your colleagues in the House of Representatives. As required by H.R. 4645, we have carefully reviewed the World Bank's role in debtor countries. In our judgment, one of the World Bank's most vital functions in these countries is to promote sound economic reform programs through its adjustment programs and to catalyze additional financial support.

In short, after careful study, we have come to conclusions somewhat parallel to the intent of legislators as expressed in H.R. 4645. Additional financial resources and an easing of debt service burdens can strengthen and sustain debtor nations' commitment to economic adjustment programs. The report summarizes our ideas on possible initiatives for voluntary, market-based debt reduction through use of Bank resources. I would underscore, at this juncture, that such funds would be available only for those countries undertaking adjustment programs, and individual transactions would b-

Strengthening the Debt Strategy

The debt difficulties of developing countries remain a serious global problem which requires cooperative efforts on the part of all parties. Following a thorough review of the current approach by the Administration, Secretary Brady has recently outlined suggestions for strengthening the international debt strategy. Our suggested approach builds upon the basic principles that have guided international efforts in recent years. It recognizes the continued vital importance of stronger growth, debtor reforms, external financial support, and a case-by-case approach to individual nations' problems.

Our suggestions would maintain a central role for the IMF and World Bank within the debt strategy in encouraging debtor policy reforms and catalyzing financial support, and recognize the continuing need for new lending from commercial banks. However, we would also place stronger emphasis on new investment flows and the repatriation of flight capital as alternative sources of private capital. To this end, we would encourage the IMF and World Bank to work with debtor nations to focus on specific measures to improve the investment climate and encourage the return of flight capital as part of their policy-based loan programs, in addition to vital macroeconomic and structural reforms.

In addition, we would focus international efforts on achieving more rapid and broadly based, voluntary debt reduction during the next three years in order to ease debt burdens and improve prospects for stronger growth. One of the key factors at play in determining the extent of voluntary debt reduction activity is the legal constraints within existing commercial bank agreements, which must be waived by most or all commercial bank participants for each individual debt reduction transaction. Debt/equity swaps and sales in the secondary market are exceptions, but there is a strong interest within debtor nations in obtaining more direct benefits from commercial banks' willingness to reduce their own exposure -- as can be obtained through debt/bond exchanges or cash buybacks.

A waiver of such provisions as sharing and negative pledge clauses in existing commercial bank loan agreements could go far to free up market activity in this area, and to accelerate the pace of debt and debt service reduction with direct benefits to debtor nations. Such waivers might have a limited life of perhaps three years, to stimulate activity within a short but measurable time frame.

In addition, an integral part of the approach would be for debtor nations engaged in debt reduction to maintain viable debt/equity swap programs, which have helped to substantially reduce the stock of debt in several countries. Provisions which permit domestic nationals to engage in such transactions can also contribute to the repatriation of flight capital, as we have seen in the case of Chile.

As debtor nations negotiate policy-based loan programs with the IMF and the World Bank, a portion of these loans would be set aside to finance debt reduction transactions negotiated between the debtor and the banks. Such "set-aside" amounts would be used to collateralize discounted debt/bond exchange transactions or to replenish debtor reserves following cash buybacks.

For debtor nations which have negotiated agreements to reduce the stock of debt, the IMF and World Bank could also make available support for interest payments on a rolling basis for a limited period. Such support could be available for transactions which involve either a substantial discount of principal or a major reduction in interest rates.

While the IMF and World Bank would set guidelines on how their funds are used, the negotiation of transactions would remain in the market place -- encouraged and supported but not managed by the international institutions.

Such transactions could lead to considerable improvements in the cash flow positions of the debtor countries, reducing their need for external financial support to more manageable levels. Nevertheless, new lending would still be needed -- in addition to efforts to repatriate flight capital and attract new investment. Such new financing could include a range of special purpose loans such as trade credits and project loans, as well as club loans by a group of banks or continued concerted lending in individual cases.

As part of this approach, creditor governments should also continue to reschedule or restructure their own exposure through the Paris Club, and to maintain export credit cover for countries with sound reform programs. In addition, creditor countries which are in a position to provide additional financing in support of this effort may wish to consider doing so. This could contribute significantly to the overall success of this effort. We believe that creditor governments should also review their regulatory, accounting, and tax regimes with a view to removing impediments to debt reduction, where these exist.

Broad international support is critical to strengthening the current strategy. It will require cooperative efforts by creditor and debtor governments, the commercial banking community, and the international financial institutions. We have consulted closely with these groups and have sought suggestions from Members of Congress prior to developing the ideas introduced last week by Secretary Brady. The Japanese have expressed their strong support, including a willingness to provide supportive financing, and a number of other creditor and debtor nations have made favorable responses to the general approach we have outlined.

Conclusion

Taken together, the ideas I have discussed today represent a basis on which we can work together to revitalize the current debt strategy. We must address key problems -- the restoration of private financial flows, the return flight capital, the need for sustained economic reforms in many countries, and preservation of the financial soundness of the multilateral institutions -- if we are to renew progress in addressing international debt problems.

We believe that through the suggestions we have outlined, including efforts to stimulate broader voluntary debt and debt service reduction, substantial benefits can be provided for debtor nations in the form of more manageable debt service obligations, smaller and more realistic financing needs, stronger economic growth, and higher standards of living for their people.

I look forward to consultations with members of Congress in the weeks and months ahead, and ask you for your support as we develop within the international community a more specific agenda for further action. Thank you.

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Statement by the Honorable David C. Mulford
Assistant Secretary of the U.S. Treasury
for International Affairs
before the
Subcommittee on International Development Finance,
Trade and Monetary Policy
U.S. House of Representatives

Mr. Chairman and members of the Subcommittee:

I welcome this opportunity to discuss the three reports that were transmitted to your full Committee, the Administration's review of the international debt strategy, and our suggestions for strengthening international efforts to alleviate the debt burden in developing countries.

In mid-December, then President-elect Bush called for a thorough reassessment of current public policy on this issue. At that time, the Treasury Department was in the midst of preparing reports, as required by law, that have had a direct bearing on the policy recommendations that we have developed. Therefore, I will open my remarks with a summary and conclusions of the reports.

<u>The Report on the World Bank's Strategy in Debtor Countries</u>

As required by H.R. 4645, we have carefully reviewed the World Bank's role in debtor countries. In our judgment, one of the World Bank's most vital functions in these countries is to promote sound economic reform programs through its adjustment programs and to catalyse additional financial support. Various Bank programs designed to achieve these twin goals are outlined in the report.

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While we call upon the Bank to increase its efforts to return borrowers to the growth path, we recognize that sustained growth in many countries has been elusive; aggregate data for 17 heavily indebted nations are included in the report which support these findings. This is not to say that the "Baker Plan" has been a failure -- far from it. The review of the debt strategy has reaffirmed the effectiveness of a case-by-case approach which emphasizes growth and debtor country reform. Highlighted in the report are achievements of the past four years, including improved export performance; sustained adjustment efforts of several major debtors, including Chile, Colombia, Mexico, Morocco and the Philippines; and declines in the stock of debt through voluntary, market-based techniques.

However, further progress on adjustment programs will require the release of additional financial resources as well as an easing of debt service burdens in order bring about sustained growth. It is recognized that the debt strategy needs to be strengthened especially in this area. In addition to new lending, negotiated reductions in debt and debt service burdens can provide important external financial support. Other non-debt creating methods, which we continue to strongly advocate, are direct and portfolio investment, debt/equity swaps, and, importantly, the return of flight capital.

We strongly believe that the international financial institutions should retain central roles in the debt work-out process. This will help win the confidence of the creditor community, and nurture a market-place where both debt reduction and new money can be negotiated in parallel. But we must also preserve the financial integrity of these institutions, and minimize risk to creditor governments and taxpayers.

By discussing several of our new ideas for facilitating debt reduction, the report directly addresses Congressional interest in expanding the World Bank's role in debt reduction. The report summarizes our ideas on possible initiatives in this area. I would underscore, at this juncture, that such funds would be available only for those countries undertaking adjustment programs, and individual transactions would be negotiated between debtors and commercial creditors.

In short, after careful analysis and review, we have come to conclusions somewhat parallel to the intent of legislators as expressed in H.R. 4645. Additional financial resources and an easing of debt service burdens can strengthen and sustain debtor nations' commitment to economic adjustment programs.

The Report on Special Purpose Allocation of SDRs

Pursuant to the 1988 Trade Act, we have studied the feasibility of a special purpose allocation by the IMF of Special Drawing Rights (SDRs) to the poorest countries for use in repaying their debt to foreign governments and international financial institutions. The report concludes that the use of SDRs would undermine adjustment incentives, contribute to inflationary pressures, weaken the liquidity of the SDR and its usefulness as a monetary asset, and undermine the ability of the United States to mobilize its SDR holdings.

The report determined that the IMF's Enhanced Structural Adjustment Facility (ESAF) is a preferred alternative for helping the poorest countries. It suggests that the Administration's request for a $150 million contribution to the ESAF represents a more effective means of providing U.S. support for efforts to deal with the balance of payments and debt problems of the poorest countries.

International Discussions on an International Debt Management Authority

Turning to the report on the negotiation of an International Debt Management Authority as required by the 1988 trade legislation, the Treasury Department has reviewed many international debt facility proposals. Most of these proposals have several common elements, including a significant, up-front injection of capital and the assumption of full risk on principal and interest.

As required by law, we fully examined possible use of IMF gold stocks or World Bank liquid assets, but determined that such measures would face significant obstacles. I refer you to the detailed analysis at the end of the report.

Our assessment concluded that negotiation of an Authority at this point could materially increase the likelihood of payment interruptions and a further decline in secondary market prices. We believe that the suggested, market-oriented approach outlined by Secretary Brady on March 10 addresses Congressional concerns with less risk to taxpayers.

Voluntary debt reduction techniques have already been developed by the commercial banks and debtor countries in response to both the banks' strategies and goals, and debtor nations' appetite for capturing the discount on their debt. Voluntary, market-driven debt reduction operations since 1985 now add up to an estimated $28 billion.

Strengthening the Debt Strategy

The debt difficulties of developing countries remain a serious global problem which requires cooperative efforts on the part of all parties. Following a thorough review of the current approach by the Administration, Secretary Brady has recently outlined suggestions for strengthening the international debt strategy. Our suggested approach builds upon the basic principles that have guided international efforts in recent years. It recognizes the continued vital importance of stronger growth, debtor reforms, external financial support, and a case-by-case approach to individual nations' problems.

Our suggestions would maintain a central role for the IMF and World Bank within the debt strategy in encouraging debtor policy reforms and catalyzing financial support, and recognize the continuing need for new lending from commercial banks. However, we would also place stronger emphasis on new investment flows and the repatriation of flight capital as alternative sources of private capital. To this end, we would encourage the IMF and World Bank to work with debtor nations to focus on specific measures to improve the investment climate and encourage the return of flight capital as part of their policy-based loan programs, in addition to vital macroeconomic and structural reforms.

In addition, we would focus international efforts on achieving more rapid and broadly based, voluntary debt reduction during the next three years in order to ease debt burdens and improve prospects for stronger growth. One of the key factors at play in determining the extent of voluntary debt reduction activity is the legal constraints within existing commercial bank agreements, which must be waived by most or all commercial bank participants for each individual debt reduction transaction. Debt/equity swaps and sales in the secondary market are exceptions, but there is a strong interest within debtor nations in obtaining more direct benefits from commercial banks' willingness to reduce their own exposure -- as can be obtained through debt/bond exchanges or cash buybacks.

A waiver of such provisions as sharing and negative pledge clauses in existing commercial bank loan agreements could go far to free up market activity in this area, and to accelerate the pace of debt and debt service reduction with direct benefits to debtor nations. Such waivers might have a limited life of perhaps three years, to stimulate activity within a short but measurable time frame.

In addition, an integral part of the approach would be for debtor nations engaged in debt reduction to maintain viable debt/equity swap programs, which have helped to substantially reduce the stock of debt in several countries. Provisions which permit domestic nationals to engage in such transactions can also contribute to the repatriation of flight capital, as we have seen in the case of Chile.

As debtor nations negotiate policy-based loan programs with the IMF and the World Bank, a portion of these loans would be set aside to finance debt reduction transactions negotiated between the debtor and the banks. Such "set-aside" amounts would be used to collateralize discounted debt/bond exchange transactions or to replenish debtor reserves following cash buybacks.

For debtor nations which have negotiated agreements to reduce the stock of debt, the IMF and World Bank could also make available support for interest payments on a rolling basis for a limited period. Such support could be available for transactions which involve either a substantial discount of principal or a major reduction in interest rates.

While the IMF and World Bank would set guidelines on how their funds are used, the negotiation of transactions would remain in the market place -- encouraged and supported but not managed by the international institutions.

Such transactions could lead to considerable improvements in the cash flow positions of the debtor countries, reducing their need for external financial support to more manageable levels. Nevertheless, new lending would still be needed -- in addition to efforts to repatriate flight capital and attract new investment. Such new financing could include a range of special purpose loans such as trade credits and project loans, as well as club loans by a group of banks or continued concerted lending in individual cases.

As part of this approach, creditor governments should also continue to reschedule or restructure their own exposure through the Paris Club, and to maintain export credit cover for countries with sound reform programs. In addition, creditor countries which are in a position to provide additional financing in support of this effort may wish to consider doing so. This could contribute significantly to the overall success of this effort. We believe that creditor governments should also review their regulatory, accounting, and tax regimes with a view to removing impediments to debt reduction, where these exist.

Broad international support is critical to strengthening the current strategy. It will require cooperative efforts by creditor and debtor governments, the commercial banking community, and the international financial institutions. We have consulted closely with these groups and have sought suggestions from Members of Congress prior to developing the ideas introduced last week by Secretary Brady. The Japanese have expressed their strong support, including a willingness to provide supportive financing, and a number of other creditor and debtor nations have made favorable responses to the general approach we have outlined.

Conclusion

Taken together, the ideas I have discussed today represent a basis on which we can work together to revitalize the current debt strategy. We must address key problems -- the restoration of private financial flows, the return flight capital, the need for sustained economic reforms in many countries, and preservation of the financial soundness of the multilateral institutions -- if we are to renew progress in addressing international debt problems.

We believe that through the suggestions we have outlined, including efforts to stimulate broader voluntary debt and debt service reduction, substantial benefits can be provided for debtor nations in the form of more manageable debt service obligations, smaller and more realistic financing needs, stronger economic growth, and higher standards of living for their people.

I look forward to consultations with members of Congress in the weeks and months ahead, and ask you for your support as we develop within the international community a more specific agenda for further action. Thank you.

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
March 21, 1989

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ADDRESS BY DR. DAVID C. MULFORD
TEMPORARY ALTERNATE GOVERNOR FOR THE UNITED STATES OF AMERICA
AT THE THIRD PLENARY SESSION
INTER-AMERICAN DEVELOPMENT BANK
IN AMSTERDAM

I want to thank the Government of the Netherlands and the people of Amsterdam for the very warm welcome we have received in this beautiful and historic city. I also want to offer my congratulations to Governor Ruding on his election as Chairman of the Board of Governors of our Bank.

Ladies and gentlemen, there is a wave of change sweeping across Latin America. Its results may be difficult to discern as we continue to wrestle with the debt problem. But, it is clear that the men and women of Latin America who are now in responsible policy positions are introducing new policies and those policies are changing their countries.

Debt remains a dominant issue in Latin America today. It preoccupies Heads of State, Finance Ministers, Central Bank Governors, businessmen, bankers, the media, and the population in general. The debt problem is also a great challenge to the United States because we are your friend, as well as your largest trading partner. Latin America's standard of living, your commitment to democracy, and your ultimate resolution of the debt problem are all high priorities for the United States. We share a deep common interest. And therefore it is highly desirable that the Inter-American Development Bank -- our Bank -- make its particular contribution to resolving Latin America's debt problems.

This same wave of change has now reached the Inter-American Development Bank itself. A year ago, at our meeting in Caracas, I encouraged President Iglesias to begin building a new consensus that could support an expanded IDB, enabling it to become a more important player in promoting sustainable growth in Latin America. Today, in Amsterdam, I offer him my congratulations and appreciation.

After years of discussion and some difficult negotiations, we are now close to agreement with other major shareholders on the essential elements of a replenishment which would transform the IDB. If important remaining issues can be resolved, the Bank's resources would increase by over \$26 billion. Its four year lending program would reach \$22.5 billion, and policy-based lending would become a reality. The replenishment, once settled, would be significant not only for the Latin American and the Caribbean borrowers of the Bank but also for the United States. Our participation in this single replenishment would amount to nearly $9 billion, raising the total financial contribution of the United States to the Bank to over $25 billion. This is a measure of the importance that the new Administration attaches to the Bank and to its mission.

We are all now looking forward with considerable hope and expectation to the Bank taking up the challenge. The replenishment, coupled with institutional and operating reforms will position the IDB to assume broader responsibilities. It will have the opportunity to make a more significant contribution to the inhabitants of our hemisphere. It will be doing so in a world economic environment marked by many positive features.

Global Economic Developments and Prospects

Maintaining a supportive macroeconomic environment in the industrial countries has been a cornerstone of our collective efforts.

A balanced assessment of the performance of the industrial nations would conclude that our macroeconomic performance in recent years has been impressive. While one could perhaps argue that this or that element of the picture has not been fully satisfactory, the positive aspects are clear: economic expansion in the industrial countries is now into its seventh consecutive year; inflationary pressures have been kept in check; and world trade flows have expanded robustly.

We should not ignore the tremendous resilience that our economies showed in the wake of the financial market turbulence in late 1987. Contrary to widespread expectations at the time, industrial country growth picked up strongly last year, pulling world trade growth up about 9 percent.

Our task now is to continue to build on the firm foundation we have laid. The next few years will surely be challenging, as the past few years have been. Sustaining growth, resisting inflation, and bolstering trade must remain the principal objectives for the industrial countries and the LDCs as well. I am confident that we will meet these challenges.

The United States has played a central role in constructing this foundation and will continue to play an important part in further efforts. Our tasks are several. First, we need to sustain growth. We anticipate real growth in the 3.0 percent range through 1990, which would be the eighth consecutive year of expansion. Second, we need to keep the lid on inflation. Some recent statistics in the U.S. point to some price firming, but the general economic data are mixed with no clear and compelling evidence that inflationary forces are rising made a clear commitment to meet the deficit targets laid out by the Gramm-Rudman process and negotiations are in progress at this time. Finally, we need to continue reducing U.S. trade and current account imbalances. Last year, 1988, we made substantial progress and we look for more progress this year.

Strengthening the Debt Strategy

In the world environment, as seen from Latin America, the debt problem casts its long shadow over the landscape. Sunday I spoke of Secretary Brady's recent proposals for strengthening the international debt strategy. Although important progress has been made in recent years, the Bush Administration recognizes that the debt difficulties facing developing nations of the Western Hemisphere remain a serious global problem.

Our suggested approach builds upon the basic principles that have guided international efforts in recent years. It recognizes the central importance of stronger growth, economic policy reforms, external financial support, and a case-by-case approach to individual nations' problems.

Our proposals would maintain a central role for the IMF and World Bank within the debt strategy in encouraging debtor policy reforms and catalyzing financial support. This is because the heart of the problem is still the reform of economic policies to produce key structural changes and sustained economic performance. While we recognize the continuing need for new lending from commercial banks, we need to place stronger emphasis on new investment flows and the repatriation of flight capital as alternatives to over-reliance in recent years on private bank loans. To this end, we would encourage the IMF and World Bank to work with debtor nations to focus on specific measures to improve the investment climate and to encourage the return of flight capital in addition to promoting vital macroeconomic and structural reforms.

The initiative for structural reform and a sound investment climate must come from within each debtor nation. This is a difficult issue for many nations in Latin America as elsewhere. But experience shows that where reforms are made, economic results help resolve non-economic problems. In any case, the problems that must be faced in order to accomplish reform are not so difficult as those that result from stagnation and decline.

In developing our new proposals we have borne in mind particularly those countries which have made important reforms, as well as those that are willing to commit their policies and energy to major reform efforts. In short, there needs to be light at the end of the tunnel.

We believe it is necessary to place greater emphasis on international efforts to achieve more rapid and broadly based voluntary debt reduction and debt service reduction. This will improve prospects for stronger growth especially where countries have already made important reforms in their economies and stand poised to benefit from their past sacrifices.

The U.S. proposals visualize redirecting and increasing available IMF and World Bank resources -- from their current capital stock -- to support debt and debt service reduction transactions agreed in the market by debtor nations and commercial banks. This concept involves an important shift in focus away from the present practice of using official resources in ways that, in effect, increase a debtor nations' stock of debt and ultimately its debt service burden.

Debtor nations which wish to engage in a debt reduction program should develop policy reform programs with the IMF and World Bank, as a condition for access to financial support for debt reduction. At the same time, commercial banks and debtors should negotiate general waivers covering such areas as the sharing and negative pledge provisions in existing commercial bank agreements. These waivers, which we have suggested might have a life of three years, could come into effect when IMF and World Bank disbursements become available, thus making it possible for multiple transactions between a debtor and the banks to reduce debt and debt service.

Once a general waiver has been agreed upon, a portion of IMF financing and World Bank policy-based loans could be made available to support debt reduction operations. The set-aside amounts could operate as standby credits to collateralize discounted debt/bond agreements or to replenish debtor reserves following cash buybacks during the period of the waiver.

For debtor nations which have negotiated agreements to reduce the stock of debt, the IMF and World Bank could also make available support for interest payments on a rolling basis for a limited period. Such support could be available for debt restructurings or exchanges which involve either a substantial discount of principal or a major reduction in interest rates.

In addition to the measures to facilitate reduction of commercial bank debt, the Paris Club should continue providing support through rescheduling based on debtor performance, with agreement contingent upon an IMF standby program or extended financing program (EFF). Key creditor countries might also seek to assure continued access to official export credit support for debtor nations adopting Fund and World Bank programs.

We would encourage creditor nations to review regulatory, accounting, and tax provisions with a view to reducing or eliminating impediments to debt reduction, where those exist, while of course maintaining the safety and soundness of the financial system. Creditor countries that are in a position to do so should provide financial support to this effort.

We are not proposing these ideas as immediate alternatives to the current process of direct negotiations between debtors and creditors. Rather, we are suggesting that new approaches and emphasis should be phased into ongoing discussions between these parties in order to avoid any interruptions in their orderly relations.

The process might work in the following way. Each debtor nation would work out with its commercial bank creditors a range of debt and debt service reduction instruments as a central element of meeting the debtor's financing needs.

Debtors and their creditors could choose any number of debt reduction mechanisms. Debt reduction transactions, for example, might include: the offer of specific instruments (such as debt/bond exchanges) to all commercial banks; cash buybacks up to a maximum amount; and/or the negotiation of specific debt/equity or non-collateralized interest reduction instruments with individual banks.

An integral part of the approach would be for debtor nations engaged in debt reduction to maintain viable debt/equity swap programs, which can make a substantial contribution to debt reduction and already has done so in several important countries. Provisions which permit domestic nationals to engage in such transactions could also contribute to the repatriation of flight capital, as we have seen already in the case of Chile.

Debt reduction transactions are not expected to cover all the financing needs of debtor countries. Additional new financing commitments will also be needed -- in the form of concerted lending, club loans by a group of banks, or a range of trade, investment, or other credits from individual banks. In some cases, this might involve a differentiation of new loans from old debt. Repatriation of flight capital and new investment are other potential sources of finance. It is hoped that the combination of these resources will enable debtor nations to finance their needs and to meet their obligations on a timely basis. The IMF should continue to monitor progress, and each country should report on a regular basis to the IMF and the World Bank on progress in its negotiations with commercial banks.

Taken together, these proposals represent a basis on which we can work together to revitalize the current debt strategy. This will require broad international support and cooperation between creditor and debtor governments, the commercial banking community, and the international financial institutions. Japan has already expressed their strong support, including a willingness to provide supportive financing, and a number of other creditor and debtor nations have responded favorably to the general approach which we have outlined.

We look forward to discussing these proposals in the coming weeks and especially at the spring meetings of the IMF and World Bank. We believe the proposals we have outlined, including efforts to stimulate broader voluntary debt and debt service reduction, provide substantial benefits for debtor nations in the form of more manageable debt service obligations, smaller and more realistic financing needs, stronger economic growth, and higher standards of living for their people.

The Inter-American Development Bank

Turning once again to the IDB, President Iglesias has already begun to create a stronger institution which can address the very serious problems of our Latin American and Caribbean member countries. His efforts to chart a course for the Bank have been impressive and he well deserves our praise for the leadership he has displayed and for his perseverance. He also needs the support of our governments and this includes more than the provision of capital.

We must help define the Bank's mission and sharpen its focus. The recent task force reports, prepared at the President's initiative, address key organizational and operational issues. We strongly encourage all members to work cooperatively and enthusiastically with the President and with Management to implement the changes that will be necessary to transform the Bank. This may be a difficult process because there are some differences between member countries. However, I am certain that we will find constructive ways to deal with our various points of view. Indeed, we must do so ... if we want to help Latin America and the Caribbean ... and we must do so, if we want a strong IDB.

The Bank needs to be in a position 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. Specific policy measures designed to help achieve these objectives should be an integral part of the Bank's lending operations.

Environment

The IDB's treatment of environmental issues must improve. This is an area of global importance of concern to us all. The Bank's assessment of the environmental impact of projects and programs that it helps to finance is critical. Over the past year, the Bank has made continued progress in providing training to its permanent staff on the importance of environmental issues. Seminars have been held on issues such as reservoir silting, shoreline conservation, and biodiversity issues in Latin America. The Bank is emphasizing environmentally-beneficial projects and providing technical assistance aimed at improvements in watershed management and riverine systems in Ecuador and Colombia. We applaud these and other initiatives the Bank has taken to promote environmental issues.

More needs to be accomplished, however, on organizational and staffing changes to produce effective environmental ~~assessment procedures~~ The Bank needs a senior environmental line unit with a clear mandate, and with the strong, consistent support from President Iglesias to participate fully in project identification, preparation and appraisal. I strongly recommend that the President's Committee on the Environment take the lead in evaluating and distributing information on the environmental assessment of the Bank's projects and programs.

Conclusion

And finally, Mr. Chairman, a closing note: The extensive and protracted negotiations to replenish the Bank's resources continue to be near completion. We need to settle the last remaining issues as soon as possible. The Bank needs to recover its momentum and to adjust its priorities. The first priority surely must be to move ahead with an expanded Bank that can address Latin America's most urgent challenges.

Thank you very much.

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 566-20

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.

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

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.

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.

TREASURY NEWS

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

TUESDAY, OCTOBER 8, 1985

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

BEFORE THE
JOINT ANNUAL MEETING OF
THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK
OCTOBER 8, 1985
SEOUL, KOREA

Chairman Toure, Managing Director de Larosiere, President Clausen, fellow Governors, and distinguished guests:

It is a pleasure to be here for the 40th annual meeting of the International Monetary Fund and the World Bank. Strong, effective international financial institutions are as essential to our economic well being today as they were 40 years ago.

Our host country, Korea, is a nation whose economic success is surpassed only by its warm hospitality. Korea's market-oriented approach and strong emphasis on private initiative are a lesson for us all.

Foundation for Growth

I would like to focus my comments today on policies for growth within the context of the internatonal debt strategy. Sound policies and sustained, low-inflation growth in the industrial countries must provide the essential foundation for a successful debt strategy, and are a prerequisite for stronger growth in the debtor countries.

The major industrial countries have already made considerable progress in this direction. Two weeks ago in New York the finance ministers and central bank governors of the Group of Five industrial nations underscored the progress which had been achieved, particularly with regard to the convergence of economic performance toward sustained, low-inflation growth. They also announced a set of policy intentions that will help to consolidate and extend that progress and to improve and sustain growth for the longer term.

We emphasized, for our own countries, the central importance of reducing structural rigidities, strengthening incentives for the private sector, reducing the size of government, and imroving the investment environment. We also rededicated our governments to resisting protectionist pressures that threaten our own prosperity and the opportunities for others. We must jointly [redacted] our efforts to launch a new round of trade

These industrial nations agreed that the significant progress already achieved in promoting a better convergence of their economic performance had not been fully reflected in exchange markets and that some further orderly appreciation of the main non-dollar currencies against the dollar was desirable. We expressed our willingness to cooperate more closely to encourage this when to do so would be helpful.

This package of measures had an immediate, significant impact on exchange markets which continues to be positive, and reflects the importance of the commitments made.

I am convinced that if each of the major industrial nations fulfills its policy intentions and maintains or improves access to its markets, we will have taken a major step toward balanced and sustainable growth, while providing a solid framework for improving the debt situation in the developing world.

Strengthening the Debt Strategy

Fellow Governors, it is essential that we beging the process of strengthening our international debt strategy.

Three years ago the international financial community developed a flexible, cooperative case-by-case strategy to address the debt problem and lay the basis for growth in the debtor nations. In three years:

-- Aggregate current account deficits in developing countries have been sharply reduced from $104 billion in 1982 to $44 billion this year.

-- Growth in developing countries has been restored to about 4 percent, compared to less than 2 percent in 1982.

-- This growth has been fueled by sharp increases in developing nations' exports, including a 21 percent increase in their exports to the United States last year.

These developments reflect improved growth and sharply lower interest rates in the industrial nations, as well as adoption of improved policies within most debtor countries. These policies have been given important support by reschedulings and rollovers amounting to approximately $210 billion, and by net new commercial bank lending.

The internatinal financial institutions have also played an important role in the progress that has been achieved. The IMF in particular has very capably played a leadership role, providing guidance on policies and temporary balance of payments financing, both of which have catalyzed commercial bank flows.

~~Despite this~~ progress, some serious problems have developed.

setbacks in their efforts to improve their economic situations, particularly with regard to inflation and fiscal imbalances, undercutting prospects for sustained growth. Bank lending to debtor nations has been declining, with very little net new lending anticipated this year. The sense of increasing reluctance among banks to participate in new money and debt rescheduling packages has introduced serious uncertainties for borrowers, in some cases making it more dificult for them to pursue economic reforms.

These problems need to be addressed, promptly and effectively, by building upon the international debt strategy in order to improve the prospects for growth in the debtor countries. This is an enterprise which will require, above all, that we work together and that we each strengthen our commitment to progress.

If the debt problem is to be solved, there must be a "Program for Sustained Growth", incorporating three essential and mutually reinforcing elements:

* First and foremost, the adoption by principal debtor countries of comprehensive macroeconomic and structural policies, supported by the international financial institutions, to promote growth and balance of payments adjustment, and to reduce inflation.

* Second, a continued central role for the IMF, in conjunction with increased and more effective structural adjustment lending by the multilateral development banks (MBDs), both in support of the adoption by principal debtors of market-oriented policies for growth.

* Third, increased lending by the private banks in support of comprehensive economic adjustment programs.

I want to emphasize that the United States does not support a departure from the case-by-case debt strategy we adopted three years ago. This approach has served us well; we should continue to follow it. It recognizes the inescapable fact that the particular circumstances of each country are different. Its main components, fundamental adjustment measures within the debtor nations and conditionality in conjunction with lending, remain essential to the restoration of external balance and longer-term growth.

We need to build upon the current strategy to strengthen its ability to foster growth. There must be greater emphasis on both market-oriented economic policies to foster growth and adequate financing to support it.

In essence, what I am suggesting is that adequate financing
available through a combination of private creditors
institutions working cooperatively, but only

where there are reasonable prospects that growth will occur. This will depend upon the adoption of proper economic policies by the developing countries. Financing can only be prudently made available when and as effective policies to promote economic efficiency, competitiveness and productivity -- the true foundations of growth --are put in place. We cannot afford to repeat the mistakes of the past. Adjustment must continue. Adjustment programs must be agreed before additional funds are made available, and should be implemented as those funds are disbursed.

These efforts should be mutually reinforcing. Sound policies in the principal debtor countries will not only promote growth, but will also stimulate the needed private bank lending. And it will be important that these policies be supported by the IMF, complemented by the MDBs. These institutions can help encourage and catalyze both needed policies and financing.

In today's highly interdependent world economy, efforts at economic isolationism are doomed to failure. Countries which are not prepared to undertake basic adjustments and work within the framework of the case-by-case debt strategy, cooperating with the international financial institutions, cannot expect to benefit from this three-point program. Additional lending will not occur. Efforts by any country to "go it alone" are likely to seriously damage its prospects for future growth.

I would like to elaborate on the actions that will be required by each participant in this three-point program.

<u>Structural Change in the Principal Debtors</u>

The essence of the need for structural change in the principal debtors is captured in two quotations I would like to share with you.

First:

> "The only way to overcome our economic crisis is to tackle at their root the structural problems of our economy to make it more efficient and productive." 1/

And second:

"Economic growth will have solid foundations only if we reestablish trust and stimulate private enterprise, which must be the flagship of our economic development . . . We will promote authentic institutional change in the economic sector." 2/

These are not the words of the U. S. Secretary of the Treasury. They are statements made in July of this year by the Presidents of Mexico and Brazil. I believe they reflect a growing

It is essential that the heavily indebted, middle income developing countries do their part to implement and maintain sound policies. Indeed, without such policies, needed financing cannot be expected to materialize. Policy and financing are not substitutes but essential complements.

For those countries which have inmplemented measures to address the imbalances in their economies, a more comprehensive set of policies can now be put in place, which promises longer term benefits from stronger growth, higher standards of living, lower inflation, and more flexible and productive economies. These must not only include macroeconomic policies, but also other medium and longer-term supply-side policies to promote growth.

We believe that such institutional and structural policies should include:

-- increased reliance on the private sector, and less reliance on government, to help increase employment, production and efficiency;

-- supply-side actions to mobilize domestic savings and facilitate efficient investment, both domestic and foreign, by means of tax reform, labor market reform and development of financial markets; and

-- market-opening measures to encourage foreign direct investment and capital inflows, as well as to liberalize trade, including the reduction of export subsidies.

This broader approach does not mean that policy areas that have been the focus of efforts to date -- in particular fiscal, monetary, and exchange rate policies -- can receive less attention. Indeed, macroeconomic policies have been central to efforts to date and must be strengthened to achieve greater progress. These policies should consist of:

-- market-oriented exchange rate, interest rate, wage and pricing policies to promote greater economic efficiency and responsiveness to growth and employment opportunities; and

-- sound monetary and fiscal policies focused n reducing domestic imbalances and inflation and on freeing up resources for the private sector.

The cornerstone of sustained growth must be greater domestic savings, and investment of those savings at home. Macroeconomic and structural policies which improve economic efficiency, mobilize domestic resources, and provide incentives to work, save and <u>invest</u> domestically will create the favorable economic

As a practical matter, it is unrealistic to call upon the support of voluntary lending from abroad, whether public or private, when domestic funds are moving in the other direction. Capital flight must be reversed if there is to be any real prospect of additional funding, whether debt or equity. If a country's own citizens have no confidence in its economic system, how can others?

There are essentially two kinds of capital inflows: loans and equity investments. Foreign borrowings have to be repaid -- with interest. Equity investment, on the other hand, has a degree of permanence and is not debt-creating. Moreover, it can have a compounding effect on growth, bring innovation and technology, and help to keep capital at home.

We believe that the debtor nations must be willing to commit themselves to these policies for growth in order that the other elements of a strengthened debt strategy can come into place.

Enhanced Effectiveness of the International Financial Institutions

The international financial institutions must also play an important role in strengthening the debt strategy to promote growth. However, we must recognize that the international financial institutions cannot have sufficient resources to meet the debtor nations' financing needs all by themselves. An approach which assumes that the IMF and the World Bank are the sole answer to the debt problems is simply a non-starter. For most developing countries other sources must play a more important role. These include private sector borrowing, increasing export earnings, foreign equity investment, and repatriation of capital which has fled abroad. All these routes should be pursued.

Among the international financial institutions, the IMF has played a major role in advising member nations on the development of policies necessary to promote adjustment and growth. There has been a particular focus on monetary, fiscal and exchange rate policies, although increasing attention is being paid to other areas such as trade liberalization, pricing policies, and the efficiency of government-owned enterprises.

Emphasizing growth does not mean deemphasizing the IMF. Through both its policy advice and balance of payments financing, the Fund has played a critical role in encouraging needed policy changes and catalyzing capital flows. It must continue to do so. But it must also develop new techniques for catalyzing financing in support of further progress. "Enhanced surveillance," for example, can sometimes provide an effective means of continued IMF involvement.

[redacted] should give higher priority to tax reform.

rigidities, and to opening economies to foreign trade and investment. This will help assure that Fund-supported programs are growth-oriented. It will be particularly important for the Fund to work closely with the World Bank in this effort.

I would now like to turn more directly to the role of the MDBs, which need to be brought into the debt strategy in a stronger way, without diminishing the role still to be played by the IMF.

The World Bank, and indeed all MDBs, have considerable scope to build on current programs and resources, and to provide additional assistance to debtor nations which is disbursed more quickly and targeted more effectively to provide the needed stimulus to growth.

There is ample room to expand the World Bank's fast-disbursing lending to support growth oriented policies, and institutional and sectoral reform. An increase in such lending can serve as a catalyst for commercial bank lending.

A serious effort to develop the programs of the World Bank and the Inrter-American Development Bank (IDB) could increase their disbursements to principal debtors by roughly 50 percent from the current annual level of nearly $6 billion.

Increased disbursements would require greater borrowing by the MDBs in world capital markets. Their ability to borrow at low rates is a precious asset which must be preserved. Therefore, their lending must be in support of sound economic programs that enhance and implement such assistance programs. This will expedite the actual disbursement of funds.

The value and role of an indigenous, competetive private sector needs to be recognized and developed more fully than it has in the past. The Bank, for its part, should actively promote the development of the private sector and, where appropriate, provide direct assistance to this sector. In addition, the Bank should seek to assist, both in a technical and financial capacity, those countries which wish to "privatize" their state-owned enterprises, which in too many cases aggravate already serious budget deficit problems.

Given the importance of increasing commercial bank flows to the principal debtors, there is also an urgent need for efforts to expand the Bank's co-financing operations. These efforts should be pursued vigorously to increase the effectiveness of the Bank in helping its borrowers to attract private finance, and should have substantial potential in the context of this three-point program.

The enhanced program of the International Finance Corporation, with an expanded capital base, and the recently negotiated Multilateral Investment Guarantee Agency (MIGA) are two important Bank Group initiatives in support of developing countries. Both organizations can do much to assist their members in attracting non-debt capital flows as well as critical technological and managerial resources. We urge all Bank members and particularly the principal debtors to give their full support to establishment of the MIGA.

If developing countries implement growth-oriented reform; if commercial banks provide adequate increases in net new lending to good performers; and if increased demand for quality IBRD lending demonstrtates the need for increased capital resources, we would be prepared to look seriously at the timing and scope of a general capital increase.

We believe the World Bank's efforts can be supplemented actively by the regional development banks. Since some of the most serious debt problems are found in Latin America, special emphasis should be placed on stengthening the IDB's policies to enable it to be a more effective partner in support of growth-oriented structural reform.

In the case of an IDB capital increase, it will be critical to assess the extent to which the institution strengthens its lending policies. There must be well-defined economic and country strategies tailored to enhance economic reforms which encourage growth. Given a firm commitment by the IDB to move in this direction, we believe that it should be permitted to introduce a major program of well targeted non-project lending. In the meantime, such lending could be associated with World Bank programs until the IDB has implemented the necessary refrorms.

<u>Increasing Lending by the International Banking Community</u>

The international banking community has played an important role during the past three years. I am, however, concerned about the decline in net bank lending to debtor nations over the past year and a half, particularly those nations which are making progress. All of us can appreciate the commercial banks' concerns, but we believe these concerns would dissipate if the banks were confident that the new lending is in support of policies for growth in the developing nations.

If creditor governments, in an age of budget austerity, are to be called upon to support increases in multilateral development bank lending to the debtor nations, and if the recipient nations are asked to adopt sound economic policies for growth to avoid wasting that financing, then there must also be a commitment by the banking community -- a commitment to help the global community make the necessary transition to stronger growth.

Our assessment of the commitment required by the banks to the entire group of heavily indebted, middle income developing countries would be net new lending in the range of $20 billion for the next three years. In addition, it would be necessary that countries now receiving adequate financing from banks on a voluntary basis continue to do so, provided they maintain sound policies.

I would like to see our banking community make a pledge to provide these amounts of new lending and make it publicly, provided the debtor countries also make similiar growth-oriented policy commitments as their part of the cooperative effort. Such financing could be used to meet both short-term financing and longer-term investment needs in the developing countries, and would be available, provided debtors took action and multilateral institutions also did their part.

We would welcome suggestions from the banking community about arrangements which could be developed in order to ensure that adequate financing to support growth is available.

The Poorest Countries

Before concluding my statement, I would like to focus briefly on the problems of another set of debtor countries, the low-income debtors with protracted balance of payments problems. Special efforts are being made to assist these countries, but more can and should be done to improve their longer-term prospects.

The United States believes that the resources provided by the Trust Fund reflows provide a unique opportunity to help address the economic problems of the poorest countries with protracted balance of payments difficulties. Recent experience demonstrates that successful resolution of the economic problems of these countries requires a comprehensive approach, including fundamental structural policy changes, as well as sound macroeconomic policies.

The $2.7 billion in Trust Fund reflows present us with an opporunity to utilize IMF resources, possibly supplemented by funds from other sources, in support of such comprehensive economic programs. The effectiveness of such programs would be enhanced by close cooperation between the Fund and Bank. In some cases, this could best be accomplished by a joint approach by the two institutions in support of comprehensive programs.

The United States is also prepared to consider a bolder approach, involving more intensive IMF and World Bank collaboration. We believe that this approach would help ensure that the institutions provide sound, mutually consistent advice on the full range of policies to promote growth.

The United States, which supported African countries with $1.7 billion in bilateral aid in 1985, would be prepared to consider seeking resources in support of such a far-reaching approach if other donors were prepared to make equitable contributions.

We recognize that some may have reservations about such an approach, viewing it as complicated and difficult to implement. can understand some of those concerns, and believe they suggest the need for further reflection on certain aspects if this proposal. But, we cannot let parochial resistance or unfounded suspicions block an idea that can significantly help the poorest countries and strengthen ties between the Fund and the Bank. I urge you to give this approach further consideration during the months ahead

Conclusion

In conclusion, much has been accomplished in the past few years in addressing the pressing economic problems of the early 1980s and preparing the foundation for future global growth. We must now join together to consolidate our progress in building stronger economies for the future.

Sound policies and growth in the industrial world can provide a solid foundation for strengthening and adapting the current international debt strategy. Let us not lose the present opportunity. I have proposed a three-point "Program for Sustained Growth" to provide renewed impetus for resolving the debt problem. We must not deceive ourselves. There are no easy solutions, and none of us can escape our responsibilities.

The principal debtor nations must take the hard policy decisions to restructure their economies. The commercial banks must provide adequate resources to support these efforts. The MDBs must increase the efficiency and volume of their lending.

Moving from proposal to implementation will be a demanding exercise and cannot be accomplished overnight. As we adapt our strategy, we must continue to look to the IMF as the catalyst for new financial flows. And with these new flows will come new hope.

We will be building on the efforts of the past. The needs are clearly recognized by borrowers and creditors alike. Fundamentally, there is no disparity of interest among our nations. We have a common interest in growth -- sustained growth that rests on productivity, innovation and investment. Let us begin our efforts now.

1/ President de la Madrid at Mexican Bankers Association Annual Meeting, July 22, 1985.

2/ President Sarney in a televised address to the nation, July 23, 1985.

TREASURY NEWS

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FOR RELEASE
MARCH 12, 1987

Statement by the Honorable David C. Mulford
Assistant Secretary of the U.S. Treasury
for International Affairs
before the
Euromoney Debt/Equity Swaps Conference
The Plaza Hotel
New York City, New York
March 12, 1987

Managing the Debt Problem: The Role for Debt/Equity Swaps in the Debt Strategy

I appreciate the opportunity to address this distinguished audience on the subject of debt/equity swaps -- one of a number of emerging market instruments designed to securitize outstanding debt.

The Treasury is firmly on record in supporting the development of debt/equity swaps. Secretary Baker and other officials have made a number of strong calls for increased equity investment and debt/equity swaps in the debtor nations in order both to limit total debt burdens and to boost potential growth. We believe that debt/equity conversions can play an increasingly important role in supplementing the debtor reforms and new financing which are essential elements of our international debt strategy.

I would like to divide my remarks this morning into two basic parts: I would like to begin by making a brief assessment of progress under the "Program for Sustained Growth". Then I will discuss the potential role of debt/equity swaps within the overall debt strategy.

The Debt Strategy: Progress and Prognosis

There is little need to outline for this audience the key elements of the strengthened debt strategy. The heart of the strategy focuses on the fundamental need for stronger, sustained growth in the debtor nations as a prerequisite to solving their debt problems. That objective has universal support among debtors and creditors alike.

The development and implementation of growth-oriented policy reforms by the debtor nations themselves, including both macro-economic and structural elements, are essential to achieving that objective. So are supportive international capital flows: new lending from the IMF, the World Bank, and the private commercial banks; new foreign direct and portfolio investment flows; and the repatriation of flight capital.

At the present time, we are in a period of rather intensive questioning about whether or not the debt stategy is working. We have heard these concerns before, usually, as is the case now, when there is a concentration of debtor country financing activity which seems to underline the enormity of the global problem.

Given the fact that the debt strategy provides a dynamic framework for policy reforms, assembling resources, and resolving country problems on a case-by-case basis, I believe this focus of attention is essentially healthy. By constant review within the case-by-case framework, new ideas and refinements can be developed and implemented. Indeed, this is what has been happening over the past 18 months.

The important point here is that the framework itself continues to provide the most widely accepted approach to the debt problem by both debtors and creditors. No workable and widely accepted alternative has been put on the table, and it is therefore on the basis of present reality that we must assess our progress.

Perhaps the most important change during the past year and a half has been in debtor attitudes. The debtor nations are increasingly focusing on the importance of market-led growth, and adopting the reforms necessary to achieve it. These include steps to increase savings and investment, improve economic efficiency, privatize public enterprises, liberalize trade and investment regimes, and reform tax and financial systems. A great deal more needs to be done, but there is general movement in the right direction in many debtor countries.

The real growth rate for the 15 major debtors as a group is expected to average approximately 3.5 percent this year, the highest since 1980, and a significant improvement over 1983, when the major debtors experienced negative growth of 3.5 percent. Import volumes are also projected to increase by more than 3 percent this year, the best performance in 6 years, while export volumes should grow by about 3 percent, the best in 3 years.

Despite recent oil and other commodity price declines, GNP growth in most of the major debtors has kept pace with or exceeded the growth in total debt. The ratio of interest payments to debt, which is key because it measures the capacity to service debt, has also improved substantially, with a projected ratio of 25 percent for the 15 major debtors this year, compared to 31 percent in 1982.

The IMF and World Bank have provided strong support for the debtors' efforts since October 1985 by committing nearly $12 billion in new loans to the 15 major debtors. In this same period, official creditors have also rescheduled $14.5 billion in outstanding loans to these countries through the Paris Club, providing important debt relief and opening new sources of financing from creditor countries.

Progress on the third leg of the strategy -- commercial bank lending -- has been slower to develop and by the end of 1986 was clearly inadequate. To some extent, this is due to the process involved: under concerted lending procedures, commercial bank loans only come into play after debtor reform programs have been developed and have in most cases received IMF and World Bank support. This takes time, and should not have been expected to produce a large increase in bank lending within the first few months of 1986. Nor would one expect net flows to be distributed evenly over time, since sizeable new loans are linked to policy negotiations. In addition, some major debtors such as Brazil and Venezuela did not need new loans in 1986.

In terms of overall financial flows linked to policy reforms in debtor countries, there have been a number of important developments in the past 18 months. These include supportive financing or specific Paris Club and commercial bank debt relief for all of the 15 major debtors, with the exception of Peru, since October 1985. Reschedulings by commercial banks, over and above the $14.5 billion of Paris Club reschedulings, have provided longer maturities at lower rates and spreads on an additional $70 billion of outstanding debt.

Nevertheless, in recent months the area of greatest difficulty in assuring new financial flows has been on the commercial bank side. Chile and Venezuela only recently reached agreement with the commercial banks after protracted negotiations, and the Mexican package, although now 97 percent subscribed, still has not been finalized.

In the past few weeks, the banks have begun to move ahead on the backlog of new financing packages. In addition to Mexico, Chile has reached agreement on a package which includes retiming and repricing arrangements. Venezuela and the banks have agreed on a rescheduling of principal payments due on previously rescheduled debt at lower spreads. The Philippines negotiations resumed in early March and agreement now appears to be very near. Progress in these discussions will help to dispel concerns of a new debt crisis, which is in the interest of debtors and creditors alike. These agreements, together with others for Argentina and we hope Brazil, will also assure substantial net new commercial bank lending to the major debtor nations in 1987.

<u>Need for Creative Thinking</u>

I believe this is a picture which represents significant progress. No one ever said that the negotiations, whether for policy change, new money, or rescheduling, would be easy. There will continue to be difficult problems and periods of significant risk, but we have built an important experience base where cooperation between debtors and creditors has been the rule.

What can we learn from this recent experience? Is there more that commercial banks can or should be doing to facilitate the completion of new money packages? I think there is.

One of the key problems has been the reluctance of a number of banks, especially those with small exposures, to provide new loans. Many different reasons have been offered for their reluctance to participate. A number of banks have reduced their exposure in individual debtor countries, either via swaps or sales of debt paper on secondary markets. In the Mexican case, dissatisfaction with the Mexican program and criticisms of communication and coordination within the bank group have also played a role in their refusal to participate, which for a time appeared to jeopardize the prospects for successful agreement with the rest of the banks. The broader implications of "free rider" banks which receive debt service payments due in part to the new loans provided by other banks still need to be addressed and resolved. I believe this must be done by the banks themselves.

In particular, I would urge the commercial banks to develop a "menu" of options for supporting debtor reforms as a means of maintaining broad bank participation in new financing packages. The banks should be able to provide a range of options which could be offered to participating banks in the syndicate. Or they might simultaneously pursue several different approaches, where permitted under their own regulatory systems, provided the liquidity value of the total transactions to the debtor nations is equivalent to the banks' new money obligation.

Obviously, this kind of approach could have significant implications for future base exposure numbers and for the relative risk positions of individual banks. The difficulties in devising mechanisms for fairly allocating new money shares with a broad diversity of types of flows shouldn't be underestimated. However, we must face the fact that greater flexibility in devising new money packages may, in effect, be essential to future bank syndications. Indeed, a case by case approach demands a willingness to develop and try new techniques as well as adjusting them to recognize performance. Instead of merely complaining that there is no leeway in current procedures, or that the IMF simply imposes new money requirements on the banks, the commercial banks have much to gain from taking the lead themselves to develop the kinds of ideas that help assure the concerted lending process works.

We may also find that both debtor governments and commercial banks -- with a common interest in limiting total debt burdens -- will increasingly be moving toward repricing, retiming, or rescheduling agreements in the future as an alternative to new loans. The benefits of such approaches may be substantial and may, in the right circumstances, be easier to achieve than new money packages. For debtors with substantial financing needs, however, new lending will still be necessary and should be expedited by debtors and commercial banks alike.

The External Environment

Before moving on to debt/equity swaps, I would like to touch on overall international developments that are also helping to buttress the debtors' reform efforts. Interest rates have been reduced by nearly 5 percentage points since 1984, saving the major debtors over $14 billion in interest payments annually. Efforts continue to achieve stronger growth among the industrial nations, to improve economic policy coordination, and to open global markets through the new multilateral trade negotiations.

At the February 22 meeting of major industrial nations in Paris, agreement was reached on concrete steps to promote global growth, reduce trade imbalances, and foster greater exchange rate stability. The surplus countries committed to follow policies designed to strengthen domestic demand. Germany agreed to undertake comprehensive tax reform and to increase tax reductions already enacted for 1988. Japan announced a reduction in interest rates and agreed to prepare a comprehensive economic program to stimulate domestic demand after the current budget is acted upon by the Diet.

For their part, deficit countries also committed to follow policies designed to encourage steady, low-inflation growth, while reducing their domestic imbalances and external deficits. The United States agreed to continue its efforts to reduce the Federal budget deficit, implement a wide range of policies to improve competitiveness, and fight protectionism.

These measures, together with continued close cooperation among the major countries, should help improve the prospects for a sound, growing world economy, which is essential to support the debtor nations' own efforts to establish sustained growth.

Debt/Equity Swaps

Debt/equity swaps have been an important part of Secretary Baker's debt initiative. Coming as I do from an investment banking background, I have great faith in their potential and in the creative diversity of the marketplace. Such swaps can contribute to a number of important objectives:

- First and foremost, converting external debt liabilities into equity holdings helps to reduce both outstanding debt and annual debt service burdens -- freeing a portion of foreign exchange earnings for other uses, including imports, or for reducing new borrowing needs.

- Second, the discounts on debt paper and attractive rates for converting foreign exchange into local currency can encourage equity investment flows over and above those which would otherwise take place.

- Third, the shift of some debt into equity holdings helps to improve the debt/equity mix of external liabilities, reducing exposure to variations in global interest rates.

- Fourth, the adoption of debt/equity swap mechanisms by debtor nations are frequently accompanied by some liberalization of the investment climate or the privatization of public enterprises, thus supporting important broader objectives.

- Fifth, where foreign exchange for debt conversions comes from residents of the debtor nations themselves, such conversions can serve as a mechanism for the repatriation of flight capital. This is the least costly of all sources of foreign capital.

- Sixth, commercial banks which engage in swaps reduce their total exposure and if swaps are for their own account maintain a positive stake in the future growth of debtor nations.

In short, debt/equity conversions hold very important potential benefits for all participants. While they cannot serve as a panacea for the debt problem, they can be very useful at the margin in reducing both debt and debt service burdens. They have already generated considerable interest among debtor nations, commercial banks, and international investors. I believe this interest will grow and that participation will broaden among both investors making direct investments and portfolio investors who see interesting prospects for equity investment in developing nations through LDC mutual funds.

Indeed, we estimate that in 1986 some $2.5 billion in debt conversions occurred within four of the major debtor nations alone. A number of other nations are now moving to permit them, and innovative mechanisms such as mutual funds which would deal exclusively in debt/equity swaps are on the drawing board. Of course, we will need to see a productive environment among the debtor nations to encourage the continuing evolution of markets.

Are additional measures needed to stimulate the development of secondary markets in LDC debt paper, as an essential resource for debt/equity swaps? Do current regulatory or accounting rules need to be clarified? Or should new regulatory, accounting, or tax provisions be adopted to provide incentives for swaps? This conference may help to answer some of these questions -- or, at a minimum, permit those of you with strong views to express them.

My own view is that we already have a functioning, albeit thin, secondary market. Banks can sell some of their debt at a discount if they want to. Within certain limits, U.S. banks can swap debt for equity holdings. And tax benefits are already provided for documented losses by U.S. banks due to the sale of debt paper. Legislation to force banks to either sell debt at a discount or to provide non-market stimulus to debt/equity swaps is neither needed nor desirable. While I understand that some banks believe there is a lack of clarity, particularly in the accounting area, this is not a generally shared view and I would hope that these concerns can be promptly put to rest. I hope this conference can help contribute to this objective.

Before closing, I would like to discuss briefly a concept which has recently surfaced on Capitol Hill and in the academic community. This concerns the creation of an IMF or World Bank debt facility. For some reason the World Bank appears to be picked on more often than the IMF, but both are offered as potential parents.

The facility would be financed, according to these proposals, by various means: contributions from nations with large current account surpluses (a polite way of saying Germany and Japan); member governments of the parent organization could be asked to provide paid-in or callable capital, or IMF gold assets could be used as a basis against which to borrow substantial sums in the market; or commercial banks could receive bonds from the facility in return for their debt paper.

These proposals suffer from a number of common problems:

Public budget and revenue costs could be extremely large. Any contributions by current account surplus countries would only be forthcoming if other major industrial countries, including the United States, contributed as well. To leverage sufficient financing to purchase commercial banks' outstanding debt, substantial paid-in or callable capital would be required. U.S. bank losses on their sale of debt paper would be tax deductible; such deductions could run into several billion dollars. The full risk on commercial bank debt portfolios would also be assumed by the facility -- backed in turn by member nations' taxpayers.

As with debt forgiveness proposals, banks which have taken a substantial loss would be unlikely to provide new loans for years to come. If the facility is closely linked with the World Bank, the Bank's credit rating would be adversely affected, in turn increasing the cost of World Bank loans to all borrowers. Debtor nations might well welcome the debt relief offered by the facility as an excuse to avoid needed policy reforms. Without such reforms, any immediate benefits to their liquidity would be short-lived and any boost to debtor growth and imports could not be sustained.

Furthermore, such a proposal would provide little effective relief for the debtor countries. Without adequate policy reforms, any short-term boost to growth or imports could not be sustained. And such short-term benefits would be very limited. Even if the new facility were able to purchase the full $283 billion in outstanding bank debt of the 15 major debtors at a 35 percent discount, they would save only $6 billion in interest payments annually. By way of comparison, reductions in market interest rates since the end of 1984 have already provided over $14 billion in annual debt service savings, while reschedulings and reductions in commercial bank spreads have provided substantial additional "debt relief", without the adverse repercussions of a debt facility.

In my view, debt conversions or swaps into either equity or local debt claims provide a preferable route to "debt relief" for the debtor nations, particularly if combined with measures to encourage new equity investment and the repatriation of flight capital. It is true that debt/equity swaps work on a smaller amount of debt than would a World Bank debt facility. But when a debt/equity swap occurs, it results in a total elimination of debt service on the debt swapped (rather than just a portion of interest payments, as under the debt facility), and a productive, job-creating investment takes place. Such swaps support efforts to open up the investment environment, and by doing so improve the prospects for growth.

Conclusion

In conclusion, I would reemphasize that there are no real "overnight solutions" to debt difficulties. Progress will take time, must be founded on economic reforms, and buttressed by enough new financing to meet the debtors' immediate needs to support reform and to generate growth. That is the essence of the strengthened debt strategy -- a process that is now being implemented, and that has the support of debtors and creditors alike. Our task is to get on with this program and to assure its success.

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AS PREPARED FOR DELIVERY

Remarks by
The Secretary of the Treasury
James A. Baker, III
at the afternoon session of the Interim Committee
of the International Monetary Fund
Washington, D.C.
April 9, 1987

The International Debt Strategy

Thank you, Mr. Chairman. I welcome the opportunity to discuss the international debt strategy. In doing so, I would like to focus on two key questions:

(1) Is the current strengthened debt strategy working?

(2) Are additional efforts needed to ensure continued progress under the debt strategy?

I believe the answer to both of these questions is "yes". The debt strategy is working. Substantial progress is being made. But more can and should be done.

Let's turn first to the record of what is being accomplished.

First, the debtor nations themselves are increasingly adopting market and growth-oriented reforms. In particular, substantial efforts are being made to reduce inflation, privatize parastatals, encourage greater efficiency, strengthen internal savings, and stimulate the repatriation of flight capital.

For example:

- Argentina has cut inflation from 600 percent to 80 percent; dramatically reduced its fiscal deficit from 12 percent to 4 percent of GDP between 1984 and 1986; reestablished real growth of 5.5 percent in 1986; liberalized trade; implemented a number of important tax reform measures; and moved to privatize public enterprises.

- o Mexico has significantly reduced the number of parastatal companies, has replaced licenses with tariffs for most of its imports while also reducing tariffs, and is focusing on increased public investment, tax reform, and more market-oriented pricing adjustments.

- o The Philippines has liberalized imports, is implementing a comprehensive tax reform program, and has instituted major agricultural reforms.

These are but a few examples of the progress underway. What are the results of these efforts, and those of other major debtors?

- o Growth in the major debtor nations averaged 3.5 percent last year, the highest in 6 years, and well above the negative 3.5 percent growth experienced in 1983.

- o Per capita GDP is again on the increase.

- o Export and import volumes are projected to increase by more than 3 percent this year, the best in three years.

- o Inflation has been cut by more than half since 1985.

- o Aggregate reserves are expected to increase by 20 percent or $5 billion this year.

- o Capital flight has either slowed or been reversed in most debtor nations.

In addition, as we had hoped, the growth in external debt has fallen sharply, averaging less than 3.5 percent annually since 1982. With reasonable growth both within the debtor nations and the global economy, this rate of increase in total debt should be manageable and consistent with declining debt-to-GNP ratios. Indeed, we estimate that for 9 of the major debtors debt-to-GNP ratios remained flat or improved during 1986.

I would also note that the 5-percentage point reduction in interest rates since 1984 has saved the debtors over $14 billion annually in interest payments. Interest/export ratios have declined sharply from 31 percent in 1982 to an expected 25 percent this year, reflecting an improved ability to carry debt.

Second, the IMF and World Bank have moved toward more growth-oriented approaches. The two institutions together have provided nearly $12 billion in support of major debtors' reform efforts during the past 18 months. On the IMF side, this includes 8 new standbys and increased emphasis on structural reforms, and for the World Bank, major policy-based reforms in 10 of the key debtor nations. World Bank disbursements to the major debtors increased by over 40 percent in 1986, and are expected to increase further in 1987.

Third, supportive international financing has been made available for virtually all of the major debtors. The Paris Club has rescheduled $15.5 billion in outstanding loans for these nations. Commercial bank reschedulings have been provided on an additional $80 billion in loans. Agreements on $8.3 billion in new financing have been completed or are nearing completion for four of the major debtors since October 1985. Substantial additional new loans have either already been requested or are likely to be requested for Argentina, Venezuela, Ecuador, and Brazil during 1987.

This is a good start. But more needs to be done. Debtors need to move ahead on market-opening reforms, particularly in the investment area. The IMF needs to strengthen its emphasis on growth and supply-side reforms. The World Bank needs to help debtors focus more explicitly on medium-term objectives and policies, with graduated structural programs designed to achieve those objectives. The industrial nations, as we discussed this morning, need to provide a more supportive external environment, through stronger growth (particularly in Europe and Japan) and markets which are open to debtors' exports. And commercial banks need to develop more flexibility in their concerted lending mechanisms to help assure continued participation in new money packages.

It is this last area that I would like to discuss in some detail this afternoon. In light of the modest amounts of new lending envisioned in the debt strategy, and commercial bank commmitments of support, bank lending last year was clearly disappointing. Net lending to the major debtors as a group was negative and the Mexican new money package has taken a considerable amount of time and energy to complete. The difficulties stem from a number of factors: numerous banks with small exposures which are reluctant to increase lending; difficulties in communication within the bank group; as well as an inability for banks to concentrate on more than one major new money package at a time.

Fortunately, progress has been made recently in completing a repricing and retiming agreement with Chile, as well as rescheduling arrangements for Venezuela and the Philippines. Other discussions are also well underway. Together with the Mexican and Nigerian new money packages, these should provide substantial net new lending for the major debtors in 1987.

But some underlying problems in organizing new lending packages remain. The major debtor nations need to be able to count on receiving timely disbursements of new loans essential to support well-conceived economic programs. The sense of urgency and willingness to cooperate in support of a larger general interest that helped to carry us through the difficult crisis period of 1982 and 1983 is now less evident. This is unfortunate.

Doubts about financing can clearly undermine the resolve to carry out needed economic reforms. And periodic financial crises are hardly in the interest of the banking community itself.

To help address these problems, I believe it is important for the commercial banks to develop a menu of alternative new money options from which all banks with debt exposure can choose in providing continuing support for debtor reforms. None of us can develop such a menu for the banks -- they must do it themselves. But we can encourage them to think creatively, and to provide a range of financing alternatives which will help to keep the banks' doors open to international finance. The continued implementation of the debt strategy may well rest on their doing so.

I would suggest that we focus on this key issue in this afternoon's discussion, and that we take up in more detail within the Development Committee tomorrow additional steps which the debtor nations themselves may need to undertake.

Finally, growth prospects for the lowest-income countries remain an issue of critical concern to the United States. The international community has been moving with increased urgency to set in place the financing and programs needed to support their reform efforts. In particular, we are pleased to note the progress made under the IMF Structural Adjustment Facility and the steps taken to coordinate its programs of reform and financial assistance with the World Bank and bilateral aid agencies. We will examine the growth prospects and financing needs of the lowest-income countries in much greater detail tomorrow in the Development Committee and I shall have a number of specific comments to offer at that time.

In concluding, I want to stress the need for all to guard against the ephemeral attraction of magical solutions, which may appear as tantalizing alternatives to the rigorous realities of grappling with our debt problems. The siren song of quick-fixes can lead us astray and detract us from the task at hand.

There are no quick-fixes, legislated or otherwise, that can solve the debt problem. Dramatic solutions won't appear overnight. It took us a decade to get into this problem, and we need to recognize that even with intensive efforts on all our parts, it will take several years before we fully put these problems to rest.

We must also operate within the reality of fiscal limitations within the industrial nations. No solutions can rest primarily on the shoulders of the taxpayer. While there is an important role for official financing, it is to catalyse, not replace, contributions from the private market.

The only path to lasting progress is to approach each situation on a case-by-case basis, bringing to bear the policies and financing needed to bring that economy back to sustained economic growth. That is the path we properly have chosen to pursue. We must now get on with that task.

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AS PREPARED
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Remarks by
The Secretary of the Treasury
James A. Baker, III
at the morning session of the Development Committee
of the International Monetary Fund and World Bank
Washington, D.C.
April 10, 1987

Chairman Chidzero, President Conable, Managing Director Camdessus:

As always, I welcome this opportunity to discuss important issues in economic development, but let me first take a moment to welcome Minister Chidzero as our new Chairman. I look forward to your able stewardship, Mr. Chairman.

As you all well know, the international financial community is engaged in an intense discussion about what might constitute the best approach to easing the international debt burden. I believe this kind of analysis is both healthy and necessary.

Yet I remain convinced that we have made considerable progress since we embarked upon the current debt strategy in Seoul, in 1985. I am also convinced that this is the approach that is most widely accepted by both debtors and creditors. Some refinements may be needed from time to time, but on balance I believe our approach is sound.

Let me highlight a few signs of progress so far:

- Many debtors are themselves making policy changes to promote growth. They are taking steps to increase private savings and investment, expose public companies to competition, liberalize trade, and encourage the return of flight capital. Fiscal deficits are now under better control and exchange rates are more realistic. As a result of these efforts, average growth in the major debtors reached 3.5 percent last year, the best rate in six years. Import and export volumes in 1987 are expected to be the best in three years. Inflation has been cut in half, reserves should increase by 20 percent this year, and capital flight is being reversed.

- The IMF and the World Bank are providing important assistance to these efforts at reform -- together they've committed nearly $12 billion in support of policy reforms for the 15 major debtors since October 1985.

- Virtually all of the major debtors have received multilateral financing, or Paris Club or commercial debt relief in the past 18 months. This includes the rescheduling of $15.5 billion in loans by the Paris Club and another $80 billion by the commercial banks.

I recognize that commercial bank financing has been the most difficult part of the strategy to implement. Despite the modest new financing called for under the debt strategy, and despite commercial bank pledges of support, new lending by the end of 1986 was disappointing. In particular, the delay in completing the Mexican package contributed to a financing backlog for other nations.

Yet in recent weeks we've seen important progress. This includes the signing of the Mexican package, a retiming and repricing arrangement for Chile, and rescheduling agreements for Venezuela and the Philippines. Other countries will be seeking new financing. I am confident that we are moving to establish the environment which will help to assure significant new financing for the major debtors this year.

What many of these recent agreements have in common is greater flexibility and innovation in their financing mechanisms. Philippine investment notes, Chilean retiming and repricing mechanisms, and Argentina's bearer bond proposals -- these are all the result of debtor and creditor ingenuity. Debt/equity swaps have also helped to reduce the burden of debt -- even as they also help to support investment, privatization, and the return of flight capital.

I welcome this trend -- indeed, I believe it is important for the commercial banks to build on these kinds of mechanisms and develop a menu of alternative new money options from which all banks with debt exposure can choose in providing continuing support for debtor reforms. Governments cannot develop such a menu for the banks -- they must do it themselves. But governments <u>can</u> encourage the banks to think creatively, and to provide a <u>range</u> of financing alternatives that will help to keep the doors of all banks open to international finance and ensure that financing flows to the debtors in a more timely fashion.

Our strategy provides a broad framework for action, but it also allows for innovation -- by both debtors and creditors. It allows debtors and creditors to work together to adapt and implement financial strategies geared to <u>specific</u> circumstances -- to individual nations and their specific needs. It puts a premium on flexibility and creativity -- creativity, I might add, that we won't get if we turn to sweeping, across-the-board solutions that I know are popular in some quarters.

Across-the-board solutions may have general appeal, but they would limit specialized innovation. They may also appear to offer short-term relief, but they would do so only at the expense of sustained growth and continued access to world financial markets for debtor countries.

No one country can legislate a solution to the world's debt problems. These problems developed over an extensive period, and they will take time to resolve. Similarly, these problems cannot be solved solely through action by the public sector. All of the players in the debt strategy -- debtor and creditor governments, commercial banks, and international financial institutions -- must remain at the table.

We can also do more on the macroeconomic front to ease the debt burden. The sharp decline in interest rates has already helped substantially, of course -- but recent developments in commodity prices, in the prospects for OECD growth, and in growing pressure for protectionism are cause for concern. Stronger OECD growth is essential to further progress, and open markets for trade are crucial if the debtors are to be able to grow and service their debt by increasing exports. A basis is being laid for stronger, non-inflationary growth through the cooperative efforts of the industrial countries. The Louvre Agreement, reinforced by the Statement of the Group of Seven, represents an important step forward in our efforts to promote higher growth, reduced imbalances, and exchange rate stability. The United States and the six major industrial countries are fully committed to implementing our undertakings in these agreements.

On balance, as I've said, I believe our debt strategy has made a good start. And I expect further progress. But we must be realistic and recognize that progress will take time, and that it will vary among nations -- depending upon each country's willingness to make the difficult reforms that will promote growth and earn the continuing financial support of the international community.

In recent months we have also seen improved economic prospects in sub-Saharan Africa. Better climatic conditions have helped, and we can only hope they persist. But some of the progress has also resulted from significant reforms taken by governments in the region. These governments deserve a good deal of credit, and their reform efforts challenge the international community.

Yet despite these positive developments, many African countries will continue to confront difficult economic and financial conditions over the next several years. Their problems are of serious concern to the United States. We must continue to be innovative in trying to identify measures that support their reform efforts. In this regard, we are prepared along with other Paris Club creditors to examine urgently what further measures might be possible to provide greater relief on official credits.

The sub-Saharan countries will of course receive 45 to 50 percent of the $12.4 billion total in IDA's eighth replenishment. The IDA agreement represents a major achievement in international cooperation to help the world's poorest nations, and my government strongly supports it. Despite our own budget constraints, I will make every effort to win support in Congress for the IDA and for the other multilateral institutions.

I should also point out that IDA's replenishment provides that $3 to $3.5 billion be made available for adjustment lending both to sub-Saharan Africa and elsewhere. This lending should take place in conjunction with the IMF's Structural Adjustment Facility, according to the terms of the cooperative policy framework approach the Bank and the Fund began last year.

Both the Bank and the Fund have made significant progress in implementing this approach during the past year, but there is clearly scope for further improvement. I believe, therefore, that it would be useful to review at our next meeting what they have achieved. The review could consider the process of cooperation in negotiating adjustment programs, the effectiveness of policy changes, the relationship of the adjustment programs to the two institutions' lending programs, and the extent to which these arrangements have catalyzed additional bilateral aid. I recommend that the Bank and Fund staffs jointly prepare a background paper for our discussion.

The relationship between economic growth and the natural environment is also a major issue on our agenda. I will make only a few points now, and outline my views in more detail this afternoon.

The U.S. believes that sustained growth in developing countries requires the prudent management of natural resources. Too often in the past, we've seen the consequences of development that fails to protect resources -- in deforestation, in soil erosion, and in expanding deserts.

I think we all recognize that this issue has political, as well as economic, implications, and I look forward to our exchange of views. Our discussions on this subject should continue at future meetings, as we review the Bank's activities in this area. I hope that we will generate a consensus for a more active Bank role.

Before I close, I'd like to mention briefly a couple of other important issues.

First, the Bank has done a service by clarifying the impact of structural adjustment lending on the poor. We should support the Bank's efforts to ensure that its programs protect the poor, and to help governments design their adjustment programs with this goal in mind. And in this connection, the U.S. government has begun new efforts to provide more food aid to low-income citizens of countries undertaking structural adjustments.

A second critical structural adjustment issue is government intervention in agriculture -- and its byproducts of overproduction, trade distortions, and resource misuse. These practices are hurting both developed and developing countries. The Declaration of the new trade round at Punta del Este was an important first step in winning commitments to negotiate on all practices that distort trade in agriculture. We must now fulfill these commitments.

Finally, President Conable has already mentioned the importance of the Multilateral Investment Guarantee Agency. I hope we can meet the requirements to establish MIGA shortly, so it can begin its work by the end of the year. For my country's part, we have already sent the legislation to Congress and are working hard to win approval.

Conclusion

Let me conclude by emphasizing again some of the progress we've made in recent months and years. World economic growth continues -- and both the developing world and the major debtor nations are now benefiting from this growth. New and creative financing packages, though sometimes slow in developing, are being agreed upon by debtors and creditors. While problems remain, we have an effective strategy for addressing them. I think we can all agree that we've come much further than we thought possible even a few years ago.

Thank you.

June 20, 1991

THE BRADY PLAN

Background

In December 1988, President-elect Bush called for a thorough reassessment of public policy toward international debt. The Administration's review recognized much had been accomplished in recent years, but more remained to be done.

At the time, several debtor countries had achieved stronger growth. Current account deficits were sharply reduced, and the portion of export earnings going to pay interest on external debt declined. A number of debtor nations also advanced toward more democratic regimes.

Meanwhile, major disruptions to the global payments system were avoided. Commercial banks had strengthened their capital and built reserves, placing them in a stronger position to contribute to a more rapid resolution of debt problems.

Despite these signs of progress, the U.S. review of the debt situation concluded that several serious problems remained. Debtor reforms in several countries were not applied consistently; low investment and capital flight weakened future economic prospects; new loans from commercial banks were not always forthcoming in a timely fashion; and many debtor nations had not achieved adequate growth on a sustained basis.

The Administration's review recognized these issues needed to be addressed to make progress on international debt and fundamental principles had to be maintained:

-- growth is essential to the resolution of debt problems;

-- debtor nations will not achieve sustainable levels of growth without reform;

-- debtor nations have a continuing need for external resources to support their reform efforts; and

-- solutions must be undertaken on a case-by-case basis.

In recognition of these principles, Secretary Brady suggested a new approach to revitalize the international debt strategy in March 1989. The key elements of this new approach included:

-- The adoption of IMF and World Bank economic reform programs by debtor countries -- with stronger emphasis on measures to increase foreign and domestic investment and the repatriation of flight capital;

-- Financial support from the IMF and World Bank for debt and debt service reduction transactions;

-- Active participation by commercial banks in providing debt and debt service reduction, as well as new lending, to debtors implementing economic reforms; and

-- Paris Club rescheduling of debt owed to official creditors.

Under the Brady Plan, debtor countries must undertake economic reforms and adopt sound economic and structural policies. It is expected these policies will help promote both foreign and domestic investor confidence, while stimulating a sustained and durable return of flight capital to those countries.

To support the reform efforts of debtor countries, the Administration encouraged the IMF and World Bank to set aside a portion of their normal policy-based loans for debt reduction transactions, such as cash buy-backs or collateralized exchanges. Also encouraged was interest support for transactions involving significant debt or debt service reduction.

The commercial banks, for their part, were encouraged to negotiate waivers, voluntary debt and debt service reduction transactions, along with new money arrangements where needed in order to provide timely support for debtors' reform efforts.

Finally, the Administration recognized that creditor governments need to continue to provide substantial support for debtor countries. In particular, official debt reschedulings are continuing in the Paris Club, and export credit cover provides for those countries adopting IMF and World Bank programs.

The Brady Plan is a versatile approach to increase voluntary debt and debt service reduction by commercial banks, while encouraging new lending and alternative sources of private capital. Through combined international efforts, we can provide substantial benefits for debtor nations in the form of more manageable debt service obligations, stronger economic growth and higher standards of living for people in countries around the world.

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

For Immediate Release
November 5, 1991

Contact: Anne Kelly Williams
(202) 566-2041

THE UNITED STATES AND THE REPUBLIC OF PERU SIGN AN AGREEMENT TO COMBAT MONEY LAUNDERING

On Monday, October 14, the governments of the United States of America and the Republic of Peru continued their fight against illicit drug trafficking and money laundering by signing an agreement to exchange financial information. The agreement, signed in Lima by U.S. Ambassador Anthony C. E. Quainton, on behalf of the U.S. Department of Treasury, and by Peruvian Prime Minister Carlos Torres y Torres Lara, provides a mechanism for exchanging currency transaction information recorded by financial institutions in each country. The information will be used in law enforcement procedures relating to drug trafficking and money laundering. The agreement was effective upon signing.

In his remarks at the signing, Ambassador Quainton emphasized the importance of this agreement to our bilateral efforts in fighting narcotics trafficking and money laundering. Prime Minister Torres y Torres Lara echoed these sentiments, noting that the accord closed Peru's banking system to those who would use it to launder proceeds of drug trafficking. After the signing, Hugo Garcia Salvatecci, Peru's Superintendent of Banking, who will implement the agreement for Peru, added that the agreement "can support our two governments in their common effort to stop money laundering."

Through this agreement, the Administration takes another significant step in the effort to track illegal drug profits around the world. It establishes a mechanism to facilitate the exchange of financial information between the governments of Peru and the United States of America, and strengthens our other domestic and international initiatives aimed at combatting illicit activities involving drugs and psychotropic substances, and related money laundering.

NB-1533

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
November 5, 1991

CONTACT: Office of Financing
202-219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 20,400 million, to be issued November 14, 1991. This offering will provide about $ 625 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $19,773 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Tuesday, November 12, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Standard time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 10,200 million, representing an additional amount of bills dated February 14, 1991, and to mature February 13, 1992 (CUSIP No. 912794 XZ 2), currently outstanding in the amount of $ 23,293 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 10,200 million, to be dated November 14, 1991, and to mature May 14, 1992 (CUSIP No. 912794 YN 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 November 14, 1991. 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 $ 954 million as agents for foreign and international monetary authorities, and $ 5,038 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 competitive 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.

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.

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.

8/89

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 5, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 3-YEAR NOTES

Tenders for $14,000 million of 3-year notes, Series U-1994, to be issued November 15, 1991 and to mature November 15, 1994 were accepted today (CUSIP: 912827C91).

The interest rate on the notes will be 6 %. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	5.97%	100.081
High	6.03%	99.919
Average	6.00%	100.000

Tenders at the high yield were allotted 66%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	25,570	25,570
New York	20,264,255	12,842,255
Philadelphia	23,060	23,060
Cleveland	90,985	90,985
Richmond	80,725	80,725
Atlanta	28,750	28,730
Chicago	845,080	561,080
St. Louis	34,940	32,940
Minneapolis	13,305	13,305
Kansas City	44,045	44,045
Dallas	18,400	18,400
San Francisco	170,685	112,185
Treasury	126,795	126,795
TOTALS	$21,766,595	$14,000,075

The $14,000 million of accepted tenders includes $852 million of noncompetitive tenders and $13,148 million of competitive tenders from the public.

In addition, $650 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $2,135 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1535

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
November 6, 1991

Contact: Claire Buchan
(202)566-8773

Statement of Treasury Secretary Brady
on Fed Discount Rate Lowering

The Federal Reserve's lowering of the discount rate is good news for the economy. Lower rates will provide stimulus for economic growth, spur incentive for business investment, and increase consumer confidence. We hope the Fed's action will quickly be reflected in interest rates charged to consumers and businesses.

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NB-1536

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR RELEASE AT 3:00 PM
November 6, 1991

Contact: Peter Hollenbach
(202) 219-3302

PUBLIC DEBT ANNOUNCES ACTIVITY FOR SECURITIES IN THE STRIPS PROGRAM FOR OCTOBER 1991

Treasury's Bureau of the Public Debt announced activity figures for the month of October 1991, of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS).

	Dollar Amounts in Thousands
Principal Outstanding (Eligible Securities)	$544,825,443
Held in Unstripped Form	$415,075,628
Held in Stripped Form	$129,749,815
Reconstituted in October	$8,809,900

The accompanying table gives a breakdown of STRIPS activity by individual loan description. The balances in this table are subject to audit and subsequent revision. 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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PA-72

TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, OCTOBER 31, 1991
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding: Total	Principal Amount Outstanding: Portion Held in Unstripped Form	Principal Amount Outstanding: Portion Held in Stripped Form	Reconstituted This Month[1]
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,327,354	$1,331,200	$60,800
11-1/4% Note A-1995	2/15/95	6,933,861	6,506,661	427,200	220,800
11-1/4% Note B-1995	5/15/95	7,127,086	5,797,166	1,329,920	22,400
10-1/2% Note C-1995	8/15/95	7,955,901	7,141,101	814,800	50,000
9-1/2% Note D-1995	11/15/95	7,318,550	5,980,150	1,338,400	12,000
8-7/8% Note A-1996	2/15/96	8,575,199	8,173,599	401,600	24,000
7-3/8% Note C-1996	5/15/96	20,085,643	19,861,643	224,000	40,000
7-1/4% Note D-1996	11/15/96	20,258,810	19,918,010	340,800	-0-
8-1/2% Note A-1997	5/15/97	9,921,237	9,820,037	101,200	-0-
8-5/8% Note B-1997	8/15/97	9,362,836	9,186,836	176,000	-0-
8-7/8% Note C-1997	11/15/97	9,808,329	9,597,129	211,200	24,000
8-1/8% Note A-1998	2/15/98	9,159,068	9,149,788	9,280	-0-
9% Note B-1998	5/15/98	9,165,387	9,128,387	37,000	-0-
9-1/4% Note C-1998	8/15/98	11,342,646	11,213,846	128,800	-0-
8-7/8% Note D-1998	11/15/98	9,902,875	9,754,075	148,800	148,800
8-7/8% Note A-1999	2/15/99	9,719,623	9,602,823	116,800	-0-
9-1/8% Note B-1999	5/15/99	10,047,103	9,176,703	870,400	-0-
8% Note C-1999	8/15/99	10,163,644	10,081,619	82,025	-0-
7-7/8% Note D-1999	11/15/99	10,773,960	10,765,960	8,000	-0-
8-1/2% Note A-2000	2/15/00	10,673,033	10,673,033	-0-	-0-
8-7/8% Note B-2000	5/15/00	10,496,230	10,373,030	123,200	-0-
8-3/4% Note C-2000	8/15/00	11,080,646	11,080,646	-0-	-0-
8-1/2% Note D-2000	11/15/00	11,519,682	11,519,682	-0-	-0-
7-3/4% Note A-2001	2/15/01	11,312,802	11,308,802	4,000	-0-
8% Note B-2001	5/15/01	12,398,083	12,398,083	-0-	-0-
7-7/8% Note C-2001	8/15/01	12,339,185	12,337,585	1,600	-0-
11-5/8% Bond 2004	11/15/04	8,301,806	4,812,206	3,489,600	510,400
12% Bond 2005	5/15/05	4,260,758	1,882,808	2,377,950	423,700
10-3/4% Bond 2005	8/15/05	9,269,713	8,550,513	719,200	250,400
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	1,818,384	4,187,200	430,400
11-1/4% Bond 2015	2/15/15	12,667,799	2,068,279	10,599,520	76,000
10-5/8% Bond 2015	8/15/15	7,149,916	1,652,636	5,497,280	105,600
9-7/8% Bond 2015	11/15/15	6,899,859	2,155,859	4,744,000	113,600
9-1/4% Bond 2016	2/15/16	7,266,854	6,502,054	764,800	86,400
7-1/4% Bond 2016	5/15/16	18,823,551	17,117,151	1,706,400	28,000
7-1/2% Bond 2016	11/15/16	18,864,448	16,626,448	2,238,000	800,000
8-3/4% Bond 2017	5/15/17	18,194,169	6,166,329	12,027,840	487,040
8-7/8% Bond 2017	8/15/17	14,016,858	9,762,458	4,254,400	576,000
9-1/8% Bond 2018	5/15/18	8,708,639	2,148,639	6,560,000	203,200
9% Bond 2018	11/15/18	9,032,870	1,442,270	7,590,600	426,200
8-7/8% Bond 2019	2/15/19	19,250,798	6,151,598	13,099,200	1,185,600
8-1/8% Bond 2019	8/15/19	20,213,832	11,480,392	8,733,440	1,111,680
8-1/2% Bond 2020	2/15/20	10,228,868	4,030,068	6,198,800	286,800
8-3/4% Bond 2020	5/15/20	10,158,883	2,952,323	7,206,560	198,240
8-3/4% Bond 2020	8/15/20	21,418,606	6,874,446	14,544,160	272,640
7-7/8% Bond 2021	2/15/21	11,113,373	8,513,373	2,600,000	396,800
8-1/8% Bond 2021	5/15/21	11,958,888	9,585,448	2,373,440	238,400
8-1/8% Bond 2021	8/15/21	12,163,482	12,152,282	11,200	-0-
Total		544,825,443	415,075,628	129,749,815	8,809,900

[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.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 6, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 10-YEAR NOTES

Tenders for $12,004 million of 10-year notes, Series D-2001, to be issued November 15, 1991 and to mature November 15, 2001 were accepted today (CUSIP: 912827D25).

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

	Yield	Price
Low	7.50%	100.000
High	7.56%	99.584
Average	7.53%	99.792

$75,000 was accepted at lower yields.
Tenders at the high yield were allotted 58%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	12,366	12,366
New York	23,099,358	11,383,478
Philadelphia	15,926	15,926
Cleveland	11,941	11,941
Richmond	25,511	25,511
Atlanta	17,561	15,461
Chicago	514,809	280,029
St. Louis	18,993	18,993
Minneapolis	5,265	5,265
Kansas City	19,218	19,218
Dallas	5,489	5,451
San Francisco	297,329	197,329
Treasury	12,858	12,852
TOTALS	$24,056,624	$12,003,820

The $12,004 million of accepted tenders includes $614 million of noncompetitive tenders and $11,390 million of competitive tenders from the public.

In addition, $473 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $300 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

The minimum par amount required for STRIPS is $80,000. Larger amounts must be in multiples of that amount.

NB-1537

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
November 6, 1991

CONTACT: Claire Buchan
(202)566-8773

Statement of Treasury Secretary Brady
on Bob Clarke

The Senate Banking Committee today completed its shameful work on Bob Clarke's nomination. This is crass politics and partisanship at its worst. It is the time honored duty of the Senate to advise and consent; it is another thing to engage in character assassination and persecution.

On a practical level, it makes no sense to take this action when credit availability is lacking, the economic recovery is sluggish, and the American people ask for leadership.

oOo

NB-1538

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

FOR IMMEDIATE RELEASE
November 6, 1991

CONTACT: Barbara Clay
202-566-5252

BRADY ANNOUNCES OECD AGREEMENT ON TIED AID

Treasury Secretary Nicholas F. Brady today announced an agreement among the major countries of the Organization for Economic Cooperation and Development (OECD) to further curb trade distortions due to the linkage of foreign aid to the purchase of a donor country's exports, and to reduce remaining subsidies in official export credits. The agreement, effective December 16, 1991, is the culmination of over two years of negotiation initiated by the United States, and is subject to approval by the individual governments.

"The OECD has taken a major step to apply the principles of a free market economy to the world's trading system", said Secretary Brady. U.S. Export-Import Bank Chairman John Macomber added, "As this agreement takes hold, it should substantially reduce the commercial disadvantages for American exporters engendered by the tied aid practices of other countries".

The agreement, which is intended to maximize the total flow of capital to developing countries, prohibits members of the OECD from providing so-called tied aid to countries whose annual per capita income exceeds $2,465. A country whose per capita income exceeds this threshold for two consecutive years automatically becomes ineligible. The least developed countries would not be subject to the new prohibitions.

Countries whose per capita income falls between those two categories would be eligible for tied aid under certain conditions. As a general principle, if a project has the capacity to support market rates of financing, tied aid funds should not be used. The agreement sets up tests and consultation procedures to distinguish between projects that should be financed on market or official export credit terms, and those that legitimately require such aid funds. Conditions under which tied aid could be provided to these countries include the unavailability of commercial or export-import bank financing, or a case where a project lacks the capacity to generate sufficient income to cover its costs at market prices.

In announcing the agreement today, Secretary Brady acknowledged the important contribution of Chairman Macomber and the staff of the Export-Import Bank to the successful conclusion of the negotiations.

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TREASURY NEWS

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

EMBARGOED FOR RELEASE
November 7, 1991
2:00 PM

Contact: Claire Buchan
(202)566-8773

Statement of Secretary of the Treasury
Nicholas F. Brady
on Credit Crunch Guidelines

I am pleased with today's announcement by the financial institutions regulators on guidelines for certain regulatory policies. The new guidelines will increase flexibility and improve consistency in bank regulation.

Treasury has been working with regulators, business leaders and bankers for more than a year to develop a coordinated, sensible approach to alleviate the credit crunch. Today's guidelines demonstrate the regulators' continued commitment to evenhanded, common-sense supervisory policies, and follow through on the goals outlined by the Economic Policy Council in October.

Improving credit availability is necessary to sustaining economic recovery. Passage by Congress of the Administration bank reform and the President's economic growth package are also vital to ensuring that the recovery is vibrant.

oOo

NFB-1540

Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

NEWS RELEASE

EMBARGOED FOR RELEASE at 2 p.m. EST
Thursday, November 7, 1991

FINANCIAL REGULATORS ISSUE JOINT SUPERVISORY POLICY STATEMENT

WASHINGTON, D.C., Nov. 7, 1991 -- The four federal regulators of bank and thrift institutions issued a joint statement today on the review and classification of commercial real estate loans. Today's action is another step by the agencies to ensure that misunderstandings about supervisory policies do not impede the availability of credit to sound borrowers. Development of this document was announced in the Administration's October 8th statement on "Easing The Credit Crunch To Promote Economic Growth."

The policy statement provides clear and comprehensive guidance on the review and classification of commercial real estate loans. The detailed guidelines, which will be sent to the chief executive officer of each depository institution and each bank and thrift examiner, cover loan portfolio review procedures, indicators of troubled loans, analysis of loans and collateral values, and the review of institutions' loss allowances.

The four regulatory agencies that issued today's guidelines are the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board

-more-

FRB), and the Office of Thrift Supervision (OTS). Together, the :our agencies supervise the activities of the nation's 12,000 :ommercial banks and 2,200 thrift institutions.

In addition to today's issuance, the regulatory agencies are ındertaking three other actions:

- <u>National Meeting of Examiners</u>
  The agencies will hold a national meeting of senior examination personnel in Baltimore, Md., on December 16 and 17 to review the policy statement and other initiatives related to credit availability.
- <u>Random Audit Program</u>
  To assess the quality of examiners' review of collateral value, the regulatory agencies will implement a random audit program to determine how examiners review and analyze the assumptions contained in appraisals as part of their loan review process.
- <u>Holding Company Preferred Stock</u>
  The Federal Reserve Board, in a move designed to grant bank holding companies greater flexibility in raising capital, has issued for public comment a proposal to lift the limit on the amount of noncumulative perpetual preferred stock that bank holding companies may include in Tier 1 capital. This proposal, if adopted, can assist organizations in strengthening their capital positions and expanding their ability to extend credit to sound borrowers.

All of these steps follow previous actions by the regulatory agencies in March and July to address credit availability concerns.

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Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation
Federal Reserve Board
Office of Thrift Supervision

Interagency Policy Statement on the Review and Classification of Commercial Real Estate Loans

November 7, 1991

The recent decline in credit extended by depository institutions has been attributed to many factors. These factors include the general slowdown in the economy, the overbuilding of commercial real estate properties in some markets, the desire of some household and business borrowers, as well as some depository institutions, to strengthen their balance sheets, changes by lenders in underwriting standards, and concerns about the potential impact of certain supervisory policies or actions. To ensure that regulatory policies and actions do not inadvertently curtail the availability of credit to sound borrowers, the four Federal regulators of banks and thrifts have taken a number of steps to clarify and communicate their policies. The attached policy statement is a further step in this effort.

On March 1, 1991, the four agencies — the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision — issued general guidelines that addressed a wide range of supervisory policies. Included in the March issuance were brief discussions of the workout of problems loans, lending by undercapitalized institutions, and a general statement on the valuation of real estate loans.

The attached policy statement expands upon the March 1 and subsequent guidance as it relates to the review and classification of commercial real estate loans.

The intent of the statement by the agencies is to provide clear and comprehensive guidance to ensure that supervisory personnel are reviewing loans in a consistent, prudent, and balanced fashion and to ensure that all interested parties are aware of the guidance.

The policy statement emphasizes that the evaluation of real estate loans is not based solely on the value of the collateral, but on a review of the borrower's willingness and capacity to repay and on the income-producing capacity of the properties.

The policy statement also provides guidance on how supervisory personnel analyze the value of collateral. In general, examiners consider the institution's appraisals of collateral (or internal evaluations, when applicable) to determine value and they review the major facts, assumptions and approaches used in determining the value of the collateral. Examiners seek to avoid challenges to underlying assumptions that differ in only a limited way from norms that would generally be associated with the property under review. Nonetheless, when reviewing the value of the collateral and any related management adjustments, examiners ascertain that the value is based on assumptions that are both prudent and realistic, and not on overly optimistic or overly pessimistic assumptions.

The policy statement covers a wide range of specific topics, including:

- the general principles that examiners follow in reviewing commercial real estate loan portfolios;
- the indicators of troubled real estate markets, projects, and related indebtedness;
- the factors examiners consider in their review of individual loans, including the use of appraisals and the determination of collateral value;
- a discussion of approaches to valuing real estate, especially in troubled markets;
- the classification guidelines followed by the agencies, including the treatment of guarantees; and
- the factors considered in the evaluation of an institution's allowance for loan and lease losses.

This statement is intended to ensure that all supervisory personnel, lending institutions and other interested parties have a clear understanding of the agencies' policies.

Interagency Policy Statement on the Review and Classification of Commercial Real Estate Loans[1]

Introduction

This policy statement addresses the review and classification of commercial real estate loans by examiners of the federal bank and thrift regulatory agencies.[2] Guidance is also provided on the analysis of the value of the underlying collateral. In addition, this policy statement summarizes principles for evaluating an institution's process for determining the appropriate level for the allowance for loan and lease losses, including amounts that have been based on an analysis of the commercial real estate loan portfolio.[3] These guidelines are intended to promote the prudent, balanced, and consistent supervisory treatment of commercial real estate loans, including those to borrowers experiencing financial difficulties.

The attachments to this policy statement address three topics related to the review of commercial real estate loans by examiners. The topics include the treatment of guarantees in the classification process (Attachment 1); background information on the valuation of income-producing commercial real estate loans in the examination process (Attachment 2); and definitions of classification terms used by the federal bank and thrift regulatory agencies (Attachment 3).

Examiner Review of Commercial Real Estate Loans

Loan Policy and Administration Review. As part of the analysis of an institution's commercial real estate loan portfolio, examiners review lending policies, loan administration procedures, and credit risk control procedures.· The maintenance of prudent written lending policies, effective internal systems and controls, and thorough

[1] For purposes of this policy statement, "commercial real estate loans" refers to all loans secured by real estate, except for loans secured by 1 – 4 family residential properties. This does not refer to loans where the underlying collateral has been taken solely through an abundance of caution where the terms as a consequence have not been made more favorable than they would have been in the absence of the lien.

[2] The agencies issuing this policy statement are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

[3] For analytical purposes, as part of its overall estimate of the allowance for loan and lease losses (ALLL) management may attribute a portion of the ALLL to the commercial real estate loan portfolio. However, this does not imply that any part of the ALLL is segregated for, or allocated to, any particular asset or group of assets. The ALLL is available to absorb all credit losses originating from the loan and lease portfolio.

For savings institutions, the ALLL is referred to as the "general valuation allowance" for purposes of the Thrift Financial Report.

loan documentation are essential to the institution's management of the lending function.

The policies governing an institution's real estate lending activities must include prudent underwriting standards that are periodically reviewed by the board of directors and clearly communicated to the institution's management and lending staff. The institution must also have credit risk control procedures that include, for example, prudent internal limits on exposure, an effective credit review and classification process, and a methodology for ensuring that the allowance for loan and lease losses is maintained at an adequate level. The complexity and scope of these policies and procedures should be appropriate to the size of the institution and the nature of the institution's activities, and should be consistent with prudent banking practices and relevant regulatory requirements.

Indicators of Troubled Real Estate Markets and Projects, and Related Indebtedness. In order to evaluate the collectibility of an institution's commercial real estate portfolio, examiners should be alert for indicators of weakness in the real estate markets served by the institution. They should also be alert for indicators of actual or potential problems in the individual commercial real estate projects or transactions financed by the institution.

Available indicators, such as permits for — and the value of — new construction, absorption rates, employment trends, and vacancy rates, are useful in evaluating the condition of commercial real estate markets. Weaknesses disclosed by these types of statistics may indicate that a real estate market is experiencing difficulties that may result in cash flow problems for individual real estate projects, declining real estate values, and ultimately, in troubled commercial real estate loans.

Indicators of potential or actual difficulties in commercial real estate projects may include:

- An excess of similar projects under construction.

- Construction delays or other unplanned adverse events resulting in cost overruns that may require renegotiation of loan terms.

- Lack of a sound feasibility study or analysis that reflects current and reasonably anticipated market conditions.

- Changes in concept or plan (for example, a condominium project converted to an apartment project because of unfavorable market conditions).

- Rent concessions or sales discounts resulting in cash flow below the level projected in the original feasibility study or appraisal.

- Concessions on finishing tenant space, moving expenses, and lease buyouts.

- Slow leasing or lack of sustained sales activity and increasing sales cancellations that may reduce the project's income potential, resulting in protracted repayment or default on the loan.

- Delinquent lease payments from major tenants.

- Land values that assume future rezoning.

- Tax arrearages.

As the problems associated with a commercial real estate project become more pronounced, problems with the related indebtedness may also arise. Such problems include diminished cash flow to service the debt and delinquent interest and principal payments.

While some commercial real estate loans become troubled because of a general downturn in the market, others become troubled because they were originated on an unsound or a liberal basis. Common examples of these types of problems include:

- Loans with no or minimal borrower equity.

- Loans on speculative undeveloped property where the borrowers' only source of repayment is the sale of the property.

- Loans based on land values that have been driven up by rapid turnover of ownership, but without any corresponding improvements to the property or supportable income projections to justify an increase in value.

- Additional advances to service an existing loan that lacks credible support for full repayment from reliable sources.

- Loans to borrowers with no development plans or noncurrent development plans.

- Renewals, extensions and refinancings that lack credible support for full repayment from reliable sources and that do not have a reasonable repayment schedule.[4]

Examiner Review of Individual Loans, Including the Analysis of Collateral Value. The focus of an examiner's review of a commercial real estate loan, including binding commitments, is the ability of the loan to be repaid. The principal factors that bear on this analysis are the income-producing potential of the underlying collateral and the borrower's willingness and capacity to repay under the existing loan terms from the borrower's other resources if necessary. In evaluating the overall risk associated with

[4] As discussed more fully in the section on classification guidelines, the refinancing or renewing of loans to sound borrowers would not result in a supervisory classification or criticism unless well-defined weaknesses exist that jeopardize repayment of the loans. Consistent with sound banking practices, institutions should work in an appropriate and constructive manner with borrowers who may be experiencing temporary difficulties.

a commercial real estate loan, examiners consider a number of factors, including the character, overall financial condition and resources, and payment record of the borrower; the prospects for support from any financially responsible guarantors; and the nature and degree of protection provided by the cash flow and value of the underlying collateral.[5] However, as other sources of repayment for a troubled commercial real estate loan become inadequate over time, the importance of the collateral's value in the analysis of the loan necessarily increases.

The appraisal regulations of the federal bank and thrift regulatory agencies require institutions to obtain appraisals when certain criteria are met.[6] Management is responsible for reviewing each appraisal's assumptions and conclusions for reasonableness. Appraisal assumptions should not be based solely on current conditions that ignore the stabilized income-producing capacity of the property.[7] Management should adjust any assumptions used by an appraiser in determining value that are overly optimistic or pessimistic.

An examiner analyzes the collateral's value as determined by the institution's most recent appraisal (or internal evaluation, as applicable). An examiner reviews the major facts, assumptions, and approaches used by the appraiser (including any comments made by management on the value rendered by the appraiser). Under the circumstances described below, the examiner may make adjustments to this assessment of value. This review and any resulting adjustments to value are solely for purposes of an examiner's analysis and classification of a credit and do not involve actual adjustments to an appraisal.

A discounted cash flow analysis is an appropriate method for estimating the value of income-producing real estate collateral.[8] This approach is discussed in more detail in Attachment 2. This analysis should not be based solely on the current performance of the collateral or similar properties; rather, it should take into account, on a discounted basis, the ability of the real estate to generate income over time based upon reasonable and supportable assumptions.

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[5] The treatment of guarantees in the classification process is discussed in Attachment 1.

[6] Department of the Treasury, Office of the Comptroller of the Currency, 12 CFR Part 34 (Docket No. 90-16); Board of Governors of the Federal Reserve System, 12 CFR Parts 208 and 225 (Regulation H and Y; Docket No. R-0685); Federal Deposit Insurance Corporation, 12 CFR 323 (RIN 3064-AB05); Department of the Treasury, Office of Thrift Supervision, 12 CFR Part 564 (Docket No. 90-1495).

[7] Stabilized income generally is defined as the yearly net operating income produced by the property at normal occupancy and rental rates; it may be adjusted upward or downward from today's actual market conditions.

[8] The real estate appraisal regulations of the federal bank and thrift regulatory agencies include a requirement that an appraisal (a) follow a reasonable valuation method that addresses the direct sales comparison, income, and cost approaches to market value; (b) reconcile these approaches; and (c) explain the elimination of each approach not used. A discounted cash flow analysis is recognized as a valuation method for the income approach.

When reviewing the reasonableness of the facts and assumptions associated with the value of the collateral, examiners may evaluate:

- Current and projected vacancy and absorption rates;
- Lease renewal trends and anticipated rents;
- Volume and trends in past due leases;
- Effective rental rates or sale prices (taking into account all concessions);
- Net operating income of the property as compared with budget projections; and
- Discount rates and direct capitalization ("cap") rates.[9]

The capacity of a property to generate cash flow to service a loan is evaluated based upon rents (or sales), expenses, and rates of occupancy that are reasonably estimated to be achieved over time. The determination of the level of stabilized occupancy and rental rates should be based upon an analysis of current and reasonably expected market conditions, taking into consideration historical levels when appropriate. The analysis of collateral values should not be based upon a simple projection of current levels of net operating income if markets are depressed or reflect speculative pressures but can be expected over a reasonable period of time to return to normal (stabilized) conditions. Judgment is involved in determining the time that it will take for a property to achieve stabilized occupancy and rental rates.

Examiners do not make adjustments to appraisal assumptions for credit analysis purposes based on worst case scenarios that are unlikely to occur. For example, an examiner would not necessarily assume that a building will become vacant just because an existing tenant who is renting at a rate above today's market rate may vacate the property when the current lease expires. On the other hand, an adjustment to value may be appropriate for credit analysis purposes when the valuation assumes renewal at the above-market rate, unless that rate is a reasonable estimate of the expected market rate at the time of renewal.

When estimating the value of income-producing real estate, discount rates and "cap" rates should reflect reasonable expectations about the rate of return that investors require under normal, orderly and sustainable market conditions. Exaggerated, imprudent, or unsustainably high or low discount rates, "cap" rates, and income projections should not be used. Direct capitalization of nonstabilized income flows should also not be used.

Assumptions, when recently made by qualified appraisers (and, as appropriate, by institution management) and when consistent with the discussion above, should be

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[9] Attachment 2 includes a discussion of discount rates and direct capitalization rates.

given a reasonable amount of deference. Examiners should not challenge the underlying assumptions, including discount rates and "cap" rates used in appraisals, that differ only in a limited way from norms that would generally be associated with the property under review. The estimated value of the underlying collateral may be adjusted for credit analysis purposes when the examiner can establish that any underlying facts or assumptions are inappropriate and can support alternative assumptions.

Classification Guidelines

As with other types of loans, commercial real estate loans that are adequately protected by the current sound worth and debt service capacity of the borrower, guarantor, or the underlying collateral generally are not classified. Similarly, loans to sound borrowers that are refinanced or renewed in accordance with prudent underwriting standards, including loans to creditworthy commercial or residential real estate developers, should not be classified or criticized unless well-defined weaknesses exist that jeopardize repayment. An institution will not be criticized for continuing to carry loans having weaknesses that result in classification or criticism as long as the institution has a well-conceived and effective workout plan for such borrowers, and effective internal controls to manage the level of these loans.

In evaluating commercial real estate credits for possible classification, examiners apply standard classification definitions (Attachment 3).[10] In determining the appropriate classification, consideration should be given to all important information on repayment prospects, including information on the borrower's creditworthiness, the value of, and cash flow provided by, all collateral supporting the loan, and any support provided by financially responsible guarantors.

The loan's record of performance to date is important and must be taken into consideration. As a general principle, a performing commercial real estate loan should not automatically be classified or charged-off solely because the value of the underlying collateral has declined to an amount that is less than the loan balance. However, it would be appropriate to classify a performing loan when well-defined weaknesses exist that jeopardize repayment, such as the lack of credible support for full repayment from reliable sources.[11]

These principles hold for individual credits, even if portions or segments of the industry to which the borrower belongs are experiencing financial difficulties. The evaluation of each credit should be based upon the fundamental characteristics

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[10] These definitions are presented in Attachment 3 and address assets classified "substandard," "doubtful," or "loss" for supervisory purposes.

[11] Another issue that arises in the review of a commercial real estate loan is the loan's treatment as an accruing asset or as a nonaccrual asset for reporting purposes. The federal bank and thrift regulatory agencies have provided guidance on nonaccrual status in the instructions for the Reports of Condition and Income (Call Reports) for banks, and in the instructions for the Thrift Financial Report for savings associations, and in related supervisory guidance of the agencies.

affecting the collectibility of the particular credit. The problems broadly associated with some sectors or segments of an industry, such as certain commercial real estate markets, should not lead to overly pessimistic assessments of particular credits that are not affected by the problems of the troubled sectors.

Classification of troubled project-dependent commercial real estate loans.[12] The following guidelines for classifying a troubled commercial real estate loan apply when the repayment of the debt will be provided solely by the underlying real estate collateral, and there are no other available and reliable sources of repayment.

As a general principle, for a troubled project-dependent commercial real estate loan, any portion of the loan balance that exceeds the amount that is adequately secured by the value of the collateral, and that can clearly be identified as uncollectible, should be classified "loss."[13] The portion of the loan balance that is adequately secured by the value of the collateral should generally be classified no worse than "substandard." The amount of the loan balance in excess of the value of the collateral, or portions thereof, should be classified "doubtful" when the potential for full loss may be mitigated by the outcomes of certain pending events, or when loss is expected but the amount of the loss cannot be reasonably determined.

If warranted by the underlying circumstances, an examiner may use a "doubtful" classification on the entire loan balance. However, this would occur infrequently.

Guidelines for classifying partially charged-off loans. Based upon consideration of all relevant factors, an evaluation may indicate that a credit has well-defined weaknesses that jeopardize collection in full, but that a portion of the loan may be reasonably assured of collection. When an institution has taken a charge-off in an amount sufficient that the remaining recorded balance of the loan (a) is being serviced (based upon reliable sources) and (b) is reasonably assured of collection, classification of the remaining recorded balance may not be appropriate. Classification would be appropriate when well-defined weaknesses continue to be present in the remaining recorded balance. In such cases, the remaining recorded balance would generally be classified no more severely than "substandard."

A more severe classification than "substandard" for the remaining recorded balance would be appropriate if the loss exposure cannot be reasonably determined, e.g., where significant risk exposures are perceived, such as might be the case for bankruptcy situations or for loans collateralized by properties subject to environmental hazards. In addition, classification of the remaining recorded balance would be appropriate when sources of repayment are considered unreliable.

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[12] The discussion in this section is not intended to address loans that must be treated as "other real estate owned" for bank regulatory reporting purposes or "real estate owned" for thrift regulatory reporting purposes. Guidance on these assets is presented in supervisory and reporting guidance of the agencies.

[13] For purposes of this discussion, the "value of the collateral" is the value used by the examiner for credit analysis purposes, as discussed in a previous section of this policy statement.

Guidelines for classifying formally restructured loans. The classification treatment previously discussed for a partially charged off loan would also generally be appropriate for a formally restructured loan when partial charge-offs have been taken. For a formally restructured loan, the focus of the examiner's analysis is on the ability of the borrower to repay the loan in accordance with its modified terms. Classification of a formally restructured loan would be appropriate, if, after the restructuring, well-defined weaknesses exist that jeopardize the orderly repayment of the loan in accordance with reasonable *modified terms*.[14] Troubled commercial real estate loans whose terms have been restructured should be identified in the institution's internal credit review system, and closely monitored by management.

Review of the Allowance for Loan and Lease Losses (ALLL)[15]

The adequacy of a depository institution's ALLL, including amounts based on an analysis of the commercial real estate portfolio, must be based on a careful, well documented, and consistently applied analysis of the institution's loan and lease portfolio.[16]

The determination of the adequacy of the ALLL should be based upon management's consideration of all current significant conditions that might affect the ability of borrowers (or guarantors, if any) to fulfill their obligations to the institution. While historical loss experience provides a reasonable starting point, historical losses or even recent trends in losses are not sufficient without further analysis and cannot produce a reliable estimate of anticipated loss.

In determining the adequacy of the ALLL, management should also consider other factors, including changes in the nature and volume of the portfolio; the experience, ability, and depth of lending management and staff; changes in credit standards; collection policies and historical collection experience; concentrations of credit risk; trends in the volume and severity of past due and classified loans; and trends in the volume of nonaccrual loans, specific problem loans and commitments. In addition, this analysis should consider the quality of the institution's systems and management in identifying, monitoring, and addressing asset quality problems. Furthermore, management should consider external factors such as local and national economic conditions and

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[14] An example of a restructured commercial real estate loan that does *not* have reasonable modified terms would be a "cash flow" mortgage which requires interest payments *only* when the underlying collateral generates cash flow but provides no substantive benefits to the lending institution.

[15] Each of the federal bank and thrift regulatory agencies have issued guidance on the allowance for loan and lease losses. The following discussion summarizes general principles for assessing the adequacy of the allowance for loan and lease losses.

[16] The estimation process described in this section permits for a more accurate estimate of anticipated losses than could be achieved by assessing the loan portfolio solely on an aggregate basis. However, it is only an estimation process and does not imply that any part of the ALLL is segregated for, or allocated to, any particular asset or group of assets. The ALLL is available to absorb all credit losses originating from the loan and lease portfolio.

developments; competition; and legal and regulatory requirements; as well as reasonably foreseeable events that are likely to affect the collectibility of the loan portfolio.

Management should adequately document the factors that were considered, the methodology and process that were used in determining the adequacy of the ALLL, and the range of possible credit losses estimated by this process. The complexity and scope of this analysis must be appropriate to the size and nature of the institution and provide for sufficient flexibility to accommodate changing circumstances.

Examiners will evaluate the methodology and process that management has followed in arriving at an overall estimate of the ALLL in order to assure that all of the relevant factors affecting the collectibility of the portfolio have been appropriately considered. In addition, the overall estimate of the ALLL and the range of possible credit losses estimated by management will be reviewed for reasonableness in view of these factors. This examiner analysis will also consider the quality of the institution's systems and management in identifying, monitoring, and addressing asset quality problems.

As discussed in the previous section on classification guidelines, the value of the collateral is considered by examiners in reviewing and classifying a commercial real estate loan. However, for a performing commercial real estate loan, the supervisory policies of the agencies do *not* require automatic increases to the ALLL solely because the value of the collateral has declined to an amount that is less than the loan balance.

In assessing the ALLL during examinations, it is important to recognize that management's process, methodology, and underlying assumptions require a substantial degree of judgment. Even when an institution maintains sound loan administration and collection procedures and effective internal systems and controls, the estimation of anticipated losses may not be precise due to the wide range of factors that must be considered. Further, the ability to estimate anticipated loss on specific loans and categories of loans improves over time as substantive information accumulates regarding the factors affecting repayment prospects. When management has (a) maintained effective systems and controls for identifying, monitoring and addressing asset quality problems *and* (b) analyzed all significant factors affecting the collectibility of the portfolio, considerable weight should be given to management's estimates in assessing the adequacy of the ALLL.

Attachment 1

TREATMENT OF GUARANTEES IN THE CLASSIFICATION PROCESS

Initially, the original source of repayment and the borrower's intent and ability to fulfill the obligation without reliance on third party guarantors will be the primary basis for the review and classification of assets.[1] The federal bank and thrift regulatory agencies will, however, consider the support provided by guarantees in the determination of the appropriate classification treatment for troubled loans. The presence of a guarantee from a "financially responsible guarantor," as described below, may be sufficient to preclude classification or reduce the severity of classification.

For purposes of this discussion, a guarantee from a "financially responsible guarantor" has the following attributes:

- The guarantor must have *both* the financial capacity and willingness to provide support for the credit;
- The nature of the guarantee is such that it can provide support for repayment of the indebtedness, in whole or in part, during the remaining loan term; and[2]
- The guarantee should be legally enforceable.

The above characteristics generally indicate that a guarantee may improve the prospects for repayment of the debt obligation.

Considerations relating to a guarantor's financial capacity. The lending institution must have sufficient information on the guarantor's financial condition, income, liquidity, cash flow, contingent liabilities, and other relevant factors (including credit ratings, when available) to demonstrate the guarantor's financial capacity to fulfill the obligation. Also, it is important to consider the number and amount of guarantees currently extended by a guarantor, in order to determine that the guarantor has the financial capacity to fulfill the contingent claims that exist.

Considerations relating to a guarantor's willingness to repay. Examiners normally rely on their analysis of the guarantor's financial strength and assume a willingness to perform unless there is evidence to the contrary. This assumption may be modified

[1] Some loans are originated based primarily upon the financial strength of the guarantor, who is, in substance, the primary source of repayment. In such circumstances, examiners generally assess the collectibility of the loan based upon the guarantor's ability to repay the loan.

[2] Some guarantees may only provide for support for certain phases of a real estate project. It would not be appropriate to rely upon these guarantees to support a troubled loan after the completion of these phases.

based on the "track record" of the guarantor, including payments made to date on the asset under review or other obligations.

Examiners give due consideration to those guarantors that have demonstrated their ability and willingness to fulfill previous obligations in their evaluation of current guarantees on similar assets. An important consideration will be whether previously required performance under guarantees was voluntary or the result of legal or other actions by the lender to enforce the guarantee. However, examiners give limited credence, if any, to guarantees from obligors who have reneged on obligations in the past, unless there is clear evidence that the guarantor has the ability and intent to honor the specific guarantee obligation under review.

Examiners also consider the economic incentives for performance from guarantors:

- Who have already partially performed under the guarantee or who have other significant investments in the project;

- Whose other sound projects are cross-collateralized or otherwise intertwined with the credit; or

- Where the guarantees are collateralized by readily marketable assets that are under the control of a third party.

Other considerations. In general, only guarantees that are legally enforceable will be relied upon. However, all legally enforceable guarantees may not be acceptable. In addition to the guarantor's financial capacity and willingness to perform, it is expected that the guarantee will not be subject to significant delays in collection, or undue complexities or uncertainties about the guarantee.

The nature of the guarantee is also considered by examiners. For example, some guarantees for real estate projects only pertain to the development and construction phases of the project. As such, these limited guarantees would not be relied upon to support a troubled loan after the completion of those phases.

Examiners also consider the institution's intent to enforce the guarantee and whether there are valid reasons to preclude an institution from pursuing the guarantee. A history of timely enforcement and successful collection of the full amount of guarantees will be a positive consideration in the classification process.

Attachment 2

THE VALUATION OF INCOME-PRODUCING REAL ESTATE

Approaches to the Valuation of Real Estate

Appraisals are professional judgments of the market value of real property. Three basic valuation approaches are used by professional appraisers in estimating the market value of real property -- the cost approach, the market data or direct sales comparison approach, and the income approach. The principles governing the three approaches are widely known in the appraisal field and were recently referenced in parallel regulations issued by each of the federal bank and thrift regulatory agencies. When evaluating the collateral for problem credits, the three valuation approaches are not equally appropriate.

1. **Cost Approach.** In the cost approach, the appraiser estimates the reproduction cost of the building and improvements, deducts estimated depreciation, and adds the value of the land. The cost approach is particularly helpful when reviewing draws on construction loans. However, as the property increases in age, both reproduction cost and depreciation become more difficult to estimate. Except for special purpose facilities, the cost approach is usually inappropriate in a troubled real estate market because construction costs for a new facility normally exceed the market value of existing comparable properties.

2. **Market Data or Direct Sales Comparison Approach.** This approach examines the price of similar properties that have sold recently in the local market, estimating the value of the subject property based on the comparable properties' selling price. It is very important that the characteristics of the observed transactions be similar in terms of market location, financing terms, property condition and use, timing, and transaction costs. The market approach generally is used in valuing owner-occupied residential property because comparable sales data are typically available. When adequate sales data are available, an analyst generally will give the most weight to this type of estimate. Often, however, the available sales data for commercial properties are not sufficient to justify a conclusion.

3. **The Income Approach.** The economic value of an income-producing property is the discounted value of the future net operating income stream, including any "reversion" value of property when sold. If competitive markets are working perfectly, the observed sales price should be equal to this value. For unique properties or in markets that are thin or subject to disorderly or unusual conditions, market value based on a comparable sales approach may be either unavailable or distorted. In such cases, the income approach is usually the appropriate method for valuing the property.

The income approach converts all expected future net operating income into present value terms. When market conditions are stable and no unusual patterns of future rents and occupancy rates are expected, the direct capitalization method is often used to estimate the present value of future income streams. For troubled properties, however, examiners typically utilize the more explicit discounted cash flow (net present value) method for analytical purposes. In that method, a time frame for achieving a "stabilized", or normal, occupancy and rent level is projected. Each year's net operating income during that period is discounted to arrive at the present value of expected future cash flows. The property's anticipated sales value at the end of the period until stabilization (its terminal or reversion value) is then estimated. The reversion value represents the capitalization of all future income streams of the property after the projected occupancy level is achieved. The terminal or reversion value is then discounted to its present value and added to the discounted income stream to arrive at the total present market value of the property.

Valuation of Troubled Income-Producing Properties

When an income property is experiencing financial difficulties due to general market conditions or due to its own characteristics, data on comparable property sales often are difficult to obtain. Troubled properties may be hard to market, and normal financing arrangements may not be available. Moreover, forced and liquidation sales can dominate market activity. When the use of comparables is not feasible (which is often the case for commercial properties), the net present value of the most reasonable expectation of the property's income-producing capacity — not just in today's market but over time — offers the most appropriate method of valuation in the supervisory process.

Estimates of the property's value should be based upon reasonable and supportable projections of the determinants of future net operating income: rents (or sales), expenses and rates of occupancy. Judgment is involved in estimating all of these factors. The primary considerations for these projections include historical levels and trends, the current market performance achieved by the subject and similar properties, and economically feasible and defensible projections of future demand and supply conditions. To the extent that current market activity is dominated by a limited number of transactions or liquidation sales, high "capitalization" and discount rates implied by such transactions should not be used. Rather, analysts should use rates that reflect market conditions that are *neither* highly speculative nor depressed for the type of property being valued and that property's location.

Technical Notes

In the process of reviewing a real estate loan and in the use of the net present value approach of collateral valuation, several conceptual issues often are raised. The following discussion sets forth the meaning and use of those key concepts.

The Discount Rate. The discount rate used in the net present value approach to convert future net cash flows of income-producing real estate into present market value terms is the rate of return that market participants require for this type of real estate investment. The discount rate will vary over time with changes in overall interest rates and in the risk associated with the physical and financial characteristics of the property. The riskiness of the property depends both on the type of real estate in question and on local market conditions.[1]

The Direct Capitalization ("Cap" Rate) Technique. The use of "cap" rates, or direct income capitalization, is a method used by many market participants and analysts to relate the value of a property to the net operating income it generates. In many applications, a "cap" rate is used as a short cut for computing the discounted value of a property's income streams.

The direct income capitalization method calculates the value of a property by dividing an estimate of its "stabilized" annual income by a factor called a "cap" rate. Stabilized income generally is defined as the yearly net operating income produced by the property at normal occupancy and rental rates; it may be adjusted upward or downward from today's actual market conditions.The "cap" rate — usually defined for each property type in a market area — is viewed by some analysts as the required rate of return stated in terms of current income. That is to say, the "cap" rate can be considered a direct observation of the required earnings-to-price ratio in current income terms. The "cap" rate also can be viewed as the number of cents per dollar of today's purchase price investors would require annually over the life of the property to achieve their required rate of return.

The "cap" rate method is appropriate if the net operating income to which it is applied is representative of all future income streams or if net operating income and the property's selling price are expected to increase at a fixed rate. The use of this technique assumes that either the stabilized income or the "cap" rate used accurately captures all relevant characteristics of the property relating to its risk and income potential. If the same risk factors, required rate of return, financing arrangements, and income projections are used, explicit discounting and direct capitalization will yield the same results.

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[1] Regulatory policy of the Office of Thrift Supervision specifies that, for supervisory purposes, thrifts are to use discount rates that are consistent with generally accepted accounting principles for thrifts (which allow the use of an average-cost-of-capital-funds rate to calculate net realizable value) or discount rates that are consistent with the practices of the federal banking agencies.

This method alone is not appropriate for troubled real estate since income generated by the property is not at normal or stabilized levels. In evaluating troubled real estate, ordinary discounting typically is used for the period before the project reaches its full income potential. A "terminal" "cap" rate is then utilized to estimate the value of the property (its reversion or sales price) at the end of that period.

Differences Between Discount and Cap Rates. When used for estimating real estate market values, discount and "cap" rates should reflect the current market requirements for rates of return on properties of a given type. The discount rate is the required rate of return including the expected increases in future prices and is applied to income streams reflecting inflation. In contrast, the "cap" rate is used in conjunction with a stabilized net operating income figure. The fact that discount rates for real estate are typically higher than "cap" rates reflects the principal difference in the treatment of expected increases in net operating income and/or property values.

Other factors affecting the "cap" rate used (but not the discount rate) include the useful life of the property and financing arrangements. The useful life of the property being evaluated affects the magnitude of the "cap" rate because the income generated by a property, in addition to providing the required return on investment, must be sufficient to compensate the investor for the depreciation of the property over its useful life. The longer the useful life, the smaller is the depreciation in any one year; hence, the smaller is the annual income required by the investor, and the lower is the "cap" rate. Differences in terms and the extent of debt financing and the related costs must also be taken into account.

Selecting Discount and Cap Rates. The choice of the appropriate values for discount and "cap" rates is a key aspect of income analysis. Both in markets marked by lack of transactions and those characterized by highly speculative or unusually pessimistic attitudes, analysts consider historical required returns on the type of property in question. Where market information is available to determine current required yields, analysts carefully analyze sales prices for differences in financing, special rental arrangements, tenant improvements, property location, and building characteristics. In most local markets, the estimates of discount and "cap" rates used in income analysis should generally fall within a fairly narrow range for comparable properties.

Holding Period vs. Marketing Period. When the income approach is applied to troubled properties, a time frame is chosen over which a property is expected to achieve stabilized occupancy and rental rates (stabilized income). That time period is sometimes referred to as the "holding period." The longer the period before stabilization, the smaller will be the reversion value included in the total value estimate.

The holding period should be distinguished from the concept of "marketing period" — a term used in estimating the value of a property under the sales comparison approach and in discussions of property value when real estate is being sold. The marketing period is the length of time that may be required to sell the property in an open market.

Glossary

Appraisal. A written statement independently and impartially prepared by a qualified appraiser setting forth an opinion as to the market value of an adequately described property as of a specific date(s), supported by the presentation and analysis of relevant market information.

Capitalization rate. A rate used to convert income into value. Specifically, it is the ratio between a property's stabilized net operating income and the property's sales price. Sometimes referred to as an overall rate because it can be computed as a weighted average of component investment claims on net operating income.

Discount rate. A rate of return used to convert future payments or receipts into their present value.

Holding period. The time frame over which a property is expected to achieve stabilized occupancy and rental rates (stabilized income).

Market value. The most probable cash sale price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. buyer and seller are typically motivated (i.e., motivated by self-interest);
2. both parties are well informed or well advised, and acting in what they consider their own best interests;
3. a reasonable time is allowed for exposure in the open market;
4. payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
5. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

Marketing period. The term in which an owner of a property is actively attempting to sell that property in a competitive and open market.

Net operating income (NOI). Annual income after all expenses have been deducted, except for depreciation and debt service.

Attachment 3

Classification Definitions[1]

The federal bank and thrift regulatory agencies currently utilize the following definitions for assets classified "substandard," "doubtful," and "loss" for supervisory purposes:

Substandard Assets. A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful Assets. An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss Assets. Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.

[1] Office of the Comptroller of the Currency, *Comptroller's Handbook for National Bank Examiners*, Section 215.1, "Classification of Credits;" Board of Governors of the Federal Reserve System, *Commercial Bank Examination Manual*, Section 215.1, "Classification of Credits;" Office of Thrift Supervision, *Thrift Activities Regulatory Handbook*, Section 260, "Classification of Assets;" Federal Deposit Insurance Corporation, *Division of Supervision Manual of Examination Policies*, Section 3.1, "Loans."

FEDERAL RESERVE press release

For immediate release October 31, 1991

The Federal Reserve Board today requested public comment on a proposal to permit bank holding companies to raise additional tier one risk-based capital through the sale of perpetual preferred stock.

Comment should be received by the Board by November 22.

Under present risk-based capital guidelines, bank holding companies are permitted to count perpetual preferred stock up to 25 percent of their tier one capital. The proposal would remove the limitation for noncumulative perpetual preferred stock but continue to limit cumulative perpetual preferred to 25 percent of tier one capital.

A copy of the Board's order is attached.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Parts 208 and 225

[Regulation H, Regulation Y; Docket No. R-0740]

Capital; Capital Adequacy Guidelines

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of Proposed Revisions to Capital Adequacy Guidelines.

SUMMARY: The Board is proposing to remove the limit on the amount of noncumulative perpetual preferred stock bank holding companies may include in Tier 1 capital. Cumulative perpetual preferred stock would continue to be included in Tier 1 capital for bank holding companies, up to a limit of 25 percent of Tier 1 capital.

DATE: Comments on the proposed revisions to the Federal Reserve Board's risk-based capital guidelines and leverage capital guidelines should be submitted on or before November 22, 1991.

ADDRESS: Comments, which should refer to docket No. R-0740, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenues, N.W., Washington, D.C. 20551; or delivered to Room B-2223, Eccles Building, between 8:45 a.m. and 5:15 p.m. weekdays. Comments may be inspected in Room B-1122 between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in section 2612.8

of the Board's Rules Regarding Availability of Information, 12 CFR 261.8.

FOR FURTHER INFORMATION CONTACT: Roger T. Cole, Assistant Director (202/452-2618), Rhoger H Pugh, Manager (202/728-5883), Norah M. Barger, Supervisory Financial Analyst (202/452-2402), Robert E. Motyka, Senior Financial Analyst (202/452-3621), Division of Banking Supervision and Regulation; and Michael J. O'Rourke, Senior Attorney (202/452-3288), Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION

I. BACKGROUND

The international bank capital standards (Basle Accord)[1] allow banks to include noncumulative perpetual preferred stock place in Tier 1 capital and place no formal limit on the amount of such instruments that may be included in Tier 1.[2] The Basle framework, which by its terms applies only to

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[1] The Basle Accord is a risk-based capital framework that was proposed by the Basle Committee on Banking Regulations and Supervisory Practices and endorsed by the central bank governors of the Group of Ten (G-10) countries in July 1988. The Committee is comprised of representatives of the central banks and supervisory authorities from the G-10 countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the United Kingdom, and the United States) and Luxembourg.

[2] Noncumulative perpetual preferred stock is perpetual preferred stock whose dividends, if missed, do not accrue and will never be paid. Cumulative perpetual preferred stock is preferred stock whose dividends, if missed because of insufficient earnings

internationally active banks, was adopted by the Federal Reserve for state nonmember banks. In addition, the Board chose to apply a risk-based capital framework similar to the Basle Accord to U.S. bank holding companies generally on a consolidated basis.[3] Under the Federal Reserve's bank holding company capital guidelines, holding companies are allowed to include both noncumulative and cumulative perpetual preferred stock in Tier 1 capital, but the total of all perpetual preferred stock includable in Tier 1 capital is limited to 25 percent of Tier 1.[4] Amounts of such stock in excess of the limitation may be included in Tier 2 capital. The limit on preferred stock is consistent with the Board's long-standing view that common equity should remain the dominant form of a banking organization's capital structure.

A principal reason for the Board's decision to limit the amount of perpetual preferred stock in bank holding Tier 1 capital is the fact that cumulative preferred, the type of perpetual preferred most prevalent in U.S. financial markets,

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or any other reason, accumulate until all arrearages are paid out. Cumulative preferred dividends have preference over common dividends, which cannot be paid out as long as any cumulative preferred dividends remain unpaid.

[3] For bank holding companies with consolidated assets of less than $150 million in assets, the risk-based capital guidelines generally are applied on a bank-only basis.

[4] Under the risk-based capital guidelines, certain types of perpetual preferred stock do not qualify for inclusion in Tier 1 capital. For example, perpetual preferred stock in which the dividend is reset periodically based, in whole or in part, upon the banking organization's credit standing is excluded from Tier 1 capital, but may be included in Tier 2 capital.

normally involves preset dividends that cannot be cancelled, but only deferred. An institution that passes dividends on cumulative preferred stock must pay off any accumulated arrearages before it can resume payment of its common stock dividends. Thus, undue reliance on cumulative perpetual preferred stock and the related possibility of large dividend arrearages could complicate an organization's ability to raise new common equity in times of financial difficulty. On the other hand, dividends on noncumulative preferred, like dividends on common stock, may be cancelled. Thus, with respect to dividends, noncumulative preferred stock has characteristics that are consistent with common stock, the principal component of Tier 1 capital.

Conditions in the banking industry underscore the desirability of affording banking organizations greater flexibility in raising capital. This can assist organizations in strengthening their capital positions and expanding their ability to extend credit to sound borrowers. In view of these considerations, the Board is proposing to lift the limit on the amount of noncumulative preferred stock that bank holding companies may include in Tier 1 capital. This proposal is consistent with other steps initiated by the Federal bank regulatory agencies, in conjunction with the Treasury Department, to address concerns relating to the availability of credit to sound borrowers.

II. Proposal

The Board is proposing to remove the limit on the amount of noncumulative perpetual preferred stock a bank holding company may include in its Tier 1 capital. Cumulative perpetual preferred stock would continue to be included in Tier 1 capital for bank holding companies, up to a limit of 25 percent of Tier 1 capital.

By removing the limit for noncumulative perpetual preferred stock, this proposal will achieve parity with regard to the treatment of noncumulative perpetual preferred stock between the U.S. risk-based capital guidelines for bank holding companies and the Basle framework for banks. Thus, the proposal will place U.S. bank holding companies on a more equal footing with foreign banks subject to the Basle Accord with regard to their ability to augment Tier 1 capital through the issuance of noncumulative perpetual preferred stock. The additional flexibility provided by this step may assist bank holding companies to strengthen their capital positions and expand their lending capacity.

Although the Board is proposing to lift the limit on noncumulative perpetual preferred stock, it continues to believe that bank holding companies should avoid overreliance on preferred stock within Tier 1 capital. In proposing this step, the Board notes that the capital structure of a bank holding company is subject to quarterly review (through the analysis of financial reports filed with the Federal Reserve), and the composition of an organization's capital base and its capital plans are subject to in-depth assessment during annual inspections and as part of the Federal Reserve's consideration of applications. The language of the Federal Reserve's risk-based capital guidelines makes clear the Board's long-standing belief that banking organizations should avoid overreliance on nonvoting equity instruments, including preferred stock, in Tier 1 capital. Capital structures that are inconsistent with this principle may result in supervisory or enforcement actions, including possible denial of applications filed with the Federal Reserve. In addition, rating agencies take the amount of common equity and preferred stock an organization has, as well as the overall composition of the organization's core capital, into account in determining the organization's financial ratings. Thus, there are a number of mechanisms in place to monitor banking organizations' use of preferred stock and to discourage undue reliance on such instruments.

III. Regulatory Flexibility Act Analysis

The Federal Reserve Board does not believe adoption of this proposal would have a significant economic impact on a substantial number of small business entities (in this case, small banking organizations), in accord with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). In addition, because the risk-based and leverage capital guidelines generally do not apply to bank holding companies with consolidated assets of less than $150 million, this proposal will not affect such companies.

List of Subjects

12 CFR Part 208

Accounting, Agricultural loan losses, Applications, Appraisals, Banks, Banking, Branches, Capital adequacy, Confidential business information, Currency, Dividend payments, Federal Reserve System, Flood insurance, Publication of reports of condition, Reporting and recordkeeping requirements, Securities, State member banks.

12 CFR Part 225

Administrative practice and procedure, Appraisals, Banks, Banking, Capital adequacy, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities, State member banks.

For the reasons set forth in this notice, and pursuant to the Board's authority under section 5(b) of the Bank Holding Company Act of 1956 (12 U.S.C. 1844(b)), and section 910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3909), the Board is amending 12 CFR Parts 208 and 225 to read as follows:

PART 208 - MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM

1. The authority citation for Part 208 continues to read as follows:

AUTHORITY: Sections 9, 11(a), 11(c), 19, 21, 25, and 25(a) of the Federal Reserve Act, as amended (12 U.S.C. 321-338, 248(a), 248(c), 461, 481-486, 601, and 611, respectively); sections 4 and 13(j) of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1814 and 1823(j), respectively); section 7(a) of the International Banking Act of 1978 (12 U.S.C. 3105); sections 907-910 of the International Lending Supervision Act of 1983 (12 U.S.C. 3906-3909); sections 2, 12(b), 12(g), 12(i), 15B(c) (5), 17, 17A, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o-4(c) (5), 78q, 78q-1, and 78w, respectively); section 5155 of the Revised Statutes (12 U.S.C. 36) as amended by the McFadden Act of 1927; and sections 1101-1122 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (12 U.S.C. 3310 and 3331-3351).

Appendix A - [Amended]

2. The footnote designator in the text is removed and footnote 6 is removed and reserved.

PART 225 - BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL

1. The authority citation for Part 225 continues to read as follows:

AUTHORITY: 12 U.S.C. 1817(j) (13), 1818, 1831i, 1843(c) (8), 1844(b), 3106, 3108, 3907, 3909, 3310, and 3331-3351.

Appendix A - [Amended]

2. Appendix A is amended by revising paragraphs (ii) and (iii) and adding paragraph (iv) in II.A.1., and by removing the last three sentences in the third paragraph and the entire fourth paragraph in II.A.1.b. and replacing them, to read as follows:

*****

II. ***

A. ***

(i) ***

(ii) qualifying noncumulative perpetual preferred stock (including related surplus).

(iii) qualifying cumulative perpetual preferred stock (including related surplus), subject to certain limitations described below.

(iv) minority interest in the equity accounts of consolidated subsidiaries.

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***

b. *** However, the aggregate amount of cumulative perpetual preferred stock that may be included in a holding company's tier 1 is limited to one-third of the sum of core capital elements, excluding the cumulative perpetual preferred stock (that is, items i, ii, and iv above). Stated differently, the aggregate amount may not exceed 25 percent of the sum of all core capital elements, including cumulative perpetual preferred stock (that is, items, i, ii, iii, and iv above). Any cumulative perpetual preferred stock outstanding in excess of this limit may be included in tier 2 capital without any sublimits within that tier (see discussion below).

While the guidelines allow for the inclusion of noncumulative perpetual preferred stock and limited amounts of cumulative perpetual preferred stock in tier 1, it is desirable from a supervisory standpoint that voting common equity remain the dominant form of tier 1 capital. Thus, bank holding companies should avoid overreliance on preferred stock or nonvoting equity elements within tier 1.*****

Appendix D - [Amended]

3. Appendix D is amended by removing the first two sentences in footnote 3 and replacing them, to read as follows:

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II. ***

[3] At the end of 1992, Tier 1 capital for bank holding companies includes common equity, minority interest in the equity accounts of consolidated subsidiaries, qualifying noncumulative perpetual preferred stock, and qualifying cumulative perpetual preferred stock. (Cumulative perpetual preferred stock is limited to 25 percent of Tier 1 capital.)***

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Board of Governors of the Federal Reserve System, October 31, 1991.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

NOV 12 91 0 0 1 0 7 2

FOR IMMEDIATE RELEASE
November 7, 1991

CONTACT: Office of Financing
202-219-3350

DEPT. OF THE TREASURY

RESULTS OF TREASURY'S AUCTION OF 30-YEAR BONDS

Tenders for $12,009 million of 30-year bonds to be issued November 15, 1991 and to mature November 15, 2021 were accepted today (CUSIP: 912810EL8).

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

	Yield	Price
Low	7.98%	100.227
High	8.01%	99.887
Average	8.00%	100.000

Tenders at the high yield were allotted 78%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	6,699	6,699
New York	29,715,868	11,746,267
Philadelphia	6,050	6,050
Cleveland	3,323	3,313
Richmond	57,234	40,009
Atlanta	12,697	9,257
Chicago	650,012	68,392
St. Louis	12,892	12,892
Minneapolis	5,150	3,150
Kansas City	17,332	17,332
Dallas	8,819	8,819
San Francisco	297,452	85,152
Treasury	1,442	1,442
TOTALS	$30,794,970	$12,008,774

The $12,009 million of accepted tenders includes $937 million of noncompetitive tenders and $11,072 million of competitive tenders from the public.

In addition, $150 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

The minimum par amount required for STRIPS is $25,000. Larger amounts must be in multiples of that amount.

NB-1541

DEPARTMENT OF THE TREASURY
BUREAU OF THE PUBLIC DEBT
WASHINGTON, D.C. 20239-0001

AUCTION YIELD TO PRICE CONVERSION TABLE

8% 30-YEAR TREASURY BONDS OF NOVEMBER 15, 2021
CUSIP NUMBER: 912810 EL 8

AUCTION DATE: NOVEMBER 7, 1991
SETTLEMENT DATE: NOVEMBER 15, 1991
MATURITY DATE: NOVEMBER 15, 2021
FIRST INT. PAYMENT: MAY 15, 1992

INTEREST (COUPON) RATE: 8.000%

YIELD%	PRICE	YIELD%	PRICE	YIELD%	PRICE	YIELD%	PRICE
7.20	109.780	7.60	104.702	8.00	100.000	8.40	95.641
7.21	109.648	7.61	104.580	8.01	99.887	8.41	95.537
7.22	109.517	7.62	104.458	8.02	99.774	8.42	95.432
7.23	109.385	7.63	104.336	8.03	99.662	8.43	95.328
7.24	109.254	7.64	104.215	8.04	99.549	8.44	95.223
7.25	109.123	7.65	104.094	8.05	99.437	8.45	95.119
7.26	108.993	7.66	103.973	8.06	99.325	8.46	95.015
7.27	108.863	7.67	103.853	8.07	99.213	8.47	94.912
7.28	108.733	7.68	103.732	8.08	99.102	8.48	94.808
7.29	108.603	7.69	103.612	8.09	98.991	8.49	94.705
7.30	108.473	7.70	103.492	8.10	98.879	8.50	94.602
7.31	108.344	7.71	103.373	8.11	98.769	8.51	94.499
7.32	108.215	7.72	103.253	8.12	98.658	8.52	94.396
7.33	108.086	7.73	103.134	8.13	98.547	8.53	94.294
7.34	107.957	7.74	103.015	8.14	98.437	8.54	94.191
7.35	107.829	7.75	102.896	8.15	98.327	8.55	94.089
7.36	107.701	7.76	102.778	8.16	98.217	8.56	93.987
7.37	107.573	7.77	102.659	8.17	98.108	8.57	93.885
7.38	107.446	7.78	102.541	8.18	97.998	8.58	93.784
7.39	107.319	7.79	102.423	8.19	97.889	8.59	93.682
7.40	107.191	7.80	102.306	8.20	97.780	8.60	93.581
7.41	107.065	7.81	102.188	8.21	97.671	8.61	93.480
7.42	106.938	7.82	102.071	8.22	97.562	8.62	93.379
7.43	106.812	7.83	101.954	8.23	97.454	8.63	93.279
7.44	106.686	7.84	101.838	8.24	97.346	8.64	93.178
7.45	106.560	7.85	101.721	8.25	97.238	8.65	93.078
7.46	106.434	7.86	101.605	8.26	97.130	8.66	92.978
7.47	106.309	7.87	101.489	8.27	97.022	8.67	92.878
7.48	106.184	7.88	101.373	8.28	96.915	8.68	92.778
7.49	106.059	7.89	101.257	8.29	96.808	8.69	92.679
7.50	105.934	7.90	101.142	8.30	96.701	8.70	92.579
7.51	105.810	7.91	101.027	8.31	96.594	8.71	92.480
7.52	105.686	7.92	100.912	8.32	96.487	8.72	92.381
7.53	105.562	7.93	100.797	8.33	96.381	8.73	92.282
7.54	105.438	7.94	100.683	8.34	96.275	8.74	92.184
7.55	105.315	7.95	100.568	8.35	96.169	8.75	92.085
7.56	105.192	7.96	100.454	8.36	96.063	8.76	91.987
7.57	105.069	7.97	100.340	8.37	95.957	8.77	91.889
7.58	104.946	7.98	100.227	8.38	95.852	8.78	91.791
7.59	104.824	7.99	100.113	8.39	95.747	8.79	91.693

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

STATEMENT BY
THE HONORABLE JOHN ROBSON
DEPUTY SECRETARY OF THE TREASURY
ON THE SIGNING OF A
MEMORANDUM OF UNDERSTANDING WITH THE
ROMANIAN BANKERS' ASSOCIATION AND THE NATIONAL BANK OF ROMANIA
NOVEMBER 7, 1991
WASHINGTON, D.C.

It is a pleasure to join our friends from Romania in signing this Memorandum of Understanding to assist in the establishment of an Institute for Banking for their reforming nation. This joint initiative for the education and training of future employees of banks and other financial institutions will be a crucial step to improve the banking system that is vital to Romania's economic reform efforts and, indeed, to the very functioning of Romania's economy.

This agreement is consistent with considerable ongoing international efforts to help all reforming nations. The United States and other major industrial nations remain firm in our commitment to supporting reforms in Central and Eastern Europe. For the United States, this means a commitment to help the region establish more efficient and effective financial systems for sustainable economic growth.

In today's competitive global marketplace, private business cannot exist without a modern, dependable and efficient banking system. Banks function as the allocators of credit for businesses -- large and small -- and as the fundamental facilitators of commerce through the payment system. Banks also create incentives for savings among individuals, families, entrepreneurs and large corporations. In turn, those savings provide capital that fuels the economy and helps businesses take advantage of opportunities for growth in competitive markets.

NB-1542

Yet, we have found that, for many countries trying to shift from a planned economy to a free market, one of the most ignored links in the reform chain is the banking system. Under the old regimes in these countries, including Romania, banks had become instruments of central planning, serving the narrow interests of the regime in power rather than the broad interests of the population. It is clear that these countries now need full-service banking systems that help consumers purchase washing machines and cars, that safeguard the savings of couples who want to buy a house, that help businesses export to the United States or raise capital to expand their capacity.

In response to this need, the Bush Administration is providing expertise and technical assistance that can help new banks get on their feet. Already, we have agreements with Bulgaria, Czechoslovakia and Yugoslavia to help put banking systems in place.

Today, the United States and Romania are entering into a pledge to work together in establishing a better banking system for Romania. Since a banking system is only as effective as the people who operate it, our agreement focuses on developing the human resources necessary to integrate Romania's banks and capital market into the broader international economy.

Specifically, the United States Treasury Department intends to work with existing and future commercial banks, along with the Romanian Bankers Association and the National Bank of Romania, to provide comprehensive training in banking and finance. We plan to help Romania establish an Institute of Banking with a practical curriculum geared toward both entry-level technicians and mid-level managers. And, we are planning for programs to train Romanian instructors, enabling the Institute to become self-sustaining as soon as possible.

But, while the United States is helping the Romanian people in the rebirth of their commercial banking industry, the real work will be done by the Institute itself. With critically needed help from the Romanian Bankers Association and the National Bank of Romania, I hope we can work together to have the Institute up and running in the next few months.

I am confident the spirit of cooperation will continue to ensure the success of this agreement. The establishment of this Institute of Banking will be a strong move in the continued development of a sound banking system of Romania. It will be a solid foundation for economic stability, sustained growth, and the fruits of free enterprise and market economics.

Thank you.

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TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
November 8, 1991

CONTACT: Office of Financing
202-219-3350

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $12,250 million of 364-day Treasury bills to be dated November 21, 1991, and to mature November 19, 1992 (CUSIP No. 912794 ZA 5). This issue will result in a paydown for the Treasury of about $ 250 million, as the maturing 52-week bill is outstanding in the amount of $ 12,493 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Thursday, November 14, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Standard time, for competitive tenders.

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 November 21, 1991. In addition to the maturing 52-week bills, there are $ 20,111 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 $1,612 million as agents for foreign and international monetary authorities, and $ 8,367 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 $ 730 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.

The following institutions may submit tenders for accounts of customers if the names of the customers and the amount for each customer are furnished: depository institutions, as described in Section 19(b)(1)(A), excluding those institutions described in subparagraph (vii), of the Federal Reserve Act (12 U.S.C. 461(b)); and government securities broker/dealers registered with the Securities and Exchange Commission that are registered or noticed as government securities broker/dealers pursuant to Section 15C(a)(1) of the Securities and Exchange Act of 1934, as amended by the Government Securities Act of 1986. 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 competitive tenders on the day of the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward contracts as well as holdings of outstanding bills with the same CUSIP number as the new offering. Those who submit tenders for the accounts of 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 competitive tenders.

Tenders from bidders who are making payment by charge to a funds account at a Federal Reserve Bank and tenders from bidders who have an approved autocharge agreement on file at a Federal Reserve Bank will be received without deposit. Tenders from all others must be accompanied by full payment for the amount of bills applied for. A cash adjustment will be made on all accepted tenders, accompanied by payment in full, for the difference between the par payment submitted and the actual issue price as determined in the auction.

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 by the issue date, by a charge to a funds account or pursuant to an approved autocharge agreement, in cash or other immediately-available funds, or in definitive Treasury securities maturing on or before the settlement date but which are not overdue as defined in the general regulations governing United States securities. Cash adjustments will be made for differences between the par value of the maturing definitive securities accepted in exchange and the issue price of the new bills.

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.

11/91

DEPARTMENT OF THE TREASURY

REPORT TO THE CONGRESS

ON

INTERNATIONAL ECONOMIC AND EXCHANGE RATE POLICY

NOVEMBER 1991

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PART I: INTRODUCTION

Section 3005 of the Omnibus Trade and Competitiveness Act of 1988 (Pub. L. 100-418) requires the Secretary of the Treasury to submit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives an annual report each October 15 on international economic policy, including exchange rate policy. In addition, Section 3005 requires the Secretary to provide a written update of developments six months after the initial report. This is the fourth annual report submitted to Congress.

Part II of this report reviews the economic situation in the industrial countries and efforts by major countries to coordinate economic policies. Part III analyzes developments in the foreign exchange markets, including the dollar's movement relative to the currencies of major trading partners and U.S. foreign exchange market intervention. Part IV examines the U.S. balance of payments situation and assesses issues related to the U.S. economic and balance of payments situation. Part V, prepared pursuant to Section 3004 of the Omnibus Trade and Competitiveness Act of 1988, considers whether countries manipulate the rate of exchange between the currencies and the U.S. dollar within the meaning of the legislation. In this connection, a status report on developments in Taiwan, Korea, and China is provided. The final part provides conclusions on the principal issues discussed in the report.

PART II: ECONOMIC POLICY COORDINATION AND THE ECONOMIC SITUATION IN THE INDUSTRIAL COUNTRIES

As the world economy has become more interdependent, the need for governments to coordinate economic policies has become essential to achieve growth and prosperity. No longer can any one country, not even the United States, formulate its economic policies in isolation. Rather, national policymakers must take into account the impact of their domestic policies on the world and the impact of other countries' policies on their economic performance.

The major industrialized nations have therefore recognized that the pursuit of international economic policy coordination is essential for sustained growth with price stability. Since the mid-1980s, G-7 Finance Ministers and Central Bank Governors have met regularly to review their economic policies and performance in order to put in place the compatible economic policies necessary to achieve their shared objectives. As this process has intensified, the G-7 has expanded its cooperation to a wide range of international economic issues.

Since the inception of the coordination process, economic performance in the G-7 countries has been strengthened: the major countries achieved sustained growth after the early 1980s recession; inflation declined; the pattern of growth has supported substantial reductions in external imbalances; and exchange markets have been far more stable, reflecting G-7 cooperation and the achievement of competitive exchange rates consistent with underlying fundamentals.

Despite these considerable successes, it is not a time for complacency. This year the G-7 has confronted difficult economic conditions and new global challenges. Weaknesses persist in the world economy, and there are many risks in the current setting. At the same time, sweeping changes are occurring in the reforming countries of Latin America and Eastern Europe, and now the Soviet Union. These changes must be supported to anchor the reforming countries firmly into the world economy and to meet the challenge of promoting global cooperation and prosperity.

Below is a description of the current economic situation and prospects in the major countries and the G-7 response. (See Table 1.)

Growth

Aggregate GNP growth in the major industrial countries slowed considerably in late 1990 and the first half of 1991. As a result, only modest economic momentum was carried into 1991, and average annual growth for 1991 is forecast by the IMF to be very weak, at around 1.3 percent.

In the first half of this year, economic activity was characterized by recession in the United States, United Kingdom, and Canada, and a significant slowdown in France and Italy. In contrast, growth was rapid in Japan and Germany. Important contributing factors to the overall slowdown included hostilities in the Persian Gulf (leading to a temporary oil price surge and sharp decline in consumer and business confidence), and the cumulative effect of relatively restrictive macroeconomic policies.

Since then, the divergence in cyclical positions has narrowed. The United Kingdom is moving toward recovery while recovery is underway in the United States and Canada; these countries are likely to have established a pattern of moderate growth by year-end. Growth in Japan is cooling substantially. Developments in continental Europe are being heavily influenced by developments in Germany and growth has slowed on a broad front.

Moreover, while G-7 activity is on the path of recovery, this recovery is widely expected to be far more modest than in the past. As a result, aggregate industrial country growth in 1992 is forecast to rise to 2-3/4 percent, reflecting the moderate recovery in the recessionary economies, somewhat greater strength in continental Europe (outside Germany), and a decline in German and Japanese growth trends.

External Account Developments

In addition to the overall weak economic growth picture, new challenges face the external adjustment process. Substantial and continuing progress has been made in reducing external imbalances, especially in the United States as well as in Germany this year. But large external imbalances are reemerging in Japan, and projections suggest that imbalances may resume widening in some other countries.

The U.S. current account deficit is expected to decline almost $90 billion this year to the $5 billion range, reflecting both large one-time Desert Storm transfer receipts and continued stronger growth of exports than imports. (Detailed discussion of U.S. developments will be found below.)

The German external accounts are also experiencing major shifts. The IMF forecasts Germany's current account balance will move from a $47.9 billion (2.9 percent of GNP) surplus in 1990 to a deficit of about $8 billion this year. Special Desert Storm transfer payments account for a portion of the shift, but the bulk reflects major changes in trade patterns: a substantial increase in imports and a diversion of exports to meet unification-related domestic demand; and, a decline in former East German exports to the former COMECON area. Import growth is likely to be more limited in 1992 as a result of slower aggregate German demand growth, contributing to a projected rebound of the current account to a surplus of about $9 billion (0.6 percent of GNP).

In Japan, however, external accounts in 1991 have been moving in the direction of larger imbalances. The import bill has been limited by slower domestic consumption and investment and lower oil prices, while exports to the Asian region have been strong; on the other hand, Japanese exports to the U.S. have changed little.

Latest IMF projections indicate that Japan's current account surplus could increase to about $63 billion this year, or about 1.9 percent of GNP; but this is likely to be an underestimate, since the cumulative Japanese surplus totaled $55.8 billion through September. The surplus is forecast by the IMF to remain at roughly this level next year ($59 billion), despite the fact that import growth may be constrained somewhat by slower domestic demand while export growth could get a modest boost from recovering demand in the industrial countries as a group.

Price Trends

Meanwhile, overall inflation trends have shown clear improvement. After averaging 5.3 percent on an annualized basis during the August 1990-February 1991 period, G-7 consumer price inflation slowed to an annualized rate of 2.8 percent between February 1991 and August 1991. Of course, both periods were strongly affected by oil market developments, first inflationary and then disinflationary, and various other transitory influences such as tax changes. Nevertheless, the general trend has been positive.

Within the G-7, the United Kingdom had the highest consumer inflation rate (9.5 percent, annual average) in 1990. Germany and Japan were the lowest (2.7 and 3.1 percent, respectively), while the United States registered a slightly above average 5.4 percent.

However, the latest data show important shifts. During February 1991 - August 1991, consumer price inflation fell to an annualized rate of 4.9 percent in the United Kingdom, 2.2 percent in the United States, 3.1 percent in Canada, and 1.4 percent in Japan. Only in Germany did the inflation rate increase substantially, to 5.4 percent, reflecting both the temporary impact of consumption tax increases as well as more fundamental wage and fiscal trends.

For 1991 as a whole, weighted average consumer price inflation in the industrial countries is expected to decline to about 4.5 percent, after 4.9 percent in 1990. The easing of price pressures is likely to be more evident on a "through-the-year" basis, with the G-7 weighted average declining to under 4 percent when measured from the fourth quarter of 1990 to the fourth quarter of 1991.

There is a fairly solid consensus that inflation rates in 1992 will largely reflect the trends established during the latter part of this year. Moderate overall industrial country demand growth, coupled with continued macroeconomic policy restraint and relatively stable commodity prices, should hold average industrial country inflation to the 3-1/2 percent range for the year.

The G-7 Response

The current global economic challenges and conditions make it critical for the industrial countries to return to a path of sustained growth. In this regard, the substantial reductions in inflation achieved in most countries provide an important foundation for sustaining recovery with price stability.

The G-7 Ministers and Governors have met often this year against this background. Most recently, at their June meeting in London and mid-October meeting in Bangkok, they emphasized the importance of fiscal and monetary policies, which while reflecting the differing circumstances in each country, provide the basis for lower real interest rates and sustained growth with price stability in a medium term context. Progress is being made in this regard. Interest rates have declined in the United States, Japan, Canada, and the United Kingdom.

In contrast, however, they have remained broadly unchanged in Germany. Reflecting the impact of regional transmission mechanisms, interest rate developments in continental Europe have been importantly influenced by developments in Germany. This has contributed to the persistence of high real interest rates internationally, with important implications for growth and investment.

Furthermore, the G-7 has stressed the importance of a strengthening of global saving to meet legitimate demands for capital that may emerge over the medium term. In this connection, the full implementation of budgetary measures adopted in some countries is essential to achieve substantial reductions in budget deficits. Also, obstacles to private saving should be removed.

Sustained growth and improved market access are also important for strengthening world economic activity, and in particular for the external environment facing the reforming countries. In this regard, the Ministers and Governors emphasized the importance of a rapid and successful conclusion of the Uruguay Round.

G-7 economic policy coordination, including cooperation on exchange markets, has also contributed to greater stability of exchange rates. This topic is discussed in the following section.

PART III: DEVELOPMENTS IN FOREIGN EXCHANGE MARKETS

Overview

Over the past year, exchange market activity at times was heavily influenced by perceptions of relative economic performance in the major countries, movements in interest differentials, and global political developments. Nevertheless, on balance, the dollar continued to move in a generally stable pattern, continuing the trend of recent years.

G-7 cooperation played a major role in contributing to this result. Small dollar purchases in February helped improve market psychology as the dollar declined toward historic lows against the Deutschemark. Later in the year, sales of dollars after the June G-7 Ministerial meeting contributed to a revision of market views on the dollar's potential for further appreciation at that time. In retrospect, G-7 cooperation can be seen as a significant factor in contributing to the broad pattern of stability in dollar movements over the past year.

The dollar's path over the year can be broadly described as showing a decline in late 1990 and early 1991, followed by a sharp rebound into mid-1991, and a gradual downward trend thereafter. These trends are described in greater detail below. (See Table 2.)

Late 1990-Early 1991

During the final quarter of 1990 and early in 1991, despite occasional bouts of safe haven demand, the dollar came under selling pressure prompted by concerns about the effect of the Gulf crisis on U.S. economic performance.

Amid the air campaign in the Gulf War, the G-7 Finance Ministers and Central Bank Governors stated at their January 21 meeting that they were "prepared to respond as appropriate to maintain stability in international financial markets." This statement and subsequent intervention reassured markets concerning the G-7 commitment to cooperative action.

Subsequently, however, downward pressure on the dollar continued ahead of the beginning of the land war in the Gulf region. On February 11, the dollar reached an historical low of DM1.4433, after the Bundesbank raised interest rated on January 31 and the Federal Reserve lowered interest rates on February 1.

After the quick success of the land campaign in the Gulf War, market psychology shifted in favor of the dollar. This shift was influenced by an increasingly critical view of developments in the German economy, Eastern Europe and the Soviet Union, as well as by concerted dollar purchases by G-7 monetary authorities.

April through Mid-Summer

With the end of the Gulf War, the dollar appreciated rapidly. The U.S. economy was considered likely to begin recovery around mid-year, while investor interest in the reunified Germany proved cooler than expected and deteriorating conditions in the USSR raised concerns. Dollar demand continued in the face of concerted intervention sales in the period ahead of the April 28 G-7 meeting.

Exchange rates were little affected by a cut in the Federal Reserve's discount rate to 5-1/2 percent from 6 percent, and lowering of the Fed funds "target" to 5-3/4 percent from 6 percent, at the end of April. Instead, the cut focussed market attention on the scope for interest rate cuts overseas. In following weeks, interest rates were cut in several European countries, and market expectations of monetary easing in Japan increased.

In early summer, demand for the dollar surged in the wake of improving U.S. employment data, which encouraged expectations of an accelerating U.S. economic recovery. Against many European currencies, the dollar appreciated to levels not seen since autumn 1989. It also appreciated against the yen, prompting the Bank of Japan to intervene in support of the yen.

Mid-Summer to Autumn

But in mid-summer the dollar began to depreciate, first against the yen in mid-June, and in early July against the DM and continental European currencies. Interest rate prospects and underlying expectations regarding the pace of economic activity in the United States generally governed the downward trend in the dollar over the remainder of the reporting period. Particularly influential were U.S. data showing unexpected declines in employment in June and July. The only significant interruption of the downtrend occurred at the time of the August coup in the USSR.

The yen began a rebound after mid-June following release of data showing rapid growth in the Japanese economy in the first quarter of 1991. But, the dollar held firm against the mark into early July, amid uncertainties surrounding Russian Federation elections and a German court decision raising the possibility of a withholding tax on interest earnings on German assets.

Intervention, and perception of official attitudes toward exchange rates, heavily influenced exchange market activity at this time. Prior to the June 23 G-7 meeting, the market grew cautious about the possibility that the G-7 would decide to curb the dollar's rise. At the meeting, the G-7 reaffirmed its "commitment to cooperate closely, taking account of the need for orderly markets, if necessary through appropriately concerted action in exchange markets."

Thereafter, the Bundesbank made a symbolic public sale of dollars in Frankfurt. Also, the U.S. and German monetary authorities indicated that they had reduced their reserves in off-market transactions, and the market inferred that they were preparing to intervene. Subsequently, there were some concerted intervention sales of dollars, and the U.S. authorities joined in at one point. (The dollar sales were not related to the U.S.-German off-market transactions, however.)

Market caution about intervention persisted after the London Economic Summit in mid-July, and the dollar settled into a lower trading range. Over following months, comments by various U.S., Japanese, and German monetary officials were perceived by participants as strongly suggesting that none of the major G-7 countries was dissatisfied with the easing of the dollar.

In August, dollar selling accelerated, reflecting market concern over a weak U.S. recovery and expectations of lower U.S. interest rates. Early in the month, the Fed reduced the apparent target Fed funds rate to 5-1/2 percent from 5-3/4 percent. At mid-month, the Bundesbank raised official interest rates, as did some other European central banks.

In early September, the dollar settled into a lower trading range on market anticipation of further Fed easing. At mid-month, the Fed cut the discount rate to 5 percent from 5-1/2 percent and moved the apparent target for the Fed funds rate another 1/4 percentage point lower to 5-1/4 percent, amid indications of decreasing price increases, weak demand, and slow money growth.

Uncertainties over prospects for interest rate differentials preoccupied the market into October. Attention focussed especially on Administration concerns about the slow pace of the U.S. recovery and the possible need for further monetary easing.

Meanwhile, the yen -- which earlier in the summer had been depressed by Japanese financial scandals -- rose ahead of the October 12-13 G-7 meeting on market perceptions that the G-7 would tolerate substantial appreciation of the yen. While the G-7's statement following the meeting did not specifically address the yen, the market inferred that the G-7 was endorsing the upward trend of the yen given its reference to the need to avoid the reemergence of very large imbalances.

PART IV: U.S. BALANCE OF PAYMENTS AND ASSOCIATED ISSUES

In the early and mid-1980s, large and growing imbalances emerged among the major countries, giving rise to protectionist pressures in the world economy. A major goal of the G-7 economic policy coordination process has been to reduce these imbalances in the context of sustained growth with price stability and an open international trading system.

Substantial progress has been made in achieving this objective, especially in reducing U.S. external deficits, resulting in a strengthening of U.S. economic performance. This owes much to the G-7's role in helping achieve and maintain competitive exchange rates, consistent with underlying economic fundamentals, in the wake of the Plaza Accord, as well as in shifting the pattern of growth in the major countries to support external adjustment. Indeed, the U.S. trade and current account deficits have declined substantially since their peaks in 1987, and the U.S. current account in 1991 is likely to register near balance, albeit in part due to one-time factors. Nevertheless, important medium term issues remain that will affect balance of payments performance over coming years.

Below is a discussion of the balance of payments situation and outlook in the United States. In addition, key issues regarding the U.S. external position and the export-driven adjustment of recent years are highlighted. Also presented is a discussion of the medium term issues concerning U.S. balance of payments prospects, as highlighted by the IMF in its recent "Article IV" bilateral surveillance consultation with the United States.

Developments in 1991

The U.S. trade deficit in the first half of 1991 continued the decline which began in late 1987. The first half deficit at an annual rate (balance of payments basis) was $68 billion, down from $108 billion for the full-year 1990 and a peak of $160 billion in 1987. (See Tables 3 and 4.)

First half 1991 exports reached $410 billion at an annual rate, up $25 billion or 6-1/2 percent from the level for the same period in 1990. As has been the case since 1987, export growth, and in particular capital goods exports, has continued to lead the adjustment of the trade deficit. Capital goods and industrial supplies and materials each contributed roughly one-half of the first half increase in exports over the year-earlier period. On a geographic basis, over 1/3 of the increase in exports went to Europe, with the remainder spread over other geographic areas. Only in the case of Canada, suffering a particularly severe economic downturn, was there a slight decline in exports. This sustained export strength reflects a continued solid competitive position for U.S. products.

Imports for first half 1991 were $478 billion at an annual rate, down about $20 billion from the full-year 1990 level. On an area basis, the bulk of the overall import decline occurred vis-a-vis Western Europe and the Asian NIEs; changes vis-a-vis other areas were modest. Capital goods imports actually increased, countering the overall declining pattern; with this exception, import declines were spread widely across product categories. This pattern of import declines is consistent with the idea that the soft U.S. economy has been an important factor in the most recent trade balance developments.

In terms of area balances, the balance with Western Europe continued to make a major contribution to the overall decline in the U.S. deficit. The United States ran a trade surplus of $17.6 billion (seasonally adjusted, annual rate) in trade with Western Europe during the first half of 1991, up from $2.1 billion for full-year 1990. Other major contributions to overall trade deficit reduction came in the deficits with OPEC (down from $24.6 billion in 1990 to an annual rate of $16.6 billion in first half 1991) and the Asian NIES (down from $20.6 billion to $10 billion over the same period). By contrast, first half deficits (again, at annual rates) vis-a-vis Japan and Canada showed little or no change from full-year 1990 levels.

The difference between the U.S. trade balance and the current account balance reflects U.S. performance on services, investment income, and transfers. The current account during the first half of 1991 was heavily influenced by a number of factors.

- First, the single most important contributor to the lower current account deficit was the lower trade deficit, which declined substantially as set out above.
- Second, there were the one-time and extraordinary receipts of transfers reflecting allied support contributions for Operation Desert Storm.
- Third, there was a rising trend in U.S. surpluses on both investment income and services.

All together, after taking account of the Desert Storm receipts which totalled over $34 billion, the current account balance in the first half of the year was in surplus by over $13 billion (at an annual rate). Abstracting from the non-recurring Desert Storm receipts, however, the current account was in deficit by about $21 billion ($42 billion at an annual rate). This is still down substantially from the 1990 level of $45 billion for first half and $92 billion for the full year.

Analysis of the capital flows which financed the current account continues to be hampered by the very large statistical discrepancy, at least part of which generally is thought to reflect unrecorded capital flows. However, it may be significant that the data for recent quarters indicate a substantial decline in direct investment inflows, compared with the very high levels of 1987-89. During these three years, direct investment flows into the United States averaged over $60 billion annually. During the latter half of 1990 and the first half of 1991, the total recorded direct investment inflow was less than $20 billion. It is too early to speculate to what extent this represents a reaction to the U.S. slowdown, and how much simply reflects the substantially smaller current account deficit.

Prospects for the Full-Year 1991 and 1992

The outlook for the remainder of 1991 depends substantially on the strength of the U.S. recovery. If the recovery is gradual, as expected in the Administration forecast, imports should remain subdued for the remainder of the year. At the same time, we expect any slackening in growth abroad to be gradual as well, so that export growth should be sustained at rates of recent quarters. Barring unforeseen shocks such as a sharp change in oil prices, the trade deficit for the full year 1991 should be in the range of $65-70 billion.

The trends noted in services and investment income also are expected to continue, yielding a current account deficit of $45 billion or so before account is taken of the non-recurring Desert Storm transfers. When these receipts -- which should total over $40 billion for the full year -- are taken into account, the 1991 current account deficit could fall below $10 billion for the first time since 1982.

Conventional models of trade and current account performance, based upon a number of static assumptions, suggest that there may be a very modest increase in the trade deficit in 1992. Exports should continue their steady growth of the past several years, assuming sustained moderate growth in our major trading partners. Also, in this regard, the U.S. competitive position should remain solid, assuming the dollar's value relative to other major currencies remains around current levels.

On the import side, it will be difficult to repeat the import moderation of 1991 (an actual decline in the first half) if the U.S. recovery proceeds as expected during 1992. Both oil and non-oil import volumes should rebound during the course of the 1992, as part of a normal cyclical recovery.

These likely trends point to a 1992 trade deficit in the $75 billion range, up modestly -- perhaps $10 billion or so -- from the 1991 level but still well below $100 billion.

However, underlying current account performance -- abstracting from the very large 1991 Desert Storm receipts -- is likely to show little change. The favorable underlying trend in the services balance is projected to continue, and this improvement is forecast to offset at least part of the expected trade balance deterioration.

Analysis of the Reduction of the U.S. External Deficit

The U.S. balance of payments situation, and the substantial adjustment we have witnessed since 1987, highlight a number of favorable developments.

First, the adjustment that has taken place since 1987 has been both considerable and continuous. This owes much to the dynamism of G-7 economic policy coordination.

A substantial portion of the underlying adjustment of external imbalances that has occurred reflects the lagged effects associated with the achievement of competitive exchange rates, consistent with underlying fundamentals, in the wake of the Plaza Accord of 1985.

Moreover, economic policy coordination has contributed importantly to improved growth in the G-7 as a whole, which has furthered the adjustment process. The G-7 recovery in the late 1980s was importantly characterized by a shift in the pattern of growth: in the United States, output growth exceeded domestic demand growth; in Japan and Germany, domestic demand growth exceeded overall GNP growth. This development was associated with the recognition among the major countries that the responsibilities for adjustment were shared by both surplus and deficit countries.

Second, this pattern of growth meant that the adjustment process in the United States has been driven by growth in exports, rather than by import compression. Since 1987, annual U.S. export growth in value terms has averaged just over 13 percent. As noted above, this reflects both sustained growth abroad and the continued solid competitiveness of U.S. products, which is in large measure exchange rate related.

The U.S. dollar, on a trade-weighted basis vis-a-vis currencies of our major trading partners adjusted for inflation differentials, has remained broadly stable over the past four years. (See chart in appendix.) To be sure, there have been fluctuations in both directions. But these have tended to be reversed. The experience of recent years suggests that modest, temporary currency movements have had relatively little impact on trade flows.

Third, our strong export growth has had important implications for overall U.S. economic performance. Exports are contributing significantly to U.S. growth, particularly at this time of moderate domestic activity. Between 1987 and 1990, real net exports (change in exports less imports on a national income accounts basis) contributed 27 percent to growth. In 1990 alone, real net exports accounted for over 40 percent of growth.

Fourth, this export growth has substantially narrowed the gap between exports and imports. When the deficit was at its peak ($160 billion in 1987), imports at roughly $410 billion were over 60 percent larger than exports ($250 billion). This gap meant that at equal growth rates of imports and exports, the trade deficit would constantly widen. So far in 1991, imports are around 17 percent larger than exports; thus the gap has been reduced by nearly three-quarters.

Fifth, the U.S. performance on services and investment income has demonstrated longer-run strength. Many analysts had anticipated that with the deterioration in the U.S. net investment position, U.S. investment income performance would steadily deteriorate due to the need to service our net debtor position; in turn, the favorable impact of trade deficit reduction on the current account would be offset. However, this has not been the case. Given the relatively soft economy at home, payments on foreign investments in the United States have been weak, whereas strong growth overseas has resulted in higher U.S. earnings on U.S. assets abroad. Also, the declines in U.S. interest rates have resulted in reduced investment income payments. Another significant factor has been net receipts for services, which show a solid favorable trend reflecting longer term competitive strength in a range of categories.

Issues Regarding Medium Term U.S. Balance of Payments Performance

Despite this considerable progress, however, the prospects for the U.S. external position pose a number of important issues. Over the medium term, U.S. current account performance will -- ex post -- reflect trends in our national savings and investment.

The recent U.S. Article IV consultations with the International Monetary Fund highlighted this basic fact. Indeed, examining U.S. payments prospects from this perspective, the Fund -- in the 1991 U.S. Article IV consultations and its World Economic Outlook -- projected that the United States faces medium term current account deficits of some 1-1/2 to 1-3/4 percent of GNP. In this regard, the IMF emphasized that low national savings would have important medium term implications for domestic investment, productivity growth, and the U.S. current account.

For its part, the IMF noted that the United States must address these issues if it is to sustain medium term growth without recourse to foreign savings. Accordingly, the Fund recommended that fiscal policies, emphasizing expenditure restraint, would need to play a key role in raising U.S. national savings. In this regard, the Fund urged the Administration to implement the Budget Agreement fully. The Fund also underscored the importance of raising private savings.

With respect to monetary policy, the Fund noted recent declines in U.S. interest rates, and was of the view that the appropriate long term goal of monetary policy should be the attainment of price stability. The Fund also welcomed the reaffirmation of the U.S. commitment to the achievement of freer trade on a multilateral basis and the priority attached by the United States to a successful conclusion of the Uruguay Round.

The United States has no target for its external position. However, it will be important for the United States to help ensure that its external position is "sustainable" and does not contribute to an excessive build-up in external indebtedness.

Sustainability cannot be quantified. It depends importantly on the perceptions of market participants, and their willingness to finance the U.S. external position at any given level of interest and exchange rates.

There are a number of fundamental reasons, however, why the U.S. position is sustainable.

- First, as noted, substantial progress has been made in correcting imbalances, and the U.S. export sector remains highly competitive.

- This progress, achieved with the help of G-7 economic policy coordination, underscores the commitment of the major countries to adapt policies to promote the smooth functioning of the international monetary system. The G-7 process is a dynamic one, focusing on a broad range of economic fundamentals.

- In this connection, the G-7 have recognized that exchange rates are not the sole means of adjustment. Rather, they are an essential complement to the sound fiscal, monetary and structural policies which are key to achieving sustained growth with price stability and assuring longer term competitiveness.

- Finally, the United States remains the world's largest and most open economy. Our capital markets are the deepest and most liquid in the world. The size, strength, and openness of the U.S. economy will continue to make the United States an extremely attractive center for investment in the years ahead. The United States is committed to the open and growing multilateral trade and payments system upon which the prosperity of the world economy rests.

PART V: ASIAN NEWLY INDUSTRIALIZED ECONOMIES (NIES) AND CHINA

Overview

Under Section 3004 of the Omnibus Trade and Competitiveness Act of 1988, the Secretary of the Treasury is required to "...consider whether countries manipulate the rate of exchange between their currency and the United States dollar for purposes of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade. If the Secretary considers that such manipulation is occurring with respect to countries that (1) have material global current account surpluses and (2) have significant bilateral trade surpluses with the United States, the Secretary of the Treasury shall take action to initiate... negotiations on an expedited basis...for the purpose of ensuring that such countries regularly and promptly adjust the rate of exchange between their currencies and the United States dollar."

It was concluded in the October 1988 report that Taiwan and Korea "manipulate" their exchange rates, within the meaning of the legislation. Pursuant to Section 3004, Treasury initiated bilateral negotiations with Taiwan and Korea for the purpose of ensuring that these two economies regularly and promptly adjust the rate of exchange between their currencies and the U.S. dollar to permit effective balance of payments adjustment and to eliminate unfair competitive advantage.

In April 1990, Treasury concluded that Taiwan and Korea were no longer directly "manipulating" their currencies within the meaning of the legislation. This finding was reaffirmed in fall 1990 and spring 1991. However, it was noted that Taiwan's external surpluses remained large and that in both Taiwan and Korea, exchange rate policy would continue to have an important role to play in promoting economic adjustment. In addition, the reports concluded that in Korea, liberalization of remaining exchange and capital controls was required to improve the functioning of the exchange markets and assure the full operation of market forces in exchange rate determination. In Taiwan, foreign exchange and capital controls were cited as impediments to the operation of market forces in exchange rate determination.

The Treasury Department has held several formal discussions with both Korea and Taiwan on their respective controls on exchange activities and capital movements, in addition to general banking and securities matters. Both Korea and Taiwan, in our judgment, must liberalize significantly the existing discriminatory restrictions placed on foreign institutions and generally let market forces play a greater role in their economies.

China's large external surpluses, including its growing bilateral trade surplus with the United States, substantial depreciation of the renminbi, and administrative controls over foreign exchange allocation and trade have prompted serious concerns as to the applicability of Section 3004 to China. The fall 1990 report, the first to cover China, concluded that China's trade surplus with the United States was primarily due to causes other than exchange rate manipulation. However, it was noted that China's administrative controls over the external sector were of serious concern, and that the United States would press China to remove them. The spring 1991 report reaffirmed these conclusions. This report contains a more detailed discussion of China's external surpluses and exchange rate system.

A summary of economic and exchange rate developments in Korea, Taiwan, and China follows. (See Chart 5.)

KOREA

The Korean won has further depreciated against the U.S. dollar in nominal terms since the spring 1991 Exchange Rate Report. This depreciation reflects in part the continued adjustment in Korea's external accounts, where significant deficits have emerged in 1991. However, the exchange rate also continues to be influenced by pervasive foreign exchange and capital controls in Korea. These controls constrain the forces of supply and demand in the exchange market, distort trade and investment flows, and position the authorities to manipulate the exchange rate through indirect means.

Trade and Economic Developments

Korea's real GNP is expected to register nearly 9 percent growth in 1991, repeating the performance of last year and in line with Korea's historic growth rates over the past three decades. Growth in 1991 is again being led by private consumption and fixed investment, with the construction and manufacturing sectors registering particularly strong performances. Inflation remains a concern and is expected to reach a 9.5 percent rate for the whole year. Unemployment remains low at 2.3 percent of the labor force.

Korea's external accounts have undergone substantial adjustment since 1989. This adjustment -- which has moved the current account from a surplus of 2.5 percent of GNP in 1989 to a forecast deficit of 2.5 percent of GNP 1991 -- has resulted largely from the strong growth of the domestic economy and imports; rising wage demands and other factors adversely affecting Korea's export competitiveness; and rising oil import prices and lost export opportunities in the wake of the Persian Gulf crisis.

For the first time since 1985, the current account fell into deficit in 1990, by $2.1 billion (0.9 percent of GNP). This included a trade deficit of $1.9 billion on a balance of payments basis, compared with a trade surplus of $4.5 billion in 1989. In the first eight months of 1991, these trends accelerated. The Korean government now projects a current account deficit in 1991 of some $7 billion (2.5 percent of GNP) and a trade deficit of $6 billion. However, these deficits do not appear to be structural in nature; external surpluses are expected to reemerge from 1993.

According to U.S. customs data, the U.S. bilateral trade deficit with Korea in 1990 fell to $4.1 billion, down 38 percent from 1989. This was based on a 7 percent increase in U.S. exports to Korea and a 6 percent decline in imports from Korea. In the first eight months of 1991, the United States ran a trade deficit of $860 million with Korea, representing a 70 percent decline in the deficit compared with the same period last year.

Reflecting the rise in the external deficits, Korea's gross and net debt figures have continued to rise in 1991. After declining steadily since 1985, Korea's gross external debt rose to $31.7 billion at the end of 1990 and to $36.8 billion at the end of June 1991. However, the mid-1991 figure was equal to only 14 percent of GNP, compared with 52 percent of GNP in 1985. Net debt doubled between the end of 1990 and mid-1991, exceeding $10 billion at the end of June for the first time in three years. The debt service ratio fell below 10 percent at the end of 1990 -- less than half the level of three years earlier -- and is expected to decline further to about 8 percent in 1991.

Gross official reserves at the end of 1990 totaled $14.8 billion, representing 2.2 months of import coverage. With the negative trends in the current account, reserves fell to $13.4 billion by the end of June 1991.

Exchange Market Developments

Under the "market average rate" (MAR) system of exchange determination, introduced on March 2, 1990, the won/dollar exchange rate at the beginning of each business day is equal to the weighted average of transactions in the inter-bank market on the preceding business day. Inter-bank and customer rates are allowed to float freely within specified margins, which were expanded in September 1991. Exchange rates between the won and third currencies are set in accordance with dollar rates in international currency markets.

During the first nineteen months of the MAR system (through October 18, 1991), the won depreciated 8.3 percent in nominal terms against the U.S. dollar. Foreign banks accounted for a large share of transactions in the inter-bank market, generally between 40-60 percent of the total. The Bank of Korea (BOK) was not a direct participant in the market, and other government-owned banks accounted for only a small share of inter-bank activity.

The cumulative nominal depreciation of the won against the U.S. dollar since the first of these reports was issued in October 1988 now stands at 5.9 percent. Since the spring 1991 report, this nominal depreciation has accelerated; the Korean currency has fallen 3.6 percent against the dollar over the past six months. However, because of higher inflation in Korea than in the United States, the won has shown little change in real terms against the dollar over this period.

Foreign Exchange and Capital Controls

The Korean authorities maintain a comprehensive array of controls on foreign exchange and capital flows. These controls prevent market forces of supply and demand from playing a fully effective role in exchange rate determination, distort trade and investment flows, and provide the Korean authorities with tools for indirectly manipulating the exchange rate.

One of the most onerous controls is the requirement that foreign exchange banks obtain and review, prior to entering into most foreign exchange transactions, original documentation of an underlying commercial transaction. This "real demand" rule seriously hampers the development of Korea's foreign exchange market, reflects the government's continued controlling hand in the foreign exchange market and its fundamental lack of confidence in market forces, and is inappropriate for a country at Korea's stage of development.

Other exchange and capital controls severely restrict the use of short-term trade finance, while there are effective limitations on a variety of current account transactions such as travel and remittances. Direct portfolio investment in Korea will be opened to foreigners for the first time in early 1992, but a number of restrictions -- including a 10 percent limit on total foreign investment in any Korean stock and a 3 percent limit on investment by individual foreigners -- will initially keep foreign participation in Korea's capital markets to a minimum. Capital flows in connection with foreign direct investment in Korea, as well as investment abroad or foreign borrowing by Korean residents, are also restricted. These and other controls hinder the ability of branches and subsidiaries of foreign companies located in Korea to obtain investment and working capital and even import finance.

In June 1991, the Korean government announced its intention to revise the Foreign Exchange Control Act (FECA) to adopt a "negative list" approach to the regulation of foreign exchange transactions. Under the proposed plan, currently under consideration in the National Assembly, all foreign exchange transactions would be permitted in principle, with exceptional restrictions explicitly listed in the regulations. While the move to a negative list approach is welcome in principle, it remains to be seen precisely how the FECA and its associated regulations will be revised and how many restrictions will remain. The U.S. Treasury Department has conveyed to the Korean authorities that we would expect the negative list of restrictions to be short. In particular, we would consider a revision of the FECA unsatisfactory if it did not include significant relaxation or elimination of the underlying documentation requirement.

Financial Policy Talks

Capital and exchange controls and other financial policy issues are the subject of the ongoing Financial Policy Talks between the Treasury Department and the Korean Ministry of Finance. Three formal rounds of these talks, and several informal rounds, have been held since February 1990, most recently in September 1991. The purpose of the talks is to provide a mechanism for addressing specific market access problems that U.S. banks and securities firms face in doing business in Korea, and for encouraging broader liberalization of Korea's financial, capital, and exchange markets.

Progress in the Financial Policy Talks has been limited. The Ministry of Finance has taken some concrete measures over the past two years to improve the treatment of foreign financial institutions in Korea. These steps include increases in the ceiling on issuance of certificates of deposit (CDs) by foreign banks, elimination of the ceiling on foreign banks' paid-in capital in Korea, and permission for foreign securities firms to establish branches in Korea.

However, significant denials of national treatment for foreign financial institutions in Korea remain. In particular, foreign banks continue to face severe difficulties in meeting the local financing needs of their traditional clients. The marginal increases in CD limits, while helpful, have been inadequate to address the local currency funding problem; the ceilings should be substantially expanded or eliminated altogether. At the same time, discrimination against foreign banks in the interbank call money market persists, while another potential won funding source, the trust business, is hindered by the requirement that a high percentage of trust deposits be invested in low-interest government bonds. In the securities area, stiff criteria for branch establishment and a limited scope of permissible activities effectively limit the attractiveness of the Korean market for foreign securities firms.

Most troubling at this stage is that the Korean Government appears to lack a "vision" and well-defined strategy for broader liberalization of its tightly controlled financial markets. Recently announced plans for the deregulation of interest rates, liberalization of foreign exchange controls, and opening of Korea's capital markets -- while steps in the right direction -- do not appear to go far or fast enough, or to be part of a coordinated strategy. The Treasury Department has called on the Korean Government to develop and publish a comprehensive blueprint with clear timetables for the full liberalization of its financial sector.

The Treasury Department views the lack of progress in these areas as evidence of an unwillingness on the part of the Korean government to undertake fundamental reform of its financial sector. We will continue to pursue these issues with the Korean Ministry of Finance through the bilateral Financial Policy Talks and the Uruguay Round financial services negotiations.

<u>Assessment</u>

There continues to be no basis at this time for concluding that Korea is directly "manipulating" its exchange rate, within the meaning of the legislation. This assessment is based on the following factors: the emergence of significant trade and current deficits in 1991, the decline in Korea's foreign reserves in the first half of 1991, the lack of evidence that the Bank of Korea is intervening directly in the exchange market, and the modest role of other government-owned foreign exchange banks in the market.

Nonetheless, the exchange rate determination system in place in Korea, while an improvement over the previous regime, is far from a truly market-determined one. In particular, we remain seriously concerned that pervasive Korean exchange and capital controls significantly constrain supply and demand in the currency market. Liberalization of these controls -- especially the "real demand" rule for foreign exchange transactions -- is imperative to strengthen the role of market forces in exchange rate determination and in Korea's trade and investment flows.

Therefore, in the period ahead, the Treasury Department will continue to monitor developments in Korea's external accounts and the operation of the MAR exchange rate system. We will also continue to press for liberalization of Korea's financial, capital, and exchange markets, as well as to seek improved treatment for U.S. financial institutions in Korea.

TAIWAN

Taiwan's trade surplus with the U.S. has decreased so far this year while the New Taiwan (NT) dollar has appreciated against the U.S. dollar in nominal terms by 2.6 percent since the end of 1990. However, Taiwan is expected to finish the year with extremely large overall trade and current account surpluses; the overall trade surplus may exceed that registered last year. The full operation of market forces in determining the exchange rate is impeded by continued limitations on foreign exchange transactions and capital flows, and by likely central bank intervention to dampen appreciation. This combination of practices contributes to Taiwan's efforts to generate the trade surpluses it views as necessary for reserve accumulation. These policies amount to indirect "manipulation" of the exchange rate and impede further adjustment in Taiwan's external imbalances.

Trade and Economic Developments

Taiwan's global current account surplus decreased by 5.4 percent in 1990 to $10.8 billion. As a proportion of GNP, this represented a decrease to 6.7 percent from 7.5 percent in 1989. Taiwan's overall trade surplus (c.i.f. basis) was down 10 percent in 1990 to $12.5 billion. Taiwan experienced a substantial rise in net capital outflow in 1990, due largely to sizable increases in overseas investment and short-term flows from NT dollar to foreign currency accounts, in part reflecting political uncertainties.

A noteworthy development this year has been a reduction in the U.S. bilateral trade balance with Taiwan. The U.S. trade deficit (according to U.S. statistics) with Taiwan in the first 8 months of 1991 was, at $5.1 billion, 19.8 percent lower than in the same period in 1990. Imports from Taiwan have decreased by 3.1 percent while U.S. exports to Taiwan increased by 13.1 percent.

Factors such as the relocation of labor-intensive export industries overseas; rising wages and production costs; and inflationary pressures continue to play an important role in reducing Taiwan's trade surplus. Slow growth over the past year in Taiwan's major export markets, particularly in the United States, has also been a significant factor over the past year.

Over the first 8 months of 1991, according to Taiwan's economic statistics, the U.S. share of Taiwan's exports fell 4.5 percentage points to 28.8 percent and its share of Taiwan's overall trade surplus fell to 60 percent, compared to 77 percent over the same period in 1990. The authorities on Taiwan have publicly expressed their concern with this decline. Taiwan's exports to Asia have increased dramatically this year as a result of Taiwan's efforts to diversify its export markets and growing demand for inputs from Taiwan's offshore industries.

The recent decrease in Taiwan's bilateral trade surplus with the United States is likely to slow or reverse as the United States recovers from recession. Taiwan's most recent data shows that its September exports to the United States increased by 21.4 percent over September 1990, the largest percentage growth since January 1988.

Taiwan's overall trade and current account surpluses are demonstrating virtually no adjustment. Taiwan's authorities have predicted that the overall trade surplus for 1991 may rise to $13.6 billion, an 8.5 percent increase over 1990. Taiwan's overall trade surplus increased by 3.6 percent in the first 9 months of 1991 as its widening deficit with Japan was more than balanced by dramatically increased surpluses with Hong Kong and Europe.

Taiwan's authorities are predicting a current account surplus of approximately $10 billion in 1991, a slight decrease from last year. The Central Bank projects that the balance of payments surplus will widen significantly to $5 billion this year. Taiwan's foreign exchange reserves increased since 1990 to $76.4 billion (sufficient to cover more than 14 months of imports) in September 1991, the world's largest stock. This level of reserves is excessive, especially given the investment needs of the economy.

According to the most recent official Taiwanese projections, the economy is growing at an annual rate of about 7 percent in 1991, up from 5.3 percent in 1990. Inflation is expected to decrease slightly from 1990's rate of 4.1 percent.

Exchange Rate Developments

Since the Fall 1988 report, Taiwan's cumulative exchange rate appreciation has totaled only 9.5 percent vs. the U.S. dollar in nominal terms. From mid-1990 to early-1991, the NT dollar fluctuated within a small range against the U.S. dollar. Since mid-1991, the NT dollar has appreciated slowly by 2.6 percent against the U.S. dollar. The NT dollar depreciated against all other major currencies as a group through the end of 1990; its performance has been mixed during 1991. As of October 18, the exchange rate stood at NT$26.41/US$1.

Given the continued strength of Taiwan's economic fundamentals, the expectation of increased growth, a steady and still-large current account surplus, excessively high reserves, and a more stable political environment, further strengthening of the NT dollar over the near-term is expected.

Exchange Rate System

The Central Bank has reportedly occasionally intervened to moderate upward pressure on the NT dollar (and to a lesser extent, downward pressure) although not with the same dominance as before the institution of the new exchange rate system in 1989. However, there is no evidence to suggest that the Central Bank has recently been consistently intervening in the market to gain unfair competitive trade advantage.

Taiwan has instituted a number of measures over the past several years to liberalize the exchange rate system and reduce capital controls. As a result, the exchange rate system appears now to reflect market forces more fully. The rate for foreign exchange transactions is freely determined between buyers and sellers. These measures have been detailed in previous reports; no new steps have been taken since our last report.

The remaining limitations on foreign exchange transactions and capital flows, while less pervasive than those imposed by some other economies in the region, impede the full operation of market forces in exchange rate determination, and remain far too restrictive for an economy with the stated objective of becoming a regional financial center. Several of the limitations are especially harmful to foreign banks and securities firms.

Taiwan continues to limit the amount of cash an individual can carry in and out of Taiwan (NT$40,000 or about $1,500). It also restricts annual non-trade-related capital inflows and outflows to $3 million per individual or firm (capital flows for trade purposes are unlimited). It is our expectation and hope that the Central Bank will raise in tandem or dismantle these limits as the market remains stable and as inflows and outflows reflect underlying market conditions as opposed to short-term speculative movements.

Limits on foreign exchange positions largely eliminate the operation of a forward foreign exchange market, a potentially major area of business for foreign banks. Ceilings limits on foreign exchange positions are based on local assets. The local assets of foreign banks, however, are relatively small since Taiwan has restrictions on their operations and branches, consistent with Taiwan's generally discriminatory treatment of foreign banks. Ceilings on overbought ("long") positions -- $50 million for the five large domestic banks and $20 million for all other banks, including foreign banks -- constrain operations in the forward market. Limits on foreign exchange liabilities ("short" positions), which vary from bank to bank have the same effect and also restrict the ability of foreign branches to offer foreign currency loans in Taiwan and to use swap funding for local currency lending. Taiwan also uses a cash or "spot" basis to calculate a bank's foreign exchange position, contrary to the internationally-accepted practice of using an accrual basis. These various requirements not only discriminate against foreign banks but also limit the range of financial instruments available to Taiwan's economy, thereby reducing its efficiency.

Financial Talks

Constraints on banking, foreign exchange and other financial policy issues are the subject of ongoing financial policy talks between the Treasury Department and Taiwan's authorities conducted under the auspices of the American Institute in Taiwan and the Coordinating Council on North American Affairs. These talks provide a forum for addressing specific market access problems encountered by U.S. banks and securities firms in Taiwan, and for encouraging Taiwan's authorities to undertake further liberalization of its financial capital and exchange markets.

In addition to the constraints imposed by Taiwan's controls on foreign exchange transactions and capital flows, U.S. financial services firms continue to face significant denials of national treatment. In many instances, there is outright discrimination against foreign banks and securities firms. For example, the number and location of additional foreign bank branches is still restricted. Special ceilings, over and above those faced by domestic banks, are imposed on loans made by a foreign bank to any single customer. Foreign banks also cannot deal directly in short term-money instruments. Substantial restrictions are placed on foreign institutional investment in the stock market, while investments by foreign individuals are prohibited altogether. Foreign firms cannot manage private pension funds.

The Treasury Department believes these continued restrictions are evidence that the authorities on Taiwan have been excessively cautious in their efforts to increase foreign participation in the financial sector, particularly in view of their desire to develop Taiwan as a regional financial center. We will continue to pursue these issues in our discussions with Taiwan's authorities.

Assessment

We recognize the decline in Taiwan's bilateral trade surplus with the U.S. so far this year. This development is primarily attributable to the dual realities of the slowdown in the U.S. economy and a shift in Taiwan's traditional labor-intensive production to China and other locations. Despite this decline, the continued high surplus is still unsustainable and indicates a need for further adjustment, particularly since the resumption of growth in the United States will likely slow or reverse this trend in coming months. In addition, adjustment in Taiwan's overall surpluses does not appear likely this year; in fact, its overall trade surplus is expected to increase. These persistently large external surpluses continue to generate concern. Substantial further adjustment is required and appreciation of the NT dollar must continue to play a role in the process.

We have no evidence of direct exchange rate "manipulation", within the meaning of the 1988 legislation. However, the Central Bank reportedly intervenes to moderate the pace of appreciation.

These actions may be motivated by the authorities' concern about their declining exports to the U.S. and their desire to maintain their large stock of foreign exchange reserves.

As we noted in our last report, the exchange rate system now more fully reflects market forces. However, limitations on foreign exchange transactions and capital flows remain far too restrictive and impede the full operation of market forces in exchange rate determination. We are increasingly concerned about the apparent lack of progress in removing the remaining restrictions. Given the advanced state of economic development on Taiwan, and the stated desire of Taiwan's authorities to develop Taiwan as a regional financial center, such limitations should be significantly relaxed in the near future.

In view of the persistence of Taiwan's large trade and current account surpluses, we are again concerned that Taiwan's exchange rate policies, in conjunction with continued limitations on foreign exchange transactions and capital flows, contribute to indirect "manipulation" of the exchange rate. Given this situation, we will continue to monitor carefully the pace of adjustment in the overall and bilateral trade balance and the role of currency appreciation in that process, and indicate the depth of our concern to Taiwan's authorities. In our discussions with Taiwan's authorities, we will continue to push for further liberalization of controls on capital and foreign exchange transactions and seek improved treatment for U.S. financial institutions.

CHINA

The Treasury Department is seriously concerned about the size of China's trade and current account surpluses. These surpluses stem primarily from the network of pervasive administrative controls maintained by the Chinese authorities over all aspects of external economic activity. The authorities combine a highly regulated system of foreign exchange allocation with strict import licensing and an array of other controls to tightly manage China's trade flows. The result is large and growing external surpluses.

Since the last report, the Treasury Department has intensified its examination of China's foreign exchange policies. Treasury delegations traveled to China in July and September of this year for consultations with the Chinese authorities both to deepen our understanding of the foreign exchange regime and to seek concrete steps toward a more market-oriented system of exchange rate determination in China. These consultations will continue in the period ahead.

Trade and Economic Developments

China's external accounts underwent significant adjustment in 1990. Through much of the 1980s, China had overall trade and current account deficits. Between 1989 and 1990, however, the trade balance experienced a swing of over $15 billion (4.8 percent of GNP), moving from a deficit of $6.6 billion in 1989 to a surplus of $8.7 billion in 1990. The current account also moved from a $4.3 billion deficit in 1989 to a $10.2 billion surplus in 1990.

The large external surpluses continued through the first six months of 1991. According to Chinese data, the trade surplus for January through June jumped to $3.7 billion, an increase of 43 percent over the same period of 1990. However, while exports have remained strong, import growth has continued to accelerate in 1991, which will moderate the increase in the trade surplus for the year. A surplus on the order of $10 billion is expected in 1991.

A principal factor in the strengthening of China's balance of payments in 1990 was the retrenchment program launched in the last quarter of 1988 to curb excess demand and high inflation, which had the effect of slowing import demand and boosting exports. In addition, an important element of the retrenchment program was stricter application of direct administrative controls over imports, which further contributed to the swing in the external accounts. This latter factor has gained increasing prominence as other retrenchment policies have been eased in 1991.

As a result of the substantial adjustment in the trade and current accounts, China's foreign exchange reserves climbed 38 percent from $17 billion at the end of 1989 to $27.3 billion, equivalent to nearly eight months of imports, at the end of last year. By end-June 1991, reserves had reached $35.2 billion.

According to U.S. customs data, China has a large and growing bilateral trade surplus with the United States.[1] The Chinese surplus rose from $6.2 billion in 1989 to $10.4 billion in 1990, an increase of 67 percent. (According to Chinese customs statistics, China had a deficit of $1.4 billion with the United States in 1990.) Through the first eight months of 1991, U.S. customs data show a Chinese bilateral trade surplus of $7.2 billion, compared with $6.4 billion in the same period of 1990, an increase of 13 percent.

China's exports to the United States in 1990 rose 27 percent, following a 41 percent expansion in 1989. These growth rates were significantly above those for China's global exports during the same period (18 percent and 7 percent, respectively). This discrepancy can largely be explained by the sizeable transfer of labor-intensive production facilities from Hong Kong and Taiwan to the mainland, boosting China's export capacity in such goods as clothing, toys, sporting goods, footwear, and consumer electronics -- products often bound for the U.S market. In the first six months of 1991, Chinese exports to the United States continued to increase, but at a slower pace of 15 percent.

According to Chinese customs statistics, Chinese imports from the United States fell 17 percent in 1990, more than the 10 percent contraction in China's global imports. This resulted from the tightening of import controls over 13 key commodities, including grains, sugar, steel, and tobacco, which accounted for roughly half of total U.S. exports to China in 1988. In the first six months of 1991, Chinese imports from the United States rose 6.2 percent over the same period last year.

Domestically, the Chinese economy has recovered from the slower growth of 1989-90 as the authorities have eased earlier retrenchment policies. Real GNP is expected to grow 6.8 percent in 1991, following a growth of 5 percent in 1990 and less than 4 percent in 1990 (the slowest growth rates in a decade). Inflation fell to 2 percent in 1990, down from 18 percent in 1989, and is running at an annualized rate of roughly 3 percent this year.

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[1] Neither country counts its goods which are shipped to Hong Kong and then re-exported to the other country as exports to that country. Because the amount of Chinese goods re-exported to the United States substantially exceeds the amount of U.S. goods re-exported to China, U.S. data are more accurate and will be used for the purposes of this analysis.

Exchange Rate System

China officially has a dual exchange rate system. There is an administered rate which generally applies to trade transactions under the state plan. There is also a "market" rate determined in the foreign exchange adjustment, or "swap", centers, where foreign invested enterprises (FIEs; mostly joint ventures) and domestic entities that are allowed to retain their foreign exchange earnings can buy and sell foreign exchange at rates established through a regulated auction system. Outside the official dual rate system, there is a sizeable, but diminishing, black market for foreign exchange.

Foreign Exchange Allocation at the Administered Rate: In April 1991, China adopted what it calls a "managed float" system for determining the administered, or official, exchange rate. In the past, the official rate had been devalued periodically by the authorities in sizeable increments (e.g., by 21 percent in December 1989 and 9.6 percent in November 1990). Under the new system, the State Administration of Exchange Control (SAEC) fixes and publishes a new rate each morning, which may vary slightly upward or downward from the previous day's rate. (The trend has been toward devaluation.) In theory, this rate is linked to a basket of currencies (principally the U.S. dollar) and follows trends in international currency markets. However, the actual criteria used by the SAEC in determining the daily rate are unclear.

The official rate generally applies to transactions under the state foreign exchange plan, which spells out planned exports and imports of priority products. In effect, only state enterprises have access to this rate.

On the import side, importers (generally government-owned foreign trade corporations) are allocated foreign exchange at the official rate for purchases of "priority" imports, i.e., goods that cannot be produced domestically in sufficient quantities and those that are urgently needed by the state, particularly for important projects. The importer is given a quota account by the SAEC. At the time of payment for the import, foreign exchange is given to the importer subject to its providing local currency against its quota account in the SAEC.

Domestic enterprises can also obtain foreign exchange at the official rate for purchases of non-priority (i.e., off-plan) imports. However, such purchases require an import license issued by the Ministry of Foreign Economic Relations and Trade (MOFERT). Moreover, applicants for licenses for non-priority imports must first obtain the approval of the ministry responsible for the enterprises producing domestic substitutes for the proposed import. Imports of certain "luxury" consumer items -- such as computer hardware, televisions, and VCRs -- are not permitted.

On the export side, foreign exchange earned by a state enterprise must initially be surrendered to the Bank of China (BOC) in exchange for local currency at the official rate. After each sale, the government gives the enterprise a foreign exchange quota according to a retention ratio determined by the government. In principle, this ratio was universally revised upward this year to 80 percent of foreign exchange earnings, but actual retention rights may vary by locality and product. The enterprise can then open a non-interest-bearing foreign exchange retention quota account at the SAEC. Though expressed in U.S. dollars, the quota accounts are not foreign currency accounts. They merely determine the amount of foreign exchange each enterprise is entitled to obtain from the state for approved purposes.

Since 1988, retention quotas have been transferable among firms through the foreign exchange adjustment, or "swap," centers. In these centers, domestic enterprises with excess foreign exchange can sell their quota rights for renminbi at a more favorable (i.e., depreciated) rate to other firms which need foreign exchange. The operations of the swap centers are discussed in greater detail below.

As an increasing percentage of China's trade is covered by foreign exchange transactions in the swap centers, the relative importance of the official allocation system, and thus of the administered exchange rate, has declined. Indeed, there is evidence that the Chinese government has deliberately attempted to wean state enterprises from access to subsidized foreign exchange allocated by the state. Nevertheless, a large percentage of China's imports is still covered by the official allocation system.

Swap Centers: China's foreign exchange adjustment centers, commonly known as "swap centers," are SAEC-supervised "markets" for the exchange of foreign currency. The first swap centers were established in late 1986 to enable foreign invested enterprises (FIEs) to buy and sell foreign exchange, theoretically at freely determined rates. Previously, FIEs had difficulty meeting the requirement that they balance their foreign exchange receipts and expenditures, i.e., that they earn sufficient foreign exchange to cover all their import needs. Establishment of the swap centers enabled FIEs to swap renminbi earned locally for foreign currency.

In early 1988, state- and collectively-owned domestic enterprises -- both those with a surplus of foreign exchange to sell as a result of increases in retention rights, and those which had been unable to obtain foreign exchange at the official rate to meet their import purchase requirements -- were also permitted to operate in the centers. Private domestic enterprises and individuals may not use the centers.

The first swap center was established in the Shenzhen Special Economic Zone (SEZ), with centers quickly spreading to other major cities. At present there are about 100 swap centers throughout

China: in all provincial capitals (except Lhasa), in the 14 open coastal cities (including Shanghai, Guangzhou, and Tianjin), in Beijing, and in the five SEZs.

Transactions volume in the swap centers has grown significantly since their establishment. The SAEC estimates that $4.2 billion was traded in swap centers throughout China in 1987, $6.2 billion in 1988, $8.6 billion in 1989, and $13.2 billion in 1990 (about one-fourth the value of China's global exports). FIEs accounted for about $2 billion (15 percent) of the total swap transactions in 1990. The trading volume has been heaviest in the SEZs and Shanghai.

The buying and selling of foreign exchange quotas comprises the bulk of transactions in the swap centers. FIEs may hold foreign exchange bank accounts and swap renminbi directly for foreign currency. Domestic enterprises generally trade in quota rights. On an experimental basis, domestic firms in the SEZs and some coastal cities have been allowed to sell actual foreign exchange, not just quota rights, in the swap centers.

The State Council's 1986 decree permitting FIEs to engage in currency swaps provided little in the way of detailed guidelines on how the swap centers were to operate. As a result, a decentralized and varied system has developed. Most notably, only the Shanghai and SEZ centers use an open auction system, in which multiple brokers buy or sell foreign currency at any price at any time; elsewhere, deals are made through face-to-face negotiations between prospective buyers and sellers in the local offices of the SAEC.

Some basic features are common to all swap centers. To trade, an application is submitted to the provincial or municipal branch of the SAEC. Foreign exchange buyers that plan to use their hard currency to purchase imports must supply documentation of import approval, a foreign exchange invoice, and proof of actual receipt of the product. Documentation of purpose for the purchase of local currency is not required, nor is documentation of the source of foreign exchange being sold.[2] Participants must inform the center of the total amount of foreign exchange they wish to buy or sell on a given day. They cannot exceed that amount without informing center officials but need not trade the full amount.

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[2] However, FIEs trading renminbi for foreign currency may be asked to document how they earned the local currency. The local exchange authority may also review the FIE's annual foreign exchange plan, which outlines the venture's domestic sales projections and expected foreign exchange needs. This plan must be consistent with the FIE's business plan, which was initially approved by MOFERT and the planning and exchange control authorities.

A number of restrictions apply to trading in the swap centers. Transactions between centers in different parts of the country require the approval of the SAEC and are only permitted for purposes of balancing supply and demand for foreign exchange rather than for price arbitrage.[3] Forward transactions are not permitted in the swap centers, making foreign exchange hedging operations impossible. And speculation on exchange rates is strictly prevented by the requirement that all swap transactions be tied to an underlying "real demand" for foreign exchange.

The most important source of government control over the swap centers lies in the delineation of the purposes for which foreign exchange obtained there may be used. According to published SAEC rules, foreign exchange may be purchased in the swap centers only for the importation of goods deemed by the state to be "necessary" for China's development. These goods include advanced technology, certain machinery and equipment, raw materials and spare parts, and educational materials. There is also a published list of 24 prohibited items for which foreign exchange may not be purchased, mainly consumer products such as televisions and other home appliances and clothing. However, the actual list of prohibited imports may be longer, according to the discretion of the local SAEC officials who supervise the swap centers.

Local swap center rules mimic the state rules covering domestic enterprises and add provisions that deal specifically with FIEs. In the Shanghai rules, for example, the purchase of foreign exchange by FIEs must be made pursuant to the "satisfaction of foreign exchange requirements of enterprises with foreign investment within their business scopes, repayment of principal and interest of loans, and remittance of profits." The authorities want to ensure that the foreign exchange purchased by a foreign enterprise will be used for China-related business purposes.

In addition to its control over uses of foreign exchange, the Chinese authorities are positioned to intervene in the swap centers by buying or selling foreign exchange to help stabilize the rate. However, there is no evidence that the government regularly intervenes to move the market in a specific direction. In addition, local swap center officials are authorized to shut down trading if fluctuations in the rate extend beyond set bands. Again, it appears that this authority has rarely been used.

Exchange Rate Developments

Administered Rate: On October 4, 1991, the official rate of the renminbi stood at 5.38 yuan to the U.S. dollar. This represents a nominal depreciation against the dollar of nearly 2 percent since

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[3] There are technical barriers to arbitrage as well, since the swap centers are not connected by telecommunications links and there is no electronic transfer of funds between them.

the adoption of the "managed float" system in April 1991, 3 percent since the last major devaluation in November 1990, and some 45 percent since the first of these reports was issued in October 1988 (when the rate stood at 3.72 yuan to the dollar). As noted earlier, these trends reflect the Chinese government's new policy of gradually devaluing the renminbi in small steps, rather than undertaking large devaluations on a periodic basis.

From 1986 to 1989, the nominal devaluation of the renminbi against the dollar was not sufficient to offset the impact of rising prices in China. (Inflation averaged 7 percent in 1987, 19 percent in 1988, and 18 percent in 1989.) In real terms, therefore, the renminbi appreciated against the dollar over this period. However, as a result of the two major devaluations at the end of 1989 and 1990, as well as lower inflation in China in 1990 and 1991 (2 percent and an estimated 3 percent, respectively), there has been renewed depreciation in real terms against the dollar over the past two years.

The Chinese authorities offer several explanations for the latest devaluations in the administered exchange rate. First, they cite the need to ease the burden on the central government of costly export subsidies. These subsidies were established to compensate Chinese exporters for an overvalued domestic currency, which reduced China's export competitiveness. Burgeoning fiscal deficits in recent years forced the central government to announce the elimination of all export subsidies on January 1, 1991. (It is not clear whether all subsidies have in fact been eliminated.) The Chinese authorities argue that the phasing out of subsidies necessitated a more "realistic" (i.e., devalued) exchange rate to restore China's export competitiveness.

Another stated goal of the Chinese authorities in devaluing the renminbi is to unify China's dual exchange rates. As discussed below, the official devaluations of the past two years have resulted in a substantial narrowing of the gap between the administered and swap center rates. The authorities have stated that further devaluations will occur, at a slower pace, until the two rates are unified. It is unclear precisely what unification will mean, since some kind of official rate with privileged access will apparently continue.

A related objective is the desire to eliminate the black market for foreign exchange. While information on unofficial transactions is sketchy, it appears that this effort has had some success, as the black market exchange rate has reportedly moved very close to the swap center rates.

Swap Rates: The average exchange rate in the swap centers[4] rose (i.e., the renminbi depreciated) from about 6 yuan to the U.S. dollar at the beginning of 1988 to a peak of 7 yuan in September 1988, reflecting the entry of domestic enterprises into the centers, mostly as buyers of foreign exchange. Beginning in February 1989, the renminbi began to steadily appreciate in the centers because of tighter credit and control over import licensing, which suppressed demand for foreign exchange. As a result, swap rates reached about 6 yuan at the end of 1989 and 5.7 yuan at the end of 1990. Over the past year, rates in the swap centers have stabilized, with a slight trend toward depreciation; at the end of September 1991, the rate was approaching 5.9 yuan to the dollar. The spread between the official and swap rates has thus declined to less than 10 percent, compared with 80 percent as recently as 1989.

Foreign Exchange and External Trade System

China's foreign exchange regime must be viewed within the framework of the country's broader economic policies. According to Chinese officials, the primary goal of balance of payments management is to secure enough foreign exchange to pay for priority imports and debt service, while securing a sufficient level of reserves. The authorities use a number of tools to accomplish this goal, including both the exchange allocation system and direct controls over imports and exports. These tools are often overlapping and redundant.

For example, as discussed earlier, an importer wishing to obtain foreign exchange for non-priority imports must obtain not only authorization from the SAEC but also an import license from MOFERT and explicit approval from the ministry responsible for enterprises producing domestic substitutes. The various approval processes do not necessarily operate consistently. Possession of an import license does not guarantee that an importer will be allocated foreign exchange, nor does approval of foreign exchange use automatically entitle the importer to a license.

In practice, it appears that the strict import licensing system is often the most significant obstacle to the importer's ability to obtain foreign exchange. Thus an effort to remove foreign exchange controls without a complementary effort to address direct trade restrictions is unlikely to result in a significant expansion of Chinese imports. At this time, we see little evidence that the Chinese authorities are contemplating reforms which would address

Swap rates vary from center to center depending on local supply and demand for foreign exchange. For example, the rate in the Shenzhen center tends to be lower (i.e., more appreciated) than the rate in other centers because of the volume of exports and thus foreign exchange earnings in the Shenzhen SEZ.

either of these impediments. Until such reforms are undertaken, there will continue to be constraints on the operation of market forces in the foreign exchange swap centers.

Assessment

The Treasury Department remains seriously concerned about the size of China's global trade and current account surpluses, as well as its growing bilateral trade surplus with the United States. It is our assessment that a principal cause of these large external surpluses is the network of pervasive administrative controls over external trade, including the foreign exchange allocation system, which restrict imports and prevent market forces from freely determining the exchange rate.

The Chinese government clearly manages its balance of payments in such a way as to generate a target level of foreign exchange reserves -- a level sufficient to cover imports critical for China's development as well as debt service payments, and to provide a cushion in the event of external shocks. Achieving this target requires China to suppress "non-priority" imports, resulting in large external surpluses.

The authorities use a variety of direct and indirect instruments to reach these broader objectives. One such tool is the highly controlled system of foreign exchange allocation, which constrains the forces of supply and demand in determining the exchange rate and distorts China's trade and investment flows. The foreign exchange system works in tandem with import licensing and other direct controls to effectively restrict China's imports to those deemed by the central authorities to be critical for development. Removing one aspect of these controls without simultaneously addressing the others will not have the desired effect of promoting market forces in China and producing more balanced trade flows.

While it is apparent that the Chinese government closely manages the trade regime, including foreign exchange allocation, to support its balance of payments objectives, there is no clear evidence that the authorities manipulate the exchange rate itself, within the specific terms of the legislation. The recent devaluations of the renminbi appear aimed at the goals of unifying China's dual exchange rates and eliminating costly export subsidies, although they obviously have the effect of making Chinese exports more competitive and therefore further contribute to China's surplus. In the eyes of the Chinese authorities, the above goals are based on a perception that the exchange rate remains overvalued, particularly as compared with the swap and black market rates. Nevertheless, in our view, the multifaceted controls maintained by the central authorities over the external sector are a much more significant contributor to China's large external surpluses. Extensive liberalization of these controls is required.

Next Steps: The Treasury Department believes that it is imperative that China take steps to eliminate its pervasive controls over foreign exchange allocation and trade so as to reduce its large and destabilizing external surpluses while achieving a more market-determined system of exchange rate determination.

In that context, further devaluation of the official rate, in the absence of far-reaching reform of China's trade, foreign exchange, and domestic price regimes, is likely to exacerbate China's already large external surpluses and to raise serious concerns in the international community about China's policy objectives.

At the same time, the Chinese authorities should take a number of concrete measures to permit the exchange rate to more fully reflect market forces. These include steps to make foreign exchange allocation automatic for companies which either have import licenses or are authorized to import without licenses, thus removing foreign exchange allocation as a redundant barrier to imports. China should also loosen controls on the swap centers, expanding participation and allowable transactions, to develop the centers into true markets for foreign exchange. In addition, all rules and regulations pertaining to foreign exchange should be made publicly available, and any proposed changes to the rules published in advance for review and comment by interested parties.

These and other issues are the subject of discussions with the Chinese authorities launched by the Treasury Department in the summer of 1991. The Department intends to continue to use this forum to discuss China's foreign exchange policies and to seek a more market-oriented system of exchange rate determination and allocation. At the same time, China's trade restrictions are the subject of a U.S. Government investigation recently initiated under Section 301 of the 1974 Trade Act.

PART VI: CONCLUSION

The period since the spring report on International Economic and Exchange Rate Policy has been marked by an expansion of the challenges facing the global economy, and, in particular, the major industrialized nations.

The G-7 have had to contend with weak economic performance, with aggregate growth among them projected at slightly above 1 percent for 1991. Moreover, while aggregate G-7 economic activity is recovering, the recovery is expected to be far more modest than in the past, registering growth of 3 percent next year. Large external imbalances are reemerging in Japan, and projections suggest that imbalances may resume widening in other countries.

These developments have intensified the need for effective international economic policy coordination to achieve sustained growth with price stability. In this context, the Ministers and Governors, at their recent meeting in Bangkok, reemphasized the importance of fiscal and monetary policies which can provide the basis for lower real interest rates.

Progress is being made in this regard. Interest rates have declined in the United States, Japan, Canada, and the United Kingdom. But they remain broadly unchanged in Germany, with important influences on interest rates in continental Europe.

At the same time, the major countries have focused on developments in other parts of the globe. An increasing number of countries are joining the trend toward market-based economic reform, including Latin America, Eastern Europe, and now the Soviet Union. To support this historic trend, which carries the promise of unprecedented global integration and prosperity, the G-7, working with the international financial institutions and others, are cooperating to forge effective means for supporting economic reform.

To meet expanding global demands for capital, the G-7 stressed the need for a strengthening of global savings, which will require full implementation of measures to reduce high budget deficits and removal of obstacles to private savings. Moreover, the G-7 noted the importance of an open external environment for reforming countries and emphasized the need for a rapid and successful conclusion of the Uruguay Round.

Though the G-7 bear a special responsibility for the smooth functioning of the world economy, all countries have a role to play in promoting sustained growth with stable prices and adjustment of external imbalances. In this context, it was determined in the October 1988 and April 1989 reports that Taiwan and Korea, within the meaning of Section 3004 of the Omnibus Trade and Competitiveness Act of 1988, were "manipulating" their exchange rates against the U.S. dollar to prevent effective balance of payments adjustment or gain unfair competitive advantage in international trade. Since April of 1990, however, it has been concluded there were no indications of currency "manipulation," within the meaning of the legislation, in either Taiwan or Korea.

This report includes analyses of economic and exchange rate developments in Korea, Taiwan, and China.

The substantial adjustment in Korea's external accounts, which began in 1989, has continued. Following the small current account deficit of 1990, the first deficit since 1985, the current account deficit for 1991 is projected by the Korean government to rise to $7 billion (2.6 percent of GNP), with a trade deficit of $6 billion. The U.S. bilateral trade deficit with Korea continues its sharp decline. After a 38 percent drop in 1990, the U.S. bilateral trade deficit for the first eight months of 1991 fell 70 percent from the same period last year to $860 million. There continues to be no basis for concluding that Korea is directly "manipulating" its exchange rate: significant trade and current account deficits have emerged in 1991; Korea's foreign reserves declined in the first half of the year; there is no evidence that the Bank of Korea is intervening directly in the exchange market; and other government-owned foreign exchange banks play a modest role in the market.

Nevertheless, we remain seriously concerned that pervasive Korean exchange and capital controls significantly constrain supply and demand in the currency market. And the Korean government still lacks a well-defined strategy for full liberalization of its tightly controlled financial markets. The Treasury Department views the lack of progress in these areas as evidence of unwillingness on the part of the Korean government to undertake fundamental reform of its financial sector. We will continue to press for liberalization of Korea's financial and exchange markets, as well as to seek improved treatment for U.S. financial institutions in Korea.

Taiwan's overall current account surplus will decrease slightly in 1991 while the trade surplus will increase. Taiwan's authorities project that the current account surplus will be about $10 billion, while the trade surplus is expected to reach $13.6 billion. It is notable, however, that in the first eight months of this year, the U.S. bilateral trade deficit with Taiwan dropped sharply by nearly 20 percent to $5.1 billion. The U.S. share of Taiwan's exports fell 4.5 percent, while Taiwan's exports to China and other parts of Asia increased dramatically, evidence of Taiwan's effort to diversify markets.

Nevertheless, the persistence of large external surpluses and excessive reserve holdings (sufficient to cover 14 months of imports) remains worrisome. Substantial further adjustment is required and appreciation of the NT dollar must continue to play a role in the process.

We have no evidence of direct exchange rate "manipulation", within the meaning of the legislation. However, the Central Bank reportedly intervenes to moderate the pace of appreciation. In addition, we remain concerned that limitations on foreign exchange transactions and capital flows, though reduced, continue to impede the operation of market forces in exchange rate determination and contribute to indirect "manipulation" of the exchange rate. Moreover, U.S. financial services firms continue to face significant denials of national treatment. We will therefore continue to monitor carefully the pace of adjustment in the overall and bilateral trade balances and the role of currency appreciation in that process. In financial policy talks with Taiwan's authorities, we will continue to push for further liberalization of controls on capital and foreign exchange transactions and seek improved treatment for U.S. financial institutions.

China's current account, which had been in deficit for much of the 1980s, moved dramatically into a surplus of $10.2 billion in 1990. In 1991, the surplus has continued to expand. The trade surplus, nearly $9 billion in 1990, is projected to surpass $10 billion in 1991. By end-June 1991, foreign exchange reserves reached $35.2 billion.

A principal cause of these large external surpluses is the network of pervasive administrative controls over external trade which severely inhibit imports, including from the United States. The Chinese government manages its balance of payments in such a way as to generate a target level of foreign exchange reserves sufficient to cover critical imports, service debt, and provide a cushion against external shocks. It uses a variety of tools to manage the external balance, including foreign exchange allocation controls, import licensing, and controls over domestic economic activity, such as the price system. All of these controls must simultaneously be addressed to promote market forces in China.

While it is apparent China closely manages the trade regime, including foreign exchange allocation, to support payments objectives, there is no clear evidence the authorities manipulate the exchange rate itself within the specific terms of the legislation. Recent devaluations of the renminbi appear aimed at the goals of unifying China's dual exchange rates and eliminating costly export subsidies, although they obviously have the effect of making Chinese exports more competitive and therefore further contribute to China's surplus. In the eyes of Chinese authorities, the above goals are based on a perception that the exchange rate remains overvalued, particularly compared with swap and black market rates. Nevertheless, in our view, the multifaceted controls maintained by China over the external sector are a much more significant contributor to China's large surpluses. Extensive liberalization of these controls is required.

In the summer of 1991, the Treasury Department launched discussions with the Chinese authorities on China's foreign exchange policies. The Department intends to continue to use this forum to address concrete measures necessary to reduce control over foreign exchange allocation and permit the exchange rate to more fully reflect market forces.

APPENDIX

TABLES AND CHART

1. Economic Performance of Key Industrial Countries
2. Measurements of Dollar Movements Versus G-7 Currencies
3. Summary of U.S. Current Account
4. Summary of U.S. Capital Account Flows
5. Asian NIEs and China: Trade and Currency Changes
6. Chart: Real Trade-Weighted Exchange Rate Indices for the Dollar, Yen, and DM

Table 1

ECONOMIC PERFORMANCE OF MAJOR INDUSTRIAL COUNTRIES

I. Real GNP/GDP (percent change; annual average)

	1989	1990	1991	1992
United States	2.5	1.0	-0.2	3.2
Japan	4.7	5.6	4.5	3.4
Germany*	3.8	4.5	3.1	2.0
France	3.9	2.8	1.3	2.4
United Kingdom	1.8	0.6	-1.8	2.4
Italy	3.0	2.0	1.3	2.5
Canada	2.5	0.5	-0.9	3.8
Total G-7	3.2	2.6	1.3	2.9

II. Consumer Prices (percent change; annual average)

	1989	1990	1991	1992
United States	4.8	5.4	4.4	3.8
Japan	2.3	3.1	3.4	2.7
Germany*	2.8	2.7	3.5	3.5
France	3.5	3.4	3.3	3.0
United Kingdom	7.8	9.5	5.9	3.9
Italy	6.3	6.5	6.3	5.6
Canada	5.0	4.8	5.9	2.8
Total G-7	4.2	4.8	4.4	3.7

III. Current Account ($ billions and percent of GNP)

	1989	1990	1991	1992
United States	-106.3	-92.1	-5.0	-50.0
	(2.0)	(1.7)	(0.1)	(0.8)
Japan	57.2	35.8	62.7	59.4
	(2.0)	(1.2)	(1.9)	(1.7)
Germany*	57.2	47.9	-8.1	9.4
	(4.8)	(2.9)	(0.5)	(0.6)
France	-4.6	-8.4	-9.3	-8.0
	(0.5)	(0.7)	(0.8)	(0.7)
United Kingdom	-32.5	-24.7	-10.8	-12.3
	(3.9)	(2.5)	(1.1)	(1.2)
Italy	-10.6	-14.5	-13.2	-16.1
	(1.2)	(1.3)	(1.2)	(1.4)
Canada	-17.5	-18.9	-16.8	-14.6
	(3.2)	(3.3)	(2.8)	(2.3)

Data for U.S.: Official forecasts; for all other countries, and G-7 totals: International Monetary Fund.
* GNP and inflation data cover west Germany only; current account data cover all of Germany from 7/1/90.

Table 2

Measurements of Dollar Movements
Vs. G-7 Currencies
Percent Appreciation (+) or Depreciation (-)

Value of the Dollar in Terms of:	Since Dollar Peak 2/26/85	Since Plaza Accord 9/20/85	Since Louvre Accord 2/20/87	Over Year Since 10/18/90	Since Previous Report 4/12/91
Japanese yen	-50.3%	-46.0%	-15.4%	4.2%	-4.8%
German mark	-51.3%	-40.8%	-7.4%	12.2%	1.3%
British pound	-39.5%	-20.6%	-11.1%	13.9%	4.1%
French franc	-45.6%	-33.8%	-5.2%	14.1%	2.0%
Italian lira	-41.7%	-34.2%	-2.6%	12.0%	1.9%
Canadian dollar	-19.6%	-18.0%	-15.0%	-3.6%	-1.9%

Source: New York 9:00 a.m. exchange rates

Table 3

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

	Quarters								Annual		
	89:3	89:4	90:1	90:2	90:3	90:4	91:1	91:2	1988	1989	1990
Total Exports	90142	92493	95244	97088	96638	100580	100900	104108	320337	361451	389550
Agricultural	10145	10539	10740	10201	9819	9457	9940	9498	38237	42185	40217
NonAgricultural	79997	81954	84504	86887	86819	91123	90960	94610	282100	319266	349333
Total Imports	119330	121104	122781	121178	125398	128308	119294	119732	447323	477368	497665
Petroleum	13052	13271	15806	12825	15456	18021	13219	12904	39632	50920	62108
Non-Petroleum	106278	107833	106975	108353	109942	110287	106075	106828	407691	426448	435557
TRADE BALANCE	-29188	-28611	-27537	-24090	-28760	-27728	-18394	-15624	-126986	-115917	-108115
Partial Bal (Excl. Ag Exps & Pet imps	-26281	-25879	-22471	-21466	-23123	-19164	-15115	-12218	-125591	-107182	-86224
Net Services	6762	8955	8901	6605	9205	13607	11955	10430	15693	25102	38318
Invest. Income	499	2472	3002	7	2802	6133	4883	2464	5354	2687	11944
Other Services	6263	6483	5899	6598	6403	7474	7072	7966	10339	22415	26374
Total Transfers	-3794	-5044	-4031	-4693	-4326	-9280	16939	8160	-14943	-15492	-22330
Remits & Pensions	-1111	-1145	-1218	-1123	-1302	-1201	-1316	-1300	-4437	-4420	-4844
Govt Grants	-2683	-3899	-2813	-3570	-3024	-8079	18255	9460	-10506	-11072	-17486
NET INVISIBLES	2968	3911	4870	1912	4879	4327	28894	18590	750	9610	15988
CURRENT ACCOUNT	-26220	-24700	-22667	-22178	-23881	-23401	10500	2966	-126236	-106307	-92127
Desert shield support incl. in in transfers	n.a.	n.a.	n.a.	n.a.	n.a.	4260	22674	11617	n.a.	n.a.	4260

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

	Quarters								Annual		
	89:3	89:4	90:1	90:2	90:3	90:4	91:1	91:2	1988	1989	1990
US Reserve Assets (Incr(-)Decr(+))	-5996	-3202	-3177	371	1739	-1091	-353	1014	-3913	-25293	-2158
Other Govt Assets	564	119	-669	-800	-314	4759	1422	-560	2966	1319	2976
Foreign Official Assets	13053	-7158	-7022	5805	13341	20301	6631	-3650	39656	8623	32425
Industrial	7608	-2443	-6917	6393	13231	12840	-8411	-3291	30306	-238	25547
OPEC	4500	-1401	3094	193	-1699	575	988	-2680	-2996	10738	2163
Other	945	-3314	-3199	-781	1809	6886	14054	2321	12346	-1877	4715
Banks, net:	3859	13453	13851	-8275	16984	-7252	1803	-37935	13913	12127	15308
Claims	-24864	-23912	57085	-17255	-9984	-24513	20598	-11248	-56322	-51255	5333
Liabilities	28723	37365	-43234	8980	26968	17261	-18795	-26687	70235	63382	9975
Securities, net	13316	11109	-8510	-4733	-3548	-8773	-715	15982	38747	45963	-25564
Foreign Securities	-9651	-4503	-8756	-11160	-1014	-7546	-9430	-13235	-7845	-22575	-28476
U.S. Treasury Securities	12544	5024	-1151	4287	24	-2029	3409	13905	20239	29618	1131
Other U.S. Securities	10423	10588	1397	2140	-2558	802	5306	15312	26353	38920	1781
U.S. Direct Invest. abroad	-8114	-10168	-8985	-2858	-17792	-3802	-11852	-2642	-17882	-33387	-33437
Reinvested Earnings	-6035	-4161	-5789	-4780	-5443	-6239	-7605	-5100	-12616	-22368	-22251
Equity & Inter-co. Debt	-2079	-6007	-3196	1922	-12349	2437	-4247	2458	-5266	-11019	-11186
For. Direct Invest. in U.S.	11446	22373	16269	9346	7060	4538	4336	3276	59424	70551	37213
Reinvested Earnings	48	-2116	-3081	-912	-2760	-7256	-3958	-4325	6561	-3844	-14009
Equity & Inter-co. Debt	11398	24489	19350	10258	9820	11794	8294	7601	52863	74395	51222
Other U.S.-Corp., net	384	2691	2309	-1061	4936	-4349	-2924	n.a.	2562	8035	1835
Claims	2318	645	1649	-1760	676	-2509	-1308	n.a.	-3064	2581	-1944
Liabilities	-1934	2046	660	699	4260	-1840	-1616	n.a.	5626	5454	3779
NET CAPITAL FLOWS	28512	29217	4066	-2205	22406	4331	-1652	-24515	135473	87938	28598
Statistical Disc.	-2292	-4517	18601	24383	1475	19072	-8849	21550	-9236	18369	63531
TOTAL *	26220	24700	22667	22178	23881	23403	-10501	-2965	126237	106307	92129

ASIAN NIES AND CHINA: TRADE AND CURRENCY CHANGES

Cumulative Change against US$ as of October 18, 1991

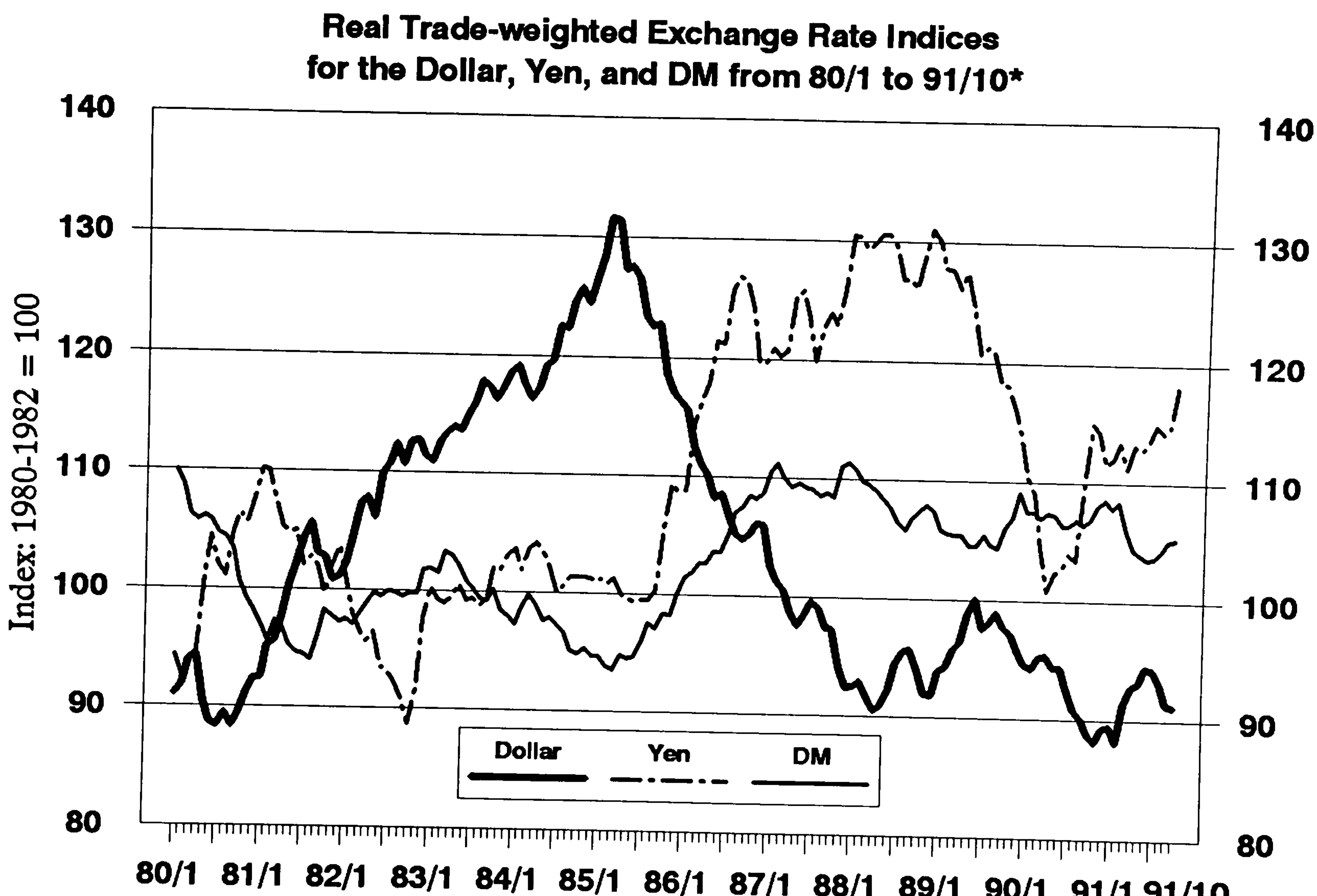
Since:	(Plaza) 9/20/85	end-86	end-87	(Report) 10/14/88	end-89	end-90
HK$	0.79%	0.47%	0.08%	0.77%	0.66%	0.59%
Won	18.52%	14.12%	4.98%	-5.88%	-10.07%	-5.07%
Singapore$	29.88%	28.02%	17.67%	19.24%	12.09%	2.57%
NT$	53.43%	34.42%	8.10%	9.43%	-0.93%	2.64%
Yen	86.60%	22.99%	-4.75%	-2.58%	10.70%	4.53%
DM	70.86%	14.80%	-5.48%	6.82%	0.11%	-11.45%
Yuan	-44.98%	-31.00%	-31.00%	-31.00%	-12.24%	-3.21%

Rate on 10/18/91	
HK$	7.7535
W	754.7
S$	1.695
NT$	26.41
Y	129.77
DM	1.689
Yuan	5.3944

* [-] signifies depreciation against the U.S. dollar.

U.S. Trade Balance with Asian NIEs and China [1]
(U.S. $ billions)

	1985	1986	1987	1988	1989	1990	1-8/90	1-8/91	% Change
Hong Kong	-5.6	-5.9	-5.9	-4.6	-3.4	-2.6	-1.7	-0.4	-74.3%
Korea	-4.1	-6.4	-8.9	-8.9	-6.3	-4.1	-2.9	-0.9	-70.6%
Singapore	-0.8	-1.3	-2.1	-2.2	-1.6	-1.8	-1.2	-0.2	-80.0%
Taiwan	-11.7	-14.3	-17.2	-12.6	-13.0	-11.2	-7.5	-6.0	-19.8%
TOTAL NIEs	-22.1	-27.8	-34.1	-28.2	-24.3	-19.7	-13.2	-7.5	-43.2%
China	0	-1.7	-2.8	-3.5	-6.2	-10.4	-6.4	-7.2	13.1%
Total U.S. Trade Bal.	-132.1	-152.7	-152.1	-118.5	-108.6	-101.0	-63.7	-39.9	-37.4%
NIEs % Total U.S. Trade Bal.	17%	18%	22%	24%	22%	20%	21%	19%	
China + NIEs % Total U.S.	17%	19%	24%	27%	28%	30%	31%	37%	



*Source:JP Morgan; 1980 trade weights (18 industrial and 22 developing countries; 1980-82=100. October 1991 data is 10/1 - 10/18.

TREASURY NEWS

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

EMBARGOED FOR RELEASE
EXPECTED AT 10:00 AM
NOVEMBER 12, 1991

STATEMENT OF THE HONORABLE
DAVID C. MULFORD
UNDER SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
UNITED STATES SENATE
NOVEMBER 12, 1991

Mr. Chairman and members of the Committee:

I am pleased to discuss the Department of the Treasury's fall 1991 report on international economic and exchange rate policy. These reports and the consultations with Congress on U.S. international economic policy have increased understanding of global economic developments and advanced U.S. international economic objectives.

Economic Policy Coordination

Starting in the mid-1980s, G-7 Finance Ministers and Central Bank Governors began to meet regularly to review their economic policies and performance and to put in place compatible policies. The aim was policy coordination of unprecedented scope, covering monetary and fiscal policies and structural policies, as well as exchange rate policy. It was understood from the beginning that the major industrial countries could not achieve their shared objectives of sustained growth with price stability without such broad cooperation.

It has not been easy to pursue such an ambitious agenda. But the effort has clearly borne fruit. We now have a well-established mechanism for consulting on G-7 economic policies. Participants now routinely consider the global economic context as they make policy decisions. Moreover, the process has broadened further to cover a wide range of international economic issues, including developments outside the G-7 economies.

Even more importantly, the G-7 process has yielded solid results in terms of G-7 economic performance.

- The major industrial countries achieved sustained growth averaging 3.3 percent per year from 1986 to 1990. This was a significant improvement over the 2.5 percent average annual growth rate for the G-7 in the first half of the 1980s.

- Higher growth was not achieved at the cost of higher inflation. The G-7 inflation rate for 1986-1990 averaged 3.4 percent per year, compared to 5.9 percent for 1981-1985.

- Exchange markets have been far more stable, reflecting achievement of exchange rates consistent with underlying fundamentals. For example, the annual range in the movement of the deutschemark against the dollar has declined from 100 pfennigs in 1985 (35 percent) to around 17 percent after 1987. This year, the range has widened slightly to about 24 percent in the wake of heightened uncertainties about developments in the Soviet Union.

Progress has been particularly striking on the problem which at the time was probably the most important catalyst for G-7 cooperation: large external imbalances. The U.S. current account deficit has plunged from its 1987 peak. This year, the U.S. current account deficit is expected to decline almost $90 billion to the $5 billion range, including large one-time Desert Storm transfer receipts. Even without Desert Storm receipts, the current account deficit for 1991 would be down to about $45 billion, sharply lower than the 1990 level of $92 billion and the 1987 peak of $160 billion.

It is important to note that this adjustment in the U.S. external position has been export driven. Since 1987, growth in our exports has averaged over 13 percent per year. Exports are contributing significantly to U.S. economic growth, particularly at this time of moderate domestic activity. In 1990 alone, real net exports accounted for over 40 percent of U.S. growth. The size of the export contribution to U.S. growth confirms the need for a continued U.S. commitment to a healthy global economy and a strong G-7 cooperative process.

Unfortunately, 1991 has not provided the G-7 an opportunity to rest on its laurels based on this record of success. The G-7 have been confronted with major challenges. Overall growth for the G-7 has slowed substantially, and the economic situations of individual G-7 members have diverged, which has led to divergent priorities.

In the first half of this year, the United States, the United Kingdom, and Canada were in recession, and economic activity in France and Italy was weak. In contrast, growth was rapid in Japan and Germany. More recently, however, the divergence has narrowed. Recovery, though sluggish, is underway in the United States, growth has picked up markedly in Canada, and the United Kingdom is moving toward recovery. But growth in Germany and Japan has slowed substantially.

Major weaknesses and risks remain. The G-7 upturn is expected to be more modest than in the past. For 1991, average growth is forecast at little more than 1 percent. And for 1992, aggregate G-growth is forecast at just under 3 percent. Moreover, large external imbalances are reemerging in Japan, and projections sugges that imbalances may resume widening in some other countries.

These conditions create a clear need for industrial countries to pursue policies that will return them to a path of sustained growth and less divergent performance. The G-7 process must adjust to changing economic conditions and prospects. Despite differing economic circumstances, participants must undertake the difficult task of reestablishing a common set of objectives and priorities. And to meet these common ends, comprehensive action must be agreed upon and implemented, encompassing all G-7 members and a broad ranc of policies.

Progress on inflation reinforces the basis for a growth-oriented strategy. Price trends have been favorable. G-7 inflation, just under 5 percent in 1990, is projected to ease to th 4-1/2 percent range this year, and to around 3-1/2 percent next year.

The G-7 Ministers and Central Bank Governors have met often this year to pursue stronger and more sustained growth. Most recently, at their mid-October meeting in Bangkok, they reemphasized the importance of fiscal and monetary policies, which, while reflecting the differing circumstances in each country, provide the basis for lower real interest rates and sustained growth with price stability. We are seeing real progress in this regard: interest rates have declined in the United States, Japan, Canada, and the United Kingdom. But they remain broadly unchanged in Germany, and high real interest rates persist internationally, hampering growth and investment.

Additional policy actions must be brought to bear in this effort. The G-7 has stressed the importance of strengthening globa savings to meet legitimate capital needs as they emerge over the medium term. This will mean full implementation of measures which have been adopted to achieve substantial reductions in budget deficits and the removal of obstacles to private savings.

The G-7 also emphasized the need for a rapid and successful conclusion of the Uruguay Round to strengthen world economic activity. Sustained growth and improved market access can provide a crucial boost to reforming countries in many regions of the world, including the Soviet Union, which are embarking on major market-oriented economic reform.

Finally, the G-7 will have to continue its record of effective cooperation on exchange markets. The benefits of G-7 cooperation were particularly evident early in the year when the dollar reached historic lows against the German mark as well as following the June G-7 Ministerial meeting, when sales of dollars contributed to a change in market views on the potential for further dollar appreciation. On balance, the dollar, despite several ups and downs this year, has continued to move in a generally stable pattern, consistent with the trend of recent years. G-7 cooperation can be seen as a critical factor in this regard.

Foreign Exchange Policies in Other Economies

The newly industrializing countries also have an important role to play in promoting sustained growth and adjustment of external imbalances. The large trade and current account surpluses that developed in several of these economies in the 1980's gave rise to concern that exchange rate policies played a role in impeding the adjustment process.

Pursuant to Section 3004, which reflected these concerns, Treasury's October 1988 report concluded that Taiwan and Korea manipulated their exchange rates, within the meaning of the legislation. Treasury subsequently initiated bilateral negotiations with Taiwan and Korea for the purpose of ensuring that these two economies regularly and promptly adjust the rate of exchange between their currencies and the U.S. dollar to permit effective balance of payments adjustment and to eliminate unfair competitive advantage in trade.

Treasury's efforts encouraged these economies to develop exchange rate policies that more fully reflect market forces. Both Korea and Taiwan introduced new exchange rate determination systems that rely more on the forces of supply and demand. These developments were reflected in reductions in the large external surpluses in both economies. In the Spring 1990 report, Treasury concluded that Taiwan and Korea were no longer directly manipulating their currencies within the meaning of the legislation, a finding reaffirmed in our subsequent reports, including this most recent one.

In the case of Korea, the balance of payments has undergone significant adjustment since 1989. Having moved into deficit in 1990 for the first time in five years, Korea's current account is expected to post a deficit of roughly $7 billion this year, while the global trade deficit is likely to be on the order of $6 billion. Bilaterally, the U.S. trade deficit with Korea fell 70 percent in the first eight months of 1991 compared with the same period of last year, and is now less than $1 billion. While the won has continued to depreciate throughout 1991, there is no evidence that the Bank of Korea is intervening in the market to encourage this depreciation. For these reasons, there is no basis for concluding that Korea is manipulating its exchange rate for purposes of competitive gain.

With regard to Taiwan, while the Central Bank occasionally intervenes in the foreign exchange market, there is no evidence of direct exchange rate manipulation within the meaning of the legislation. Taiwan's trade surplus with the U.S. has dropped by 20 percent in the first eight months of 1991 compared to the same period last year, and the NT dollar has appreciated by 2.6 percent since the end of 1990. However, the overall trade and current account surpluses are demonstrating virtually no adjustment in 1991 and still remain too large. Substantial further adjustment is required. In view of this situation and Taiwan's excessive reserve holdings, we remain strongly concerned that Taiwan's exchange rate policies, in conjunction with some continued limitations on foreign exchange transactions and capital flows, are contributing to indirect manipulation of the exchange rate. We will continue, therefore, to monitor carefully the pace of adjustment in Taiwan's overall and bilateral trade balances. We believe that currency appreciation must be a factor in that adjustment process.

We also recognize that other financial policies can also have an important effect on the currency markets. Both Korea and Taiwan maintain an array of controls over financial activity, including the activities of foreign financial firms, which severely constrain the forces of supply and demand in their economies. To address this broader need for financial market liberalization, as well as to improve the treatment of U.S. financial institutions in the two economies, the Treasury Department launched separate bilateral discussions with Taiwan and Korea.

Some progress has been achieved in these broader financial policy discussions, but much work remains to be done. In Korea, significant denials of national treatment for U.S. financial institutions remain. Moreover, the Korean government still lacks a well-defined strategy for complete liberalization of its tightly controlled financial markets. The Treasury Department views the lack of progress in these areas as evidence of unwillingness on the part of the Korean government to undertake fundamental reform of its financial sector. Indeed, we have not yet received a response from the Koreans to our communication following up on the latest round of Financial Policy Talks in late September. We had asked the Korean authorities to clarify their plans for financial market liberalization and to provide us with a broad idea of the time frame for implementation. We will continue to monitor developments in Korea's exchange rate and external adjustment, and, through our ongoing Financial Policy Talks with the Ministry of Finance, to press for liberalization of Korea's financial and exchange markets.

In Taiwan, liberalization of the financial sector is proceeding at an excessively slow pace. U.S. financial institutions are not accorded full equality of competitive opportunity, and in some cases, face outright discrimination, including restrictions on the number and location of additional bank branches. We welcome the recent announcement that Taiwan's forward foreign exchange market has been reopened as of November 1, one of the many steps Treasury has long urged Taiwan's authorities to take. Nevertheless, significant restrictions remain in this and many other areas, and should be relaxed. We will continue to indicate the depth of our concern to Taiwan's authorities, and in the ongoing talks with Taiwan's authorities, will push for more rapid liberalization of the financial sector.

Our experience with exchange rate and broader financial policies in Korea and Taiwan has been relevant to our approach to these issues in China, where the root of the problem lies in broader policies beyond the exchange rate itself.

Balance of payments developments in China continue to be a source of serious concern. China's global trade and current accounts, which moved sharply into surplus in 1990, are likely to register even larger surpluses this year. By end-June 1991, foreign exchange reserves had reached $35.2 billion. And China's large bilateral trade surplus with the United States, over $10 billion in 1990, grew 13 percent in the first eight months of 1991 over the same period of last year.

A principal cause of these large external surpluses is the network of pervasive administrative controls over external trade which severely restrict imports, including those from the United States. The Chinese government manages its trade and balance of payments in such a way as to generate sufficient foreign exchange reserves to cover critical imports and debt service payments and to provide a cushion against external shocks. It uses a variety of tools to manage the external sector, including mandatory foreign exchange surrender requirements and controls over foreign exchange allocation, import licensing, and controls over domestic economic activity, notably prices. All of these controls must simultaneously be addressed in order to promote market forces and market-oriented trade flows in China.

While it is apparent that the Chinese government closely manages the trade regime, including foreign exchange allocation, to support its balance of payments objectives, there is no clear evidence that the Chinese authorities are manipulating the exchange rate itself within the specific terms of the legislation. The recent devaluations of the renminbi appear aimed at the narrower goals of unifying China's dual exchange rates and easing the budgetary burden of export subsidies, although they obviously have the effect of making Chinese exports more competitive and therefore further contribute to China's surpluses. In the eyes of the Chinese authorities, the above goals are based on a perception that the exchange rate remains overvalued, particularly as compared with the swap and black market rates. In our view, the multifaceted controls maintained by the central authorities over the external sector are a much more significant contributor to China's large external surpluses. Extensive liberalization of these controls is required.

In the summer of 1991, the Treasury Department launched discussions with the Chinese authorities on China's foreign exchange policies. We intend to continue to use this forum to seek concrete measures to reduce control over foreign exchange allocation and permit the exchange rate to reflect market forces more fully.

Conclusion

Mr. Chairman, as the trend toward market-based economic reform sweeps the globe, I believe we have an historic opportunity to promote unprecedented integration and cooperation in the global economy. All countries must play a constructive role in meeting this challenge. We are continuing to make progress, but there is much left to be done in coordinating economic policies and sharing responsibility for promoting a healthy world economy.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 12, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,247 million of 13-week bills to be issued November 14, 1991 and to mature February 13, 1992 were accepted today (CUSIP: 912794XZ2).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.63%	4.76%	98.830
High	4.65%	4.78%	98.825
Average	4.64%	4.77%	98.827

$1,000,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 17%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	34,205	34,205
New York	32,267,145	8,405,510
Philadelphia	17,275	17,275
Cleveland	48,580	48,580
Richmond	83,170	74,870
Atlanta	35,025	30,875
Chicago	1,060,410	270,000
St. Louis	52,455	14,155
Minneapolis	21,725	13,425
Kansas City	30,220	30,220
Dallas	21,965	21,965
San Francisco	742,200	360,150
Treasury	926,245	926,245
TOTALS	$35,340,620	$10,247,475
Type		
Competitive	$30,916,540	$5,823,395
Noncompetitive	1,728,665	1,728,665
Subtotal, Public	$32,645,205	$7,552,060
Federal Reserve	2,533,010	2,533,010
Foreign Official Institutions	162,405	162,405
TOTALS	$35,340,620	$10,247,475

An additional $83,295 thousand of bills will be issued to foreign official institutions for new cash.

NB-1545

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 12, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,326 million of 26-week bills to be issued November 14, 1991 and to mature May 14, 1992 were accepted today (CUSIP: 912794YN8).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.69%	4.88%	97.629
High	4.71%	4.90%	97.619
Average	4.71%	4.90%	97.619

Tenders at the high discount rate were allotted 35%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	27,635	27,635
New York	30,465,510	9,064,810
Philadelphia	14,750	14,750
Cleveland	28,965	28,965
Richmond	126,215	88,515
Atlanta	39,430	32,400
Chicago	1,405,135	158,385
St. Louis	33,835	15,585
Minneapolis	18,895	12,395
Kansas City	38,670	38,670
Dallas	16,625	16,625
San Francisco	770,025	114,725
Treasury	712,185	712,185
TOTALS	$33,697,875	$10,325,645
Type		
Competitive	$29,387,995	$6,015,765
Noncompetitive	1,216,185	1,216,185
Subtotal, Public	$30,604,180	$7,231,950
Federal Reserve	2,550,000	2,550,000
Foreign Official Institutions	543,695	543,695
TOTALS	$33,697,875	$10,325,645

An additional $292,405 thousand of bills will be issued to foreign official institutions for new cash.

NB-1546

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
November 12, 1991

CONTACT: Office of Financing
202/ 219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 20,400 million, to be issued November 21, 1991. This offering will provide about $ 300 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 20,111 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, November 18, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Standard time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 10,200 million, representing an additional amount of bills dated August 22, 1991 and to mature February 20, 1992 (CUSIP No. 912794 YA 6), currently outstanding in the amount of $ 10,422 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 10,200 million, to be dated November 21, 1991, and to mature May 21, 1992 (CUSIP No. 912794 YP 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 November 21, 1991. In addition to the maturing 13-week and 26-week bills, there are $ 12,493 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 $ 857 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $ 1,587 million as agents for foreign and international monetary authorities, and $ 8,392 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).

NB-1547

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 competitive 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.

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.

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.

8/89

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
NOVEMBER 13, 1991

Contact: Keith Carroll
(202) 566-5252

Thomas E. Anfinson Appointed
Executive Director of the
United States Savings Bond Division

Thomas E. Anfinson was appointed executive director of the U.S. Savings Bonds Division, Department of the Treasury, by Secretary Nicholas F. Brady. He was sworn in on October 15, 1991.

As executive director, Mr. Anfinson will direct the national program for marketing and sales of U.S. Savings Bonds. This national effort uses Savings Bond division resources and volunteers from the business, banking and communications sectors.

Since 1989, Mr. Anfinson had served as deputy under secretary for management at the U.S. Department of Education. In this position, he was responsible for the overall direction and administration of the department's administrative management and financial functions.

Mr. Anfinson has served in various positions within the federal government. From 1986 to 1989, he was the chairman of the Federal Prevailing Rate Advisory Committee. Prior to this, he served as special assistant to the associate administrator of the Health Care Financing Administration at the U.S. Department of Health and Human Services. From 1985 to 1986, Mr. Anfinson was the special assistant to the assistant secretary for Employment and Training Adminstration at the U.S. Department of Labor.

Previously, Mr. Anfinson served at the U.S. Department of Housing and Urban Development. In addition to his government service, Mr. Anfinson was deputy treasurer for the Reagan-Bush 1984 Committee to Re-Elect the President.

Mr. Anfinson received his B.S. in business from the University of Southern California in 1964. He is married and has 3 children. Mr. Anfinson and his family reside in Great Falls, Virginia.

NB-1548

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PRESS RELEASE

OVERSIGHT BOARD

Resolution Trust Corporation
1777 F STREET, N.W. WASHINGTON, D.C. 20232

FOR IMMEDIATE RELEASE
November 13, 1991
OB 91-82

CONTACT: Arthur Siddon
(202)786-9675

RTC NATIONAL ADVISORY BOARD CHAIRMAN CRITICIZES RIEGLE BILL

A Senate proposal to restructure the Resolution Trust Corporation (RTC) is "deeply flawed," RTC National Advisory Board Chairman Philip F. Searle said today.

The bill, S. 1943, introduced by Senate Banking Committee Chairman Donald Riegle (D-MI), "provides no funding whatsoever for the S&L cleanup," Searle stated, and would remove critically needed independent oversight.

The RTC was established by Congress in August 1989 to manage and sell failed savings S&Ls and recover taxpayer funds through the management and sale of the institutions' assets. It currently has run out of funds, and the Administration has asked for $80 billion to complete the task of closing and selling failed institutions and paying off their depositors.

The National Advisory Board, chaired by Searle, is made up of chairpersons of the six private-sector Regional Advisory Boards established to advise the RTC on policies and programs for the disposal of real estate acquired from failed S&Ls. Searle made his comments today before a meeting of the Region 1 Board in Tampa.

The RTC proposal that the Administration took to Congress, Searle explained, not only would provide sufficient funds, but would answer Congressional concerns regarding structure "without increasing the life or the cost of the S&L cleanup" or disrupting the momentum of the RTC. It's important to note, he said, that the Administration's proposal "is strongly endorsed by the people who have to do this job -- including the new RTC CEO, Albert V. Casey."

-- more --

Searle, who earlier had been invited to testify on restructuring before the Banking Committee's Subcommittee on Consumer and Regulatory Affairs, said he was disappointed in the legislative product resulting from those hearings.

"The lack of independent oversight would put the expenditure of up to $160 billion of taxpayer funds and the disposition of huge amounts of property and securities in the hands of a fully independent board without proper oversight by the Administration, which will be held accountable," Searle stressed.

"The GAO has testified that independent oversight of the RTC's expenditures is essential," he added, and, in testimony before Congress, "I have urged that effective oversight also include RTC performance and accountability."

Searle also stressed that unless Congress provides funds by its Thanksgiving adjournment, February 1 will be the earliest such funds can next be provided. The cost of this delay, he said, "is estimated at $300 million to $400 million for the quarter -- or an average of $3 million to $4.5 million each day."

Having criticized the Senate legislation, Searle also discussed the RTC refunding bill recently reported out of the House Financial Institutions Subcommittee. Faulting this bill for not providing full funding, Searle noted that, with limited modifications, however, this legislation could be improved to provide both adequate funding and appropriate, independent oversight. The Riegle proposal, he said, could not.

Searle, retired chairman of SunBanks Inc., also criticized amendments in both bills that he said would tie the hands of the CEO, creating bureaucratic obstacles and limiting flexibility in decision making. He also pointed out several provisions -- including those "with laudable social goals" such as affordable housing, minority and women institutions and environmental concerns -- that would add "substantial additional costs to the cleanup."

Passage of "thoughtfully conceived legislation now," Searle concluded, "is critical to the future successful operation of the RTC." The Region 1 Advisory Board concurred, voting unanimously in support of Searle's views.

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 14, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $12,264 million of 52-week bills to be issued November 21, 1991 and to mature November 19, 1992 were accepted today (CUSIP: 912794ZA5).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.71%	4.97%	95.238
High	4.73%	4.99%	95.217
Average	4.72%	4.98%	95.228

Tenders at the high discount rate were allotted 9%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	14,810	14,810
New York	47,988,970	11,656,490
Philadelphia	13,115	13,115
Cleveland	10,285	10,285
Richmond	15,095	15,095
Atlanta	27,730	15,000
Chicago	1,502,110	194,210
St. Louis	18,535	8,895
Minneapolis	5,475	5,475
Kansas City	16,170	15,260
Dallas	9,880	9,880
San Francisco	914,420	68,520
Treasury	236,890	236,890
TOTALS	$50,773,485	$12,263,925
Type		
Competitive	$46,718,000	$8,208,440
Noncompetitive	475,485	475,485
Subtotal, Public	$47,193,485	$8,683,925
Federal Reserve	3,150,000	3,150,000
Foreign Official Institutions	430,000	430,000
TOTALS	$50,773,485	$12,263,925

NB-1549

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
November 14, 1991

Contact: Desiree Tucker-Sorini
202-566-8191

Statement by
Nicholas F. Brady
Secretary of the Treasury

Last night the Senate passed an amendment to S. 543 which would regulate the interest rates charged to customers by credit card companies. The result will be less credit available to the lower and middle income Americans who need it the most.

The Administration strongly supports lower credit card rates. In fact, several companies have already lowered rates charged to consumers. But we should let the market place determine the rates, not inflexible legislation that some estimate could reduce credit to Americans by $100 billion. This would only make the credit crunch worse and impede the economic recovery. This legislation could eliminate one-third to two-thirds of outstanding credit cards, is regressive and would benefit the more fortunate at the expense of the less fortunate.

We strongly oppose this amendment and will work to eliminate it from the final banking package.

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NB-1550

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TREASURY NEWS

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

FOR IMMEDIATE RELEASE
November 14, 1991

CONTACT: Cheryl Crispen
(202) 566-2041

STATEMENT BY
NICHOLAS F. BRADY
SECRETARY OF THE TREASURY

The failure of the House of Representatives to pass H.R. 2094 is a blow to taxpayers and depositors, and a step backward for banking reform. Despite this failure, today's votes show that interstate branching continues to have the support of a bipartisan majority in both the House and the Senate.

Congress must pass banking reform this year that will do more than just replenish the Bank Insurance Fund. We need legislation that addresses the underlying structural problems of the industry. Legislation that simply pours money into the Fund, without fixing the industry so that it can pay for itself would leave the taxpayer exposed and contribute to the credit crunch.

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NB-1551

TREASURY NEWS

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

FOR IMMEDIATE RELEASE
November 15, 1991

David Michael Nummy Appointed Assistant Secretary For Management

David Michael Nummy was sworn in today by Treasury Secretary Nicholas F. Brady as assistant secretary of the Treasury for management.

As assistant secretary for management, Mr. Nummy will develop and manage the budget for the Department of the Treasury and preside over the daily management and administrative affairs of the department.

Since 1989 Mr. Nummy had served as deputy assistant secretary for finance and management with the Treasury Department. Prior to joining Treasury, he was the comptroller of the Bush-Quayle '88 campaign, and comptroller for the office of the President-elect.

Mr. Nummy had previously worked with the accounting firm of Ernst & Whinney and became a Certified Public Accountant in 1980. He subsequently served on the staff of the Senate Budget Committee for several years as an analyst for the Federal Credit Programs, as senior analyst for tax policy, and as special assistant to the staff director. He also has served in the private sector as business manager for a consulting firm before joining the Bush-Quayle campaign.

Born on April 6, 1957 in Oklahoma City, Oklahoma, Mr. Nummy is the son of James A. and Dorothy A. Nummy. He received both a bachelor of science and a master of science degree from Oklahoma State University.

Mr. Nummy resides in Washington, D.C.

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 18, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,245 million of 13-week bills to be issued November 21, 1991 and to mature February 20, 1992 were accepted today (CUSIP: 912794YA6).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.54%	4.67%	98.852
High	4.58%	4.71%	98.842
Average	4.58%	4.71%	98.842

Tenders at the high discount rate were allotted 69%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	25,965	25,965
New York	30,725,315	8,882,360
Philadelphia	16,350	16,350
Cleveland	47,390	47,390
Richmond	61,860	48,760
Atlanta	26,080	24,770
Chicago	941,205	139,395
St. Louis	50,430	10,430
Minneapolis	21,650	17,000
Kansas City	29,410	29,410
Dallas	18,830	18,830
San Francisco	739,215	111,465
Treasury	872,395	872,395
TOTALS	$33,576,095	$10,244,520
Type		
Competitive	$29,115,575	$5,734,000
Noncompetitive	1,512,290	1,512,290
Subtotal, Public	$30,627,865	$7,296,290
Federal Reserve	2,708,985	2,708,985
Foreign Official Institutions	239,245	239,245
TOTALS	$33,576,095	$10,244,520

An additional $6,155 thousand of bills will be issued to foreign official institutions for new cash.

NB-1553

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
November 18, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,210 million of 26-week bills to be issued November 21, 1991 and to mature May 21, 1992 were accepted today (CUSIP: 912794YP3).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	4.59%	4.78%	97.680
High	4.62%	4.81%	97.664
Average	4.62%	4.81%	97.664

Tenders at the high discount rate were allotted 82%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	26,160	26,160
New York	26,283,840	8,890,160
Philadelphia	14,515	14,515
Cleveland	34,075	34,075
Richmond	97,235	65,935
Atlanta	23,095	22,915
Chicago	896,545	255,145
St. Louis	35,085	19,185
Minneapolis	21,380	20,480
Kansas City	30,530	30,530
Dallas	12,090	12,090
San Francisco	701,130	173,270
Treasury	645,225	645,225
TOTALS	$28,820,905	$10,209,685
Type		
Competitive	$24,279,110	$5,667,890
Noncompetitive	1,090,840	1,090,840
Subtotal, Public	$25,369,950	$6,758,730
Federal Reserve	2,650,000	2,650,000
Foreign Official Institutions	800,955	800,955
TOTALS	$28,820,905	$10,209,685

An additional $42,545 thousand of bills will be issued to foreign official institutions for new cash.

NB-1554