Department of the Treasury

PRESS RELEASES

The following numbers were not used:

JS-2341 and 2392

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 16, 2005
JS-2316

Statement by Secretary of the Treasury John Snow on the Death of John Linton

On behalf of the Treasury Department, I offer the deepest condolences to the family of John Linton, a veteran of nearly 17 years of service to the U.S. Treasury. John served honorably in Treasury's Office of Tax Policy, and news of his death came as a blow to that office, as well as to the extended Treasury family.

Among his many accomplishments at Treasury, John's work on tax-related database and modeling projects helped save and preserve over 30 years' worth of invaluable tax and economic data.

We wish his family comfort; John will be profoundly missed.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 16, 2005
JS-2317

Testimony of Robert J. Carroll
Deputy Assistant Secretary (Tax Analysis)
United States Department of the Treasury
Before the Senate Finance Committee
United States Senate

Mr. Chairman, Senator Baucus, and distinguished members of the Committee.

Thank you for the opportunity to discuss the Administration's proposals to extend expiring tax provisions.

Expiring provisions vary widely in intent and purpose from the higher expensing limits for small businesses and the research and experimentation credit to the work opportunity and welfare-to-work tax credits to the higher exemption for AMT taxpayers. As you know, many of the expiring provisions were extended through the end of 2005 by Congressional action last fall as part of the Working Families Tax Relief Act of 2004 and the American Jobs Creation Act of 2004.

The choices made with respect to expiring provisions inevitably reflect a balancing of the various and sometimes competing goals of fiscal discipline, providing a stable tax code on which households and businesses can make clear and well-informed decisions, and reevaluation of the effectiveness of special tax provisions. The President has proposed to extend many of these expiring provisions in his FY 2006 Budget.

Whether to extend these provisions and for how long is a multi-faceted and complex decision. Some of these provisions involve substantial revenue cost. Others are relatively new provisions whose temporary nature is by design to give policy makers an opportunity to evaluate their effectiveness. Still others are fully intended to be temporary, such as the provision providing 50 percent bonus depreciation, to allow the economic recovery to strengthen and provide the needed incentive for new corporate investment at just the right time.

I would like to spend a few moments providing some insights on how the Administration approached the choices with respect to expiring provisions for the FY 2006 Budget. Three factors were considered in making decisions about expiring provisions, as well as some of the other budget proposals:

1. Is the provision central to the President's program for promoting economic growth and creating jobs?
2. Should the provision be more broadly considered with reform of the tax system, a key domestic priority of the President?
3. Does the provision otherwise serve an important policy objective?

Although not the subject of this hearing, the 2001 and 2003 tax cuts were essential to the robust economic growth that we now enjoy. The tax cuts increased after-tax rewards from working and reduced taxes paid by entrepreneurs thereby increasing their rewards to innovation and risk-taking. The cost of equity capital and investing were reduced. More risk-taking, investment and innovation mean higher productivity, greater capital formation, and, ultimately, higher living standards.

Permanent extension of these tax cuts is a key component of the President's economic agenda to ensure that taxes do not increase for millions of Americans.

Households and businesses also need a predictable and stable tax code on which they can rely to make sound decisions.

There are several other provisions that fall into the first category of expiring provisions, although not necessarily core elements of the 2001 and 2003 tax cuts which are also important to achieving the nation's full potential for economic growth. The research and experimentation (R&E) tax credit provides a substantial incentive for businesses to invest in technology development and encourages innovation in the economy. The Congress acted this past fall in the Working Families Tax Relief Act to extend the R&E credit through 2005. However, businesses need the certainty and assurance of this credits' availability over the long-term to make R&D plans and commitments that can involve significant lead times. The President's FY 2006 Budget once again proposes permanent extension.

The President has made reforming our tax system a key priority. The tax code is extremely complex is perceived by many as unfair, and the compliance costs place a huge drag on our economy. Complexity arises from the myriad provisions with income phase-ins and phase-outs, numerous definitions and overlapping and duplicative purposes. This complexity translates to total compliance costs of the tax system of what experts estimate to be roughly $125 billion per year and 3.5 billion hours spent by individuals to maintain records and understand and comply with the tax system. The economic costs are even greater, with some estimates suggesting that fundamental reform could ultimately add $200 billion to $400 billion in output to our economy annually.

The President's Advisory Panel on Federal Tax Reform, named by the President earlier this year, will develop options to reform our tax system to make it simpler, fairer and more pro-growth. A number of provisions were excluded from the Budget in anticipation of this panel's work and to provide the panel with greater flexibility and latitude.

Examples of tax provisions that fall into this second category are the provisions to increase the AMT exemption and allow all personal credits to be claimed against the AMT – the so-called "AMT patch" – both of which remain in effect through 2005. These provisions were excluded from the FY 2006 Budget in anticipation of the tax panel developing a long-term solution to the AMT problem.

Similarly, extensions of the low- and moderate-income savers credit and the deduction for higher education expenses were not included as in deference to the panel's work. In last year's Budget submission, the Administration included a simplification proposal to collapse the four existing education provisions into the HOPE Scholarship and Lifetime Learning Credits. These duplicative and overlapping provisions require taxpayers to understand all four provisions to determine which they should claim. The Administration anticipates that all of these education provisions will be considered by the panel as it considers option for how the tax code can best provide appropriate incentives for individuals to invest in education.

The tax code also includes numerous provisions that allow individuals to save through tax-preferred accounts. The FY 2006 Budget again includes a proposal to consolidate many of these savings vehicles into the Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs). Similar to the education provisions, the Administration anticipates that the tax panel will broadly consider options that promote savings.

The third category of expiring provisions are those with certain policy objectives that need to be extended at least for several years to provide taxpayers a basis for planning, but that also need to remain temporary, to allow the Congress and the Administration to continue to reevaluate and monitor their effectiveness on a periodic basis. The Administration has proposed to extend many of these provisions, which are varied in their purposes, through 2007 (see Table below). One consideration in determining whether to extend these and other provisions permanently is whether the benefits they provide exceed the costs associated with their complexity.

Thank you again, Mr. Chairman, Senator Baucus, and members of the Committee for the opportunity to appear before you today. We look forward to working together with this Committee and others in the Congress on this and other issues.

REPORTS

- Tax Provisions that Expire Through FY 2006 Proposed to be Extended

Tax Provisions That Expire Through FY 2006 Proposed to be Extended			
Tax Provision	**Expiration Date**	**Proposed Expiration Date**	**Revenue Estimate, 2006-20015 (in millions)**
Leaking Underground Storage Tank Trust Fund excise tax	03/31/2005	03/31/2007	229
Various Vehicle Tax Provisions	09/30/2005	09/30/2011	65
IRS Authority for Undercover Operations	12/31/2005	12/31/2010	___
Credit for research and experimentation	12/31/2005	permanent	-76,225
Deduction for Elementary and Secondary School Teachers	12/31/2005	permanent	-2,630
Corporate Contributions of Computers to Schools Donations	12/31/2005	12/31/2006	-122
Brownfields Remediation	12/31/2005	permanent	-1,743
Credit for Electricity Production from Renewable Sources	12/31/2005	12/31/2007	-1,779
Combat Pay Included as Income for EITC Purposes	12/31/2005	12/31/2006	_____
Work Opportunity and Welfare-to-Work Tax Credits	12/31/2005	12/31/2006	-383
Qualified Zone Academy Bonds	12/31/2005	12/31/2007	-162
Tax credit for first-time DC homebuyers	12/31/2005	12/31/2006	-19
Tax information for Employment Tax Reporting and to Inform Officials of Terrorist Activity	12/31/2005	12/31/2006	_____
Disclosure of tax return information for student loans	12/31/2005	-	_____

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Tax credit for first-time DC homebuyers	12/31/2005	12/31/2006	-19
Tax information for Employment Tax Reporting and to Inform Officials of Terrorist Activity	12/31/2005	12/31/2006	_____
Disclosure of tax return information for student loans	12/31/2005	-	_____

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 16, 2005
JS-2318

Testimony of Robert Werner, Director
Office of Foreign Assets Control
U.S. Department of the Treasury
Before the House Committee on Agriculture

I. Introduction

Good morning Chairman Goodlatte; Ranking Member Peterson; and Members of the Committee. I am pleased to have been invited here today to discuss the issue of payments for United States agricultural exports to Cuba.

As you know, the Department of the Treasury's Office of Foreign Assets Control ("OFAC") is responsible for administering and enforcing economic embargoes and sanctions programs, including the embargo of Cuba. In performing its mission, OFAC relies principally on delegations of authority made pursuant to the President's broad powers under the Trading With the Enemy Act ("TWEA") and the International Emergency Economic Powers Act ("IEEPA") to prohibit or regulate commercial or financial transactions involving specific foreign countries, entities, or individuals. OFAC exercises an array of responsibilities in administering and enforcing numerous economic sanctions and embargo programs, including rulemaking; licensing; compliance-oriented outreach and education; civil penalties; referrals for criminal enforcement actions; the blocking of assets in the United States in which foreign states or persons have an interest; and required recordkeeping and reporting. We also conduct investigations and analysis in preparation for designations and drafting or implementation of new sanctions programs.

In administering and enforcing economic sanctions and embargo programs, OFAC maintains a close working relationship with numerous other federal departments and agencies to ensure that these programs are implemented properly and enforced effectively. Among the agencies OFAC works with outside the Treasury Department are: the Department of State ("State") for foreign policy guidance in promulgating regulations and in considering sensitive license applications; the Department of Commerce ("Commerce") on issues regarding exports and reexports; U.S. Customs and Border Protection and U.S. Immigration and Customs Enforcement for assistance in the many enforcement matters involving exports, imports, transportation, and travel; the bank regulatory agencies to assure bank compliance with financial restrictions; the Department of Justice on legal issues and matters in litigation; and numerous law enforcement agencies.

II. The Cuba Embargo and the Trade Sanctions Reform and Export Enhancement Act of 2000

On July 8, 1963, the United States imposed an economic embargo against Cuba in response to hostile actions by the Cuban government. The embargo was implemented by OFAC through promulgation of the Cuban Assets Control Regulations (31 CFR Part 515). Cuba is also presently listed as a state sponsor of terrorism by the Department of State.

Most relevant to today's hearing, however, is the fact that in 2000, Congress enacted the Trade Sanctions Reform and Export Enhancement Act of 2000 ("TSRA"). Among other things, this legislation directed the adjustment of restrictions on the export of agricultural commodities to countries subject to U.S. unilateral controls.

In order to implement TSRA, on July 21, 2001, OFAC published amendments to the Cuban Assets Control Regulations, as well as amendments to the Sudanese Sanctions Regulations (31 CFR Part 538), the Libyan Sanctions Regulations (31 CFR Part 550), and the Iranian Transactions Regulations (31 CFR Part 560). OFAC believes that these amendments, which were produced in consultation with other government agencies, are consistent with both the statutory language of TSRA and the intent of its drafters. We also believe that the amendments provide exporters with an efficient and expedited process for engaging in authorized exports of agricultural commodities.

With respect to Cuba, OFAC's implementation of TSRA focused on methods of payment for agricultural exports licensed by the Commerce Department.

The Cuban Assets Control Regulations, prior to the passage of TSRA, already provided a general license for transactions, including payments, incident to exportations that were licensed or otherwise authorized by the Commerce Department. This meant that an exporter who had received a Commerce license to export goods to Cuba did not need to seek further authorization from OFAC. This provision, found in §515.533 of the regulations, was amended, however, in order to implement the financing restrictions contained in TSRA. OFAC also amended §515.533 to clarify that reexports of U.S.-origin items by persons subject to the jurisdiction of the United States were also covered by the general license (§515.533 (a)) and that specific licenses would be issued for travel engaged in for the purpose of arranging licensed sales (§515.533(e)).

III. Financing Exports to Cuba

Mirroring the language in the statute, OFAC's 2001 amendment to §515.533 provides that licensed agricultural sales are authorized as long as they are financed by payment of cash in advance or through financing by a third country financial institution. With respect to third country financing, the regulation permits U.S. financial institutions to confirm or advise such financing. These provisions are reflected in §515.533(a)(2) and provide specifically that:

Only the following payment or financing terms may be used:

(i) Payment of cash in advance;

(ii) For authorized sales of agricultural items, financing by a banking institution located in a third country provided the banking institution is not a designated national, United States citizen, United States permanent resident alien, or an entity organized under the laws of the United States or any jurisdiction within the United States (including foreign branches). Such financing may be confirmed or advised by a United States banking institution.

It is important to emphasize that financing through letters of credit, by a non-target bank in a third country, has always been authorized under these provisions. That is as true today as it was when the TSRA amendments were introduced. Letters of credit are a recognized method of payment in international trade, including agriculture. When a bank issues a letter of credit, it is creating its own obligation to pay a seller, as long as the seller submits documents in accordance with the terms of the letter of credit. Such financing provides a "buffer" between the buyer and the seller with a bank substituting its name and credit for that of the buyer. In the case of OFAC's regulations, the payment to the U.S. exporter may even be guaranteed and expedited by a U.S. bank based on a credit facility with a legitimate non-target foreign bank. In terms of accommodating sales contracts, goods are often shipped before documents can be presented in letter of credit transactions; payment from a third country bank may well be received after shipment.

IV. Interpreting Section 515.533(a)(2)(i)

The term "payment of cash in advance" found in §515.533(a)(2)(i) is not defined in either TSRA, or its legislative history. Similarly, OFAC's regulations do not contain a separate definition of this term. OFAC's research indicates, however, that the commonly understood meaning of the term in the international trade finance community is that full payment for the goods is received by the exporter before the goods are shipped. And this, as will be discussed further, is the construction that OFAC applies to this term.

A complicating factor here is that the general license provisions of §515.533 made monitoring payments for agricultural shipments to Cuba difficult since, under a general license, the parties involved in the transaction had no obligation to file reports with OFAC. It is now apparent that this allowed a discrepancy to develop between OFAC's expectation of how cash in advance payments would be processed and how many exporters actually implemented this financing option.

In 2003, however, at the request of the State Department, OFAC did send out a survey to a number of U.S. exporters, asking them to certify that they were in compliance with the payment provisions of §515.533. Virtually all of the letters received in response to OFAC's inquiry merely certified that the exporters were in compliance with the "payment of cash in advance" provisions of §515.533.

A recent review of these responses has revealed that there were a handful of letters that indicated that, despite the commonly understood meaning of "payment of cash in advance" as described above, some exporters were interpreting the term to allow for the shipping of goods to Cuba provided cash payment was received prior to delivery of title to the goods. This method of payment more closely resembles a financing mechanism known in the international trade as documentary collection. A further review of these responses was not conducted.

V. Clarification of Section 515.533(a)(2)(i)

In the summer of 2004, OFAC's Compliance Division began receiving specific inquiries from U.S. financial institutions seeking guidance on the question of whether or not the shipment of goods prior to receipt of payment by U.S. exporters was permitted under §515.533(a)(2)(i).

OFAC is not certain what triggered the inquiries. We believe it may have been an article concerning agricultural trade with Cuba and methods of payment, which was published in late July (Economic Eye on Cuba, 26 July-15 August 2004). OFAC Compliance actually referred two of these cases to OFAC's Enforcement Division for investigation and notified senior OFAC management about the issue. However, OFAC found itself in the position of being unable to provide definitive guidance and began extensive consultations within Treasury and with other executive branch agencies on the interpretation of the term "payment of cash in advance." These consultations took a number of months.

As an interim step, in order to mitigate any disruption of licensed agricultural exports to Cuba, OFAC adopted a temporary policy of issuing specific licenses permitting cash payment against documents to exporters whose transactions occurred while guidance was pending. OFAC created the interim specific licensing policy to ensure that U.S. exporters received payment for goods already shipped to Cuba and the Cuban people did not see a disruption in agricultural shipments to the island.

On February 22, 2005, following the completion of the interagency consultations, OFAC announced a clarification of the term "payment of cash in advance," as set forth in §515.533(a)(2)(i), that conforms to the common understanding of the term in international trade finance described above. Specifically, OFAC confirmed that "payment of cash in advance" with regard to Commerce-licensed shipments of agricultural items to Cuba means payment of cash prior to shipment of goods. This clarification of "payment of cash in advance" had no effect on payments financed through letters of credit under §515.533(a)(2)(ii).

VI. Transition Period

The final rule on this payment policy went into effect on the day it was announced. In order to provide a transition period, the language in the final rule provides a 30-day window (March 24, 2005) for exporters to engage in transactions under financing terms resembling "cash against documents," but requires payment for such transactions to be completed within that 30-day period. Exporters will continue to need to obtain authorization from Commerce to ship the goods.

After the 30-day "cash against documents" financing period ends, any transactions under financing terms resembling "cash against documents" will be prohibited. To the extent an exporter has an existing contract that requires "cash against documents" financing transactions to occur after the 30-day period, the payment terms of that contract would need to be renegotiated to allow for cash in advance of shipment or a letter of credit issued by a third-country bank. It is consistent with the President's authority and with OFAC's past practice in other sanctions programs, such as the sanctions against Iran and Sudan, to provide for a limited grace period for export transactions under pre-existing contracts.

VII. Conclusion

OFAC believes the clarification announced on February 22, 2005, implements TSRA in a manner that is most consistent with the plain meaning of the statutory language.

It is also important to emphasize that the provisions allowing for payment through letters of credit issued by third country banks remain unaffected by the clarification of "cash payment in advance."

Thank you for the opportunity to address the Committee on this important topic.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 16, 2005
JS-2319

Remarks of U.S. Treasurer Anna Escobedo Cabral
Go Direct Partnership Recognition Event
Chicago, Illinois

Good morning and welcome to all of you. It's a pleasure to be here. It is such an honor to join in thanking you for all you have done to help us launch the Go Direct campaign here in Chicago. I applaud the efforts of each and every one of you.

Before I get into that further, I'd like to talk for just a minute about another event going on here in Chicago today – a meeting of the President's Tax Reform Panel at the University of Chicago's Graduate School of Business Gleacher Center. In recognition of the need to change our tax system, to make it fairer, simpler, and more pro-growth, the President earlier this year, created an Advisory Panel on Federal Tax Reform.

Given the fact that it's tax filing season, this may not surprise many of you, but consider this: there are over one million words in our tax code and the number of pages has doubled over the last 20 years; in 1940, it took only two pages of instructions to explain how to fill out the regular Form 1040; today, there are 36 pages of instructions accompanying the 1040 EZ or "short" form, and it takes the average taxpayer 11 hours to complete it. All in all, Americans spend upwards of $125 billion each year just to comply with their tax obligations.

Our current tax code is a complex and cluttered mess that discourages economic growth and vitality. Our tax laws penalize hard work, discourage savings and investment, and hinder the competitiveness of American businesses abroad. Compliance with the tax code is complicated and burdensome. Nobody likes paying taxes. But instead of making it as easy as possible, our tax code is an obstacle for those who want to pay their fair share.

The Panel's mandate is to propose options to reform our cumbersome tax code into something that is simpler, fairer, and more conducive to economic growth.

After holding a few meetings in Washington, the panel is now beginning to travel around the country. They intend to take a comprehensive look at our current system - making sure that we understand all of the headaches, burden, and distortions in it. They will hear from academics, economists, lawyers, accountants, individual taxpayers, and business owners.

This morning, the panel is meeting here in Chicago to get additional perspectives on the impact of the tax laws on important taxpayer decisions and how the tax system treats investment alternatives.

The Panel is in the early stages of their work - but we are confident that by July 31, 2005, they will accomplish their goal of delivering options to reform this outdated and overly complex system. Taxpayers everywhere deserve a tax code that is fair, easy to understand, and allows them to grow and flourish.

Now let me turn back to why I'm here today. I was confirmed by the Senate as the Treasurer of the United States in November of last year, and the Go Direct campaign was one of the first projects in which I became involved, shortly after being sworn in. And it has been, without question, a very positive experience. I look forward to continuing to work to convert people to direct deposit in the future.

As you all well know at this point, moving from checks to direct deposit has been a focus of the Treasury for many years. As the federal government's money manager, the Treasury Department has worked hard to increase the efficiency with which payments are made and improve the service we provide to benefit recipients

Treasury issues almost one billion payments a year, including Social Security, veterans' benefits, federal government salaries and retirement, and tax refunds. While the vast majority of these payments are already issued electronically, almost 250 million, including about 160 million benefit payments, are paid with checks – at no small cost to the taxpayer.

That is why we started down this road, and it is why we reached out to the Federal Reserve and to you for your support. The Federal Reserve's strong support and the expertise they bring to the table as well as your contributions have been absolutely critical. In my view, the success of this campaign is that it is locally driven and locally supported. The idea may have been hatched by Treasury and the Fed, but it's people like you who have brought it home.

We know that direct deposit is better for benefit recipients and you have helped us get that message out to thousands of people. That's the key. We need to make sure people are aware that direct deposit is safe, secure, fast and reliable – while it also enables Treasury to be a better, more efficient steward of taxpayer money today and for future generations – a factor that is very important as the first wave of "Baby Boomers" reaches retirement age in the next few years.

We have learned that despite all the merits, the growth rate for direct deposit has fallen in recent years, down to less than one percent annually – even while many people who receive checks are elderly, disabled, or low-income individuals who would benefit greatly from direct deposit.

That is why your support has been so important. Working side-by-side with you, we've been able to test outreach strategies, and the work we've done together over the last several months is really beginning to reveal which approaches work the best.

As you know, before we started working together, we at Treasury and the Fed realized that we needed to better understand why the direct deposit growth rate wasn't more robust. We needed some insight into why some benefit recipients are so resistant to switching. And we needed to determine how we might be able to overcome this resistance. The results of the research we did, which I'll speak to in a moment, are guiding the Go Direct marketing campaign.

One of the things the research indicated was that a sizable percentage of check recipients do see the appeal of direct deposit. In fact, about 31 percent were inclined to move to direct deposit, if properly motivated.

In addition, the research found that many individuals will react more positively to direct deposit if its benefits are presented to them by entities that they know and trust – such as community organizations, faith-based groups and local financial institutions. And, of course, that's where you came in.

We recognize that day in and day out, you work with exactly the people we are trying to reach. You work tirelessly to make the lives of these individuals better. You play such an important role in your communities.

With your help, we have already made great strides. We have reached literally thousands of benefit recipients.

And let there be no doubt - your involvement has been pivotal. Your contributions of time, access, expertise and enthusiasm truly have been invaluable. This has been a uniquely collaborative effort. And I am pleased to say that the response we have received to this effort in the communities you serve has been very positive.

The Chicago pilot was the first to be launched and really, the outpouring of support has been tremendous. Participation has been extraordinary. We have 80 partner organizations in the Illinois pilot area, including several hundred volunteers working on the ground. And there have been close to 100 events relating to the Go Direct campaign. Close to 14,000 people have attended these events.

You and your fellow Chicagoans have made remarkable progress.

Speaking on behalf of the Treasury Department and the entire Go Direct team, I want everyone in this room to know that we truly appreciate what you have done these last few months. We couldn't be more pleased that you were willing to give so much of your time and energy to this effort. Your participation and help have already made a very important difference. Thank you.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 16, 2005
JS-2320

Treasury Secretary Lauds Choice of Paul Wolfowitz to Lead World Bank

Treasury Secretary John Snow today praised the President's nomination of Paul Wolfowitz to be the next World Bank President. "The tremendously important mission of the World Bank demands that it be led by an outstanding person; someone with proven leadership skills, management experience in large organizations, international diplomatic experience, real vision, a commitment and passion for development, and the knowledge of how to make it happen. Paul Wolfowitz meets and exceeds each and all of these criteria. He is a highly qualified candidate for this post, which is one of great magnitude and far-reaching consequences. I am proud to join the President in advancing this recommendation.

"As the leading international institution charged with reducing poverty, the World Bank's purpose is noble and unique. It represents the hope of impoverished people across the globe. In considering candidates for this position, we consulted extensively with the Bank's Executive Board and Development Committee to come to a consensus on the essential qualifications of a World Bank leader as well as the timing of this selection. We wanted to find a person with the ability to build on Jim Wolfensohn's outstanding leadership and invaluable contributions. Mr. Wolfensohn has been a faithful, ardent and inspiring World Bank President; he is a tough act to follow, but I believe we have found the man who can do so and continue Jim's distinguished record of accomplishment.

"The timing of this nomination will also allow for a smooth transition, well in advance of the Spring Meetings of the World Bank and International Monetary Fund (IMF)

"We evaluated many exceptional candidates and have recommended an individual that more than meets the standards of excellence for this position. Paul Wolfowitz is a proven leader, manager and diplomat. He is the right man for the job, and the World Bank will benefit from his unique set of skills and great passion for the Bank's cause."

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 14, 2005
JS-2321

Treasury Joined by Members of Congress and Lenders to Discuss Financial Education

Treasury's Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. was today joined on Capitol Hill by Sen. Daniel Akaka (HI), Rep. Judy Biggert (IL), Rep. David Dreier (CA) and members of the lending community at the fifth in a series of six information-gathering meetings to develop a national strategy for financial education.

"Today's meetings reflect an important partnership for financial literacy: between the private and public sector, between Congress and the Administration and among numerous federal agencies," said Iannicola. "No one agency, entity or policymaker has all the right answers, but by talking and working together we're confident we can learn what we need to know to improve financial literacy in America."

Rep. Biggert spoke about the new House Financial Economic Literacy Caucus, which she launched in February with Rep. Ruben Hinojosa (TX). Rep. Dreier commended the efforts of those organizations providing financial education at the grass roots level, as well as the work of the Financial Economic Literacy Caucus and the Financial Literacy and Education Commission. Sen. Akaka underscored that while improving financial education among young people is important, adult financial literacy needs must also be a priority.

Today's meeting was part of the Financial Literacy and Education Commission's efforts to develop a national strategy for financial education. The Commission was established by the Fair and Accurate Credit Transactions Act, which was signed into law by President Bush in December of 2003. The meetings, which have included federal, state and local government, nonprofits, lending institutions, academic organizations and individuals, are to gather information about best practices for improving financial literacy among all Americans. Previous sector-specific meetings have been hosted by the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the United States Mint and the Office of Personnel Management with support from the Office of the Comptroller of the Currency, the Federal Reserve Board and the Department of Defense. The final meeting will take place on March 17 at the Department of Health and Human Services.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 16, 2005
JS-2322

Statement of Paul Wolfowitz Candidate for President of World Bank

REPORTS

- (PDF) Statement of Paul Wolfowitz Candidate for President of World Bank

Statement of Paul Wolfowitz
Candidate for President of World Bank

I appreciate Secretary Snow's counsel as I look forward to this remarkable opportunity. I have met with the President and Vice President, and am deeply grateful for their expressions of support and confidence.

Yesterday, I had an excellent conversation with Jim Wolfensohn. I know Jim well and think he's done a remarkable job. He leaves an impressive legacy and it is humbling to contemplate following in his footsteps.

I am deeply grateful to have had the chance to serve the President and the nation in my present job for the last four years. If approved by the Board, I look forward to being an international civil servant with the responsibility for heading the world's leading institution of economic development-an institution whose aim is reducing poverty and developing opportunities for all the people of the world to achieve their full potential.

People who don't know me may not understand why I am so eager to take on this challenge.

In fact, I believe deeply in the mission of the World Bank. Helping people to lift themselves out of poverty is both a noble mission and it is also a matter of enlightened self-interest. Nothing is more gratifying than being able to help people in need-as I experienced once again when I witnessed the tsunami relief operations in Indonesia and Sri Lanka. It is also a critical part of making the world a better place for all of us. It is not just poor people who benefit when poverty is reduced; we all do. It is not just the material side of life that improves: Peace and freedom are also advanced when more people can enjoy the benefits of prosperity and human dignity.

I experienced this closely and personally twenty years ago working with the Philippine people in their remarkable transition to democracy, where economic development was as critical as political development. I then spent three years in Indonesia where economic development was the most important issue on the agenda. I saw first-hand what the World Bank could accomplish, working in support of dedicated development professionals in the Indonesian government and from many donor countries.

I also saw first-hand the harm that corruption and weak institutions can inflict to defeat development and poverty reduction. That is one of many reasons why I applaud the legacy that Jim Wolfensohn will be leaving at the World Bank. He has deepened the Bank's commitment to poverty reduction, emphasizing such key factors in development as education, health-particularly HIV/AIDS, women, youth, and the environment. Jim Wolfensohn has also brought an important focus on issues of transparency, accountability and governance as critical elements of the economic development agenda-and indeed as critical elements of human progress more broadly.

I also look forward to working with the extraordinary group of professionals who work at the World Bank. The World Bank is the repository of the deepest understanding of development issues assembled in one place. It's truly exciting for me to contemplate working with such diverse talents, whose noble pursuit is nothing less than improving life opportunities for all humanity.

So, I want to extend these words to the staff of the World Bank, and its related organizations: If my nomination should be approved, I look forward to working with you. I have the highest regard for you as individuals. I have the deepest respect for all you have accomplished. And together I think we can do great things for the less fortunate of the world, and for economic development across the globe.

I also look forward to hearing the views of the many constituencies of the World Bank, borrowers and donors, governments and NGOs, as we shape a common vision of how to continue the noble work of this important institution. In order to develop my own vision, I intend to rely on a lot of listening and improving my understanding of the views of those who have served the world's poor with skill, devotion and compassion.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 17, 2005
js-2323

Key Note Address of Assistant Secretary
Juan C. Zarate
Securities Industry Association Anti-Money
Laundering Compliance Conference

NEW YORK, NY – Thank you for inviting me and other Treasury officials – including FinCEN Director Bill Fox and Office of Foreign Assets Control (OFAC) Director Bob Werner – to speak today with you. We all recognize that the Securities Industry Association is an important partner of ours on a series of critical issues – especially on the matters related to money laundering and terrorist financing. With an employee base of over 790,000 personnel, which manages accounts of nearly 93 million investors, the securities industry finds itself, along with its private sector associates, on the front lines in the defense of the financial system.

This discussion today comes amidst important changes underway in how the private sector and the government view their roles and responsibilities in preventing money laundering and terrorist financing. The tragic events of 9/11 catalyzed serious paradigmatic shifts that have required a rethinking of how the private sector and government interact – and in particular how we at the Treasury Department ensure the security of our financial system.

The fundamental premise of this shift is that the financial system is less vulnerable to abuse if there is greater domestic and international accountability and transparency in financial transactions and dealings. Whether it is in the securities sector or in the money service business context, the anti-money laundering regime must now be applied – judiciously and in a balanced manner – but applied nonetheless. Our ability to prevent flows of capital from reaching the hands of terrorists, organized criminals and rogue international actors not only affects our national security but also our direct economic interests.

As Secretary Snow has remarked, application and enforcement of the *Bank Secrecy Act* is a critical part of that responsibility. Though the transition to a higher level of due diligence and practices may sometimes be challenging, its purpose – to better protect us and our financial system from the taint of terrorist financing, money laundering, and financial crime – is an essential one. Certainly, we know that the private sector is hard at work adjusting to the expansion and deepening of the *Bank Secrecy Act* and the anti-money laundering laws and expectations.

There is no question that these responsibilities bring with them new costs and burdens. These are issues that we must consistently monitor and balance with the benefits incurred by requiring financial institutions to engage in due diligence and reporting. This balancing is at the heart of what the Treasury Department must do, and it is an assignment that requires the direct engagement of the private sector. This is precisely why Secretary Snow has directed us to ensure that the *Bank Secrecy Act* is not only being enforced aggressively, but also that we are doing so fairly and judiciously.

At the end of the day, we know that the true guardians of the financial system do not work in the halls of the Treasury building, but they are working in the brokerage houses, at teller windows and in casas de cambio. The private sector is the prime gatekeeper of the financial system. That's why this conference, and others like it, is extremely important as we talk about evolving trends in money laundering and terrorist financing and the expanded requirements under the law.

This recasting of responsibilities – for the government and the private sector – has taken shape in the context of our overarching war against terrorist financing.

Terrorist groups and networks, like organized criminal enterprises, need money to exist. They are dependent on resources to finance everything from day-to-day necessities, like food and shelter, to long-term activities, including recruitment, training and ultimately acts of terror. This is a war where we have successfully disrupted and dismantled the financial infrastructure of terrorist operations. We have choked off money channels depended on by terrorist supporters, captured or killed key terrorist facilitators and deterred donors from supporting al Qaida and other like-minded terrorist groups. All in all, we have made it harder and costlier for al Qaida and other terrorist groups to raise and move money around the world.

These are accomplishments credited to the private sector as well as government agencies. The due diligence and entries to barrier of tainted capital have made it harder and costlier to move money in the formal financial system. The private sector has had much to do with this success. You can be confident that the information provided to us by the financial community – pursuant to the *Bank Secrecy Act* – is extremely valuable. We use it every day around the country. It helps those of us in the government to find leads, develop cases, understand trends, inform our regulations and educate the regulators and the public. That's why proper filing of SARs – without defensive filing – is an important issue for us and one which we frequently address. The publication by FinCEN of SAR Activity Reviews gives a clear sense of the valuable information we see in what your institutions and others produce.

The responsibilities of the private sector to ensure compliance with our anti-money laundering laws and OFAC sanctions are issues we take seriously. The enforcement actions that we have seen over the past few months are a reflection of this. However, it is important to note that these have resulted not simply because there is a heightened environment for monitoring of such activities. Instead, we have seen institutions with fundamental, systemic failures to apply the basic standards of anti-money laundering systems. This was certainly the case with Riggs, where the lax or non-existent anti-money laundering controls and practices led to a record fine of $25 million. With UBS, we saw a straightforward decision to ignore its obligation to honor OFAC related regulations and restrictions – resulting in a $100 million fine and punitive action by Swiss authorities.

That is why we have worked very hard, through FinCEN, to make certain that the regulatory community and the Treasury are working together to ensure consistent examinations and enforcement. This is also why Secretary Snow has called upon us to work with the Department of Justice on these matters as well. Diligence in FinCEN and OFAC compliance matters must be taken seriously. This relates not only to sound practices, but also to fundamental issues of national security.

In this new environment, we, as the government, have critical responsibilities, too. Because terrorist financing transactions may bear no inherent suspicious or identifying trademarks, it is particularly important that we share more information with the financial sector, so as to allow it to recognize accounts and transactions of interest. This will be especially useful as we expand the reach of our regulations to new segments of the financial sector. This will not be an easy task, however. Much of the information relevant to terrorist financing is classified. Moreover, law enforcement is correctly reticent about sharing information that could compromise an investigation. We also need to be acutely sensitive to the privacy and reputational interests of our citizens and ensure that appropriate controls are in place to safeguard information.

Specific *USA PATRIOT Act* provisions have given us new tools to help thoughtfully fulfill our obligations to the private sector and the American public at large. With Section 314 of the *PATRIOT Act*, we are mandated to share information with and within the financial sector; that is, both vertically – between the government and the industry – and horizontally – providing a safe harbor that allows industry members to share with each other. Treasury has implemented this section by creating a "pointer" system for law enforcement. The system gives the appropriate authorities, in the right circumstances, the ability to work with FinCEN to transmit the names of persons of interest to the financial sector to determine whether those institutions possess any relevant transaction or account information.

The system has been successful, and law enforcement has affirmed its value. You have seen the statistics we publish about the number of cases that have been helped using this tool. Given its importance, FinCEN recently announced the establishment of a secure web-based 314a communications system. This is an important mechanism that will allow us to share even more information – more quickly and freely – to allow you to make better risk-based decisions.

We are also now in a position to use powers under the authorities of Section 311 of the *PATRIOT Act* – not only to protect the U.S. financial system, but also to notify the financial community of the concerns we have regarding money laundering risks. It is important to remember that the movement of money in the 21st century knows no borders, and that terrorist financing and money laundering have global reach. Financial transparency worldwide is required if we are to be effective in combating these scourges.

Section 311, which we have now used on eight occasions, allows us to protect our financial system from illicit funds emanating from jurisdictions that do not retain internationally recognized standards of anti-money laundering and counter-terrorist financing. Section 311 gives the Secretary of the Treasury the authority to prevent jurisdictions and foreign financial institutions found to be of "primary money laundering concern" from doing business with the United States. Importantly, it also sounds an alarm with banks and governments worldwide, alerting them to designated parties and their illicit activities.

Our responsibilities for greater information sharing apply in the OFAC context as well. Our policies, standards and relevant information regarding the application of our sanctions policies – in the trade and financial contexts – need to be elucidated well for all industries. Compliance with OFAC programs is a cornerstone of our ability to affect access to the U.S. markets and flows of dollars to rogue elements in the international community. That is why Director Werner has launched an outreach effort with the private sector to ensure a close working relationship that enhances the effectiveness of all of OFAC's sanctions programs.

Thus, we have a responsibility to the private sector to provide as much information and guidance as possible to ensure the proper application of these preventative systems. The Treasury – through FinCEN and OFAC – must help drive this process, along with our regulatory brethren at the federal and state levels.

In addition, the expansion of our anti-money laundering regime to new financial sectors has played a critical role in insulating our financial system against the movement of tainted capital from within the U.S. and abroad. The *PATRIOT Act* has provided us with numerous mechanisms to assist in this effort, such as those found in Sections 313, 319 and 326. The first two sections are aimed at preventing money laundering and terrorist financing through correspondent accounts maintained by U.S. banks and securities brokers on behalf of foreign banks. Specifically, Section 313 expressly prohibits shell banks from participating in the U.S. financial system and insists upon strict record-keeping regarding the ownership of each non-U.S. bank that maintains a correspondent account with a U.S. institution. Section 319 allows the U.S. to seize criminal assets through inter-bank accounts when foreign bank secrecy laws prevent law enforcement cooperation.

In addition, the application of Section 326 requirements to ensure that proper customer identification and due diligence requirements are implemented by the financial sector is important in ensuring legitimate entry into the financial system.

Beyond determined implementation of BSA and *PATRIOT Act* provisions, it is essential that we establish an embedded ethos as we move forward on efforts such as information sharing between financial institutions and government authorities, and directly between individual financial institutions. With this in mind, Treasury relies heavily on the Bank Secrecy Act Advisory Group (BSAAG) as a forum in which to discuss controversial issues and emerging threats. BSAAG is comprised of high-level representatives from financial institutions, federal law enforcement agencies, regulatory authorities and others from the private and public sectors. Through the BSAAG and other regulatory and educational seminars and programs, Treasury maintains a close relationship with U.S. financial institutions to ensure a smooth exchange of information related to money laundering and terrorist financing. We will continue to use this forum and opportunities such as this to talk about concerns the financial community has and steps we can take together to address emerging threats to all of us.

We are also improving our information sharing and collaboration internationally through the establishment of the "Buddy Bank" initiative. This program's goal is to create a culture of anti-money laundering compliance internationally in the private sector -- through private sector mentoring. We are in the process of developing such projects in Latin American and Africa, so as to ensure that the private sector around the world is fully capable to deal with and engage in the anti-money laundering campaign. We are glad to have strong partners within the private sector who are exploring the constructive and creative roles they can play internationally.

All of this represents the evolution of the post-9/11 environment – where the public and private sectors have to work hand in glove and share responsibility for the issues of money laundering and terrorist financing. In this new environment, you and your colleagues in the financial community are the guardians of the financial system. Your role of witnessing and monitoring the entry and movement of capital around the world comes with great responsibility. Your role and ours has evolved, and we must continue to work together to ensure full accountability.

Much is at stake in the battle against money laundering and terrorist financing. I thank you for your help in meeting the important challenges we face and for the opportunity to speak with you today.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 17, 2005
JS-2324

Treasury Designation Targets North Valle Drug Cartel Leader

In another step aimed at depriving Colombian narcotics traffickers of capital, the U.S. Department of the Treasury today added the name of North Valle drug cartel leader Carlos Alberto Renteria Mantilla ("Beto Renteria") to its list of Specially Designated Narcotics Traffickers (SDNTs), along with 11 front companies and individuals operating on his behalf.

"Designating Beto Renteria as a leader of North Valle cartel is a fundamental step in our battle to undermine the financial network of this notorious Colombian drug cartel," said Robert Werner, Director of the Treasury's Office of Foreign Assets Control (OFAC). "The North Valle drug cartel depends on its financial network to stay in businesses, and actions like today's can deal a serious blow to those resources."

Beto Renteria is a leading member of the North Valle drug cartel, and his involvement in narcotics trafficking has been documented back to the late 1970s. Beto Renteria is the subject of two federal criminal indictments in the United States. In 2004, the District Court for the District of Columbia charged Beto Renteria with violations of the Racketeer Influenced and Corrupt Organizations Act (RICO). Ten years prior, an indictment was filed in the Southern District of Florida charging Beto Renteria with conspiracy to import, possess and distribute cocaine in the United States. The United States is offering up to $5 million for information leading to his arrest.

This action also targets a financial network of 11 front companies and individuals that act for or on behalf of Beto Renteria. The four Colombian businesses identified today are Dimabe Ltda., Inversiones Agroindustriales del Occidente Ltda., Compania Agropecuaria del Sur Ltda. and Colombo Andino Comercial Coalsa Ltda. All four businesses are located in Bogota, Colombia. The seven Colombian individuals designated today include Beto Renteria's wife, Maria Nury Caicedo Gallego, and their key financial front man, Mauricio Pardo Ojeda.

Today's announcement is a result of OFAC's close working relationship with U.S. law enforcement authorities, and particularly in this case, the Drug Enforcement Administration (DEA).

SDNTs are subject to the economic sanctions imposed against Colombian drug cartels in Executive Order 12978. Today's action freezes any assets found in the United States and prohibits all financial and commercial transactions between the designees and any U.S. person.

The U.S. Government continues to work with and support the Colombian government in attacking the finances of Colombia's drug cartels. In February 2005, the Colombian government seized the airline Intercontinental de Aviacion, which had been designated by OFAC in October 2004 because it was owned and controlled by North Valle cartel leaders Gabriel Puerta Parra and Luis Hernandez Zea.

The assets of a total of 1,159 business and individuals in Colombia, Costa Rica, Ecuador, Panama, Peru, Spain, Vanuatu, Venezuela, the Bahamas, the British Virgin Islands and the Cayman Islands are now blocked under E.O. 12978. The 428 SDNT businesses include agricultural, aviation, consulting, construction, distribution, financial, investment, manufacturing, mining, offshore, pharmaceutical, real estate and service firms. The SDNT list includes 17 kingpins from the Cali, North Valle, and North Coast drug cartels in Colombia, including North Valle cartel leader Carlos Alberto Renteria Mantilla.

A complete list of the entities identified today can be found at: http://www.treas.gov/offices/enforcement/ofac/actions/.

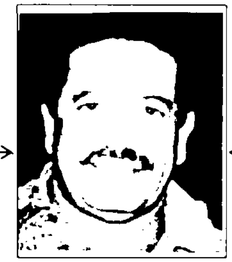
REPORTS

- Renteria Chart

Department of the Treasury
Office of Foreign Assets Control

North Valle Drug Cartel
Financial Network
March 2005

U.S. Federal Indictment
May 2004
Racketeering Influenced and Corrupt Organizations (RICO)



U.S. Federal Indictment
July 1995
Narcotics Trafficking

Carlos Alberto RENTERIA MANTILLA
a.k.a. Beto RENTERIA
a.k.a. Don Beto
C.C. 6494208
DOB 11 Mar 1945

FAMILY and COMPANY SHAREHOLDERS

Beatriz RENTERIA CAICEDO
C.C. 52424737
DOB 30 Nov 1977

Maria Nury CAICEDO GALLEGO
C.C. 31191388
DOB 16 Nov 1956

Maria RENTERIA CAICEDO
C.C. 52410645
DOB 27 May 1981

FRONT COMPANIES

Colombo Andina Comercial
Coalsa Ltda.
NIT 800084516-0

Compania Agropecuaria del Sur Ltda.
Coagrosur Ltda.
NIT 80107990-1

Inversiones Agroindustriales
del Occidente Ltda.
a.k.a. Inagroccidente
NIT 800107993-1

Dimabe Ltda.
NIT 800107988-4

FRONTMEN

Mauricio PARDO OJEDA
C.C. 19445690
DOB 27 Jul 1961

Javier CAMACHO VALLEJO
C.C. 16614154

Luis Mario CEDENO HERRERA
C.C. 16637213

Jairo Camilo COLLAZOS TELLO
C.C. 14998261
DOB 9 Dec 1953

FROM THE OFFICE OF PUBLIC AFFAIRS

March 17, 2005
JS-2325

Statement by Rob Nichols, Assistant Secretary of the Treasury for Public Affairs

Treasury Secretary John Snow, Chair of the Boards of Trustees of the Social Security and Medicare Trust Funds, has convened the spring 2005 meeting of the Boards of Trustees for Wednesday, March 23, 2005 at the Treasury Department.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 17, 2005
JS-2326

New Treasury Data Shows Tax Cuts Providing Benefits to Millions of Taxpayers

WASHINGTON, DC – New Department of the Treasury estimates released today show that over 105 million Americans will have a lighter tax bill thanks to the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. Nearly 94 million Americans benefit from the new 10% rate, 27 million families benefit from the increase in the child tax credit, and over 32 million married couples enjoy a lower tax burden thanks to the reduction of the marriage penalty.

"While no one looks forward to paying taxes, thanks to President Bush's tax cuts this tax day will be far less painful for millions of Americans," Treasury Secretary John Snow stated. "Tax relief has resulted in a growing economy that is producing jobs and creating a better standard of living for Americans. Now is the time to make tax relief permanent so that we can extend this period of economic growth and allow families to plan for their future without worrying that their taxes might be raised."

The attached table contains national and state estimates of the number of filers that benefit from tax relief.

REPORTS

- TY2003

COMBINED EFFECT OF THE
ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 (EGTRRA) &
JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003 (JGTRRA)
STATE-BY-STATE DISTRIBUTION

BASED ON NUMBER OF RETURNS FILED IN 2004 THAT WOULD HAVE BENEFITED FROM THE ACTS
(in thousands)

	Entire EGTRRA and JGTRRA Acts[1]	Specific Provisions of the Acts					Addendum: Returns with Business Income[3] Benefiting from Acts
		New 10% Bracket	Reduction in Top Rates	Reduction of Marriage Penalty	Increase in Child Tax Credit	Reduction in Rates on Capital Gains and Dividends[2]	
United States	105,607	93,925	25,615	32,655	27,205	22,116	24,148
Alabama	1,474	1,270	268	461	440	268	311
Alaska	268	246	72	82	63	59	71
Arizona	1,872	1,659	420	587	499	376	396
Arkansas	868	748	133	284	253	153	206
California	12,473	11,034	3,489	3,744	3,080	2,775	3,149
Colorado	1,712	1,548	465	559	420	383	483
Connecticut	1,382	1,247	461	445	324	348	329
Delaware	323	292	87	99	82	70	61
Florida	6,249	5,492	1,311	1,788	1,597	1,214	1,399
Georgia	2,972	2,602	691	890	838	596	694
Hawaii	485	440	114	148	117	99	123
Idaho	457	405	75	166	128	87	132
Illinois	4,640	4,151	1,250	1,437	1,200	1,017	1,013
Indiana	2,261	2,037	473	751	611	453	474
Iowa	1,070	969	199	371	284	211	288
Kansas	975	874	199	338	262	198	249
Kentucky	1,365	1,206	247	459	370	260	303
Louisiana	1,444	1,238	258	412	429	255	323
Maine	494	446	91	160	125	96	132
Maryland	2,200	1,992	712	660	549	516	481
Massachusetts	2,555	2,323	817	787	565	618	622
Michigan	3,654	3,291	934	1,202	947	785	737
Minnesota	1,969	1,799	515	663	485	440	490
Montana	328	291	50	107	84	60	106
Mississippi	888	751	133	251	278	145	182
Missouri	2,044	1,825	418	663	543	404	449
North Carolina	2,958	2,595	597	936	837	571	685
North Dakota	239	216	38	79	60	45	74
Nebraska	641	579	121	217	168	126	169
Nevada	878	791	206	254	225	178	173
New Hampshire	528	484	142	179	128	120	127
New Jersey	3,386	3,023	1,132	1,065	823	836	731
New Mexico	628	548	117	185	170	115	140
New York	6,907	6,127	1,954	1,883	1,695	1,515	1,576
Ohio	4,415	4,003	1,022	1,242	1,038	878	869
Oklahoma	1,137	993	190	381	318	209	296
Oregon	1,270	1,138	277	417	325	259	325
Pennsylvania	4,633	4,174	1,071	1,480	1,169	967	923
Rhode Island	410	373	107	123	97	88	94
South Carolina	1,430	1,252	264	426	409	261	301
South Dakota	279	250	43	92	73	52	86
Tennessee	2,030	1,781	376	642	570	382	455
Texas	7,356	6,392	1,619	2,305	2,043	1,460	1,730
Utah	779	696	143	287	218	155	202
Vermont	243	221	50	77	59	49	70
Virginia	2,861	2,570	819	932	708	657	602
Washington	2,336	2,115	614	773	587	515	534
Wisconsin	2,114	1,931	478	707	537	443	453
West Virginia	575	505	89	201	156	105	111
Wyoming	191	172	39	65	50	39	55
DC	234	210	81	33	45	53	47
Other Areas	727	612	142	157	124	150	115

Notes and footnotes appear on following page.

3-14-05

Notes

The figures in the table are based on tabulations of all individual income tax returns filed and processed through the IRS Individual Master File (IMF) during calendar year 2004. Most returns filed in 2004 were for tax year 2003.

Classification by state was based on the address used on the return. Usually this address is the taxpayer's home address. However, some taxpayers may have used the address of a tax attorney or accountant, or a place of business, and that address could be in a different state than the taxpayer's home.

Footnotes

[1] The number of returns benefiting from each of the specific provisions shown may not add to the number benefiting from the entire package because some returns will benefit from more than one provision. In addition to the provisions shown separately, the Acts included a temporary increase in exemption levels for the alternative minimum tax (AMT).

[2] Only returns with capital gains and dividend income are included. Returns reporting no such income can also benefit from the provision because they will receive higher returns on other investments.

[3] Returns with business income are those that report at least one dollar of income or loss from a sole proprietorship, farm proprietorship, partnership, S corporation, and/or rental income.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 21, 2005
js-2327

Deputy Assistant Secretary for Critical Infrastructure Protection
D. Scott Parsons Prepared Remarks
America's Community Bankers
2005 National Operations, Security & Technology Conference

Orlando, Florida

Thank you, it's a pleasure and honor to be here today representing the Bush Administration and the Treasury. I appreciate the opportunity to talk about the important role that community banks have in protecting the financial critical infrastructure.

One of the hallmarks of the Administration is the effort to strengthen our country, and that effort has been productive. Our economy is strong today and growing stronger. Last month, 262,000 new jobs were created. There are more people working in America than ever before in our nation's history. And economic growth is healthy; the Bureau of Economic Analysis last month reported a 3.8 percent increase in the gross domestic product for the fourth quarter of 2004.

The President has led the effort to protect our country against those who wish to do us harm by strengthening our borders, reforming our intelligence programs, and creating the Department of Homeland Security. He strengthened and improved the quality of education. And the President is working to strengthen retirement.

I want to spend just a moment on this because the President has made Social Security reform a priority in his second term agenda. The Social Security system is a pay-as-you-go system, which means that the payroll taxes paid by today's workers support benefits paid to today's seniors. In 1950, there were 16 workers to support every one beneficiary. Today, that number has dropped to 3.3 workers, and by the time today's young workers turn 65, there will only be 2 workers to support each beneficiary. In 2008, the baby boomer generation will begin to retire, and the number of retirees will continue to rise rapidly.

Americans are also getting older - by 2035, 20 percent of all Americans will be over the age of 65. And people are living longer - life expectancy has hit a high of 78 years. These demographic shifts have created significant challenges for Social Security and threaten its solvency.

According to the 2004 Social Security Trustees Report, the cost of doing nothing to fix the system has reached $10.4 trillion - that's twice the combined wages and salaries of every working American last year. In 2018, Social Security will begin to pay out more than it takes in. The shortfalls will grow larger with each passing year until the system is bankrupt in 2042.

The President believes this is a problem that has to be addressed now so that our children, and future generations, will not have to face these same fiscal challenges down the road. The President has put forth some basic principles for Social Security reform.

- There will be no benefit changes for those born before 1950. Social Security will not change for those 55 or older.
- The President has ruled out an increase in tax rates. We will not jeopardize the economic strength of our nation by raising payroll tax rates. The Social Security payroll tax, which was once 2 percent, is now 12.4 percent - that's $1 out of every $8 we earn.

- Another principle is fairness. We must ensure that lower-income Americans get the help they need to have dignity and peace of mind in their retirement. Reform should maintain the progressivity of the system.
- The President has also called for the establishment of personal retirement accounts. This will allow younger workers to build a nest-egg for retirement that the government cannot take away. Personal accounts offer a chance to receive a higher rate of return from sound, long-term investing beyond anything the current system can deliver. The accounts would be voluntary and offer workers various low-cost options similar to those available through the retirement system available to federal workers.

With this framework guiding us, the Administration looks forward to working with Congress to fix Social Security once and for all for future generations. I believe that a fair examination of the President's ideas will demonstrate that they will be good for all Americans and will ensure the strength of the Social Security system for future generations.

Critical Infrastructure Protection

In addition to the strength of our Social Security system, the President and Secretary Snow are concerned, as you are, with protecting the resilience and strength of our economy and financial system. At the Department of Treasury, we develop and implement policies that enhance the resilience of the economy, minimize economic damage, speed economic recovery from any adverse circumstance, and promote the protection of our critical financial infrastructure. Our process is to first identify the systemically critical infrastructures, assess vulnerabilities within those infrastructures, remediate the vulnerabilities, and measure the results. My office is responsible for protecting the critical infrastructure of the financial services sector.

America's Community Bankers are an important part of the financial infrastructure. The economy relies upon the strength and resilience of the financial system. Secretary Snow has said that "the financial system is the engine of our economy." A key insight into the strategy to protect our critical infrastructures is that the private sector owns over 90 percent of that infrastructure, and protecting the infrastructure is best accomplished through a public/private partnership. The government and the financial services sector are working together to protect our nation's critical infrastructure on both the physical and cyber front.

On the physical front, we face threats from terrorists whose objective is to create devastation, measured in the loss of lives and the destruction of property. Their techniques include the use of car bombs and homicide bombers. On the cyber front, we face threats from hackers and identity thieves who want to disrupt systems and steal from our customers and citizens.

Recently, their have been several well publicized incidents that involve the theft personal information. It is important that financial institutions continue to safeguard their customer's assets and their personal information, such as their Social Security numbers. I believe that the financial sector does a good job in this area. But I encourage you to continue to work to increase your protections, because the thieves who want to steal this information are sophisticated, adaptive, and in many cases organized. Our challenge is to work together to address these threats and make our institutions stronger. With the old adage that a chain is only as strong as its weakest link, our goal is to protect all financial institutions.

Our strategy to protect our infrastructure is built on two pillars. We have a public sector pillar, known as the Financial and Banking Information Infrastructure Committee (FBIIC), which is comprised of the federal and state financial regulators and chaired by Treasury. We also have created a private sector pillar, the Financial Services Sector Coordinating Council (FSSCC) that is comprised of the leading financial industry trade associations and financial institutions. Treasury appoints the chair of the FSSCC, and we work closely together to form policies that advance preparedness and protection. Information sharing between the government and private sector channels is the cornerstone of our strategy. Generating accurate and timely information about threats to our physical and cyber infrastructure and then sharing that information are essential outcomes of this communication. One mechanism for disseminating vital threat information is the Financial Services Information Sharing and Analysis Center (FS-ISAC). We've invested to improve the ISAC, and if you aren't already a member, I encourage you to join.

Four principles guided our actions in the aftermath of September 11 and they continue to guide our actions today. These principles form the bedrock of our collaboration with the financial sector. While we have a strong regulatory regime in place that ensures the safety and soundness of financial institutions, I believe that protecting critical infrastructure is really a risk management problem, and that there is no "one size fits all solution" to be achieved through additional regulation.

The first principle is the protection of people. We depend on people - tellers, technicians, loan officers - to operate the financial system and to see the system through during times of stress. Indeed, it was the commitment of these professionals to their institutions, customers, and colleagues that helped the financial system recover from the September 11 attacks.

The second principle is maintaining confidence in the nation's financial system. We rely on financial services, such as those provided by thousands of community banks, to process our paychecks, buy groceries, purchase a house, finance our children's education, or save for retirement. We must ensure that consumers trust in the financial system. And this in turn produces confidence.

The third principle is to ensure that the financial system remains accessible and helps keep America "open for business." When a disaster strikes, investors rely on markets to price the impact of the disruption on assets. The longer markets are closed, the longer investors must go without knowing the effects of the disaster. This uncertainty can itself be harmful to the economy, compounding the impact of any disruption. Opening financial institutions quickly reduces uncertainty, enabling us to moderate the effect of the disruption and hasten recovery.

Fourth, we encourage decentralized decision-making and swift, responsible action by the private sector. In general, financial institutions should engage in problem-solving and make appropriate decisions without waiting for guidance from Washington. The private sector owns and operates the majority of the financial systems, and therefore knows best how to mend these systems after a disruption.

As government and private industry share more and better information, financial institutions become better prepared to estimate the risks they bear and better equipped to effectively reduce the likelihood of a disruption through strategic investments. Furthermore, as more institutions enhance security and reliability, the incentive increases for competitors to invest in innovative solutions as well. In some firms, it may shift infrastructure protection from a corporate liability to an asset. Finally, an industry that responsibly protects itself reduces the need for the government to impose costly, inflexible, and potentially ineffective regulation.

The four principles - protecting people, maintaining confidence, maintaining access to financial institutions, and promoting de-centralized decision-making and responsibility - shape our policies to enhance the resilience of the U.S. economy. I thank you for your time and attention today.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 21, 2005
js-2328

Treasury and IRS Issue Regulations on the Reduction of Consolidated Attributes

WASHINGTON -- Today the Treasury Department and the Internal Revenue Service issued final regulations that provide rules for reducing tax attributes (e.g., net operating losses, tax credit carryovers) when the debt of a member of a consolidated group is forgiven. The final regulations are similar to temporary regulations that were issued in August of 2003. They provide that all of the consolidated attributes of the group are available for reduction when the debt of a member of the group is discharged. In addition, they provide a methodology for reducing attributes.

The text of the regulations is attached.

REPORTS

- Regulation Text (TD9192)

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9192]

RIN 1545-BC38; RIN 1545-BC74; RIN 1545-BC95

Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations, temporary regulations, and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 1502 of the Internal Revenue Code that govern the application of section 108 when a member of a consolidated group realizes discharge of indebtedness income. These final regulations affect corporations filing consolidated returns.

DATES: Effective Date: These regulations are effective March 21, 2005.

Applicability Dates: For dates of applicability, see §1.1502-11(c)(7), §1.1502-13(g)(3)(i)(A) and (ii)(C), §1.1502-19(h)(2)(ii), §1.1502-21(h)(6), §1.1502-28(d), and §1.1502-32(h)(7).

FOR FURTHER INFORMATION CONTACT: Concerning §1.1502-11 of the final regulations, Candace B. Ewell at (202) 622-7530 (not a toll-free number), concerning all other sections of the final regulations, Amber R. Cook at (202) 622-7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to 26 CFR part 1 under section 1502 of the Internal Revenue Code (Code). On September 4, 2003, temporary regulations (TD 9089) (the first temporary regulations) relating to the application of section 108 to members of a consolidated group were published in the **Federal Register** (68 FR 52487). A notice of proposed rulemaking (REG-132760-03) cross-referencing the first temporary regulations was published in the **Federal Register** for the same day (68 FR 52542). The first temporary regulations added §1.1502-28T, which provides guidance regarding the determination of the attributes that are available for reduction when a member of a consolidated group realizes discharge of indebtedness income that is excluded from gross income (excluded COD income) and the method for reducing those attributes. Section 1.1502-28T reflects a consolidated approach that is intended to reduce all attributes that are available to the debtor member.

Because the first temporary regulations may not have provided for the reduction of all the attributes that are available to the debtor member, on December 11, 2003, the IRS and Treasury Department published in the **Federal Register** (68 FR 69024) temporary regulations (TD 9098) (the second temporary regulations) under section 1502 amending §1.1502-28T. A notice of proposed rulemaking (REG-153319-03) cross-referencing the second temporary regulations was published in the **Federal Register** for the same day (68 FR 69062). The second temporary regulations clarify that certain attributes that arise (or are treated as arising) in a separate return year are subject to reduction when no SRLY limitation applies to the use of such attributes.

On March 15, 2004, the IRS and Treasury Department published in the **Federal Register** (69 FR 12069) temporary regulations (TD 9117) (the third temporary regulations) under section 1502 amending §§1.1502-13 and 1.1502-28T. A notice of proposed rulemaking (REG-167265-03) (the 2004 proposed regulations) cross-referencing the third temporary regulations was published in the **Federal Register** for the same day (69 FR 12091). The third temporary regulations address certain technical issues relating to the application of excluded COD income to reduce attributes under sections 108 and 1017 and §1.1502-28T.

The 2004 proposed regulations, in addition to cross-referencing the third temporary regulations, proposed amendments to §§1.1502-28T and 1.1502-11 to provide a methodology for computing consolidated taxable income and for effecting attribute reduction when there is a disposition of the stock of a member in a year during which any member realizes excluded COD income.

No public hearing was requested or held for any of the regulations described above. Written and electronic comments responding to the notices of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision, and the affected provisions in the corresponding temporary regulations are removed. The more significant revisions are discussed below.

A. Apportionment of Net Operating Losses

In addition to adding §1.1502-28T, the first temporary regulations added several provisions to §1.1502-21T. Sections 1.1502-21 and 1.1502-21T include rules relating to the amount of consolidated net operating losses apportioned to a subsidiary when a subsidiary departs from the group. The provisions added to §1.1502-21T require a recomputation of the percentage of a consolidated net operating loss attributable to a member when a portion of the loss is carried back to a separate return year or is reduced in respect of excluded COD income, or when a member departs. Questions have arisen regarding the timing of the recomputation of the percentage of a consolidated net operating loss attributable to a member in cases in which a portion of a consolidated net operating loss is carried back to a separate return year or a portion is reduced in respect of excluded COD income. Therefore, these final regulations clarify the timing of the recomputation in these cases.

B. Timing of Asset Basis Reduction

Section 108(b)(4)(A) requires the reduction of the tax attributes listed in section 108(b)(2), including basis in property, in respect of excluded COD income after the determination of the tax imposed for the taxable year of the discharge. Section 1017(a) provides that when any portion of excluded COD income is to be applied to reduce basis, then such portion is applied to reduce the basis of any property held by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge occurs. As a result of the reference in section 1017(a) to the property held by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge occurs, questions have arisen regarding the appropriate time to reduce the basis of property of the taxpayer.

The IRS and Treasury Department believe that the reference in section 1017 to the property held by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge occurs merely identifies those properties the basis of which are subject to reduction. It does not prescribe that basis of property should not be reduced until the beginning of the taxable year following the taxable year in which the discharge occurs. Accordingly, these regulations clarify that basis of property is subject to reduction pursuant to the rules of sections 108 and 1017 and §1.1502-28 after the determination of tax for the year during which the member realizes excluded COD income (and any prior years) and coincident with the reduction of other attributes pursuant to section 108 and §1.1502-28. However, only the basis of property held as of the beginning of the taxable year following the taxable year during which the excluded COD income is realized is available for reduction.

C. Application of Look-Through Rule

The first temporary regulations include a look-through rule that applies if the attribute of the debtor member reduced is the basis of stock of another member of the group. In these cases, corresponding reductions must be made to the attributes attributable to the lower-tier member. To effect those corresponding reductions, the lower-tier member is treated as realizing excluded COD income in the amount of the stock basis reduction. Questions have arisen regarding whether the look-through rule applies when there is a reduction in the basis of stock of a corporation that is a member of the group on the last day of the debtor's taxable year during which the excluded COD income is realized, but is not a member of the group on the first day of the debtor's following taxable year. For example, suppose P1 owns all of the stock of S1 and S1 owns all of the stock of S2. P1, S1, and S2 file a consolidated return. In Year 1, P1 realizes excluded COD income. On the last day of Year 1, P1 sells 50 percent of the stock of S1 to P2. P1 reduces its basis in the 50 percent of the S1 stock that it owns on the first day of Year 2 in respect of its excluded COD income. Commentators have questioned whether the look-through rule applies to reduce S1's attributes.

The IRS and Treasury Department believe that because S1 and S2 were members of the same group on the last day of the debtor's taxable year during which the excluded COD income was realized, it is appropriate to apply the single entity principles reflected in the look-through rule. The IRS and Treasury Department have also considered whether the look-through rule applies when there is a reduction in the basis of stock of a corporation that is not a member of the group on the last day of the debtor's taxable year during which the excluded COD income is realized (by reason of the application of the next day rule of §1.1502-76), but is a member of the group on the first day of the debtor's following taxable year. In these cases too, the IRS and

Treasury Department believe that it is appropriate to apply the single entity principles reflected in the look-through rule. Therefore, these regulations provide that, if the basis of stock of a corporation (the lower-tier member) that is owned by another corporation (the higher-tier member) is reduced and both of such corporations are members of the same consolidated group on the last day of the higher-tier member's taxable year that includes the date on which the excluded COD income is realized or the first day of the higher-tier member's taxable year that follows the taxable year that includes the date on which the excluded COD income is realized, the look-through rule will apply to reduce the attributes of the lower-tier member.

D. Attributes Available for Reduction on Departure of Debtor Member

Questions have arisen regarding the identification of the attributes available for reduction in cases in which the member that realizes the excluded COD income leaves the group (for example, by reason of a stock acquisition) or the assets of the member are acquired by a corporation that is not a member of the group in a transaction to which section 381(a) applies on or prior to the last day of the consolidated return year during which the excluded COD income is realized. At least one commentator has questioned whether the attributes of other members of the group from which the debtor member departs are available for reduction in these cases. These final regulations confirm that, in such cases, the tax attributes that remain after the determination of the tax imposed on the group that belong to members of the group are available for reduction.

E. Intragroup Reorganizations and Group Structure Changes

Questions have also arisen regarding the application of the attribute reduction rules when a taxpayer that is a member of a consolidated group realizes excluded COD income during the same consolidated return year during which it transfers assets in a transaction to which section

381(a) applies to a corporation that is a member of the group immediately after the transaction. Section 1.108-7 provides that if a taxpayer realizes excluded COD income either during or after a taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a), any tax attributes to which the acquiring corporation succeeds, including the basis of property acquired by the acquiring corporation in the transaction, must reflect the reductions required by section 108(b). If a member of the group transfers assets in a transaction to which section 381(a) applies to a corporation that is a member of the group immediately after the transaction and, as a result, the taxable year of the transferor member ends prior to the end of the consolidated return year, the basis of the transferred property following the transfer may generate depreciation deductions that are allowed in computing the group's consolidated taxable income for the entire consolidated return year that includes the date of the discharge. Requiring the basis of the transferred property to reflect a reduction in respect of the excluded COD income immediately after the transfer could arguably violate the directive of section 108(b)(4)(A) that attributes (including basis) be reduced only after the determination of tax for the taxable year of the discharge. However, if attributes were reduced after the determination of the group's tax for the taxable year of the discharge, it may be difficult to determine which attributes of the combined entity are attributable to the debtor member and available for reduction. For example, if after the transaction to which section 381(a) applies the acquiring corporation purchases property, it may be difficult to determine whether that property is property of the debtor the basis of which is available for reduction or property of the acquiring corporation the basis of which may not be available for reduction. Similar issues may arise with respect to other attributes of the transferor.

To address this issue, these final regulations provide that, if the taxable year of a member during which such member realizes excluded COD income ends prior to the last day of the consolidated return year and, on the first day of the taxable year of such member that follows the taxable year during which such member realizes excluded COD income, such member has a successor member, the successor member is treated as if it had realized the excluded COD income. Accordingly, all attributes of the successor member listed in section 108(b)(2) (including attributes that were attributable to the successor member prior to the date such member became a successor member) are subject to reduction prior to the attributes attributable to other members of the group. For this purpose, a successor member means a person to which the member that realizes excluded COD income transfers its assets in a transaction to which section 381(a) applies if such transferee is a member of the group immediately after the transaction. This rule avoids the difficulty of tracing attributes and property of the debtor member once the debtor member has been acquired by another member and recognizes that the direction of a transaction to which section 381(a) applies in a group may not be meaningful. These regulations provide a similar rule for cases in which a member of the group acquires the assets of another member in a transaction to which section 381(a) applies that is also a group structure change.

F. Application of Next Day Rule

Under §1.1502-76, a consolidated return must include the common parent's items of income, gain, deduction, loss, and credit for the entire consolidated return year, and each subsidiary's items for the portion of the year for which it is a member. A corporation that leaves a consolidated group during the tax year must generally file a short period separate return (or join in the consolidated return of another group) for the portion of the year not included in the consolidated return. If a corporation ceases to be a member during a consolidated return year, it ceases to be a member at the end of the day on which its status as a member changes, and its tax year ends at the end of that day. Under the next day rule, however, any transaction that occurs on the day the member ceases to be affiliated with the group that is properly allocable to the portion of the subsidiary's day after the event terminating affiliation must be treated as occurring at the beginning of the following day. Commentators have questioned whether the next day rule can be applied when the debt of a subsidiary is discharged in exchange for stock of the subsidiary and, as a result of the issuance of the subsidiary's stock to the creditor, the subsidiary ceases to be a member of the group. As a result of the application of that rule, the excluded COD income would be treated as realized at the beginning of the day following the day the subsidiary ceases to be a member of the group, rather than on the day it ceases to be a member of the group.

The IRS and Treasury Department believe that because the excluded COD income accrued in the group, it is not appropriate to apply the next day rule in these cases. Therefore, these regulations provide that the next day rule cannot be applied to treat excluded COD income as realized at the beginning of the day following the day on which it is realized.

G. Timing of Investment Adjustments

Under §1.1502-32, excluded COD income of a subsidiary results in a positive basis adjustment to the extent it is applied to reduce attributes and the reduction of the subsidiary's attributes (other than credits) in respect of excluded COD income will generally result in a negative basis adjustment. Commentators have requested clarification regarding when these basis adjustments are effective in cases in which a subsidiary ceases to be a member of the group on or prior to the end of the consolidated return year during which a member realizes excluded COD income. Therefore, these regulations clarify that, in those cases, basis adjustments resulting from the realization of excluded COD income and from the reduction of attributes in respect thereof are made immediately after the determination of tax for the group for the consolidated return year during which the excluded COD income is realized (and any prior years) and are effective immediately before the beginning of the day following the day the member departs from the group. Therefore, if the departing member becomes a member of another group (the new group), the adjustments to the basis of the departing member's stock in respect of the excluded COD income will not cause stock basis adjustments in the new group.

H. Elimination of Circular Stock Basis on Disposition of Member Stock

The 2004 proposed regulations provide a methodology for computing consolidated taxable income and for effecting attribute reduction when there is a disposition of member stock during the same taxable year in which any member realizes excluded COD income. The methodology is intended to prevent the reduction of tax attributes from affecting the basis of the member stock that is sold, which would affect the tax liability of the group for the taxable year of the discharge. Accordingly, the methodology limits the actual reduction of tax attributes to the amount of tax attributes available for reduction following the tentative computation of taxable income (or loss).

Commentators have noted, however, that pursuant to section 108(b)(4)(A), attributes are reduced only after the determination of tax for the taxable year of the discharge. Computing the limitation on attribute reduction based on the tax attributes remaining after a tentative computation of taxable income (or loss) does not account for the use of credits in the computation of the group's tax liability for the taxable year of the discharge. Therefore, in response to these comments, the final regulations provide for the computation of the limitation on attribute reduction after the computation of the tax imposed by chapter 1 of the Code, rather than after the computation of taxable income (or loss).

I. Transactions Designed to Avoid the Application of the Attribute Reduction Rules

The preamble to the first temporary regulations stated that the IRS and Treasury Department are considering adopting rules under section 1502 (and possibly other Code sections) to address the effect of transitory transactions and other transactions designed to avoid the application of the rules concerning attribute reduction. The IRS and Treasury Department continue to believe that general principles (including step transaction doctrine) could be applied to disregard certain transactions that have the effect of changing the result of the application of the attribute reduction rules. Therefore, the IRS and Treasury Department have decided not to adopt any additional rules at this time.

J. Elective Retroactive Application of Final Regulation

The portion of these regulations finalizing the rules contained in §1.1502-28T apply to discharges of indebtedness that occur after March 21, 2005. Groups, however, may apply those rules in whole, but not in part, to discharges of indebtedness that occur on or before March 21, 2005 and after August 29, 2003.

These regulations also permit further retroactive application of a rule included in the third temporary regulations that prevents the potential duplication of ordinary income recapture under section 1245 that could be caused by reason of the application of both section 1245 and either section 1017(b)(3)(D) (which permits subsidiary stock to be treated as depreciable property to the extent that the subsidiary consents to a corresponding reduction in the basis of its depreciable property) or the look-through rule. This section 1245 rule provides that a reduction of the basis of subsidiary stock is treated as a deduction allowed for depreciation only to the extent that the amount by which the basis of the subsidiary stock is reduced exceeds the total amount of the attributes attributable to such subsidiary that are reduced pursuant to the subsidiary's consent under section 1017(b)(3)(D) or as a result of the application of the look-through rule. The third temporary regulations made this special rule effective for discharges of indebtedness that occur after August 29, 2003, the effective date of the look-through rule. The IRS and Treasury Department are aware that the problem addressed by this special rule could have occurred in cases of discharges of indebtedness that occurred before August 29, 2003, if section 1017(b)(3)(D) was applied. Accordingly, these final regulations provide that groups may apply this special rule to discharges of indebtedness that occur on or before August 29, 2003, in cases in which section 1017(b)(3)(D) was applied.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Further, it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file a consolidated return, which tend to be larger businesses. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notices of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Amber R. Cook of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.1502-13T, 1.1502-19T, and 1.1502-28T and adding the following entry in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805. * * *

Section 1.1502-28 also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502-11 is amended as follows:

1. Paragraph (b)(1) is revised.

2. Paragraph (c) is redesignated as paragraph (d).

3. New paragraph (c) is added.

The revision and addition read as follows:

§1.1502-11 Consolidated taxable income.

* * * * *

(b) Elimination of circular stock basis adjustments when there is no excluded COD income--(1) In general. If one member (P) disposes of the stock of another member (S), this paragraph (b) limits the use of S's deductions and losses in the year of disposition and the carryback of items to prior years. The purpose of the limitation is to prevent P's income or gain from the disposition of S's stock from increasing the absorption of S's deductions and losses, because the increased absorption would reduce P's basis (or increase its excess loss account) in S's stock under §1.1502-32 and, in turn, increase P's income or gain. See paragraph (b)(3) of this section for the application of these principles to P's deduction or loss from the disposition of S's stock, and paragraph (b)(4) of this section for the application of these principles to multiple stock dispositions. This paragraph (b) applies only when no member realizes discharge of indebtedness income that is excluded from gross income under section 108(a) (excluded COD income) during the taxable year of the disposition. See paragraph (c) of this section for rules that apply when a member realizes excluded COD income during the taxable year of the disposition. See §1.1502-19(c) for the definition of disposition.

* * * * *

(c) Elimination of circular stock basis adjustments when there is excluded COD income--(1) In general. If one member (P) disposes of the stock of another member (S) in a year during which any member realizes excluded COD income, this paragraph (c) limits the use of S's deductions and losses in the year of disposition and the carryback of items to prior years, the amount of the attributes of certain members that can be reduced in respect of excluded COD income of certain other members, and the attributes that can be used to offset an excess loss account taken into account by reason of the application of §1.1502-19(c)(1)(iii)(B). In addition to the purpose set forth in paragraph (b)(1) of this section, the purpose of these limitations is to prevent the reduction of tax attributes in respect of excluded COD income from affecting P's income, gain, or loss on the disposition of S stock (including a disposition of S stock that results from the application of §1.1502-19(c)(1)(iii)(B)) and, in turn, affecting the attributes available for reduction pursuant to sections 108 and 1017 and §1.1502-28. See §1.1502-19(c) for the definition of disposition.

(2) Computation of tax liability, reduction of attributes, and computation of limits on absorption and reduction of attributes. If a member realizes excluded COD income in the taxable year during which P disposes of S stock, the steps used to compute tax liability, to effect the reduction of attributes, and to compute the limitations on the absorption and reduction of attributes are as follows. These steps also apply to determine whether and to what extent an excess loss account must be taken into account as a result of the application of §1.1502-19(b)(1) and (c)(1)(iii)(B).

(i) Limitation on deductions and losses to offset income or gain. First, the determination of the extent to which S's deductions and losses for the tax year of the disposition (and its deductions and losses carried over from prior years) may offset income and gain is made pursuant to paragraphs (b)(2) and (3) of this section.

(ii) Tentative adjustment of stock basis. Second, §1.1502-32 is tentatively applied to adjust the basis of the S stock to reflect the amount of S's income and gain included, and unlimited deductions and losses that are absorbed, in the tentative computation of taxable income or loss for the year of the disposition (and any prior years) that is made pursuant to paragraph (b)(2) of this section, but not to reflect the realization of excluded COD income and the reduction of attributes in respect thereof.

(iii) Tentative computation of stock gain or loss. Third, in the case of a disposition of S stock that does not result from the application of §1.1502-19(c)(1)(iii)(B), P's income, gain, or loss from the disposition of S stock is computed. For this purpose, the result of the computation pursuant to paragraph (c)(2)(ii) of this section is treated as the basis of such stock.

(iv) Tentative computation of tax imposed. Fourth, the tax imposed by chapter 1 of the Internal Revenue Code for the year of disposition (and any prior years) is tentatively computed. For this purpose, in the case of a disposition of S stock that does not result from the application of §1.1502-19(c)(1)(iii)(B), the tentative computation of tax imposed takes into account P's income, gain, or loss from the disposition of S stock computed pursuant to paragraph (c)(2)(iii) of this section. The tentative computation of tax imposed is made without regard to whether all or a portion of an excess loss account in a share of S stock is required to be taken into account pursuant to §1.1502-19(b)(1) and (c)(1)(iii)(B).

(v) Tentative reduction of attributes. Fifth, the rules of sections 108 and 1017 and §1.1502-28 are tentatively applied to reduce the attributes remaining after the tentative computation of tax imposed pursuant to paragraph (c)(2)(iv) of this section.

(vi) Actual adjustment of stock basis. Sixth, §1.1502-32 is applied to reflect the amount of S's income and gain included, and unlimited deductions and losses that are absorbed, in the tentative computation of tax imposed for the year of the disposition (and any prior years) made pursuant to paragraph (c)(2)(iv) of this section, and the excluded COD income applied to reduce attributes and the attributes tentatively reduced in respect of the excluded COD income pursuant to paragraph (c)(2)(v) of this section.

(vii) Actual computation of stock gain or loss. Seventh, the group's actual gain or loss on the disposition of S stock (including a disposition that results from the application of §1.1502-19(c)(1)(iii)(B)) is computed. The result of the computation pursuant to paragraph (c)(2)(vi) of this section is treated as the basis of such stock.

(viii) Actual computation of tax imposed. Eighth, the tax imposed by chapter 1 of the Internal Revenue Code for the year of the disposition (and any prior years) is computed. The actual tax imposed on the group for the year of the disposition is computed by applying the limitation computed pursuant to paragraph (c)(2)(i) of this section, and by including the gain or loss recognized on the disposition of S stock computed pursuant to paragraph (c)(2)(vii) of this section. However, attributes that were tentatively used in the computation of tax imposed pursuant to paragraph (c)(2)(iv) of this section and attributes that were tentatively reduced pursuant to paragraph (c)(2)(v) of this section cannot offset any excess loss account taken into account as a result of the application of §1.1502-19(b)(1) and (c)(1)(iii)(B).

(ix) Actual reduction of attributes. Ninth, the rules of sections 108 and 1017 and §1.1502-28 are actually applied to reduce the attributes remaining after the actual computation of tax imposed pursuant to paragraph (c)(2)(viii) of this section.

(A) S or a lower-tier corporation realizes excluded COD income. If S or a lower-tier corporation of S realizes excluded COD income, the aggregate amount of excluded COD income that is applied to reduce attributes attributable to members other than S and any lower-tier corporation of S pursuant to this paragraph (c)(2)(ix) shall not exceed the aggregate amount of excluded COD income that was tentatively applied to reduce attributes attributable to members other than S and any lower-tier corporation of S pursuant to paragraph (c)(2)(v) of this section. The amount of the actual reduction of attributes attributable to S and any lower-tier corporation of S that may be reduced in respect of the excluded COD income of S or a lower-tier corporation of S shall not be so limited.

(B) A member other than S or a lower-tier corporation realizes excluded COD income. If a member other than S or a lower-tier corporation of S realizes excluded COD income, the aggregate amount of excluded COD income that is applied to reduce attributes (other than credits) attributable to S and any lower-tier corporation of S pursuant to this paragraph (c)(2)(ix) shall not exceed the aggregate amount of excluded COD income that was tentatively applied to reduce attributes (other than credits) attributable to S and any lower-tier corporation of S pursuant to paragraph (c)(2)(v) of this section. The amount of the actual reduction of attributes attributable to any member other than S and any lower-tier corporation of S that may be reduced in respect of the excluded COD income of S or a lower-tier corporation of S shall not be so limited.

(3) Special rules. (i) If the reduction of attributes attributable to a member is prevented as a result of a limitation described in paragraph (c)(2)(ix)(B) of this section, the excluded COD income that would have otherwise been applied to reduce such attributes is applied to reduce the remaining attributes of the same type that are available for reduction under §1.1502-28(a)(4), on a pro rata basis, prior to reducing attributes of a different type. The reduction of such remaining attributes, however, is subject to any applicable limitation described in paragraph (c)(2)(ix)(B) of this section.

(ii) To the extent S's deductions and losses in the year of disposition (or those of a lower-tier corporation of S) cannot offset income or gain because of the limitation under paragraph (b) of this section or this paragraph (c) and are not reduced pursuant to sections 108 and 1017 and §1.1502-28, such items are carried to other years under the applicable provisions of the Internal Revenue Code and regulations as if they were the only items incurred by S (or a lower-tier corporation of S) in the year of disposition. For example, to the extent S incurs an operating loss in the year of disposition that is limited and is not reduced pursuant to section 108 and §1.1502-28, the loss is treated as a separate net operating loss attributable to S arising in that year.

(4) Definition of lower-tier corporation. A corporation is a lower-tier corporation of S if all of its items of income, gain, deduction, and loss (including the absorption of deduction or loss

and the reduction of attributes other than credits) would be fully reflected in P's basis in S's stock under §1.1502-32.

(5) Examples. For purposes of the examples in this paragraph (c), unless otherwise stated, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, all transactions are between unrelated persons, tax liabilities are disregarded, and no election under section 108(b)(5) is made. The principles of this paragraph (c) are illustrated by the following examples:

Example 1. Departing member realizes excluded COD income. (i) Facts. P owns all of S's stock with a $90 basis. For Year 1, P has ordinary income of $30, and S has an $80 ordinary loss and $100 of excluded COD income from the discharge of non-intercompany indebtedness. P sells the S stock for $20 at the close of Year 1. As of the beginning of Year 2, S has Asset A with a basis of $0 and a fair market value of $20.

(ii) Analysis. The steps used to compute the tax imposed on the group, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain. To determine the amount of the limitation under paragraph (c)(2)(i) of this section on S's loss and the effect of the absorption of S's loss on P's basis in S's stock under §1.1502-32(b), P's gain or loss from the disposition of S's stock is not taken into account. The group is tentatively treated as having a consolidated net operating loss of $50 (P's $30 of income minus S's $80 loss). Thus, $30 of S's loss is unlimited and $50 of S's loss is limited under paragraph (c)(2)(i) of this section. Under the principles of §1.1502-21(b)(2)(iv), all of the consolidated net operating loss is attributable to S.

(B) Tentative adjustment of stock basis. Then, pursuant to paragraph (c)(2)(ii) of this section, §1.1502-32 is tentatively applied to adjust the basis of S stock. For this purpose, however, adjustments attributable to the excluded COD income and the reduction of attributes in respect thereof are not taken into account. Under §1.1502-32(b), the absorption of $30 of S's loss decreases P's basis in S's stock by $30 to $60.

(C) Tentative computation of stock gain or loss. Then, P's income, gain, or loss from the sale of S stock is computed pursuant to paragraph (c)(2)(iii) of this section using the basis computed in the previous step. Thus, P is treated as recognizing a $40 loss from the sale of S stock.

(D) Tentative computation of tax imposed. Pursuant to paragraph (c)(2)(iv) of this section, the tax imposed for the year of disposition is then tentatively computed, taking into account P's $40 loss on the sale of the S stock computed pursuant to paragraph (c)(2)(iii) of this section. The group has a $50 consolidated net operating loss for Year 1 that, under the principles of §1.1502-21(b)(2)(iv), is wholly attributable to S and a consolidated capital loss of $40 that, under the principles of §1.1502-21(b)(2)(iv), is wholly attributable to P.

(E) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28 are tentatively applied to reduce attributes remaining after the tentative computation of the tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S would first be reduced to take into account its $100 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 would be reduced by $50, the portion of that consolidated net operating loss attributable to S under the principles of §1.1502-21(b)(2)(iv), to $0. Then, pursuant to §1.1502-28(a)(4), S's remaining $50 of excluded COD income would reduce the consolidated capital loss attributable to P of $40 by $40 to $0. The remaining $10 of excluded COD income would have no effect.

(F) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, §1.1502-32 is applied to reflect the amount of S's income and gain included, and unlimited deductions and losses that are absorbed, in the tentative computation of the tax imposed for the year of the disposition and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32(b), the absorption of $30 of S's loss, the application of $90 of S's excluded COD income to reduce attributes of P and S, and the reduction of the $50 loss attributable to S in respect of the excluded COD income results in a positive adjustment of $10 to P's basis in the S stock. P's basis in the S stock, therefore, is $100.

(G) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, P's actual gain or loss on the sale of the S stock is computed using the basis computed in the previous step. Accordingly, P recognizes an $80 loss on the disposition of the S stock.

(H) Actual computation of tax imposed. Pursuant to paragraph (c)(2)(viii) of this section, the tax imposed is computed by taking into account P's $80 loss from the sale of S stock. Before the application of §1.1502-28, therefore, the group has a consolidated net operating loss of $50 that is wholly attributable to S under the principles of §1.1502-21(b)(2)(iv), and a consolidated capital loss of $80 that is wholly attributable to P under the principles of §1.1502-21(b)(2)(iv).

(I) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and §1.1502-28 are then actually applied to reduce attributes remaining after the actual computation of the tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S must first be reduced to take into account its $100 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 is reduced by $50, the portion of that consolidated net operating loss attributable to S under the principles of §1.1502-21(b)(2)(iv), to $0. Then, pursuant to §1.1502-28(a)(4), S's remaining $50 of excluded COD income reduces consolidated tax attributes. In particular, without regard to the limitation imposed by paragraph (c)(2)(ix)(A) of this section, the $80 consolidated capital loss, which under the principles of §1.1502-21(b)(2)(iv) is attributable to P, would be reduced by $50 from $80 to $30. However, the limitation imposed by paragraph (c)(2)(ix)(A) of this section prevents the reduction of the consolidated capital loss attributable to P by more than $40. Therefore, the consolidated capital loss attributable to P is reduced by only $40 in respect of S's excluded COD income. The remaining $10 of excluded COD income has no effect.

Example 2. Member other than departing member realizes excluded COD income. (i) Facts. P owns all of S1's and S2's stock. P's basis in S2's stock is $600. For Year 1, P has ordinary income of $30, S1 has a $100 ordinary loss and $100 of excluded COD income from the discharge of non-intercompany indebtedness, and S2 has $200 of ordinary loss. P sells the S2 stock for $600 at the close of Year 1. As of the beginning of Year 2, S1 has Asset A with a basis of $0 and a fair market value of $10.

(ii) Analysis. The steps used to compute the tax imposed on the group, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain. To determine the amount of the limitation under paragraph (c)(2)(i) of this section on S2's loss and the effect of the absorption of S2's loss on P's basis in S2's stock under §1.1502-32(b), P's gain or loss from the sale of S2's stock is not taken into account. The group is tentatively treated as having a consolidated net operating loss of $270 (P's $30 of income minus S1's $100 loss and S2's $200 loss). Consequently, $20 of S2's loss from Year 1 is unlimited and $180 of S2's loss from Year 1 is limited under paragraph (c)(2)(i) of this section. Under the principles of §1.1502-21(b)(2)(iv), $90 of the consolidated net operating loss is attributable to S1 and $180 of the consolidated net operating loss is attributable to S2.

(B) Tentative adjustment of stock basis. Then, pursuant to paragraph (c)(2)(ii) of this section, §1.1502-32 is tentatively applied to adjust the basis of S2's stock. For this purpose, however, adjustments to the basis of S2's stock attributable to the reduction of attributes in respect of S1's excluded COD income are not taken into account. Under §1.1502-32(b), the absorption of $20 of S2's loss decreases P's basis in S2's stock by $20 to $580.

(C) Tentative computation of stock gain or loss. Then, P's income, gain, or loss from the disposition of S2 stock is computed pursuant to paragraph (c)(2)(iii) of this section using the basis computed in the previous step. Thus, P is treated as recognizing a $20 gain from the sale of the S2 stock.

(D) Tentative computation of tax imposed. Pursuant to paragraph (c)(2)(iv) of this section, the tax imposed for the year of disposition is then tentatively computed, taking into account P's $20 gain from the sale of S2 stock computed pursuant to paragraph (c)(2)(iii) of this section. Although S2's limited loss cannot be used to offset P's $20 gain from the sale of S2's stock under the rules of this section, S1's loss will offset that gain. Therefore, the group is tentatively treated as having a consolidated net operating loss of $250, $70 of which is attributable to S1 and $180 of which is attributable to S2 under the principles of §1.1502-21(b)(2)(iv).

(E) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28 are tentatively applied to reduce attributes remaining after the tentative computation of the tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S1 would first be reduced to take into account its $100 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 would be reduced by $70, the portion of that consolidated net operating loss attributable to S1 under the principles of §1.1502-21(b)(2)(iv), to $0. Then, pursuant to §1.1502-28(a)(4), S1's remaining $30 of excluded COD income would reduce the consolidated net operating loss for Year 1 attributable to S2 of $180 by $30 to $150.

(F) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, §1.1502-32 is applied to reflect the amount of S2's income and gain included, and unlimited deductions and losses that are absorbed, in the tentative computation of the tax imposed for the year of the disposition and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32(b), the absorption of $20 of S2's loss to offset a portion of P's income and the application of $30 of S1's excluded COD income to reduce attributes attributable to S2 results in a negative adjustment of $50 to P's basis in the S2 stock. P's basis in the S2 stock, therefore, is $550.

(G) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, P's actual gain or loss on the sale of the S2 stock is computed using the basis computed in the previous step. Therefore, P recognizes a $50 gain on the disposition of the S2 stock.

(H) Actual computation of tax imposed. Pursuant to paragraph (c)(2)(viii) of this section, the tax imposed is computed by taking into account P's $50 gain from the disposition of the S2 stock. Before the application of §1.1502-28, therefore, the group has a consolidated net operating loss of $220, $40 of which is attributable to S1 and $180 of which is attributable to S2 under the principles of §1.1502-21(b)(2)(iv).

(I) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and §1.1502-28 are then actually applied to reduce attributes remaining after the actual computation of the tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S1 must first be reduced to take into account its $100 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 is reduced by $40, the portion of that consolidated net operating loss attributable to S1 under the principles of §1.1502-21(b)(2)(iv), to $0. Then, pursuant to §1.1502-28(a)(4), without regard to the limitation imposed by paragraph (c)(2)(ix)(B) of this section, S1's remaining $60 of excluded COD income would reduce S2's net operating loss of $180 to $120. However, the limitation imposed by paragraph (c)(2)(ix)(B) of this section prevents the reduction of S2's loss by more than $30. Therefore, S2's loss of $180 is reduced by $30 to $150 in respect of S1's excluded COD income. The remaining $30 of excluded COD income has no effect.

Example 3. Lower-tier corporation of departing member realizes excluded COD income. (i) Facts. P owns all of S1's stock, S2's stock, and S3's stock. S1 owns all of S4's stock. P's basis in S1's stock is $50 and S1's basis in S4's stock is $50. For Year 1, P has $50 of ordinary loss, S1 has $100 of ordinary loss, S2 has $150 of ordinary loss, S3 has $50 of ordinary loss, and S4 has $50 of ordinary loss and $80 of excluded COD income from the discharge of non-intercompany indebtedness. P sells the S1 stock for $100 at the close of Year 1. As of the beginning of Year 2, S4 has Asset A with a fair market value of $10. After the computation of tax imposed for Year 1 and before the application of sections 108 and 1017 and §1.1502-28, Asset A has a basis of $0.

(ii) Analysis. The steps used to compute the tax imposed on the group, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain. To determine the amount of the limitation under paragraph (c)(2)(i) of this section on S1's and S4's losses and the effect of the absorption of S1's and S4's losses on P's basis in S1's stock under §1.1502-32(b), P's gain or loss from the sale of S1's stock is not taken into account. The group is tentatively treated as having a consolidated net operating loss of $400. Consequently, $100 of S1's loss and $50 of S4's loss is limited under paragraph (c)(2)(i) of this section.

(B) Tentative adjustment of stock basis. Then, pursuant to paragraph (c)(2)(ii) of this section, §1.1502-32 is tentatively applied to adjust the basis of S1's stock. For this purpose, adjustments to the basis of S1's stock attributable to S4's realization of excluded COD income and the reduction of attributes in respect of such excluded COD income are not taken into account. There is no adjustment under §1.1502-32 to the basis of the S1 stock. Therefore, P's basis in the S1 stock for this purpose is $50.

(C) Tentative computation of stock gain or loss. Then, P's income, gain, or loss from the sale of S1 stock is computed pursuant to paragraph (c)(2)(iii) of this section using the basis computed in the previous step. Thus, P is treated as recognizing a $50 gain from the sale of the S1 stock.

(D) Tentative computation of tax imposed. Pursuant to paragraph (c)(2)(iv) of this section, the tax imposed for the year of disposition is then tentatively computed, taking into account P's $50 gain from the sale of the S1 stock computed pursuant to paragraph (c)(2)(iii) of this section. Although S1's and S4's limited losses cannot be used to offset P's $50 gain from the sale of S1's stock under the rules of this section, $10 of P's loss, $30 of S2's loss, and $10 of S3's loss will offset that gain. Therefore, the group is tentatively treated as having a consolidated net operating loss of $350, $40 of which is attributable to P, $100 of which is attributable to S1, $120 of which is attributable to S2, $40 of which is attributable to S3, and $50 of which is attributable to S4 under the principles of §1.1502-21(b)(2)(iv).

(E) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28 are tentatively applied to reduce attributes remaining after the tentative computation of the tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S4 would first be reduced to take into account its $80 of excluded COD. Accordingly, the consolidated net operating loss for Year 1 would be reduced by $50, the portion of the consolidated net operating loss attributable to S4 under the principles of §1.1502-21(b)(2)(iv), to $300. Then, pursuant to §1.1502-28(a)(4), S4's remaining $30 of excluded COD income would reduce the consolidated net operating loss for Year 1 that is attributable to other members. Therefore, the consolidated net operating loss for Year 1 would be reduced by $30. Of that amount, $4 is attributable to P, $10 is attributable to S1, $12 is attributable to S2, and $4 is attributable to S3.

(F) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, §1.1502-32 is applied to reflect the amount of S1's and S4's income and gain included, and unlimited deductions and losses that are absorbed, in the tentative computation of tax imposed for the year of the disposition and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32(b), the application of $80 of S4's excluded COD income to reduce attributes, and the reduction of S4's loss in the amount of $50 and S1's loss in the amount of $10 in respect of the excluded COD income results in a positive adjustment of $20 to P's basis in the S1 stock. Accordingly, P's basis in S1 stock is $70.

(G) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, P's actual gain or loss on the sale of the S1 stock is computed using the basis computed in the previous step. Accordingly, P recognizes a $30 gain on the disposition of the S1 stock.

(H) Actual computation of tax imposed. Pursuant to paragraph (c)(2)(viii) of this section, the tax imposed is computed by taking into account P's $30 gain from the sale of S1 stock. Before the application of §1.1502-28, therefore, the group has a consolidated net operating loss of $370, $44 of which is attributable to P, $100 of which is attributable to S1, $132 of which is attributable to S2, $44 of which is attributable to S3, and $50 of which is attributable to S4.

(I) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and §1.1502-28 are then actually applied to reduce attributes remaining after the actual computation of the tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S4 must first be reduced to take into account its $80 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 is reduced by $50, the portion of that consolidated net operating loss attributable to S4 under the principles of §1.1502-21(b)(2)(iv), to $320. Then, pursuant to §1.1502-28(a)(4), without regard to the limitation imposed by paragraph (c)(2)(ix)(A) of this section, S4's remaining $30 of excluded COD income would reduce the consolidated net operating loss for Year 1 by $30 ($4.12 of the consolidated net operating loss attributable to P, $9.38 of the consolidated net operating loss attributable to S1, $12.38 of the consolidated net operating loss attributable to S2, and $4.12 of the consolidated net operating loss attributable to S3) to $290. However, the limitation imposed by paragraph (c)(2)(ix)(A) of this section prevents the reduction of the consolidated net operating loss attributable to P, S2, and S3 by more than $4, $12, and $4 respectively. The $.62 of excluded COD income that would have otherwise reduced the consolidated net operating loss attributable to P, S2, and S3 is applied to reduce the consolidated net operating loss attributable to S1. Therefore, S1 carries forward $90 of loss.

Example 4. Excess loss account taken into account. (i) Facts. P is the common parent of a consolidated group. On Day 1 of Year 2, P acquired all of the stock of S1. As of the beginning of Year 2, S1 had a $30 net operating loss carryover from Year 1, a separate return limitation year. A limitation under §1.1502-21(c) applies to the use of that loss by the P group. For Years 1 and 2, the P group had no consolidated taxable income or loss. On Day 1 of Year 3, S1 acquired all of the stock of S2 for $10. In Year 3, P had ordinary income of $10, S1 had ordinary income of $25, and S2 had an ordinary loss of $50. In addition, in Year 3, S2 realized $20 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S2 had no liabilities. As of the beginning of Year 4, S2 had Asset A with a fair market value of $10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and §1.1502-28, Asset A has a basis of $0. S2 had no taxable income (or loss) for Year 1 and Year 2.

(ii) Analysis. The steps used to compute the tax imposed on the group, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain, tentative basis adjustments, tentative computation of stock gain or loss. Because it is not initially apparent that there has been a disposition of stock, paragraph (c)(2)(i) of this section does not limit the use of deductions to offset income or gain, no adjustments to the basis are required pursuant to paragraph (c)(2)(ii) of this section, and no stock gain or loss is computed pursuant to paragraph (c)(2)(iii) of this section or taken into account in the tentative computation of tax imposed pursuant to paragraph (c)(2)(iv) of this section.

(B) Tentative computation of tax imposed. Pursuant to paragraph (c)(2)(iv) of this section, the tax imposed for Year 3 is tentatively computed. For Year 3, the P group has a consolidated taxable loss of $15, all of which is attributable to S2 under the principles of §1.1502-21(b)(2)(iv).

(C) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28 are tentatively applied to reduce attributes remaining after the tentative computation of tax imposed. Pursuant to §1.1502-28(a)(2), the tax attributes attributable to S2 would first be reduced to take into account its $20 of excluded COD income. Accordingly, the consolidated net operating loss for Year 3 is reduced by $15, the portion of that consolidated net operating loss attributable to S2 under the principles of §1.1502-21(b)(2)(iv), to $0. The remaining $5 of excluded COD income is not applied to reduce attributes as there are no remaining attributes that are subject to reduction.

(D) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, §1.1502-32 is applied to reflect the amount of S2's income and gain included, and unlimited deductions and losses that are absorbed, in the tentative computation of tax imposed for the year of the disposition and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32, the absorption of $35 of S2's loss, the application of $15 in respect of S2's excluded COD income to reduce attributes, and the reduction of $15 in respect of the loss attributable to S2 reduced in respect of the excluded COD income results in a negative adjustment of $35 to the basis of the S2 stock. Therefore, S1 has an excess loss account of $25 in the S2 stock.

(E) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, S1's actual gain or loss, if any, on the S2 stock is computed. Because S2 realized $5 of excluded COD income that was not applied to reduce attributes, pursuant to §1.1502-19(b)(1) and (c)(1)(iii)(B), S1 is required to take into account $5 of its excess loss account in the S2 stock.

(F) Actual computation of tax imposed. Pursuant to paragraph (c)(2)(viii) of this section, the tax imposed is computed by taking into account the $5 of the excess loss account in the S2 stock required to be taken into account. See §1.1502-28(b)(6) (requiring an excess loss account that is required to be taken into account as a result of the application of §1.1502-19(c)(1)(iii)(B) to be included in the group's tax return for the year that includes the date of the debt discharge). However, pursuant to paragraph (c)(2)(viii) of this section, such amount may not be offset by any of the consolidated net operating loss attributable to S2. It may, however, subject to applicable limitations, be offset by the separate net operating loss of S1 from Year 1.

(G) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and §1.1502-28 are then actually applied to reduce attributes remaining after the actual computation of the tax imposed. Attributes will be actually reduced in the same way that they were tentatively reduced.

(6) Additional rules for multiple dispositions. [Reserved]

(7) Effective date. This paragraph (c) applies to dispositions of subsidiary stock that occur after March 22, 2005. Taxpayers may apply §1.1502-11(c) of REG-167265-03 (2004-15 IRB 730) (see §601.601(d)(2) of this chapter) in whole, but not in part, to any disposition of subsidiary stock that occurs on or before March 22, 2005, if a member of the group realized excluded COD income after August 29, 2003, in the taxable year that includes the date of the disposition of such subsidiary stock.

* * * * *

Par. 3. Section 1.1502-13 is amended as follows:

1. Three sentences are added at the end of paragraph (g)(3)(i)(A).

2. Paragraph (g)(3)(ii)(B) is revised.

3. Paragraph (g)(3)(ii)(C) is added.

The revision and additions read as follows:

§1.1502-13 Intercompany transactions.

* * * * *

(g) * * *

(3) * * *

(i) * * *

(A) * * * For purposes of the preceding sentence, a reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and 1.1502-28 is not a comparable transaction. Notwithstanding paragraph (l) of this section, the preceding sentence applies to transactions or events occurring during a taxable year the original return for which is due (without regard to extensions) after March 21, 2005. For transactions or events occurring during a taxable year the original return for which is due (without regard to extensions) on or before March 21, 2005 and after March 12, 2004, see §1.1502-13T(g)(3)(ii)(B)(3) as contained in 26 CFR part 1 revised as of April 1, 2004.

* * * * *

(ii) * * *

(B) Timing and attributes. For purposes of applying the matching rule and the acceleration rule --

(1) Paragraph (c)(6)(ii) of this section (limitation on treatment of intercompany income or gain as excluded from gross income) does not apply to prevent any intercompany income or gain from being excluded from gross income;

(2) Paragraph (c)(6)(i) of this section (treatment of intercompany items if corresponding items are excluded or nondeductible) will not apply to exclude any amount of income or gain

attributable to a reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and §1.1502-28; and

(3) Any gain or loss from an intercompany obligation is not subject to section 108(a), section 354 or section 1091.

(C) Effective date. Notwithstanding paragraph (l) of this section, paragraph (g)(3)(ii)(B) of this section applies to transactions or events occurring during a taxable year the original return for which is due (without regard to extensions) after March 12, 2004. For transactions or events occurring during a taxable year the original return for which is due (without regard to extensions) on or before March 12, 2004, see §1.1502-13(g)(3)(ii)(B) as contained in 26 CFR part 1 revised as of April 1, 2003.

* * * * *

§1.1502-13T [Removed]

Par. 4. Section 1.1502-13T is removed.

Par. 5. Section 1.1502-19 is amended as follows:

1. Paragraph (b)(1) is revised.

2. Paragraph (h)(2)(ii) is revised.

The revisions read as follows:

§1.1502-19 Excess loss accounts.

* * * * *

(b) * * *

(1) Operating rules--(i) General rule. Except as provided in paragraph (b)(1)(ii) of this section, if P is treated under this section as disposing of a share of S's stock, P takes into account its excess loss account in the share as income or gain from the disposition.

(ii) Special limitation on amount taken into account. Notwithstanding paragraph (b)(1)(i) of this section, if P is treated as disposing of a share of S's stock as a result of the application of paragraph (c)(1)(iii)(B) of this section, the aggregate amount of its excess loss account in the shares of S's stock that P takes into account as income or gain from the disposition shall not exceed the amount of S's indebtedness that is discharged that is neither included in gross income nor treated as tax-exempt income under §1.1502-32(b)(3)(ii)(C)(1). If more than one share of S's stock has an excess loss account, such excess loss accounts shall be taken into account pursuant to the preceding sentence, to the extent possible, in a manner that equalizes the excess loss accounts in S's shares that have an excess loss account.

(iii) Treatment of disposition. Except as provided in paragraph (b)(4) of this section, the disposition is treated as a sale or exchange for purposes of determining the character of the income or gain.

* * * * *

(h) * * *

(2) * * *

(ii) Application of special limitation. If P was treated as disposing of stock of S because S was treated as worthless as a result of the application of paragraph (c)(1)(iii)(B) of this section after August 29, 2003, the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount, are determined or redetermined with regard to paragraph (b)(1)(ii) of this section. If P was treated as disposing of stock of S because S was treated as worthless as a result of the application of paragraph (c)(1)(iii)(B) of this section on or before August 29, 2003, the group may determine or redetermine the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount with regard to paragraph (b)(1)(ii) of this section.

* * * * *

§1.1502-19T [Removed]

Par. 6. Section 1.1502-19T is removed.

Par. 7. In §1.1502-21, paragraphs (b)(1), (b)(2)(ii)(A), (b)(2)(iv), (c)(2)(vii), and (h)(6) are revised to read as follows:

§1.1502-21 Net operating losses.

* * * * *

(b) * * *

(1) Carryovers and carrybacks generally. The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of section 172 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. In addition, the amount of any CNOL absorbed by the group in any year is apportioned among members based on the percentage of the CNOL attributable to each member as of the beginning of the year. The percentage of the CNOL attributable to a member is determined pursuant to paragraph (b)(2)(iv)(B) of this section. Additional rules provided under the Internal Revenue Code or regulations also apply. See, e.g., section 382(l)(2)(B) (if losses are carried from the same taxable year, losses subject to limitation under section 382 are absorbed before losses that are not subject to limitation under section 382). See paragraph (c)(1)(iii) of this section, Example 2, for an illustration of pro rata absorption of losses subject to a SRLY limitation. See §1.1502-21T(b)(3)(v) regarding the treatment of any loss that is treated as expired under §1.1502-35T(f)(1).

(2) * * *

(ii) Special rules--(A) Year of departure from group. If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, and then are subject to reduction under section 108 and §1.1502-28 in respect of discharge of indebtedness income that is realized by a member of the group and that is excluded from gross income under section 108(a). Only the amount so attributable that is not absorbed by the group in that year or reduced under section 108 and §1.1502-28 is carried to the corporation's first separate return year. For rules concerning a member departing a subgroup, see paragraph (c)(2)(vii) of this section.

* * * * *

(iv) Operating rules--(A) Amount of CNOL attributable to a member. The amount of a CNOL that is attributable to a member shall equal the product of the CNOL and the percentage of the CNOL attributable to such member.

(B) Percentage of CNOL attributable to a member--(1) In general. Except as provided in paragraph (b)(2)(iv)(B)(2) of this section, the percentage of the CNOL attributable to a member shall equal the separate net operating loss of the member for the year of the loss divided by the sum of the separate net operating losses for that year of all members having such losses. For this purpose, the separate net operating loss of a member is determined by computing the CNOL by reference to only the member's items of income, gain, deduction, and loss, including the member's losses and deductions actually absorbed by the group in the taxable year (whether or not absorbed by the member).

(2) Special rules--(i) Carryback to a separate return year. If a portion of the CNOL attributable to a member for a taxable year is carried back to a separate return year, the

percentage of the CNOL attributable to each member as of immediately after such portion of the CNOL is carried back shall be recomputed pursuant to paragraph (b)(2)(iv)(B)(2)(iv) of this section.

(ii) Excluded discharge of indebtedness income. If during a taxable year a member realizes discharge of indebtedness income that is excluded from gross income under section 108(a) and such amount reduces any portion of the CNOL attributable to any member pursuant to section 108 and §1.1502-28, the percentage of the CNOL attributable to each member as of immediately after the reduction of attributes pursuant to sections 108 and 1017 and §1.1502-28 shall be recomputed pursuant to paragraph (b)(2)(iv)(B)(2)(iv) of this section.

(iii) Departing member. If during a taxable year a member that had a separate net operating loss for the year of the CNOL ceases to be a member, the percentage of the CNOL attributable to each member as of the first day of the following consolidated return year shall be recomputed pursuant to paragraph (b)(2)(iv)(B)(2)(iv) of this section.

(iv) Recomputed percentage. The recomputed percentage of the CNOL attributable to each member shall equal the unabsorbed CNOL attributable to the member at the time of the recomputation divided by the sum of the unabsorbed CNOL attributable to all of the members at the time of the recomputation. For purposes of the preceding sentence, a CNOL that is reduced pursuant to section 108 and §1.1502-28 or that is otherwise permanently disallowed or eliminated shall be treated as absorbed.

* * * * *

(c) * * *

(2) * * *

(vii) Corporations that leave a SRLY subgroup. If a loss member ceases to be affiliated with a SRLY subgroup, the amount of the member's remaining SRLY loss from a specific year is determined pursuant to the principles of paragraphs (b)(2)(ii)(A) and (b)(2)(iv) of this section.

* * * * *

(h) * * *

(6) Certain prior periods. Paragraphs (b)(1), (b)(2)(ii)(A), (b)(2)(iv), and (c)(2)(vii) of this section shall apply to taxable years the original return for which the due date (without regard to extensions) is after March 21, 2005. Paragraph (b)(2)(ii)(A) of this section and §1.1502-21T(b)(1), (b)(2)(iv), and (c)(2)(vii) as contained in 26 CFR part 1 revised as of April 1, 2004, shall apply to taxable years the original return for which the due date (without regard to extensions) is on or before March 21, 2005 and after August 29, 2003. For taxable years the original return for which the due date (without regard to extensions) is on or before August 29, 2003, see paragraphs (b)(1), (b)(2)(ii)(A), (b)(2)(iv), and (c)(2)(vii) of this section and §1.1502-21T(b)(1) as contained in 26 CFR part 1 revised as of April 1, 2003.

* * * * *

Par. 8. Section 1.1502-21T is amended as follows:

1. Paragraphs (a) through (b)(2)(v) are revised.

2. Paragraphs (c)(1) through (h)(7) are revised.

The revisions read as follows:

§1.1502-21T Net operating losses (temporary).

(a) through (b)(2)(v) [Reserved]. For further guidance, see §1.1502-21(a) through (b)(2)(v).

* * * * *

(c)(1) through (h)(7) [Reserved]. For further guidance, see §1.1502-21(c)(1) through (h)(7).

* * * * *

Par. 9. Section 1.1502-28 is added to read as follows:

§1.1502-28 Consolidated section 108.

(a) In general. This section sets forth rules for the application of section 108(a) and the reduction of tax attributes pursuant to section 108(b) when a member of the group realizes discharge of indebtedness income that is excluded from gross income under section 108(a) (excluded COD income).

(1) Application of section 108(a). Section 108(a)(1)(A) and (B) is applied separately to each member that realizes excluded COD income. Therefore, the limitation of section 108(a)(3) on the amount of discharge of indebtedness income that is treated as excluded COD income is determined based on the assets (including stock and securities of other members) and liabilities (including liabilities to other members) of only the member that realizes excluded COD income.

(2) Reduction of tax attributes attributable to the debtor--(i) In general. With respect to a member that realizes excluded COD income in a taxable year, the tax attributes attributable to that member (and its direct and indirect subsidiaries to the extent required by section 1017(b)(3)(D) and paragraph (a)(3) of this section), including basis of assets and losses and credits arising in separate return limitation years, shall be reduced as provided in sections 108 and 1017 and this section. Basis of subsidiary stock, however, shall not be reduced below zero pursuant to paragraph (a)(2) of this section (including when subsidiary stock is treated as depreciable property under section 1017(b)(3)(D) when there is an election under section 108(b)(5)).

(ii) Consolidated tax attributes attributable to a member. For purposes of this section, the amount of a consolidated tax attribute (e.g., a consolidated net operating loss) that is attributable to a member shall be determined pursuant to the principles of §1.1502-21(b)(2)(iv). In addition, if the member is a member of a separate return limitation year subgroup, the amount of a tax attribute that arose in a separate return limitation year that is attributable to that member shall also be determined pursuant to the principles of §1.1502-21(b)(2)(iv).

(3) Look-through rules--(i) Priority of section 1017(b)(3)(D). If a member treats stock of a subsidiary as depreciable property pursuant to section 1017(b)(3)(D), the basis of the depreciable property of such subsidiary shall be reduced pursuant to section 1017(b)(3)(D) prior to the application of paragraph (a)(3)(ii) of this section.

(ii) Application of additional look-through rule. If the basis of stock of a corporation (the lower-tier member) that is owned by another corporation (the higher-tier member) is reduced pursuant to sections 108 and 1017 and paragraph (a)(2) of this section (but not as a result of treating subsidiary stock as depreciable property pursuant to section 1017(b)(3)(D)), and both of such corporations are members of the same consolidated group on the last day of the higher-tier member's taxable year that includes the date on which the excluded COD income is realized or the first day of the higher-tier member's taxable year that follows the taxable year that includes the date on which the excluded COD income is realized, solely for purposes of sections 108 and 1017 and this section other than paragraphs (a)(4) and (b)(1) of this section, the lower-tier member shall be treated as realizing excluded COD income on the last day of the taxable year of the higher-tier member that includes the date on which the higher-tier member realized the excluded COD income. The amount of such excluded COD income shall be the amount of such basis reduction. Accordingly, the tax attributes attributable to such lower-tier member shall be reduced as provided in sections 108 and 1017 and this section. To the extent that the excluded COD income realized by the lower-tier member pursuant to this paragraph (a)(3) does not reduce a tax attribute attributable to the lower-tier member, such excluded COD income shall not be applied to reduce tax attributes attributable to any member under paragraph (a)(4) of this section and shall not cause an excess loss account to be taken into account under §1.1502-19(b)(1) and (c)(1)(iii)(B).

(4) Reduction of certain tax attributes attributable to other members. To the extent that, pursuant to paragraph (a)(2) of this section, the excluded COD income is not applied to reduce the tax attributes attributable to the member that realizes the excluded COD income, after the application of paragraph (a)(3) of this section, such amount shall be applied to reduce the remaining consolidated tax attributes of the group, other than consolidated tax attributes to which a SRLY limitation applies, as provided in section 108 and this section. Such amount also shall be applied to reduce the tax attributes attributable to members that arose (or are treated as arising) in a separate return limitation year to the extent that the member that realizes excluded COD income is a member of the separate return limitation year subgroup with respect to such attribute if a SRLY limitation applies to the use of such attribute. In addition, such amount shall be applied to reduce the tax attributes attributable to members that arose in a separate return year or that arose (or are treated as arising) in a separate return limitation year if no SRLY limitation applies to the use of such attribute. The reduction of each tax attribute pursuant to the three preceding sentences shall be made in the order prescribed in section 108(b)(2) and pursuant to the principles of §1.1502-21(b)(1). Except as otherwise provided in this paragraph (a)(4), a tax attribute that arose in a separate return year or that arose (or is treated as arising) in a separate return limitation year is not subject to reduction pursuant to this paragraph (a)(4). Basis in assets

is not subject to reduction pursuant to this paragraph (a)(4). Finally, to the extent that the realization of excluded COD income by a member pursuant to paragraph (a)(3) does not reduce a tax attribute attributable to such lower-tier member, such excess shall not be applied to reduce tax attributes attributable to any member pursuant to this paragraph (a)(4).

(b) Special rules--(1) Multiple debtor members--(i) Reduction of tax attributes attributable to debtor members prior to reduction of consolidated tax attributes. If in a single taxable year multiple members realize excluded COD income, paragraphs (a)(2) and (3) of this section shall apply with respect to the excluded COD income of each such member before the application of paragraph (a)(4) of this section.

(ii) Reduction of higher-tier debtor's tax attributes. If in a single taxable year multiple members realize excluded COD income and one such member is a higher-tier member of another such member, paragraphs (a)(2) and (3) of this section shall be applied with respect to the excluded COD income of the higher-tier member before such paragraphs are applied to the excluded COD income of the other such member. In applying the rules of paragraph (a)(2) and (3) of this section with respect to the excluded COD income of the higher-tier member, the liabilities that give rise to the excluded COD income of the other such member shall not be treated as discharged for purposes of computing the limitation on basis reduction under section 1017(b)(2). A member (the first member) is a higher-tier member of another member (the second member) if the first member is the common parent or investment adjustments under §1.1502-32 with respect to the stock of the second member would affect investment adjustments with respect to the stock of the first member.

(iii) Reduction of additional tax attributes. If more than one member realizes excluded COD income that has not been applied to reduce a tax attribute attributable to such member (the remaining COD amount) and the remaining tax attributes available for reduction under paragraph (a)(4) of this section are less than the aggregate of the remaining COD amounts, after the application of paragraph (a)(2) of this section, each such member's remaining COD amount shall be applied on a pro rata basis (based on the relative remaining COD amounts), pursuant to paragraph (a)(4) of this section, to reduce such remaining available tax attributes.

(iv) Ownership of lower-tier member by multiple higher-tier members. If stock of a corporation is held by more than one higher-tier member of the group and more than one such higher-tier member reduces its basis in such stock, then under paragraph (a)(3) of this section the excluded COD income resulting from the stock basis reductions shall be applied on a pro rata basis (based on the amount of excluded COD income caused by each basis reduction) to reduce the attributes of the corporation.

(v) Ownership of lower-tier member by multiple higher-tier members in multiple groups. If a corporation is a member of one group (the first group) on the last day of the first group's higher-tier member's taxable year that includes the date on which that higher-tier member realizes excluded COD income and is a member of another group (the second group) on the following day and the first group's higher-tier member and the second group's higher-tier member both reduce their basis in the stock of such corporation pursuant to sections 108 and 1017 and this section, paragraph (a)(3) of this section shall first be applied in respect of the excluded COD income that results from the reduction of the basis of the corporation's stock owned by the first group's higher-tier member and then shall be applied in respect of the excluded COD income that results from the reduction of the basis of the corporation's stock owned by the second group's higher-tier member.

(2) Election under section 108(b)(5)--(i) Availability of election. The group may make the election described in section 108(b)(5) for any member that realizes excluded COD income. The election is made separately for each member. Therefore, an election may be made for one member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section) while another election, or no election, may be made for another member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section). See §1.108-4 for rules relating to the procedure for making an election under section 108(b)(5).

(ii) Treatment of shares with an excess loss account. For purposes of applying section 108(b)(5)(B), the basis of stock of a subsidiary that has an excess loss account shall be treated as zero.

(3) Application of section 1017--(i) Timing of basis reduction. Basis of property shall be subject to reduction pursuant to the rules of sections 108 and 1017 and this section after the determination of the tax imposed by chapter 1 of the Internal Revenue Code for the taxable year during which the member realizes excluded COD income and any prior years and coincident with the reduction of other attributes pursuant to section 108 and this section. However, only the basis of property held as of the beginning of the taxable year following the taxable year during which the excluded COD income is realized is subject to reduction pursuant to sections 108 and 1017 and this section.

(ii) Limitation of section 1017(b)(2). The limitation of section 1017(b)(2) on the reduction in basis of property shall be applied by reference to the aggregate of the basis of the property held by the member that realizes excluded COD income, not the aggregate of the basis of the property held by all of the members of the group, and the liabilities of such member, not the aggregate liabilities of all of the members of the group.

(iii) Treatment of shares with an excess loss account. For purposes of applying section 1017(b)(2) and §1.1017-1, the basis of stock of a subsidiary that has an excess loss account shall be treated as zero.

(4) Application of section 1245. Notwithstanding section 1017(d)(1)(B), a reduction of the basis of subsidiary stock is treated as a deduction allowed for depreciation only to the extent that the amount by which the basis of the subsidiary stock is reduced exceeds the total amount of the attributes attributable to such subsidiary that are reduced pursuant to the subsidiary's consent under section 1017(b)(3)(D) or as a result of the application of paragraph (a)(3)(ii) of this section.

(5) Reduction of basis of intercompany obligations and former intercompany obligations--(i) Intercompany obligations that cease to be intercompany obligations. If excluded COD income is realized in a consolidated return year in which an intercompany obligation becomes an obligation that is not an intercompany obligation because the debtor or the creditor becomes a nonmember or because the assets of the creditor are acquired by a nonmember in a transaction to which section 381(a) applies, the basis of such intercompany obligation is not available for reduction in respect of such excluded COD income pursuant to sections 108 and 1017 and this section. However, in such cases, the basis of the debt treated as new debt issued under §1.1502-13(g)(3) is available for reduction in respect of such excluded COD income pursuant to sections 108 and 1017 and this section.

(ii) Intercompany obligations. The reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and this section shall not result in the satisfaction and reissuance of the obligation under §1.1502-13(g). Therefore, any income or gain (or reduction of loss or deduction) attributable to a reduction of the basis of an intercompany obligation will be taken into account when §1.1502-13(g)(3) applies to such obligation. Furthermore, §1.1502-13(c)(6)(i) (regarding the treatment of intercompany items if corresponding items are excluded or nondeductible) will not apply to exclude any amount of income or gain attributable to a reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and this section. See §1.1502-13(g)(3)(i)(A) and (ii)(B)(2).

(6) Taking into account of excess loss account--(i) Determination of inclusion. The determination of whether any portion of an excess loss account in a share of stock of a subsidiary that realizes excluded COD income is required to be taken into account as a result of the application of §1.1502-19(c)(1)(iii)(B) is made after the determination of the tax imposed by chapter 1 of the Internal Revenue Code for the year during which the member realizes excluded COD income (without regard to whether any portion of an excess loss account in a share of stock of the subsidiary is required to be taken into account) and any prior years, after the reduction of tax attributes pursuant to sections 108 and 1017 and this section, and after the adjustment of the basis of the share of stock of the subsidiary pursuant to §1.1502-32 to reflect the amount of the subsidiary's deductions and losses that are absorbed in the computation of taxable income (or loss) for the year of the disposition and any prior years, and the excluded COD income applied to reduce attributes and the attributes reduced in respect thereof. See §1.1502-11(c) for special rules related to the computation of tax that apply when an excess loss account is required to be taken into account.

(ii) Timing of inclusion. To the extent an excess loss account in a share of stock of a subsidiary that realizes excluded COD income is required to be taken into account as a result of the application of §1.1502-19(c)(1)(iii)(B), such amount shall be included on the group's tax return for the taxable year that includes the date on which the subsidiary realizes such excluded COD income.

(7) Dispositions of stock. See §1.1502-11(c) for limitations on the reduction of tax attributes when a member disposes of stock of another member (including dispositions that result from the application of §1.1502-19(c)(1)(iii)(B)) during a taxable year in which any member realizes excluded COD income.

(8) Departure of member. If the taxable year of a member (the departing member) during which such member realizes excluded COD income ends on or prior to the last day of the consolidated return year and, on the first day of the taxable year of such member that follows the taxable year during which such member realizes excluded COD income, such member is not a member of the group and does not have a successor member (within the meaning of paragraph (b)(10) of this section), all tax attributes listed in section 108(b)(2) that remain after the determination of the tax imposed that belong to members of the group (including the departing member and subsidiaries of the departing member) shall be subject to reduction as provided in section 108 and the regulations promulgated thereunder (including §1.108-7(c), if applicable) and this section.

(9) Intragroup reorganization--(i) In general. If the taxable year of a member during which such member realizes excluded COD income ends prior to the last day of the consolidated return year and, on the first day that follows the taxable year of such member during which such member realizes excluded COD income, such member has a successor member, for purposes of applying the rules of sections 108 and 1017 and this section, notwithstanding §1.108-7, the successor member shall be treated as the member that realized the excluded COD income. Thus, all attributes attributable to the successor member listed in section 108(b)(2) (including attributes

that were attributable to the successor member prior to the date such member became a successor member) are available for reduction under paragraph (a)(2) of this section.

(ii) Group structure change. If a member that realizes excluded COD income acquires the assets of the common parent of the consolidated group in a transaction to which section 381(a) applies and succeeds such common parent under the principles of §1.1502-75(d)(2) as the common parent of the consolidated group, the member's attributes that remain after the determination of tax for the group for the consolidated return year during which the excluded COD income is realized (and any prior years) (including attributes that were attributable to the former common parent prior to the date of the transaction to which section 381(a) applies) shall be available for reduction under paragraph (a)(2) of this section.

(10) Definition of successor member. A successor member means a person to which the member that realizes excluded COD income (or a successor member) transfers its assets in a transaction to which section 381(a) applies if such transferee is a member of the group immediately after the transaction.

(11) Non-application of next day rule. For purposes of applying the rules of sections 108 and 1017 and this section, the next day rule of §1.1502-76(b)(1)(ii)(B) shall not apply to treat a member's excluded COD income as realized at the beginning of the day following the day on which such member's status as a member changes.

(c) Examples. The principles of paragraphs (a) and (b) of this section are illustrated by the following examples. Unless otherwise indicated, no election under section 108(b)(5) has been made and the taxable year of all consolidated groups is the calendar year. The examples are as follows:

Example 1. (i) Facts. P is the common parent of a consolidated group that includes subsidiary S1. P owns 80 percent of the stock of S1. In Year 1, the P group sustained a $250 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $125 was attributable to P and $125 was attributable to S1. On Day 1 of Year 2, P acquired 100 percent of the stock of S2, and S2 joined the P group. As of the beginning of Year 2, S2 had a $50 net operating loss carryover from Year 1, a separate return limitation year. In Year 2, the P group sustained a $200 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $90 was attributable to P, $70 was attributable to S1, and $40 was attributable to S2. In Year 3, S2 realized $200 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a $50 consolidated net operating loss, of which $40 was attributable to S1 and $10 was attributable to S2 under the principles of §1.1502-21(b)(2)(iv). As of the beginning of Year 4, S2 had Asset A with a fair market value of $10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, Asset A had a basis of $40 and S2 had no liabilities.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S2 must first be reduced to take into account its excluded COD income in the amount of $200.

(1) Reduction of net operating losses. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss attributable to S2, to $40. Then, again pursuant to section 108(b)(4)(B), S2's net operating loss carryover of $50 from its separate return limitation year is reduced to $0. Finally, the consolidated net operating loss carryover from Year 2 is reduced by $40, the portion of that consolidated net operating loss carryover attributable to S2, to $160.

(2) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S2 reduces its basis in Asset A by $40, from $40 to $0.

(B) Reduction of remaining consolidated tax attributes. The remaining $60 of excluded COD income then reduces consolidated tax attributes pursuant to paragraph (a)(4) of this section. In particular, the remaining $40 consolidated net operating loss for Year 3 is reduced to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20 from $250 to $230. Pursuant to paragraph (a)(4) of this section, a pro rata amount of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced. Therefore, $10 of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced.

Example 2. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 100 percent of the stock of S1 and S1 owns 100 percent of the stock of S2. None of P, S1, or S2 has a separate return limitation year. In Year 1, the P group sustained a $50 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $10 was attributable to P, $20 was attributable to S1, and $20 was attributable to S2. In Year 2, the P group sustained a $70 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $30 was attributable to P, $30 was attributable to S1, and $10 was attributable to S2. In Year 3, S1 realized $170 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a $50 consolidated net operating loss, of which $10 was attributable to S1 and $40 was attributable to S2 under the principles of §1.1502-21(b)(2)(iv). As of the beginning of Year 4, S1's sole asset was the stock of S2, and S2 had Asset A with a $10 value. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, S1 had a $80 basis in the S2 stock, Asset A had a basis of $0, and neither S1 nor S2 had any liabilities.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of $170.

(1) Reduction of net operating losses. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss for Year 3 attributable to S1, to $40. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20, the portion of that consolidated net operating loss carryover attributable to S1, to $30, and the consolidated net operating loss carryover from Year 2 is reduced by $30, the portion of that consolidated net operating loss carryover attributable to S1, to $40.

(2) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by $80, from $80 to $0.

(3) Tiering down of stock basis reduction. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing $80 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by an additional $40, the portion of the consolidated net operating loss for Year 3 attributable to S2, to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20, the portion of that consolidated net operating loss carryover attributable to S2, to $10. Then, the consolidated net operating loss carryover from Year 2 is reduced by $10, the portion of that consolidated net operating loss carryover attributable to S2, to $30. S2's remaining $10 of excluded COD income does not reduce consolidated tax attributes attributable to P or S1 under paragraph (a)(4) of this section.

(B) Reduction of remaining consolidated tax attributes. Finally, pursuant to paragraph (a)(4) of this section, S1's remaining $30 of excluded COD income reduces the remaining consolidated tax attributes. In particular, the remaining $10 consolidated net operating loss carryover from Year 1 is reduced by $10 to $0, and the remaining $30 consolidated net operating loss carryover from Year 2 is reduced by $20 to $10.

Example 3. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of S1, S1 owns 100 percent of the stock of S2, and S2 owns 100 percent of the stock of S3. None of P, S1, S2, or S3 had a separate return limitation year prior to Year 1. In Year 1, the P group sustained a $150 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $50 was attributable to S2, and $100 was attributable to S3. In Year 2, the P group sustained a $50 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $40 was attributable to S1 and $10 was attributable to S2. In Year 3, S1 realized $170 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a $50 consolidated net operating loss, of which $10 was attributable to S1, $20 was attributable to S2, and $20 was attributable to S3 under the principles of §1.1502-21(b)(2)(iv). At the beginning of Year 4, S1's only asset was the stock of S2, and S2's only asset was the stock of S3 with a value of $10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, S1's stock of S2 had a basis of $120 and S2's stock of S3 had a basis of $180. In addition, none of S1, S2, and S3 had any liabilities.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of $170.

(1) Reduction of net operating losses. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss attributable to S1, to $40. Then, the consolidated net operating loss carryover from Year 2 is reduced by $40, the portion of that consolidated net operating loss carryover attributable to S1, to $10.

(2) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by $120, from $120 to $0.

(B) Tiering down of stock basis reduction to S2. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing $120 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is further reduced by $20, the portion of the consolidated net operating loss attributable to S2, to $20. Then, the consolidated net operating loss carryover from Year 1 is reduced by $50, the portion of that consolidated net operating loss carryover attributable to S2, to $100. Then, the consolidated net operating loss carryover from Year 2 is further reduced by $10, the portion of that consolidated net operating loss carryover attributable to S2, to $0. Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S2 reduces its basis in its S3 stock by $40 to $140.

(C) Tiering down of stock basis reduction to S3. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing $40 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and the net operating loss carryovers attributable to S3 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is further reduced by $20, the portion of the consolidated net operating loss attributable to S3, to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $20, the lesser of the portion of that consolidated net operating loss carryover attributable to S3 and the remaining excluded COD income, to $80.

Example 4. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of each of S1 and S2. Each of S1 and S2 owns stock of S3 that represents 50 percent of the value of the stock of S3. None of P, S1, S2, or S3 had a separate return limitation year prior to Year 1. In Year 1, the P group sustained a $160 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $10 was attributable to P, $50 was attributable to S2, and $100 was attributable to S3. In Year 2, the P group sustained a $110 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $40 was attributable to S1 and $70 was attributable to S2. In Year 3, S1 realized $200 of excluded COD income from the discharge of non-intercompany indebtedness, and S2 realized $270 of excluded COD income from the discharge of non-intercompany indebtedness. In that same year, the P group sustained a $50 consolidated net operating loss, of which $10 was attributable to S1, $20 was attributable to S2, and $20 was attributable to S3 under the principles of §1.1502-21(b)(2)(iv). At the beginning of Year 4, S3 had one asset with a value of $10. After the computation of tax imposed for Year 3 and before the application of sections 108 and 1017 and this section, S1's basis in its S3 stock was $60, S2's basis in its S3 stock was $120, and S3's asset had a basis of $200. In addition, none of S1, S2, and S3 had any liabilities.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtors. Pursuant to paragraph (b)(1)(i) of this section, the tax attributes attributable to each of S1 and S2 are reduced pursuant to paragraph (a)(2) of this section. Then, pursuant to paragraph (a)(3) of this section, the tax attributes attributable to S3 are reduced so as to reflect a reduction of S1's and S2's basis in the stock of S3. Then, paragraph (a)(4) is applied to reduce additional tax attributes.

(1) Reduction of net operating losses generally. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating losses and the net operating loss carryovers attributable to S1 and S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B).

(2) Reduction of net operating losses attributable to S1. The consolidated net operating loss for Year 3 is reduced by $10, the portion of the consolidated net operating loss attributable

to S1, to $40. Then, the consolidated net operating loss carryover from Year 2 is reduced by $40, the portion of that consolidated net operating loss carryover attributable to S1, to $70.

(3) Reduction of net operating losses attributable to S2. The consolidated net operating loss for Year 3 is also reduced by $20, the portion of the consolidated net operating loss attributable to S2, to $20. Then, the consolidated net operating loss carryover from Year 1 is reduced by $50, the portion of that consolidated net operating loss carryover attributable to S2, to $110. Then, the consolidated net operating loss carryover from Year 2 is reduced by $70, the portion of that consolidated net operating loss carryover attributable to S2, to $0.

(4) Reduction of basis. Following the reduction of the net operating losses and the net operating loss carryovers attributable to S1 and S2, S1 and S2 must reduce their basis in their assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S3 by $60, from $60 to $0, and S2 reduces its basis in the stock of S3 by $120, from $120 to $0.

(B) Tiering down of basis reduction. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing $180 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and the net operating loss carryovers attributable to S3 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 3 is further reduced by $20, the portion of the consolidated net operating loss attributable to S3, to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by $100, the portion of that consolidated net operating loss carryover attributable to S3, to $10. Following the reduction of the net operating loss and the net operating loss carryover attributable to S3, S3 reduces its basis in its asset pursuant to section 1017 and §1.1017-1. Accordingly, S3 reduces its basis in its asset by $60, from $200 to $140.

(C) Reduction of remaining consolidated tax attributes. Finally, pursuant to paragraph (a)(4) of this section, the remaining $90 of S1's excluded COD income and the remaining $10 of S2's excluded COD income reduce the remaining consolidated tax attributes. In particular, the remaining $10 consolidated net operating loss carryover from Year 1 is reduced by $10 to $0. Because that amount is less than the aggregate amount of remaining excluded COD income, such income is applied on a pro rata basis to reduce the remaining consolidated tax attributes. Accordingly, $9 of S1's remaining excluded COD income and $1 of S2's remaining excluded COD income is applied to reduce the remaining consolidated net operating loss carryover from Year 1. Consequently, of S1's excluded COD income of $200, only $119 is applied to reduce tax attributes, and, of S2's excluded COD income of $270, only $261 is applied to reduce tax attributes.

Example 5. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of S1 and S2, and S1 owns 100 percent of the stock of S3. None of P, S1, S2, or S3 has a separate return limitation year prior to Year 1. In Year 1, the P group sustained a $90 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $10 was attributable to P, $15 was attributable to S1, $20 was attributable to S2, and $45 was attributable to S3. On January 1 of Year 2, P realized $140 of excluded COD income from the discharge of non-intercompany indebtedness. On December 31 of Year 2, S1 issued stock representing 50 percent of the vote and value of its outstanding stock to a person that was not a member of the group. As a result of the issuance of stock, S1 and S3 ceased to be members of the P group. For the consolidated return year of Year 2, the P group sustained a $60 consolidated net operating loss, of which $5 was attributable to S1, $40 was attributable to S2, and $15 was attributable to S3 under the principles of §1.1502-21(b)(2)(iv). As of the beginning of Year 3, P's only assets were the stock of S1 and S2, S1's sole asset was the stock of S3, S2 had Asset A with a value of $10, and S3 had Asset B with a value of $10. After the computation of tax imposed for Year 2 and before the application of sections 108 and 1017 and this section, P had a $80 basis in the S1 stock and a $50 basis in the S2 stock, S1 had a $80 basis in the S3 stock, and Asset A and B each had a basis of $10. In addition, none of P, S1, S2, and S3 had any liabilities.

(ii) Analysis. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to P must first be reduced to take into account its excluded COD income in the amount of $140.

(A) Reduction of net operating losses. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryover attributable to P under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss carryover from Year 1 is reduced by $10, the portion of that consolidated net operating loss carryover attributable to P, to $80.

(B) Reduction of basis. Following the reduction of the net operating loss and the net operating loss carryover attributable to P, P reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, P reduces its basis in the stock of S1 by $80, from $80 to $0, and its basis in the stock of S2 by $50, from $50 to $0.

(C) Tiering down of stock basis reduction to S1. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S1 is treated as realizing $80 of excluded COD income, despite the fact that it ceases to be a member of the group at the end of the day on December 31 of Year 2. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S1 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by $5, the portion of the consolidated net operating loss for Year 2 attributable to S1, to $55. Then, the consolidated net operating loss carryover from Year 1 is reduced by an additional $15, the portion of that consolidated net operating loss carryover attributable to S1, to $65. Following the reduction of the net operating loss and the net operating loss carryover attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and §1.1017-1. Accordingly, S1 reduces its basis in the stock of S3 by $60, from $80 to $20.

(D) Tiering down of stock basis reduction to S2. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing $50 of excluded COD income. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S2 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by an additional $40, the portion of the consolidated net operating loss for Year 2 attributable to S2, to $15. Then, the consolidated net operating loss carryover from Year 1 is reduced by an additional $10, a portion of the consolidated net operating loss carryover attributable to S2, to $55.

(E) Tiering down of stock basis reduction to S3. Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing $60 of excluded COD income (by reason of S1's reduction in its basis of its S3 stock). Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, therefore, the net operating loss and net operating loss carryovers attributable to S3 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by an additional $15, the portion of the consolidated net operating loss for Year 2 attributable to S3, to $0. Then, the consolidated net operating loss carryover from Year 1 is reduced by an additional $45, the portion of that consolidated net operating loss carryover attributable to S3, to $10.

Example 6. (i) Facts. P1 is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P1 owns 100 percent of the stock of S1 and S2. S1 owns 100 percent of the stock of S3. None of P1, S1, S2, or S3 has a separate return limitation year prior to Year 1. In Year 1, the P1 group sustained a $120 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $40 was attributable to P1, $35 was attributable to S1, $30 was attributable to S2, and $15 was attributable to S3. On January 1 of Year 2, S3 realized $65 of excluded COD income from the discharge of non-intercompany indebtedness. On June 30 of Year 2, S3 issued stock representing 80 percent of the vote and value of its outstanding stock to P2, the common parent of another group. As a result of the issuance of stock, S3 ceased to be a member of the P1 group and became a member of the P2 group. For the consolidated return year of Year 2, the P1 group sustained a $50 consolidated net operating loss, of which $5 was attributable to S1, $40 was attributable to S2, and $5 was attributable to S3 under the principles of §1.1502-21(b)(2)(iv). As of the beginning of its taxable year beginning on July 1 of Year 2, S3's sole asset was Asset A with a $10 value. After the computation of tax imposed for Year 2 on the P1 group and before the application of sections 108 and 1017 and this section and the computation of tax imposed for Year 2 on the P2 group, Asset A had a basis of $0. In addition, S3 had no liabilities. On January 1 of Year 3, P1 sold all of its stock of S1.

(ii) Analysis--(A) Reduction of tax attributes attributable to debtor. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S3 must first be reduced to take into account its excluded COD income in the amount of $65. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryover attributable to S3 under the principles of §1.1502-21(b)(2)(iv) are reduced in the order prescribed by section 108(b)(4)(B). Accordingly, the consolidated net operating loss for Year 2 is reduced by $5, the portion of the consolidated net operating loss for Year 2 attributable to S3, to $45. Then, the consolidated net operating loss carryover from Year 1 is reduced by $15, the portion of that consolidated net operating loss carryover attributable to S3, to $105.

(B) Reduction of remaining consolidated tax attributes. Pursuant to paragraphs (a)(4) and (b)(8) of this section, S3's remaining $45 of excluded COD income reduces the remaining consolidated tax attributes in the P1 group. In particular, the remaining $45 consolidated net operating loss for Year 2 is reduced by an additional $45 to $0.

(C) Basis Adjustments. For purposes of computing P1's gain or loss on the sale of the S1 stock in Year 3, P1's basis in its S1 stock will reflect a net positive adjustment of $40, which is the excess of the amount of S3's excluded COD income that is applied to reduce attributes ($65) over the reduction of S1's and S3's attributes in respect of such excluded COD income ($25).

Example 7. (i) Facts. P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 100 percent of the stock of S1, and S1 owns 100 percent of the stock of S2. None of P, S1, or S2 has a separate return limitation year prior to Year 1. In Year 1, the P group sustained a $50 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $10 was attributable to P, $20 was attributable to S1, and $20 was attributable to S2. On January 1 of Year 2, S1 realized $55 of excluded COD income from the discharge of non-intercompany indebtedness. On June 30 of Year 2, P transferred all of its assets to S1 in a transaction to which section 381(a) applied. As a result of that transaction, pursuant to §1.1502-75(d)(2)(ii), S1 succeeded P as the common parent of the group. Pursuant to §1.1502-75(d)(2)(iii), S1's taxable year closed on the date of the acquisition. However, P's taxable year did not close. On the consolidated return for Year 2, the group sustained a $50 consolidated net operating loss. Under the principles of §1.1502-21(b)(2)(iv), of that amount, $10 was attributable to S1 for its taxable year that ended on June 30, $15 was attributable to S1 as the successor of P, and $25 was attributable to S2.

(ii) Analysis. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of $55. For this purpose, S1's attributes that remain after the determination of tax for the group for Year 2 are subject to reduction. Pursuant to section 108(b)(2)(A) and paragraph (a) of this section, the net operating loss and the net operating loss carryover attributable to S1 under the principles of §1.1502-21(b)(2)(iv) are reduced. Accordingly, the consolidated net operating loss for Year 2 is reduced by $25, the portion of the consolidated net operating loss for Year 2 attributable to S1, to $25. Then, the consolidated net operating loss carryover from Year 1 is reduced by $30, the portion of that consolidated net operating loss carryover attributable to S1 (which includes the portion attributable to P), to $20.

(d) Effective dates. This section applies to discharges of indebtedness that occur after March 21, 2005. Groups, however, may apply this section in whole, but not in part, to discharges of indebtedness that occur on or before March 21, 2005 and after August 29, 2003. For discharges of indebtedness occurring on or before March 21, 2005 and after August 29, 2003, with respect to which a group chooses not to apply this section, see §1.1502-28T as contained in 26 CFR part 1 revised as of April 1, 2004. Furthermore, groups may apply paragraph (b)(4) of this section to discharges of indebtedness that occur on or before August 29, 2003, in cases in which section 1017(b)(3)(D) was applied.

§1.1502-28T [Removed]

Par. 10. Section 1.1502-28T is removed.

Par. 11. Section 1.1502-32 is amended as follows:

1. Paragraph (b)(1)(ii) is redesignated as paragraph (b)(1)(iii).

2. New paragraph (b)(1)(ii) is added.

3. Paragraphs (b)(3)(ii)(C)(1) and (b)(3)(iii)(A) are revised.

4. Paragraph (b)(5)(ii), Example 4, paragraphs (a), (b), and (c) are revised.

5. Paragraph (h)(7) is revised.

The addition and revisions read as follows:

§1.1502-32 Investment adjustments.

* * * * *

(b) * * *

(1) * * *

(ii) Special rule for discharge of indebtedness income. Adjustments under this section resulting from the realization of discharge of indebtedness income of a member that is excluded from gross income under section 108(a) (excluded COD income) and from the reduction of attributes in respect thereof pursuant to sections 108 and 1017 and §1.1502-28 (including reductions in the basis of property) when a member (the departing member) ceases to be a member of the group on or prior to the last day of the consolidated return year that includes the date the excluded COD income is realized are made immediately after the determination of tax for the group for the taxable year during which the excluded COD income is realized (and any prior years) and are effective immediately before the beginning of the taxable year of the departing member following the taxable year during which the excluded COD income is realized. Such adjustments when a corporation (the new member) is not a member of the group on the last day of the consolidated return year that includes the date the excluded COD income is realized but is a member of the group at the beginning of the following consolidated return year are also made immediately after the determination of tax for the group for the taxable year during which the excluded COD income is realized (and any prior years) and are effective immediately before the beginning of the taxable year of the new member following the taxable year during which the excluded COD income is realized. If the new member was a member of another group immediately before it became a member of the group, such adjustments are treated as occurring immediately after it ceases to be a member of the prior group.

* * * * *

(3) * * *

(ii) * * *

(C) * * *

(1) In general. Excluded COD income is treated as tax-exempt income only to the extent the discharge is applied to reduce tax attributes attributable to any member of the group under section 108, section 1017 or §1.1502-28. However, if S is treated as realizing excluded COD income pursuant to §1.1502-28(a)(3), S shall not be treated as realizing excluded COD income for purposes of the preceding sentence.

* * * * *

(iii) * * *

(A) In general. S's noncapital, nondeductible expenses are its deductions and losses that are taken into account but permanently disallowed or eliminated under applicable law in determining its taxable income or loss, and that decrease, directly or indirectly, the basis of its assets (or an equivalent amount). For example, S's Federal taxes described in section 275 and loss not recognized under section 311(a) are noncapital, nondeductible expenses. Similarly, if a loss carryover (e.g., under section 172 or 1212) attributable to S expires or is reduced under section 108(b) and §1.1502-28, it becomes a noncapital, nondeductible expense at the close of the last tax year to which it may be carried. However, when a tax attribute attributable to S is reduced as required pursuant to §1.1502-28(a)(3), the reduction of the tax attribute is not treated as a noncapital, nondeductible expense of S. Finally, if S sells and repurchases a security subject to section 1091, the disallowed loss is not a noncapital, nondeductible expense because the corresponding basis adjustments under section 1091(d) prevent the disallowance from being permanent.

* * * * *

(5) * * *

(ii) * * *

Example 4. Discharge of indebtedness. (a) Facts. P forms S on January 1 of Year 1 and S borrows $200. During Year 1, S's assets decline in value and the P group has a $100 consolidated net operating loss. Of that amount, $10 is attributable to P and $90 is attributable to S under the principles of §1.1502-21(b)(2)(iv). None of the loss is absorbed by the group in Year 1, and S is discharged from $100 of indebtedness at the close of Year 1. P has a $0 basis in the S stock. P and S have no attributes other than the consolidated net operating loss. Under section 108(a), S's $100 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and §1.1502-28, the consolidated net operating loss is reduced to $0.

(b) Analysis. Under paragraph (b)(3)(iii)(A) of this section, the reduction of $90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense in Year 1 because that loss is permanently disallowed by section 108(b) and §1.1502-28. Under paragraph (b)(3)(ii)(C)(1) of this section, all $100 of S's discharge of indebtedness income is treated as tax-exempt income in Year 1 because the discharge results in a \$100 reduction to the consolidated net operating loss. Consequently, the loss and the cancellation of the indebtedness result in a net positive \$10 adjustment to P's basis in its S stock.

(c) Insufficient attributes. The facts are the same as in paragraph (a) of this Example 4, except that S is discharged from \$120 of indebtedness at the close of Year 1. Under section 108(a), S's \$120 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and §1.1502-28, the consolidated net operating loss is reduced by \$100 to \$0 after the determination of tax for Year 1. Under paragraph (b)(3)(iii)(A) of this section, the reduction of \$90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense. Under paragraph (b)(3)(ii)(C)(1) of this section, only \$100 of the discharge is treated as tax-exempt income because only that amount is applied to reduce tax attributes. The remaining \$20 of discharge of indebtedness income excluded from gross income under section 108(a) has no effect on P's basis in S's stock.

* * * * *

(h) * * *

(7) Rules related to discharge of indebtedness income excluded from gross income. Paragraphs (b)(1)(ii), (b)(3)(ii)(C)(1), (b)(3)(iii)(A), and (b)(5)(ii), Example 4, paragraphs (a), (b), and (c) of this section apply with respect to determinations of the basis of the stock of a subsidiary in consolidated return years the original return for which is due (without regard to extensions) after March 21, 2005. However, groups may apply those provisions with respect to determinations of the basis of the stock of a subsidiary in consolidated return years the original return for which is due (without regard to extensions) on or before March 21, 2005 and after August 29, 2003. For determinations of the basis of the stock of a subsidiary in consolidated return years the original return for which is due (without regard to extensions) on or before March 21, 2005 and after August 29, 2003, with respect to which a group chooses not to apply paragraphs (b)(1)(ii), (b)(3)(ii)(C)(1), (b)(3)(iii)(A), and (b)(5)(ii), Example 4, paragraphs (a), (b), and (c) of this section, see §1.1502-32T(b)(3)(ii)(C)(1), (b)(3)(iii)(A), and (b)(5)(ii), Example 4, paragraphs (a), (b), and (c) as contained in 26 CFR part 1 revised as of April 1, 2004.

Par. 12. Section 1.1502-32T is amended as follows:

1. Paragraph (a)(3) is added.

2. Paragraphs (b) through (b)(3)(iii)(B) are revised.

3. Paragraphs (b)(5)(i) through (h)(5)(ii) are revised.

4. Paragraph (h)(7) is revised.

The revisions read as follows:

§1.1502-32T Investment adjustments (temporary).

* * * * *

(a)(3) through (b)(3)(iii)(B) [Reserved]. For further guidance, see §1.1502-32(a)(3) through (b)(3)(iii)(B).

* * * * *

(b)(5)(i) through (h)(5)(ii) [Reserved]. For further guidance, see §1.1502-32(b)(5)(i) through (h)(5)(ii).

* * * * *

(h)(7) [Reserved]. For further guidance, see §1.1502-32(h)(7).

Par. 13. In §1.1502-76, paragraph (b)(1)(ii)(B)(3) is revised to read as follows:

§1.1502-76 Taxable year of members of group.

* * * * *

(b) * * *

(1) * * *

(ii) * * *

(B) * * *

(3) Whether the allocation is inconsistent with other requirements under the Internal Revenue Code and regulations promulgated thereunder (e.g., if a section 338(g) election is made

in connection with a group's acquisition of S, the deemed asset sale must take place before S becomes a member and S's gain or loss with respect to its assets must be taken into account by S as a nonmember (but see §1.338-1(d)), or if S realizes discharge of indebtedness income that is excluded from gross income under section 108(a) on the day it becomes a nonmember, the discharge of indebtedness income must be treated as realized by S as a member (see §1.1502-28(b)(11))); and

* * * * *

Par. 14. In §1.1502-80, the second sentence of paragraph (c) is revised to read as follows:

§1.1502-80 Applicability of other provisions of law.

* * * * *

(c) * * * See §§1.1502-11(d) and 1.1502-35T for additional rules relating to stock loss. * * *

* * * * *

Par. 15. In §1.1502-80T, the third sentence of paragraph (c) is revised to read as follows:

§1.1502-80T Applicability of other provisions of law (temporary).

* * * * *

(c) * * * See §§1.1502-11(d) and 1.1502-35T for additional rules relating to stock loss. * * *

* * * * *

Deputy Commissioner for Services and Enforcement.

Approved:

Acting Assistant Secretary of the Treasury.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 21, 2005
JS-2329

Statement of Treasury Secretary John W. Snow On the Departure of Treasury Under Secretary John Taylor

Since the spring of 2001, Dr. John Taylor has served brilliantly and honorably as Treasury's Under Secretary for International Affairs. As he prepares to leave us and return to private life, we can't help but reflect on the size and scope of his service to our country over these past four years.

Of particular note and historic value, was John's participation in the Bush Administration's efforts to fight terror and spread freedom around the world. John was part of the creation of an international coalition to freeze terrorist assets in the weeks following September 11, 2001 . He played a key role in the successful creation of a new currency in Iraq . He also helped shepherd international agreements to reduce Iraq 's debt by 80 percent and led efforts to establish an historic new economic engagement with the Broader Middle East and North African countries.

John has always felt strongly that the President's call for greater integration of economic issues into the traditional political and security parts of foreign policy is having, and will have, enormous payoffs for freedom and prosperity around the globe.

Though he dealt with issues of global significance every hour of every day, John's greatest pride and pleasure at the Treasury Department was his interaction with the highly skilled people of Treasury's Office of International Affairs.

John has been a moral and intellectual leader in this Department, across the federal government, and in economic circles throughout the world. In fact, every central banker and finance minister I have met has been a student of John Taylor's work -- some have even been students in his classrooms. His wisdom and guidance will be sorely missed, and I speak on behalf of the entire department when I say we were extremely fortunate to have him serve in our ranks.

John will always be remembered at Treasury for both his fine mind and his friendly demeanor. He was a valued counselor to me and a valued professor to staff across the Department. His vision for economic growth around the globe is grounded in ethics and backed by economic understanding of the highest degree. His contributions to the Treasury and to the broader economic world in his Treasury role were invaluable.

The Treasury bids a fond farewell to a gentleman and a scholar; we thank him for his contributions and wish him all the best in all future endeavors.

REPORTS

- Dr. Taylor's Resignation Letter To The President

DEPARTMENT OF THE TREASURY
WASHINGTON D.C.

UNDER SECRETARY

March 21, 2005

The President
The White House
Washington, D.C. 20500

Dear Mr. President,

It has been an honor and a privilege to serve you and the country during the first term of your Administration. As you know, in order to ensure a smooth transition, I have been flexible about the date of my return to the private sector, and, having consulted with Secretary Snow, I would now like to set April 22 as the effective date of my resignation.

I thank you for giving me the opportunity to be part of your economic team. I am pleased to have participated during your first presidential campaign in developing economic plans, including the tax rate cuts, which helped restore economic growth. I am also pleased to have helped forge several international agreements to reform the international monetary system, including the grants and measurable results initiatives at the World Bank, the new limits on exceptional finance at the International Monetary Fund, and a market-oriented process for sovereign debt workouts. I have enjoyed working closely with finance and central bank officials in other countries on policies to raise growth and deal with financial crises. It is a reflection of better economic policies that there are now no major financial crises and that global growth is higher than it has been in decades.

But most of all I am pleased to have been part of your historic efforts to fight terror and spread freedom around the world. I am proud of the international coalition we put together to freeze terrorist assets in the weeks after September 11, 2001, of the expedited economic reconstruction effort in Afghanistan, of the successful creation of a new currency in Iraq, of the international agreement to reduce Iraq's debt by 80 percent, and our historic new economic engagement with the Broader Middle East and North African countries. I believe that your call for greater integration of economic issues into the traditional political and security parts of foreign policy is already having huge payoffs.

I am particularly honored to have led the dedicated and highly skilled people of Treasury International Affairs who work to promote economic freedom around the world and who play a vital role in the successful operation of U.S. foreign policy.

Very respectfully,

John

John B. Taylor
Under Secretary of Treasury for
International Affairs

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 22, 2005
JS-2330

UPDATED
MEDIA ADVISORY
Secretary Snow Visits Delaware and Pennsylvania This Week
to Discuss Strengthening and Preserving Social Security

U.S. Treasury Secretary John W. Snow will travel to Wilmington, Delaware and Chester County, Pennsylvania on Thursday, March 24 to discuss the President's efforts to strengthen and preserve the U.S. Social Security system.

"The President is committed to saving Social Security," said Secretary Snow. "Social Security is sound for today's retirees, but the system must be fixed to keep the promise of Social Security for our children and grandchildren.

"Social Security faces real problems that must be addressed today," said Secretary Snow. "The President has laid out basic principles that must guide reform and voluntary personal retirement accounts are an important part of comprehensive reform."

The following events are open to credentialed media with photo identification:

Thursday, March 24

Roundtable with Local Business Leaders
The Wilmington Club
1103 Market Street
Wilmington, DE
8:30 am EST
**** Media must RSVP to Jeanne Mell at 302-576-6571**
**** Media must arrive by 8:00 am EST**
**** A brief media availability will be held immediately following the event**

Remarks to Chester County Chamber of Business and Industry
Exelon Corporation
300 Exelon Way
Kennett Square, PA
1:00 pm EST ** UPDATED TIME **
**** Media must RSVP to Mary Rucci at 610-765-6925**
**** Media must arrive by 12:30 am EST**
**** A brief media availability will be held immediately following the event**

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 22, 2005
JS-2331

Statement by Treasury Assistant Secretary Rob Nichols

The Administration respects the independence of the Federal Reserve in making decisions about our nation's monetary policy. We share the Federal Reserve's goals of maintaining healthy economic growth while preserving low inflation.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 22, 2005
2005-3-22-17-20-52-11171

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $80,349 million as of the end of that week, compared to $80,869 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	March 11, 2005			March 18, 2005		
TOTAL		**80,869**			**80,349**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	12,346	15,135	27,481	12,203	15,024	27,227
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	12,118	3,042	15,160	11,983	3,020	15,003
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			15,406			15,345
3. Special Drawing Rights (SDRs) [2]			11,780			11,733
4. Gold Stock [3]			11,042			11,042
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	March 11, 2005			March 18, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	March 11, 2005			March 18, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 23, 2005
JS-2332

Treasury Secretary John W. Snow Statement on the 2005 Social Security and Medicare Trust Fund Reports

Welcome to the Treasury. The Social Security and Medicare Board of Trustees met here earlier today to complete the annual financial review of the trust funds and to transmit the Trustees' Reports to Congress.

The numbers published today leave no question that Social Security reform is needed, and it is needed soon. Reform of this system, for the sake of our children, grandchildren and the financial future of our country, is a very real and pressing matter.

For Social Security, this year's report shows a small deterioration from last year's report. It once again demonstrates that the Social Security program is seriously under-funded and financially unsustainable in the long run. Cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The latter two dates are one year earlier than last year's report due to slightly higher benefit expenditures and slightly lower revenue than anticipated. The unfunded obligation, that is, the difference between the present values of Social Security inflows and outflows plus the existing trust fund, is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years. The actuarial imbalance as a percent of taxable payroll is -1.92 percent over 75 years and -3.5 percent over the indefinite future. This means that taxes would have to be raised immediately by 3.5 percentage points, or benefits reduced immediately by 22 percent, to make the system whole on a permanent basis.

As you well know, the President has called for bipartisan efforts to create a permanently sustainable system. His leadership has been the catalyst for a terrific national dialogue. Ideas are coming forward. As the President has continued to say, we can preserve benefits for current and near retirees and offer great hope to younger workers without raising the payroll tax rate. And we need to enact these reforms this year.

Since March 3rd, Administration officials – from President Bush and Vice President Cheney to Cabinet members and policy experts – have been traveling throughout the country as part of a coordinated 60-day tour of at least 60 stops to discuss the President's message of strengthening Social Security with the American people.

We passed the 20 day mark this week, and so far Administration officials have traveled to 52 events in 22 states to talk about the need for a permanent fix to save Social Security for future generations. We'll hit the 60 stop mark this week – after less than 30 days on the road – and the final number of stops will be much higher than anticipated.

Since the President started this national dialogue, membership of both parties have agreed that a permanent solution is needed. Both parties are discussing possible approaches to reform and substantial progress is being made.

I look forward to sharing the news of today's report when I am on the road tomorrow, and for the next several weeks. Because this report once again confirms that the sooner action is taken, the better for all concerned. Each year that passes without reform makes the ultimate resolution more difficult and the required changes more severe.

As this report shows, a 3.5 percent payroll tax rate increase would achieve long-term balance. But we don't think that's the way to go because it is an economically damaging solution. Payroll taxes have been raised some 20 times since Social Security was established and those increases have failed to make the system solvent. Raising the payroll tax will harm our economy and hurt job growth. Even the most resilient economy can be devastated by dramatic tax increases.

For future generations of retirees, the President believes an awful lot of hope lies in personal accounts – something that would allow younger workers to build a nest egg that they own and control, something the government could never take away from them, and that would tap into the great force of compound interest.

Albert Einstein believed, and the President and I agree, that compound interest is one of the most powerful forces in the universe. It's why a personal account nest egg would give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits.

The national dialogue on Social Security has put wind in the sails of reform. The stark numbers in this report remind us that we need to stay the course. Now is the time to take the steps necessary to preserve and protect Social Security so that commitments to our seniors are kept and the retirement prospects for our children and grandchildren can be improved.

Let me now offer a few words on the 2005 Medicare Trustees' Report. Although the 2005 Medicare Report shows a slight improvement over last year's report, more fundamentally it reveals even greater challenges. While Medicare faces the same demographic challenges as Social Security, it is additionally burdened by sharp increases in underlying health care costs.

Cash flow for the Hospital Insurance (HI) Trust Fund is projected to be negative again this year, as in 2004. Taking interest into account, total trust fund income is projected to exceed expenditures through 2012. The Hospital Insurance Trust Fund is projected to become insolvent in 2020, one year later than projected in last year's report and the 75-year actuarial imbalance as a percent of payroll is -3.09, a 0.03 percent improvement from last year's report.

The Supplementary Medical Insurance (SMI) Trust Fund, including expenditures associated with the prescription drug program, is financed in large part by general revenues. SMI expenditures are projected to increase rapidly, resulting in increasing pressures on future federal budgets. General revenue financing for SMI is expected to increase from 0.9 percent of GDP in 2004 to 6.2 percent in 2079. The projected growth in SMI expenditures poses serious issues for the federal budget and, in turn, the U.S. economy.

Controlling health care costs is the real key to the long run fiscal sustainability of both Medicare and in turn the federal budget. Indeed, according to this year's Trustees' Report, reducing the projected growth in per beneficiary health care costs to one percentage point lower would reduce the 75-year actuarial imbalance for the HI program by two thirds.

The Administration is addressing the issue of rising health care costs through the creation of Health Savings Accounts (HSAs) – already available and gaining in popularity – reducing the lawsuit abuse that increases costs and reduces access to necessary medical services, creating Association Health Plans to increase the affordability and availability of health insurance for small-business owners and their employees, and modernizing medical technology with new investments in health information technology. It is estimated that a national health information network, for example, could save about $140 billion per year through improved care and reduced duplication of medical tests.

Starting in 2006, for the first time all seniors will be guaranteed access to affordable prescription drug coverage under Medicare. Further reforms to Medicare should be considered in light of experience with other reforms contained the 2003 Act which are just starting to be implemented.

The weighty concerns raised by the Trustees' Reports demand the attention of America's policymakers and the public. Those who depend on Social Security and Medicare urgently need the best efforts of those of us in public life and in the private sector to address the long-term funding issues. Successful reform of these programs should be seen as a shared responsibility, not an opportunity to engage in partisan politics.

-30-

LINKS

- The 2005 OASDI Trustees Report (SSA website)
- The 2005 HI and SMI Trustees Report (CMS website)

REPORTS

- Summary document of reports
- Social Security Trustees' report
- Medicare Trustees' report

A MESSAGE TO THE PUBLIC:

Each year the Trustees of the Social Security and Medicare trust funds report on the current status and projected condition of the funds over the next 75 years. This message summarizes the 2005 Annual Reports.

The fundamentals of the financial status of Social Security and Medicare remain problematic under the intermediate economic and demographic assumptions. Social Security's current annual cash surpluses will soon begin to decline and will be followed by deficits that begin to grow rapidly toward the end of the next decade as the baby boom generation retires. The Medicare Hospital Insurance (HI) Trust Fund that pays hospital benefits had negative cash flows in 2004 and annual cash flow deficits are expected to continue and to grow rapidly after 2010 as baby boomers begin to retire. The growing deficits in both programs will lead to exhaustion in trust fund reserves for HI in 2020 and for Social Security in 2041. In addition, the Medicare Supplementary Medical Insurance (SMI) Trust Fund that pays for physician services and the new prescription drug benefit will require substantial increases over time in both general revenue financing and premium charges. As the reserves in Social Security and HI are drawn down and SMI general revenue financing requirements continue to grow, the pressure on the Federal budget will intensify. We do not believe the currently projected long run growth rates of Social Security and Medicare are sustainable under current financing arrangements.

Social Security

The annual cost of Social Security benefits represents 4.3 percent of Gross Domestic Product (GDP) today and is projected to rise to 6.4 percent of GDP in 2079. The projected 75-year actuarial deficit in the combined Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) Trust Funds is 1.92 percent of taxable payroll, up slightly from 1.89 percent in last year's report. The program continues to fail our long-range test of close actuarial balance by a wide margin. Projected OASDI tax income will begin to fall short of outlays in 2017 and will be sufficient to finance only 74 percent of scheduled annual benefits by 2041, when the combined OASDI trust fund is projected to be exhausted.

Social Security could be brought into actuarial balance over the next 75 years in various ways, including an immediate increase of 15 percent in the amount of payroll taxes or an immediate reduction in benefits of 13 percent (or some combination of the two). To the extent that changes are *delayed or phased in gradually, greater adjustments in scheduled benefits and revenues would be required. Ensuring that the system is solvent on a sustainable basis over the next 75 years and beyond would also require larger changes.*

Medicare

As we reported last year, Medicare's financial difficulties come sooner—and are much more severe—than those confronting Social Security. While both programs face essentially the same demographic challenge, underlying health care costs per enrollee are projected to rise faster than the wages per worker on which the payroll tax is paid and on which Social Security benefits are based. As a result, while Medicare's annual costs are currently 2.6 percent of GDP, or about 60 percent of Social Security's, they are now projected to surpass Social Security expenditures in 2024 and reach almost 14 percent of GDP in 2079.

The projected 75-year actuarial deficit in the Hospital Insurance (HI) Trust Fund is now 3.09 percent of taxable payroll, down slightly from 3.12 percent in last year's report due primarily to slightly greater income in 2004, and slightly lower costs, than estimated in last year's report. The fund again fails our test of short-range financial adequacy, as assets drop below the level of the next year's projected expenditures within 10 years—in 2014. The fund also continues to fail our long-range test of close actuarial balance by a wide margin. Though the projected date of HI Trust Fund exhaustion moved back slightly to 2020, from 2019 in last year's report, projected HI tax income falls short of outlays in this and all future years. HI could be brought into actuarial balance over the next 75 years by an immediate 107 percent increase in program income or an immediate 48 percent reduction in program outlays (or some combination of the two). However, as with Social Security, adjustments of far greater magnitude would be necessary to the extent changes are delayed or phased in gradually, or to make the program solvent on a sustainable basis over the next 75 years and beyond.

Part B of the Supplementary Medical Insurance (SMI) Trust Fund, which pays doctors' bills and other outpatient expenses, and the new Part D, which pays for access to prescription drug coverage, are both projected to remain financed into the indefinite future because current law automatically sets financing each year to meet next year's expected costs. However, expected rapid cost increases will result in a rapidly growing amount of general revenue financing—projected to rise from just under

1 percent of GDP today to 6.2 percent in 2079—as well as substantial increases over time in beneficiary premium charges.

Conclusion

Though highly challenging, the financial difficulties facing Social Security and Medicare are not insurmountable. But we must take action to address them in a timely manner. The sooner they are addressed the more varied and less disruptive can be their solutions. With informed public discussion and creative thinking that relates the principles underlying these programs to the economic and demographic realities, as well as to the changing needs and preferences of working and retired households, Social Security and Medicare can continue to play a critical role in the lives of all Americans.

By the Trustees:

John W. Snow,
Secretary of the Treasury,
and Managing Trustee

Elaine L. Chao,
Secretary of Labor,
and Trustee

Michael O. Leavitt,
Secretary of Health
and Human Services,
and Trustee

Jo Anne B. Barnhart,
Commissioner of
Social Security,
and Trustee

John L. Palmer,
Trustee

Thomas R. Saving,
Trustee

A SUMMARY OF THE 2005 ANNUAL SOCIAL SECURITY AND MEDICARE TRUST FUND REPORTS

Who Are the Trustees? There are six Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security and two members appointed by the President and confirmed by the Senate to represent the public. The Public Trustees are John L. Palmer, University Professor and Dean Emeritus of the Maxwell School of Citizenship and Public Affairs at Syracuse University, and Thomas R. Saving, Director of the Private Enterprise Research Center and Professor of Economics at Texas A & M University.

What Are the Trust Funds? The trust funds were created in the U.S. Treasury to account for all program income and disbursements. Social Security and Medicare taxes, premiums and other income are credited to the funds. Benefit payments and program administrative costs are the only purposes for which disbursements from the funds can be made. Program revenues not needed in the current year to pay benefits and administrative costs are invested in special non-negotiable securities of the U.S. Government on which a market rate of interest is credited. Thus, the trust funds represent the accumulated value, including interest, of all prior program annual surpluses, and provide automatic authority to pay benefits.

There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits. (The combined trust funds are described as OASDI.) For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care. The Supplementary Medical Insurance (SMI) Trust Fund is composed of Part B, which pays for physician and outpatient services, and effective in 2004, Part D, which provides a prescription drug benefit that begins in 2006. Medicare benefits are provided to most people age 65 and over and to most workers who are receiving Social Security disability benefits.

What Were the Trust Fund Results in 2004? In December 2004, 39.7 million people were receiving OASI benefits, 7.9 million were receiving DI benefits, and 41.7 million were covered under Medicare. Trust fund operations, in billions of dollars, are shown below (totals may not add due to rounding).

	OASI	DI	HI	SMI
Assets (end of 2003)	$1,355.3	$175.4	$256.0	$24.0
Income during 2004	566.3	91.4	183.9	133.8
Outgo during 2004	421.0	80.6	170.6	138.3
Net increase in assets	145.3	10.8	13.3	-4.5
Assets (end of 2004)	1,500.6	186.2	269.3	19.4

How Has the Outlook for the Trust Funds Changed Since Last Year? During the past year there has been no important change in the financial outlook for either Social Security or Medicare. Under the intermediate assumptions, the combined OASDI Trust Funds show a 75-year actuarial deficit equal to 1.92 percent of taxable payroll, slightly larger than last year's estimate of 1.89 percent. That change is largely attributable to moving the valuation period forward a year from 2004-78 to 2005-79, which adds a year (2079) with a large projected deficit into the estimate of long-range funding adequacy. The OASDI Trust Funds, separately and combined, are adequately financed over the next 10 years under the intermediate assumptions.

Medicare's HI Trust Fund now has a projected 75-year actuarial deficit equal to 3.09 percent of payroll compared with last year's estimate of 3.12 percent under the intermediate assumptions. That change results primarily from slightly lower expenditures and slightly higher income in 2004 than previously estimated. The HI Trust Fund is inadequately funded over the next 10 years, with trust fund assets falling short of 100 percent of expenditures in 2014. That represents a small improvement from last year's estimate of 2012. The SMI Trust Fund is adequately financed in both the short and long term because of the automatic financing established for Medicare Parts B and D.

How Are Social Security and Medicare Financed? For OASDI and HI, the major source of financing is payroll taxes on earnings that are paid by employees and their employers and by the self-employed (157 million for OASDI and 160 million for HI in 2004). The self-employed are charged the equivalent of the combined employer and employee tax rates. The payroll tax rates are set by law and for OASDI apply to earnings up to an annual maximum that rises as average wages increase ($90,000 in 2005). HI taxes are paid on total earnings. The tax rates (in percent) for 2005 and later are:

	OASI	DI	OASDI	HI	Total
Employees	5.30	0.90	6.20	1.45	7.65
Employers	5.30	0.90	6.20	1.45	7.65
Combined total. . .	10.60	1.80	12.40	2.90	15.30

Within SMI both Part B and Part D are financed largely (about 75 percent) by payments from Federal general fund revenues supplemented by monthly premiums charged beneficiaries ($78.20 in 2005 for Part B; Part D premiums begin in 2006). Part D also will receive payments from States beginning in 2006 for Federal assumption of Medicaid responsibilities for premium and cost-sharing subsidies for individuals eligible for both Medicare and Medicaid. Part B and Part D premium amounts are based on methods defined in law and increase as the estimated costs of those programs rise. Income to each trust fund by source in 2004 is shown in the table below (totals may not add due to rounding).

Source *(in billions)*	OASI	DI	HI	SMI
Payroll taxes	$472.8	$80.3	$156.7	—
General fund revenue	—	—	.6	$100.9
Interest earnings	79.0	10.0	15.0	1.5
Beneficiary premiums	—	—	1.9	31.4
Taxes on benefits	14.6	1.1	8.6	—
Other	*	—	1.2	*
Total	566.3	91.4	183.9	133.8

* Less than $50 million.

What Were the Administrative Expenses in 2004? Administrative expenses, as a percentage of total expenditures, were:

	OASI	DI	HI	SMI
Administrative expenses 2004	0.6	2.7	1.8	2.1

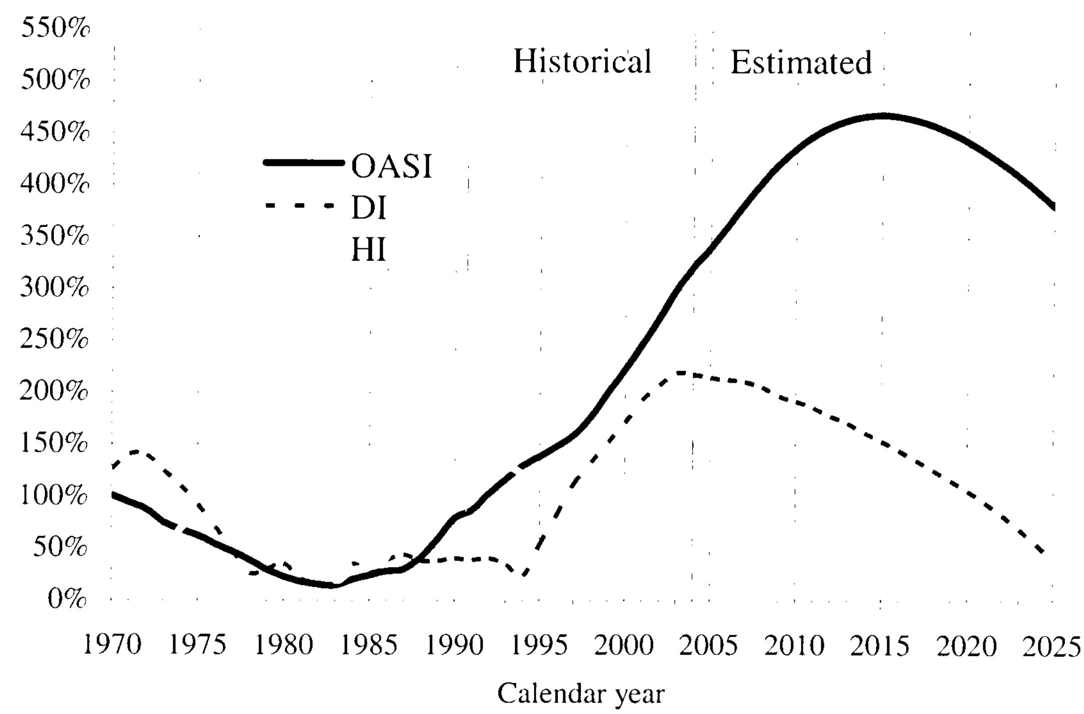
How Are Estimates of the Trust Funds' Future Status Made? Short-range (10-year) and long-range (75-year) estimates are reported for all funds. The estimates are based on current law and assumptions about all of the factors that affect the income and outgo of each trust fund. Assumptions include economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as factors relating to disability incidence and the cost of hospital, medical, and prescription drug services.

Because the future is inherently uncertain, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions (alternative II) reflect the Trustees' best estimate of future experience. The low-cost alternative I is more optimistic for trust fund financing, and the high-cost alternative III is more pessimistic; they show trust fund projections for more and less favorable economic and demographic conditions for trust fund financing than the best estimate. The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years.

What is the Short-Range Outlook (2005-2014) for the Trust Funds? For the short range, we measure the adequacy of the OASI, DI, and HI Trust Funds by comparing their assets at the beginning of a year to projected costs for that year (the "trust fund ratio"). A trust fund ratio of 100 percent or more—that is, assets at least equal to projected benefit payments for a year—is considered a good indicator of a fund's short-term adequacy. This level of projected assets for any year means that even if expenditures exceed income, the trust fund reserves, combined with annual tax revenues, would be sufficient to pay full benefits for several years, allowing time for legislative action to restore financial adequacy.

By this measure, the OASI and DI funds are considered financially adequate throughout the short range because the assets of each fund exceed the 100 percent level through the year 2014. The HI fund does not meet the short-range test of financial adequacy because its assets fall below the 100 percent level of one year's outgo during 2014. Chart A shows these trust fund ratios under the intermediate assumptions through 2025.

Chart A–OASI, DI, and HI Trust Fund Ratios
[Assets as a percentage of annual expenditures]



For SMI, a less stringent annual "contingency reserve" asset test applies to both Part B and Part D because the financing of each of those accounts is provided by beneficiary premiums and Federal general fund revenue payments automatically adjusted each year to meet expected costs. Thus, under current law both SMI accounts are fully financed throughout the 75-year projection period no matter what the costs may be.

The following table shows the projected income and outgo, and the change in the balance of each trust fund except SMI, over the next 10 years. Note the separation of SMI income and expenditures into columns for Parts B and D. The change in SMI is not shown because of its automatic annual adjustments in income to meet the next year's projected expenditures.

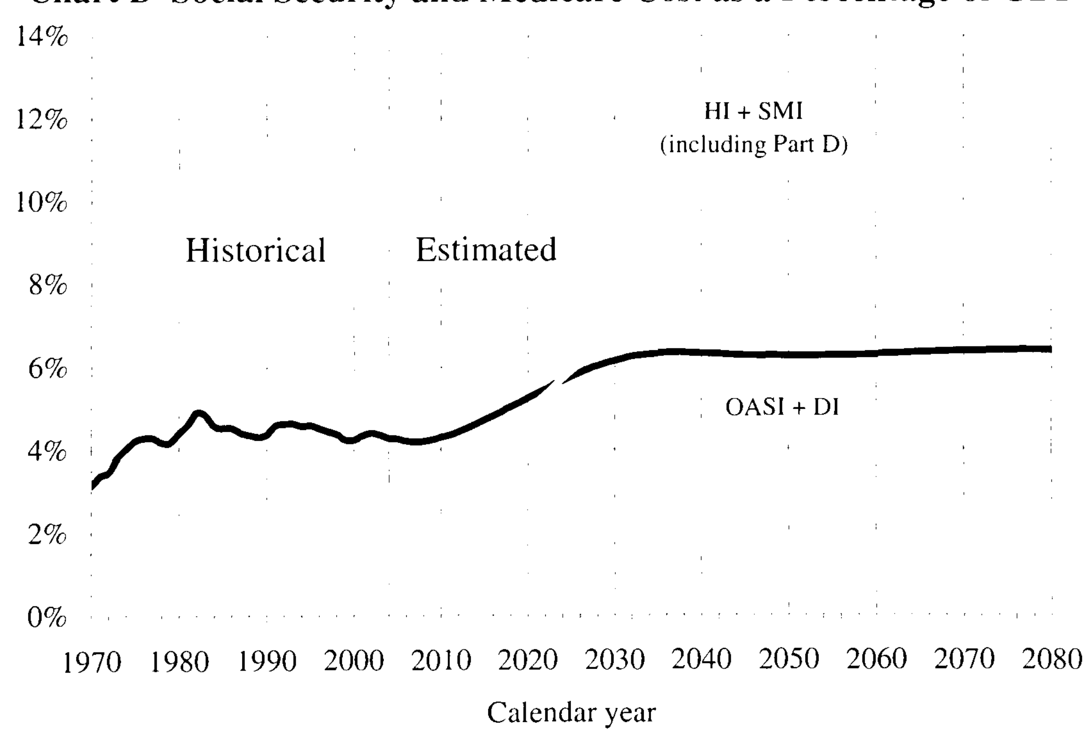
ESTIMATED OPERATIONS OF TRUST FUNDS

(In billions—totals may not add due to rounding)

	Income					Expenditures					Change in fund		
				SMI					SMI				
Year	OASI	DI	HI	B	D	OASI	DI	HI	B	D	OASI	DI	HI
2005	$594	$96	$195	$155	$7	$440	$86	$183	$153	$7	$154	$9	$12
2006	634	102	207	174	82	457	92	195	161	82	178	10	12
2007	671	107	218	177	90	477	98	208	170	90	195	9	10
2008	714	112	231	182	99	501	104	219	179	99	212	8	11
2009	755	117	243	205	109	531	113	233	187	109	224	5	9
2010	800	123	254	182	116	564	118	248	197	116	236	5	6
2011	849	129	268	209	128	602	124	265	207	128	247	5	3
2012	897	135	282	226	142	643	132	283	223	142	254	2	-1
2013	947	140	295	249	158	689	140	303	245	158	258	1	-8
2014	998	146	308	273	175	739	147	324	268	175	259	-1	-15

What is the Long-Range (2005-2079) Outlook for Social Security and Medicare Costs? Costs for both programs increase steeply between 2010 and 2030 because the number of people receiving benefits will increase rapidly as the large baby boom generation retires. Thereafter, Social Security costs grow slowly due primarily to projected increasing life expectancy. Medicare costs continue to grow rapidly due to expected increases in the use and cost of health care. In particular, the continued development of new technology is expected to cause per capita health care expenditures to continue to grow faster in the long term, as they have in the past, than the economy as a whole.

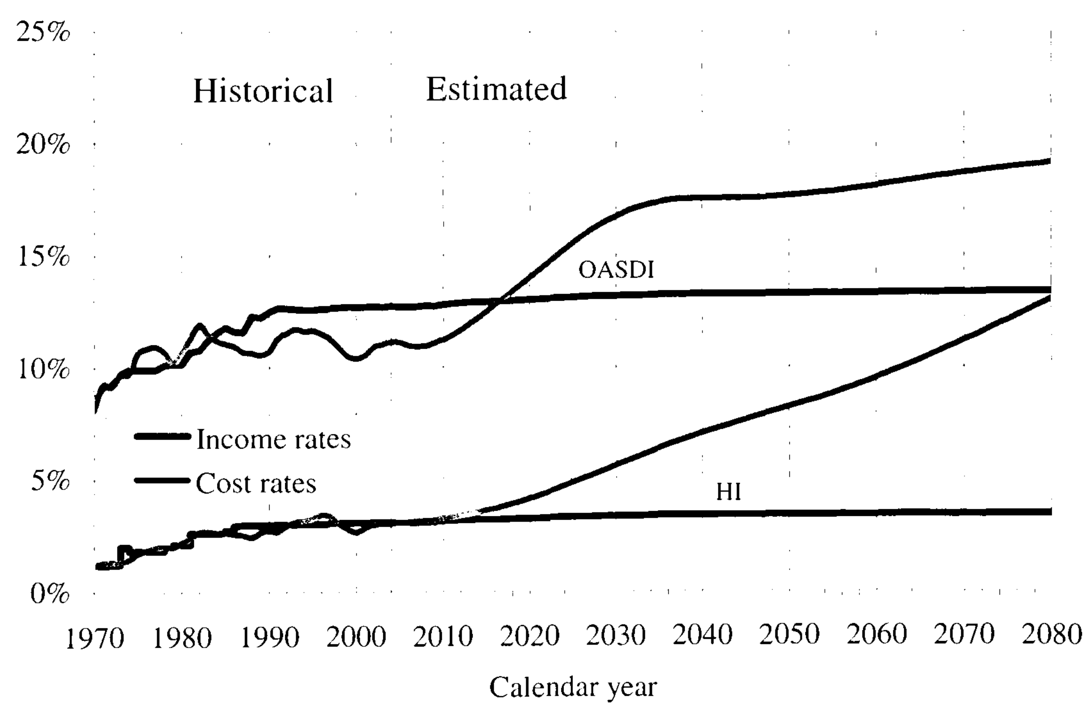
Chart B–Social Security and Medicare Cost as a Percentage of GDP



Thus, a good way to view the projected cost of Social Security and Medicare is in relation to gross domestic product (GDP), the most frequently used measure of the total U.S. economy (Chart B). Medicare's cost will first exceed Social Security's in 2024. Social Security outgo amounted to 4.3 percent of GDP in 2004 and is projected to increase to 6.4 percent of GDP in 2079. Medicare's cost was smaller in 2004, 2.6 percent of GDP, but is projected to grow more than fivefold to 13.6 percent of GDP in 2079, when it will be more than twice that of Social Security.

What is the Outlook for OASDI and HI Costs Relative to Tax Income? Although Medicare's and Social Security's costs are projected to grow substantially faster than the economy over the next several decades, tax income to the HI and OASDI Trust Funds is not. Because their primary source of income is the payroll tax, it is customary to compare HI and Social Security income and cost rates as a percentage of taxable payroll, as in Chart C. Note that the income rate lines do not rise substantially over the long run. This is because payroll tax rates are not scheduled to change and income from the other tax source to these programs, taxation of OASDI benefits, will rise only gradually from a greater proportion of beneficiaries being subject to taxation in future years.

Chart C–Income and Cost Rates
[Percentage of taxable payroll]



What is the Long-Range Actuarial Balance of the OASI, DI, and HI Trust Funds? The traditional way to view the outlook of the payroll tax-financed trust funds is in terms of their actuarial balances for the 75-year valuation period. The actuarial balance of a fund is essentially the difference between annual income and costs, expressed as a percentage of taxable payroll, summarized over the 75-year projection period. Because

SMI is brought into balance annually through premium increases and general revenue transfers, actuarial balance is not a useful concept for that program.

The OASI, DI, and HI Trust Funds each have an actuarial deficit under the intermediate assumptions, as shown below. Each actuarial deficit can be interpreted as the percentage that could be either added to the current law income rate or subtracted from the cost rate for each of the next 75 years to bring the funds into actuarial balance. However, such uniform changes, while adequate for this period as a whole, would close less than one-third of the gap for 2079 between the annual income and cost rates for OASDI and HI shown in Chart C.

LONG-RANGE ACTUARIAL DEFICIT OF THE OASI, DI, AND HI TRUST FUNDS
(As a percentage of taxable payroll)

	OASI	DI	OASDI	HI
Actuarial Deficit	1.60	0.32	1.92	3.09

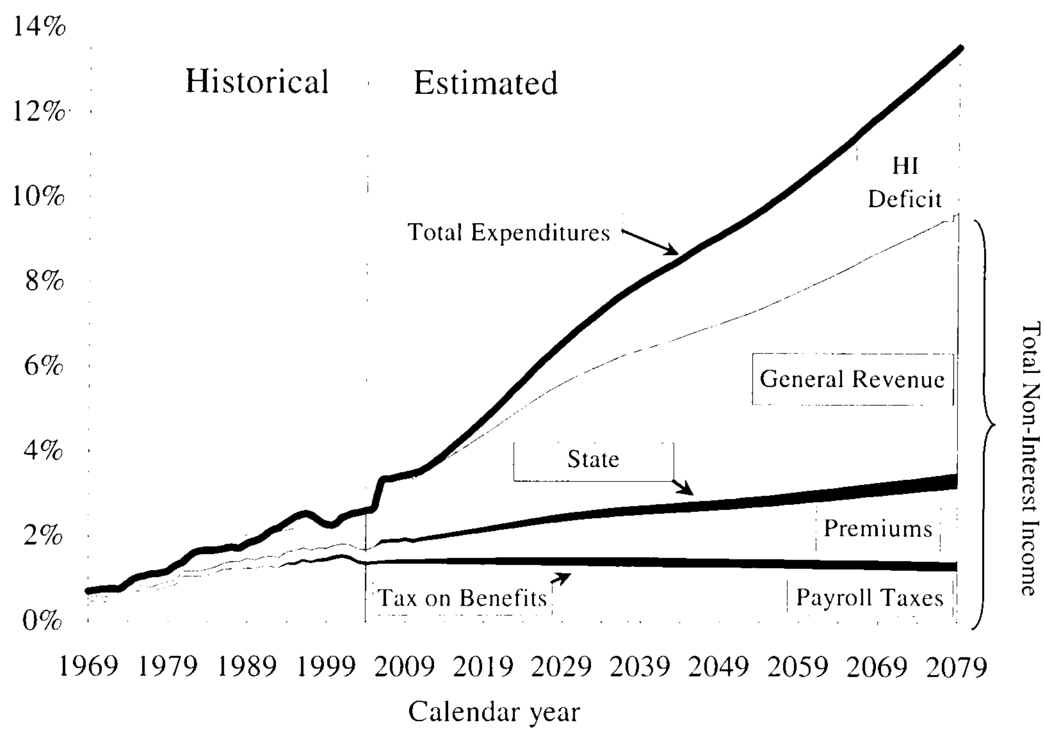
What Are Key Dates in Long-Range OASI, DI, and HI Financing? When costs exceed tax income (shown in Chart C), use of trust fund assets occurs in stages. For HI the process began in 2004, when interest earnings had to be used to help pay benefits. Beginning in 2012 assets will have to be redeemed each year until the trust fund is exhausted in 2020. At that time, tax income is estimated to be sufficient to pay 79 percent of HI costs—and by 2079 only 27 percent. OASDI first needs to utilize interest in 2017 and to begin redeeming assets in 2027. OASDI assets are projected to be exhausted in 2041, when tax income would cover 74 percent of costs—and by 2079 only 68 percent. The key dates regarding cash flows are shown below.

KEY DATES FOR THE TRUST FUNDS

	OASI	DI	OASDI	HI
First year outgo exceeds income excluding interest	2018	2005	2017	2004
First year outgo exceeds income including interest	2028	2014	2027	2012
Year trust fund assets are exhausted	2043	2027	2041	2020

How Do the Sources of Medicare Financing Change? As Medicare costs grow over time, general revenues and beneficiary premiums will play a larger role in financing the program. Chart D shows expenditures and current law non-interest revenue sources for HI and SMI combined as a percentage of GDP. The total expenditure line is the same as shown in Chart B and shows Medicare costs rising to 13.6 percent of GDP by 2079. Revenues from taxes are expected to remain just over 1.4 percent of GDP, while general fund revenue contributions are projected to rise from 1.0 percent in 2005 to 6.2 percent in 2079, and beneficiary premiums from 0.3 to 1.7 percent of GDP. Thus, revenues from taxes will fall substantially as a share of total non-interest Medicare income (from 53 percent to 15 percent) while general fund revenues will rise (from 35 to 64 percent), as will premiums (from 12 percent to 18 percent). The gap between total non-interest income and expenditures steadily widens due to growing annual HI deficits, which reach 4 percent of GDP by 2079. Medicare law now requires a determination in future reports of whether the difference between total outlays and earmarked revenues (the first four layers in Chart D) exceeds 45 percent of total Medicare outlays within the first 7 years of the 75-year projection period. That threshold is now expected to be reached in 2012.

Chart D–Medicare Expenditures and Non-Interest Income by Source as a Percent of GDP



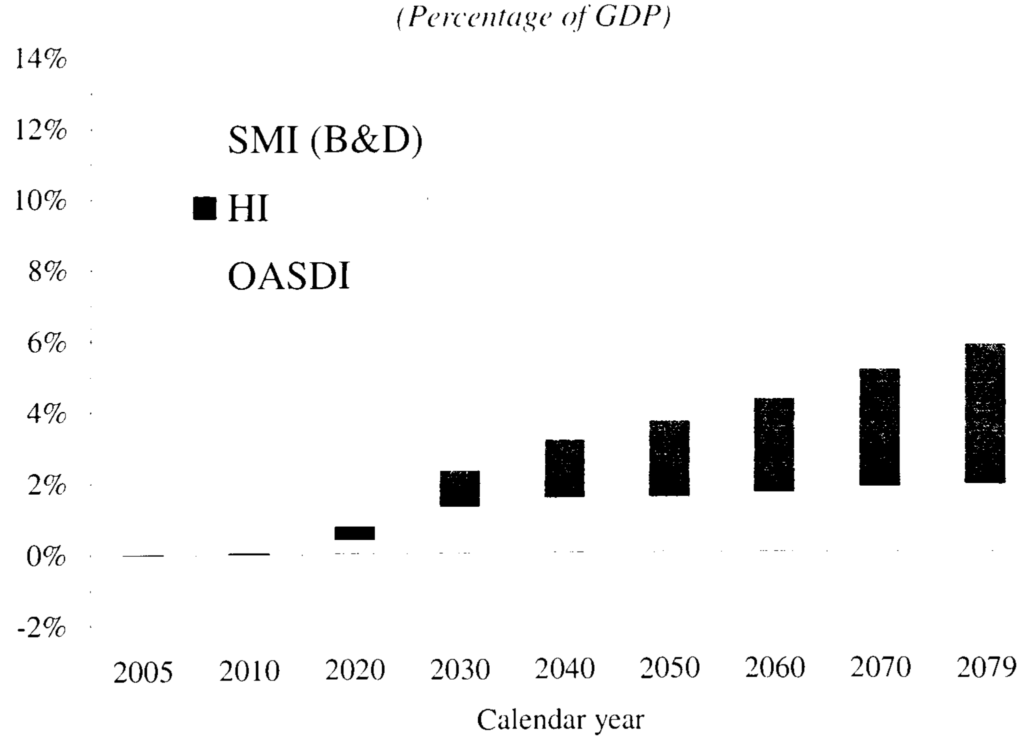
Why is Reform to Improve the Medicare and Social Security Financial Imbalance Needed? Public concern about the financial status of Medicare and Social Security tends to focus on the HI and OASDI Trust Fund exhaustion dates when benefits scheduled under current law can no longer be paid in full. But there are more immediate and fundamental reasons why Medicare and Social Security financing reform is needed. The two programs together will place greater demands on Federal general fund revenues long before trust fund exhaustion, and their financing in the long term is more problematic than suggested by the 75-year actuarial deficits for HI and OASDI.

The mounting financial shortfall in these programs is illustrated in Chart E. It shows, as a percentage of GDP, the gap between annual HI and OASDI tax income and the cost of scheduled benefits, plus the 75 percent general fund revenue contributions to SMI's Part B and Part D. The initial negative amounts for OASDI in 2005 and for more than a decade thereafter represent net revenues to the Treasury that result in the issuance of Treasury bonds to the trust funds in years of annual cash flow surpluses. Conversely, the positive amounts for OASDI and HI initially represent payments the Treasury must make to the funds when assets are redeemed to help pay benefits in the years leading up to exhaustion of the funds. After the exhaustion date, the positive amounts depict growing shortfalls in program finances.

In 2005 the Social Security tax income surplus is estimated to be more than offset by the shortfall in tax and premium income for Medicare, resulting in a small overall cash shortfall that must be covered by transfers from general fund revenues. The combined shortfall is projected to grow each year such that by 2017 net revenue flows from the general fund to the trust funds will total $515 billion, or 2.3 percent of GDP. Since neither the interest paid on the Treasury bonds held in the HI and OASDI Trust Funds, nor their redemption, provides any net new income to the Treasury, the full amount of the required Treasury payments to these trust funds must be financed by some combination of increased taxation, increased Federal borrowing and debt, or a reduction in other government expenditures. Thus, these payments along with the 75 percent general fund revenue contributions to SMI will add greatly to pressures on Federal general fund revenues much sooner than is generally appreciated.

Chart E–OASDI and HI Income Shortfall to Pay Scheduled Benefits, and the 75 Percent General Fund Revenue Contribution to SMI

(Percentage of GDP)



It is also evident from Chart E that currently projected benefit costs for Medicare and Social Security pose a far more serious long-term financing problem than is often recognized. There is a big increase in the shortfall of dedicated payroll tax and premium income in the 2010 to 2030 period as the baby boom generation reaches retirement age, but this shortfall continues to grow rapidly after that point due to health care costs that are expected to grow faster than GDP and to the increasing life expectancy of beneficiaries. In 2004 the combined annual cost of HI, SMI, and OASDI was about 7 percent of GDP, or two-fifths of total Federal revenues. It is projected to double to 14 percent of GDP by 2040 and then to rise further to 20 percent of GDP in 2079, at which time it would exceed total Federal revenues at their historic share of 19 percent of GDP. We do not believe such a long-term rate of growth for the two programs can be sustained.

In summary, the projections for Medicare and Social Security under current law manifest mounting draws on Federal general fund revenues, exhaustion of trust funds beginning in 15 years (for HI) that would not permit full payment of currently scheduled benefits, and unsustainable long-term growth in costs. The sooner these problems are addressed, the more varied and less disruptive will be their solutions.

A MESSAGE FROM THE PUBLIC TRUSTEES

These are the fifth annual Trustees Reports in which we have participated, and our extended terms end upon the issuance of these reports. Our goal as Public Trustees has been to ensure the integrity of the process by which these reports are prepared and the credibility of the information they contain. We believe that the Public Trustees' role is important and urge the President to nominate, and the Senate to confirm, Public Trustees for new terms as soon as possible, so that they can be full participants in the process leading up to next year's reports.

Changes in Outlook Over the Past Five Years

The long-term financial outlooks for Medicare and for Social Security have changed little from last year's reports. Therefore, we focus here on how those outlooks have altered during our watch over the last five years, and on some lessons we have learned during that time in helping determine the annual Trustees' projections.

The financial outlook for Social Security has improved marginally since 2000 due to a myriad of factors, including updated information on immigration, a better economic outlook and improvements in projection methodology. Annual cash-flow deficits for the combined OASDI Trust Funds are now projected to begin two years later (2017 rather than the 2015 date projected five years ago), the exhaustion of trust fund assets is projected to occur four years later (2041 rather than 2037), and Social Security's cost as a percentage of gross domestic product (GDP) at the end of the 75-year period has decreased from 6.8 to 6.4. However, once they begin, the program's annual cash-flow deficits are still projected to grow rapidly through mid-century—and then more slowly thereafter—with trust fund income sufficient to pay only 74 percent of scheduled benefits at the time of asset exhaustion and 68 percent at the end of the 75-year projection period.

In sharp contrast, Medicare's financial outlook has deteriorated dramatically over the past five years and is now much worse than Social Security's. This is due primarily to a major change in the projected long-term growth rate of Medicare costs relative to that of the economy and, secondarily, to more rapid expenditure growth so far this decade than previously anticipated. In 2000 annual cash-flow deficits were projected to first appear for HI in 2010. But these deficits actually began last year, resulting in the projected exhaustion date for HI Trust Fund reserves moving forward from 2025 to 2020—at which time trust fund income would be *sufficient to pay only 79 percent of HI costs. HI costs are expected to rise so rapidly thereafter that trust fund income will be adequate to cover only 27 percent of program costs by the end of the 75-year period.*

The change in the outlook is equally stark for SMI, where Part B is now joined by the new Part D Prescription Drug Benefit. Annual income to the SMI Trust Fund is always projected to be sufficient to cover costs, since general revenue transfers and beneficiary premiums are automatically adjusted each year to achieve this outcome. But the required rate of growth of such revenues is far more than previously anticipated. With the retirement of the baby boom generation, SMI costs (as a percent of GDP) are now projected to nearly quadruple from 1.2 to 4.6 over the next 30 years and to continue to increase rapidly thereafter. As a result, total Medicare expenditures are now projected to increase from 2.6 to 5.7 percent of GDP by 2024, when Medicare expenses will first exceed those of Social Security. By the end of the 75-year period, the cost of Medicare is now expected to approach 14 percent of GDP. In contrast, in 2000 the cost was projected to be less than 4 percent of GDP in 2024 and to reach only 5.3 percent of GDP by the end of the 75-year period.

A notable addition to the Trustees Reports during our tenure has been the inclusion of new measures that summarize program finances for a period extending beyond the traditional 75 years and indicate whether those finances can be expected to improve in this extended time frame. These measures indicate that both Social Security and Medicare will be subject to increasing deficits into the indefinite future under current policies.

Two important observations follow from an examination of the 2000-2005 Trustees Reports projections. First, Medicare's costs are expected to grow at a much faster rate than those of Social Security. The impending retirement of the baby boom generation, continued lower birth rates, and further increases in life expectancy thereafter will cause the costs of both programs to grow faster than the economy. But Medicare's costs are also fueled by ever increasing scientific knowledge, medical technology incorporating that knowledge, and per capita utilization of the resulting health care capabilities. The second observation follows from the first: there is considerable inherent uncertainty in the future path of costs under current law for both programs, with projections for Medicare being a less reliable guide than those for Social Security the further out in time they go. In the balance of this message we briefly examine the reasons for the uncertainty inherent in these projections and the relevance to policy discussions.

What are the Major Sources of Uncertainty in the Projections?

There are two major sources of uncertainty inherent in the long-term projections for Medicare and Social Security.

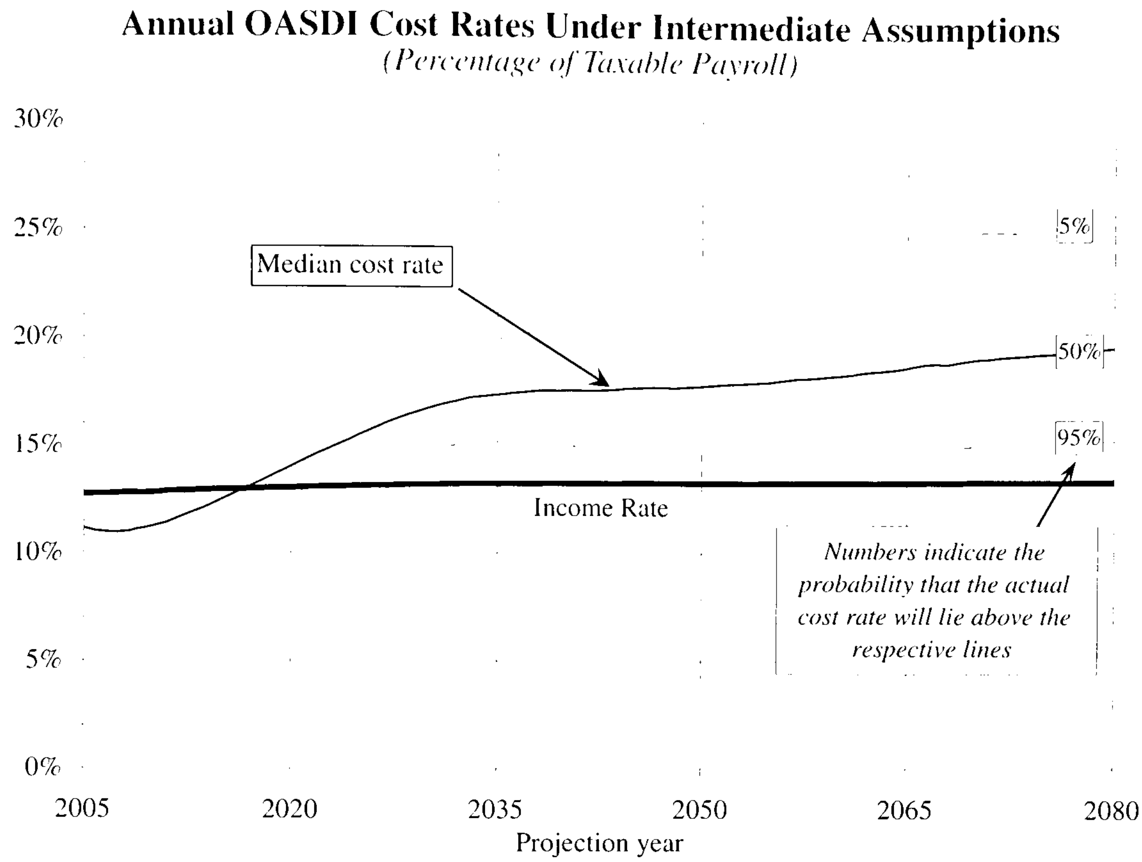
First, the projections for both programs depend on many common factors, including the size and characteristics of the population receiving program benefits, the size of the American workforce, and the level of workers' earnings. The projections therefore require assumptions about future birth rates, death rates by age, immigration, marriage and divorce rates, retirement-age patterns, productivity gains, wage increases, inflation, and many other demographic and economic factors. Although historical experience is generally a good guide for the likely future courses of these factors, these courses cannot be known with certainty. When substantial change occurs in a factor in a concentrated period of time, it is particularly difficult to sort out how much of it is simply a movement to a new level of related activity and how much represents a change in a long-term trend. For example, expert economic opinion remains divided on whether the revolution in information technology, which has contributed to the recent productivity surge, will provide continuing year-to-year productivity increases for only another decade or so, or for many more decades into the future (as did the spread of the steam engine and then electric power in the past).

Minor variations in assumptions about the future paths of important factors can lead to significant differences in expected program costs and revenues over many decades. This is illustrated in the differences between the long-term projections for Social Security done by the Trustees and those done by the Congressional Budget Office (CBO) for the first time last year. CBO utilizes the same demographic assumptions as the Trustees but somewhat more optimistic economic assumptions. While the fundamental character of the financial future portrayed for the program under the two sets of projections is quite similar, there are substantial differences in the details of the projections—most notably in the expected date of trust fund exhaustion.

There are also sources of uncertainty specific to the long-term Medicare projections beyond those inherent in the economic and demographic assumptions common to both programs: for example, the rate of scientific breakthroughs, the frequency of release of "blockbuster" drugs, new diseases or widespread recurrence of older ones, and new medical treatment techniques that improve the quality of or prolong life. Such factors have *been a principal reason that per capita health care costs have grown well over two percent more rapidly than has per capita GDP over the past half-century. The intermediate projections of the Medicare Trustees prior to 2001 assumed the difference in the two growth rates would gradually decline to zero over the subsequent 25 years. But this seemed an increasingly unrealistic expectation during the 1990s as evidence mounted for a persistent one to two percent differential due to the increasing use of new technologies. Pursuant to the recommendation of the 2000 Medicare Technical Panel, Trustees Reports since then have assumed this differential would decline to one percent after 25 years and remain at that level thereafter. While clearly an improvement, the current assumption is still subject to considerable uncertainty and reflects our relative ignorance about the forces at work in determining the long-term growth rate of health care costs. We strongly encourage further work on this important issue.*

The Trustees have traditionally reported projections based on intermediate, low cost, and high cost assumptions for the important factors determining the future financial status of Medicare and Social Security. The low and high cost alternatives assume that these factors vary individually, as well as collectively, in a direction resulting in an outcome that is either less or more costly, than the intermediate assumptions. While it may be reasonable for all these factors to vary together in a cost-increasing or cost-decreasing direction for several years in a row, as the length of the projection period expands, the likelihood that they will continue to do so declines dramatically. Thus, the low and high cost alternatives reflect very low probability outcomes.

Since 2003 the Trustees Reports have included a presentation based on stochastic modeling techniques in order to communicate the uncertainty involved in the projections more effectively. An important advantage of such techniques is that they assign probabilities to possible outcomes that can be displayed in graphic form to illustrate the uncertainty surrounding the intermediate assumptions more clearly. The chart shows the probability distribution of year-by-year Social Security costs as a percentage of taxable payroll. (The income rate also is shown for comparison but as a single line as it is set largely by law.) The blue area surrounding the median cost rate denotes a 90% confidence interval (i.e., the probability of the actual cost rate lying within this area is projected to be 90%). The widening of the confidence interval as the projection extends further into the future provides a strong visual impression of the increasing uncertainty over time. But it is important to recognize that the stochastic results *are sensitive to many technical choices made by forecasters and, at this juncture, are more useful as illustrative devices than precise depictions.*



Conclusion

The economy has strong equilibrating mechanisms over long periods of time. Despite the uncertainties discussed above, we believe that the central tendencies of the long-run projections for Medicare and Social Security are robust: demographics are driving both and nearly unimaginable changes in expected rates of fertility, mortality, and immigration would be required to dramatically alter the long-term financial outlooks for the two programs for the better or worse. Furthermore, the costs of Medicare under current policies will continue to be strongly influenced by the fact that, as incomes increase, so does the value of health care. Thus, expenditure on health care can be expected to rise faster than non-health care consumption for the foreseeable future. Prudence dictates action sooner rather than later to address the challenges posed by the financial outlook for both Medicare and Social Security.

John L. Palmer, *Trustee*	*Thomas R. Saving,* *Trustee*

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 24, 2005
JS-2333

Secretary John W. Snow
Prepared Remarks: The Wilmington Club
Wilmington, DE

Thank you so much for having me here; it's great to be in Wilmington.

I appreciate the chance to talk with you about strengthening the nation's Social Security system. The President's leadership on this issue is providing our country with a tremendous opportunity to save Social Security for current and near retirees and improve it for younger generations. Conversations like this are an important part of reaching decisions as to what, exactly, should be done.

Since March 3rd, Administration officials – from President Bush and Vice President Cheney to Cabinet members like me and policy experts – have been traveling throughout the country as part of a coordinated 60-day tour of at least 60 stops to discuss the President's message of strengthening Social Security with the American people.

We passed the 20 day mark this week, and so far we have traveled to 58 events in 24 states to talk about the need for a permanent fix to save Social Security for future generations. We'll hit the 60 stop mark this afternoon – after less than 30 days on the road – and the final number of stops will be much higher than anticipated.

We were reminded of the serious nature of the Social Security problem yesterday, back in Washington, DC, when the Social Security and Medicare Trustees – for whom I serve as Board Chairman – issued our annual report on the financial health if the programs' trust funds. The numbers contained in the Social Security report leave little doubt that the system is financially unsustainable, and in need of expeditious and lasting change.

The Trustees' report showed that Social Security cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The unfunded obligation, that is, the difference between the present values of Social Security inflows (plus the trust fund) and outflows, is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

Now, the President doesn't believe that we should make up that shortfall with tax increases. The report showed just how much we would have to raise taxes to achieve long-term balance: the payroll tax rate would have to be raised immediately by 3.5 percentage points to make the system whole on a permanent basis. In other words, the payroll tax would have to be increased by nearly 30 percent.

That kind of tax increase would have significant, negative economic repercussions. Americans would start taking home less pay, and that's bad for countless facets of our economy. I imagine that, as business owners, you appreciate what I'm saying. After all, you would shoulder half of that tax increase – because you pay that tax on all of your employees. For the smallest of employers I fear that much of a tax increase would force you to make terrible choices, from lay-offs to health benefit cuts. And it would make hiring new people even more difficult. Am I right?

Increasing payroll taxes hurts the economy and it hurts job creation, period. We know this from talking to business leaders like you, and that's why the President is against it.

It is also worth noting that payroll tax increases have been the standard "solution" to Social Security's problems, and they have never solved the problem! Payroll taxes have been raised some 20 times since Social Security was established – and it has failed to make the system solvent.

Tax increases aren't the answer, so the President has encouraged the Congress to propose a variety of ideas that might be, and he has put a number of ideas on the table as well.

When the President took this issue to the country in his State of the Union Address, he said his objective was to engender a broad national dialogue to get people talking about this issue. He wanted Americans to talk about Social Security, and a national conversation has begun as a direct result.

Today, people are talking about the issue from the halls of Congress to the halls of local shopping malls! The President's leadership has drawn critical attention to the problem and is creating movement. Progress, real progress, is being made.

Over lunch counters, over breakfast and dinner tables all over America... the topic is Social Security reform. It's the front page story in virtually every newspaper. It's on the evening news. And it's there because of the President of the United States. It's there because of the courage that he's had to directly confront and deal with what so many in political life call the "third rail."

The American people respect leaders who call a spade a spade. The President touched the "third rail" without fear, and now we're moving forward. Neighbors and co-workers are talking about it; families are talking about it; Congress is talking about it.

We've seen a clear shift in the course of the last month or so from the question: "Is there a problem?" to the question: "How do we fix it?"

I imagine that you are talking about it with your spouse and family members, your business partners, customers and employees. Those conversations are critical, and I hope our meeting here today can help make them even more lively, more productive.

I know that you understand that if you are 55 or older your Social Security benefits are solid. They will not change. You know that you don't need to change your retirement plan or strategy because of Social Security reform, period.

But now I'll ask: how many of you have children or grandchildren? It's those children and grandchildren, those young workers and future workers, who we need to be worried about. They are the ones for whom we need to fix this system.

The issue of Social Security is really a matter of basic arithmetic, and the threat to Social Security in the near future makes more sense when you look at the simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system, supporting the retirees drawing benefits.

In 1950, there were 16 workers to support every beneficiary of Social Security - a very comfortable ratio of those paying in versus those drawing benefits. Today there are only 3.3 workers supporting every beneficiary. By the time today's youngest workers – many of you have children in that age group – turn 65, there will only be two workers supporting each retiree.

Just three years from now, in 2008, the first baby boomers will begin to retire. According to the new Trustees' report, the government will begin to pay out more in Social Security benefits than it collects in payroll taxes in 2017 – that's just 12 years from now. By 2041, when younger workers begin to retire, the system will be bankrupt.

We must make Social Security better for those younger workers.

Raising their payroll taxes won't make it better. What the President would like to see, instead, for future generations is an ability to save some of their payroll taxes, to build a nest egg that belongs to them, not to the government. Something they could pass on to their heirs. A nest egg that would give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits.

Albert Einstein believed, and the President and I agree, that compound interest is one of the most powerful forces in the universe.

With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

For the life of me, I can't imagine why anybody would argue against young workers having the ability to invest and build a better retirement for their future. It costs the Social Security system nothing to do so, it will cost current and near-retirees nothing, it gives our children and grandchildren a better retirement, and it helps our country create a larger pool of savings. And as the president has said the retirement security of our young people is too important for partisan politics. Why wouldn't we do this? I have not heard one good reason not to and it's hard to figure out why anybody would oppose it.

Additionally, as former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed recently, "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg." The President and I couldn't agree more.

Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren ca*n be achieved.*

We are part of an exciting moment in American history, where a President's courageous leadership has inspired a national discussion and, I'm confident, will lead to historic results. I encourage you to be involved, whether it's talking about the issue with your colleagues, with your children, or writing a letter to your Members of Congress.

Many of you in this room may want to pass your business on to your children or grandchildren. I know you'll want your business to be in top shape, financially, when that time comes.

Let's make sure we do the same with Social Security. If we act now, we can make sure that Social Security, and our economy, are on sound financial footing for our children and grandchildren.

Thanks so much for having me here today.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 24, 2005
JS-2334

Secretary John W. Snow
Prepared Remarks
Chester County Chamber of Business and Industry
at Exelon Corporation
Kennett Square, PA

Thank you so much for having me here; it's great to be in Kennett Square,and I'm delighted to be able to visit Exelon.

I appreciate the chance to talk with you about strengthening the nation's Social Security system. The President's leadership on this issue is providing our country with a tremendous opportunity to save Social Security for current and near retirees and improve it for younger generations. Conversations like this are an important part of reaching decisions as to what, exactly, should be done.

Since March 3rd, Administration officials – from President Bush and Vice President Cheney to Cabinet members like me and policy experts – have been traveling throughout the country as part of a coordinated 60-day tour of at least 60 stops to discuss the President's message of strengthening Social Security with the American people.

We passed the 20 day mark of this tour this week, and I'm proud to announce that this stop, here at Exelon, is number 60! We've hit this mark after less than 30 days on the road – and the final number of stops will be much higher than anticipated.

We were reminded of the serious nature of the Social Security problem yesterday, back in Washington, DC, when the Social Security and Medicare Trustees – for whom I serve as Board Chairman – issued our annual report on the financial health if the programs' trust funds. The numbers contained in the Social Security report leave little doubt that the system is financially unsustainable, and in need of expeditious and lasting change.

The Trustees' report showed that Social Security cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The unfunded obligation, that is, the difference between the present values of Social Security inflows (plus the trust fund) and outflows, is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

Now, the President doesn't believe that we should make up that shortfall with tax increases. The report showed just how much we would have to raise taxes to achieve long-term balance: the payroll tax rate would have to be raised immediately by 3.5 percentage points to make the system whole on a permanent basis. In other words, the payroll tax would have to be increased by nearly 30 percent.

That kind of tax increase would have significant, negative economic repercussions. Americans would start taking home less pay, and that's bad for countless facets of our economy. I imagine that, as business owners, you appreciate what I'm saying. After all, you would shoulder half of that tax increase – because you pay that tax on all of your employees. For the smallest of employers I fear that much of a tax increase would force you to make terrible choices, from lay-offs to health benefit cuts. And it would make hiring new people even more difficult. Am I right?

Increasing payroll taxes hurts the economy and it hurts job creation, period. We know this from talking to business leaders like you, and that's why the President is against it.

It is also worth noting that payroll tax increases have been the standard "solution" to Social Security's problems, and they have never solved the problem! Payroll taxes have been raised some 20 times since Social Security was established – and it has failed to make the system solvent.

Tax increases aren't the answer, so the President has encouraged the Congress to propose a variety of ideas that might be, and he has put a number of ideas on the table as well.

When the President took this issue to the country in his State of the Union Address, he said his objective was to engender a broad national dialogue to get people talking about this issue. He wanted Americans to talk about Social Security, and a national conversation has begun as a direct result.

Today, people are talking about the issue from the halls of Congress to the halls of local shopping malls! The President's leadership has drawn critical attention to the problem and is creating movement. Progress, real progress, is being made.

Over lunch counters, over breakfast and dinner tables all over America... the topic is Social Security reform. It's the front page story in virtually every newspaper. It's on the evening news. And it's there because of the President of the United States. It's there because of the courage that he's had to directly confront and deal with what so many in political life call the "third rail."

The American people respect leaders who call a spade a spade. The President touched the "third rail" without fear, and now we're moving forward. Neighbors and co-workers are talking about it; families are talking about it; Congress is talking about it.

We've seen a clear shift in the course of the last month or so from the question: "Is there a problem?" to the question: "How do we fix it?"

I imagine that you are talking about it with your spouse and family members, your business partners, customers and employees. Those conversations are critical, and I hope our meeting here today can help make them even more lively, more productive.

I know that you understand that if you are 55 or older your Social Security benefits are solid. They will not change. You know that you don't need to change your retirement plan or strategy because of Social Security reform, period.

But now I'll ask: how many of you have children or grandchildren? It's those children and grandchildren, those young workers and future workers, who we need to be worried about. They are the ones for whom we need to fix this system.

The issue of Social Security is really a matter of basic arithmetic, and the threat to Social Security in the near future makes more sense when you look at the simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system, supporting the retirees drawing benefits.

In 1950, there were 16 workers to support every beneficiary of Social Security - a very comfortable ratio of those paying in versus those drawing benefits. Today there are only 3.3 workers supporting every beneficiary. By the time today's youngest workers – many of you have children in that age group – turn 65, there will only be two workers supporting each retiree.

Just three years from now, in 2008, the first baby boomers will begin to retire. According to the new Trustees' report, the government will begin to pay out more in Social Security benefits than it collects in payroll taxes in 2017 – that's just 12 years from now. By 2041, when younger workers begin to retire, the system will be bankrupt.

We must make Social Security better for those younger workers.

Raising their payroll taxes won't make it better. What the President would like to see, instead, for future generations is an ability to save some of their payroll taxes, to build a nest egg that belongs to them, not to the government. Something they could pass on to their heirs. A nest egg that would give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits.

Albert Einstein believed, and the President and I agree, that compound interest is one of the most powerful forces in the universe.

With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

For the life of me, I can't imagine why anybody would argue against young workers having the ability to invest and build a better retirement for their future. It costs the Social Security system nothing to do so, it will cost current and near-retirees nothing, it gives our children and grandchildren a better retirement, and it helps our country create a larger pool of savings. And as the president has said the retirement security of our young people is too important for partisan politics. Why wouldn't we do this? I have not heard one good reason not to and it's hard to figure out why anybody would oppose it.

Additionally, as former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed recently, "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg." The President and I couldn't agree more.

Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren *can be achieved*.

We are part of an exciting moment in American history, where a President's courageous leadership has inspired a national discussion and, I'm confident, will lead to historic results. I encourage you to be involved, whether it's talking about the issue with your colleagues, with your children, or writing a letter to your Members of Congress.

Many of you in this room may want to pass your business on to your children or grandchildren. I know you'll want your business to be in top shape, financially, when that time comes.

Let's make sure we do the same with Social Security. If we act now, we can make sure that Social Security, and our economy, are on sound financial footing for our children and grandchildren.

Thanks so much for having me here today.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 25, 2005
JS-2335

Assistant Treasury Secretary Mark Warshawsky's Remarks to the American Enterprise Institute on the Urgent Need for Social Security Reform

Thank you for the kind introduction. It's both an honor and a pleasure to be speaking here at the American Enterprise Institute, which is so well known and highly regarded for its careful and thoughtful analysis of public policy issues.

This morning, I'm sure Mark McClellan, Rick Foster and Steve Goss did able jobs of bringing you up to date on the financial outlooks for Medicare and Social Security as documented in the latest Trustees' Reports. So my remarks today will cover different ground. I will begin by giving praise to the process that generates the reports. I will then turn to my main topic--why it is important that responsible Social Security reform occur now, and why one element of a successful reform plan must be personal retirement accounts. Finally, I will say a few words about Medicare.

The Process Generating the Trustees' Reports

As evidenced by this conference, the Trustees' Reports get a lot of attention and are extremely influential. And well they should in my opinion! The reports have consistently provided a wealth of information in a clear and impartial format. No doubt many of the numbers in this year's Social Security report will be commonly referenced in the ongoing reform debate; for example, 2017 as the first year with negative projected cash-flows, 2041 as the year of trust fund exhaustion, $4.0 trillion as the 75-year unfunded obligation, and $11.1 trillion as the infinite horizon unfunded obligation.

My experience tells me that four important factors underlie the credibility and objectivity of the Trustees Reports. First is the composition of the Board of Trustees, which since 1984 includes two members from the private sector, the so-called "public" members, in addition to the four ex-officio members. The public members, who cannot both be from the same political party, have served the purpose espoused by the 1983 Greenspan Commission, which is to increase the public "confidence in the integrity of the trust funds." Since 1984 the Boards have had four sets of public trustees, including the most recent members Professors Tom Saving and John Palmer. All have served admirably.

The second factor contributing to the integrity of the Trustees' reports is the periodic review by external experts of the methods and assumptions underlying the projections. These reviews result in widely disseminated reports. Most recently, the assumptions and methods underlying the 2004 Medicare report and the 2003 Social Security report were reviewed by separate technical panels. Both Panels made important contributions: For example, the Social Security Panel ratified the Trustees' decision to include in the Trustee Report the infinite-horizon unfunded obligation estimates and uncertainty estimates based on stochastic simulations and the Medicare Panel endorsed the Medicare actuaries' methods for projecting prescription drug benefit costs.

The third factor contributing to the integrity of the Trustees' reports are the Actuaries' opinions at the end of the Reports. The Actuaries have fully endorsed the assumptions and methods underlying the projections.

The fourth and final factor contributing to the integrity of the Trustees' reports is a recent innovation to the report-generating process of which I am especially proud. Preparation of the Trustees reports is now a year-round effort, involving professionals from each of the interested agencies that bring to the table an enormous amount of knowledge and experience. Each year, starting soon after the spring Trustees' meeting, the Trustees' staffs along with the Actuaries and the Public Trustees examine ways to improve both the presentation and the substance of the reports. This is a top-to-bottom evaluation that ranges from potential language changes in the reports to background studies of the economic and demographic underpinnings of the projections. Agreed-upon improvements are recommended to the Board at the fall meeting. I am especially heartened at the deep involvement in this process of the Public Trustees, the Actuaries, and their respective staffs.

As a result of these annual reviews, several substantive additions have been made to the reports in the past couple of years. Among these additions are an appendix to the Social Security report presenting stochastic simulations of trust fund projections, an appendix to the Medicare report describing the relationship between the trust funds and the federal budget (a detailed version can be found on Treasury's website), and, in both reports, estimates of unfunded obligations over the infinite horizon. A large number of presentational improvements have also been made. With some justification, we could add the words "New and Improved" to the title page of each annual report.

SOCIAL SECURITY REFORM

Now, let me turn to my main topic, Social Security reform. As you are aware, President Bush has made Social Security reform a major priority of his second term. Today I'll explain why it is so important that responsible Social Security reform occur now, and why one element of a successful reform plan must be personal retirement accounts that give individuals more control over their financial futures.

The Size of Social Security's Financial Shortfall

How big is Social Security's current funding gap? The most widely cited measure of that gap is the 75-year actuarial imbalance, which is now estimated at $4.3 trillion or 1.92 percent of taxable payroll. This measure suggests that immediately raising the payroll tax rate by 1.92 percentage points, to 14.32 percent, would fix Social Security. But as many of you are aware, that is not true. If the payroll tax rate was raised in that manner, a large Trust Fund balance would be accumulated in the short-term that would peak in about 2060, and would then commence a steady decline to complete exhaustion at the end of the 75-year projection period. This type of reform would therefore not make the system permanently solvent. With each passing year, the Trustees would report an ever larger financial imbalance as the 75-year scoring window is moved forward to include years with ever larger gaps between expected system costs and income.

As this example makes clear, estimates made over a 75 year horizon do not fully capture the financial status of the Social Security program. In fact, no finite forecast period completely embodies the financial status of the program because people pay taxes in advance of receiving benefits; at any finite cutoff date, people will have accrued benefits that have not yet been paid. For example, the current 75 year projections include nearly all of the 2010 birth cohort's taxes but virtually none of their benefits. In order to get a complete picture of Social Security's permanent financial problem, the time horizon for calculating income and costs must be extended to the indefinite future. Such a calculation is provided in the 2005 Trustees Report; it is estimated there that for the entire past and future of the program, the present value of scheduled benefits exceeds the present value of scheduled tax income by $11.1 trillion. This is the financing gap that program reforms must ultimately close. To put this in perspective, eliminating the permanent deficit could be accomplished with an immediate and permanent 3.5 percentage point increase in the payroll tax rate (to 15.9 percent), or with a 22 percent reduction in all current and future benefits. In both cases, there would be massive near-term Trust Fund accumulations.

The Administration insists that reform make Social Security permanently solvent. 75-year solvency is not sufficient. The permanent solvency goal was recently unanimously endorsed by the Senate in an amendment to the Senate Budget Resolution. That amendment states that "the American people including seniors, workers, women, minorities, and disabled persons should work together at the earliest opportunity to enact legislation to achieve a solvent and permanently sustainable Social Security system."

Intergenerational Equity: Why Social Security Must be Reformed Now

It is clear that the Social Security system is not financially viable and must be fixed. How to close the permanent financing gap raises difficult questions over how the net benefits of Social Security should be shared across generations. In this context, it is important to recognize that the large unfunded obligations in the system are primarily the consequence of the past system generosity to generations that are now either dead or retired. Of course, those early generations are beyond reform's reach, so the entitlement reforms needed to close the financing gap must fall entirely on later generations.

Viewing Social Security from the perspective of how it affects generations and individuals explains why it is imperative that Social Security be reformed now. Delaying reform only reduces the options for fairly distributing the benefits of Social Security across generations. Most people agree that it would not be fair to alter Social Security's promises to retirees and near retirees. The longer reform is delayed, the fewer generations that are left to participate in a reformed entitlement system so as to close Social Security's funding gap, and the more severe those reforms will be.

To make this point more concretely, consider a policy of closing Social Security's permanent financing gap by immediately increasing the payroll tax rate by 3.5 percentage points. If the tax increase were instead delayed until 2041 when the trust fund is depleted, the requisite tax increase would be 6.3 percentage points. Clearly, I do not advocate any of these policies. My point is that there is no doubt that fairness to future generations requires that action be taken now.

I would also point out that purely pay-as-you go financing of Social Security would be grossly unfair to future generations. For example, one way to make Social Security solvent would be to leave benefits unchanged and to raise payroll taxes year by year beginning when the Trust Fund is exhausted. According to current projections, the payroll tax rate under that policy would steadily rise beginning in 2041 and reach 19 percent at the end of the 75-year projection period. No reasonable person would view that as a fair policy. I conclude that any reform that is fair would at least partially pre-fund Social Security benefits.

Fixing the System

Fortunately, the current untenable situation of Social Security is fixable. President Bush has said that "Social Security is one of the greatest achievements of the American government, and one of the deepest commitments to the American people." The President supports social security reform that increases the power of the individual, does not increase the tax burden, and provides economic opportunity for more Americans. The President has issued guiding principles for reforming Social Security.

One very important principle is that the benefits of seniors at or near retirement should be protected, and that payroll taxes should not be increased.

Another principle is that personal retirement accounts (PRAs) should be made available for younger workers to build a nest egg for retirement that they own and control, and which they can pass on to their children and grandchildren.

Additionally, we must pursue the goal of a permanently sustainable system, eschewing halfway measures that would necessitate further reforms in the future.

Personal Retirement Accounts

I would like to focus on the advantages of PRAs. PRAs provide individual control, ownership, and offer individuals the opportunity to partake in the benefits of investing in private-sector markets. Individual control and ownership means that people would be free to pass the value of accounts to their heirs (bequests).

Personal retirement accounts will be voluntary. At any time a worker can "opt in" by making a one-time election to put a portion of his or her payroll taxes into a personal retirement account. A worker who chooses not to opt in will receive traditional Social Security benefits, reformed so as to make the system permanently solvent.

Perhaps most importantly, the retirement security of our current young and future workers depends on PRAs. PRAs allow individuals to save now to help fund their retirement incomes. In principle, that could be done with reforms that save tax revenues in the Social Security Trust Fund. But such "saving" would almost certainly be undone by political pressures to increase government spending and hence produce larger deficits outside of Social Security. The only way to truly save for our retirement and give our children and grandchildren a fair deal is with personal accounts. Personal accounts serve as private and therefore effective "lock boxes". When pre-funding is done using a personal account, there is no pressure to increase government spending, because this pre-funding belongs to individuals and does not appear on the government balance sheet as budget surpluses.

MEDICARE

Some have questioned the policy focus on Social Security when the financial shortfalls facing Medicare are so much larger than those facing Social Security. One reason is simply that much more analytical groundwork needs to be done and experience gathered before we as a society can begin to coalesce around options that completely address the unsustainable growth in Medicare and other health care expenditures. The same is not true of Social Security. Ever since the release of the 1994-96 Social Security Advisory Council report, the research and policy communities here in Washington and elsewhere have put a tremendous amount of thought and effort into exhaustively identifying and analyzing the possibilities for effective Social Security reform. Unlike with Medicare, we know our options very well.

But I assure you that the Administration is aware of the important issues with Medicare's finances, and, as I'll point out, has already begun to lay the necessary policy groundwork.

Medicare finances are projected to get out of hand not only because of an aging society, but more importantly because of rapidly increasing health care costs. High health cost growth is not a Medicare-specific problem, but an economy-wide problem. The same projections that show the Medicare program consuming 13.5 percent of GDP in 2079 also show health care consuming well over 40 percent of GDP that same year. So, efforts to confront unsustainable trends in Medicare expenditure growth must coincide with efforts to deal with unsustainable economy-wide health expenditure growth.

Indeed, the Administration has promoted incremental policies to make health care choices better informed and more responsive to costs and benefits. Several such policies were included in the Medicare Modernization Act (MMA). To promote consumer cost-consciousness, the MMA introduced health savings accounts, or HSAs, to the commercial health insurance market. The MMA also expanded the role of private plans in Medicare, and increased price competition between those plans.

Also, Medicare is just now beginning to collect data on hospital quality. We expect this data will lead to future reimbursement policies that reward not just utilization, but good outcomes as well. In addition, the Administration is currently exploring ways to encourage the adoption of health care information technology, which shows the promise of reducing errors and waste

CONCLUSION

To conclude, let me say that I am encouraged that Social Security reform is finally being earnestly debated, and that all parties are motivated to make Social Security fair and permanently solvent. Today, my small contribution to this debate consists of four major points:

1. Social Security as currently designed cannot be sustained. We know with absolute certainty that Social Security will ultimately be reformed. The only question is when and how.

2. Social Security reform is urgent. The longer reform is delayed, the more unfair

reform will be to future generations, and the more difficult it will be for individuals to plan their financial futures.

3. Social Security reform must make Social Security permanently solvent. Half measures ensure that further reforms will be necessary, and amount to a delay of reform that would be unfair to future generations.

4. Making Social Security permanently solvent requires that retirement incomes be pre-funded in PRAs rather than the Social Security Trust Fund. Any attempt to pre-fund retirement incomes in the Trust Fund would be undone by excessive government spending outside of Social Security.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 25, 2005
JS2336

MEDIA ADVISORY
Secretary Snow Visits Oregon, Montana and North Dakota Next Week to Discuss Strengthening and Preserving Social Security

U.S. Treasury Secretary John W. Snow will travel to Portland, Oregon; Bozeman, Montana; and Bismarck, North Dakota on March 28-31 to discuss the President's efforts to strengthen and preserve the U.S. Social Security system.

Following the release of the Social Security and Medicare Trustees' reports on March 23, Secretary Snow, the Managing Trustee of the Social Security and Medicare Trust Funds, said, "The numbers published today leave no question that Social Security reform is needed, and it is needed soon. Reform of this system, for the sake of our children, grandchildren and the financial future of our country, is a very real and pressing matter.

"The President is committed to saving Social Security and has laid out some basic principles," he said. "He wants to preserve benefits for current and near-retirees while saving and strengthening the system for future generations. For future generations of retirees, the President believes an awful lot of hope lies in personal accounts – something that would allow younger workers to build a nest egg that they own and control."

The following events are open to credentialed media with photo identification (credentials must be visible at all times):

Monday, March 28

Remarks and Discussion with FLIR System, Inc. Employees
FLIR Systems, Inc.
16505 SW 72nd Avenue
Portland, OR
2:00 p.m. PST
**** Media must RSVP to Doug Badger, (503) 260-3235**
**** Media must arrive by 1:15 p.m. PST**
**** A brief media availability will be held immediately following the event**

Wednesday, March 30

Remarks to Local Community Leaders
Holiday Inn
5 E. Baxter Lane
Bozeman, MT
9:00 a.m. MST
**** Media must arrive by 8:30 a.m. MST**
**** A brief media availability will be held immediately following the event**

Thursday, March 31

Breakfast Roundtable with Local Business Leaders
University of Mary
Harold Schafer Leadership Center Board Room
7500 University Drive
Bismarck, ND
7:30 a.m. CST
**** Media must RSVP to Tom Ackerman, 701- 471-5698**

**** Media must arrive by 7:00 a.m. CST**
**** A brief media availability will be held immediately following the event**

Remarks to Government Class at Bismarck High School
Bismarck High School
800 North 8th Street
Bismarck, ND
10:30 a.m. CST
**** Media must RSVP to Renae Walker, 701-258-2507**
**** Media must arrive by 10:00 a.m. CST**
**** A brief media availability will be held immediately following the event**

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 25, 2005
JS-2337

Prepared Remarks of Assistant Secretary Juan Zarate
Islamic Society of North America's Sixth
Annual Education Event

Assalamualaikum. Dear friends, I am honored to be here today to continue our engagement on important terrorist financing issues facing all of us, and to discuss the critical role of the American Muslim and Arab communities in protecting and promoting our collective interests in charitable giving.

Let me begin by thanking our hosts, the Islamic Society of North America and the Muslim Public Affairs Council, for inviting me to be a part of this weekend's gathering. The Treasury Department and the U.S. Government are committed to strengthening our relationship with the Islamic and Arab American communities to protect the interests that we all share as a free, tolerant and charitable society, and I am grateful for this opportunity to be with you today.

As we gather today, I am pleased to recognize many familiar faces. Such familiarity bears testimony to our sustained efforts and shared commitment to work together in protecting and promoting charitable giving, not just over the course of a weekend conference, but rather, on an ongoing basis to achieve meaningful and significant progress. The importance of our dialogue and cooperation in our collective mission cannot be overstated. In this sense, continuity is a welcome sign, and I view our gathering today as an opportunistic point along a progressive continuum of engagement to advance our efforts.

The Muslim and Arab American communities are essential elements of our great country's eclectic fabric. As all Americans unite in the fight against terrorism and terrorist financing, constructive engagement between your community and the U.S. Government is a vital aspect of the overall strategy to overcome those aiming to destroy the liberties we enjoy every day as Americans.

Over the last several years, the U.S. Treasury has established an important relationship and dialogue with the Muslim and Arab American communities as we work together to deal with the corrosive effects and threat of terrorist financing to the United States and the Muslim and Arab worlds. This relationship is acutely necessary as we work to protect and preserve the sanctity of charitable giving and Zakat from terrorist groups like al Qaida, which have purposely usurped the goodwill and donations of Muslims around the world to fuel their terrorist agenda. It is also critical to advancing our collective mission of promoting charitable relief and development around the world to those most in need of our assistance.

The American Muslim and Arab communities are uniquely situated to advance these interests. You all have the powers of the purse and persuasion to affect global practices and perceptions that are essential to protecting and promoting charitable giving and winning the long-term battle against terrorism.

Today's gathering is especially important, as diverse representatives from the American Muslim leadership join forces and minds to create a National Council of American Muslim Non-Profits. Your decision to establish the Council as a forum for developing and implementing best practices to ensure the effective and safe delivery of charitable funds and services creates tremendous opportunity - opportunity to effect positive and meaningful change at a time of great importance in the development of the Islamic and Arab worlds.

This development comes at an important crossroads - where the need to protect and promote charity around the world faces the challenge of terrorist abuse and corruption. We must combat this abuse and advance our charitable mission by working independently, and by working together. The development of a National Council for American Muslim Non-Profits represents a significant step forward in dealing with these challenges and in providing your community with a vehicle for promoting change. I am particularly excited about the opportunities that the Council will have to advance the interests we share.

Let me talk for a moment about how we view charity and the importance we ascribe to it. Charitable giving is a proud and vibrant component of virtually every community in America, regardless of religion, culture or background. This is especially true in the case of Islam, where Zakat - or charity - is a pillar of the faith. Charitable giving and the benevolent work of non-profits within the American Muslim community are dignified characteristics of your faith. We appreciate and respect the importance Z in the Muslim community, just as we encourage the charitable nature of all Americans.

The U.S. Government is also devoted to altruistic works. President Bush, at the beginning of this month, announced that we had awarded $2 billion in grants in 2004 to social programs operated by churches, mosques and synagogues The President also announced in the State of the Union that he would ask Congress for $350 million for the Palestinians to support - both immediately and in the long-term - political, economic and security reforms. Additionally, since 1993 the Palestinian people have received more than $1.5 billion in U.S. economic assistance via USAID projects - more than from any other donor country. These commitments reflect the generous and philanthropic culture that defines America.

We need look no further than the recent tsunami disaster in South Asia for evidence of the importance of charitable giving - as both a humane response to disaster and as a compassionate face of our foreign policy. During the tsunami aftermath, the benevolence of all Americans took center stage, as private donations linked with U.S. Government resources from the aid community and military were delivered to thousands in desperate need. Importantly, the tsunami also highlighted the need to enhance our capabilities to rapidly transmit money and other assistance to those in desperate need.

Often, however, money is most needed in places where we encounter high levels of risk that charitable relief may be diverted from intended recipients and end up into the hands of terrorists or other criminals. We must recognize the importance of ensuring that humanitarian aid and other charitable giving originates from and is delivered through legitimate channels and to valid recipients. This is not easy, yet remains an essential part of our work.

In the dangerous environment we face in parts of the world that have the greatest need, we must make every effort to protect our charitable interests so donors can be assured that their well intentioned contributions are delivered safely and effectively to legitimate beneficiaries and recipients. Simply put, we must protect charitable giving in order to promote the continued support of our charitable communities to those who need it most.

The unfortunate reality of the post-9/11 world is that al-Qaida, Hamas and like-minded terrorist groups have abused non-profits to support their terrorist agendas, often misappropriating religion to justify their actions. Terrorists establish charitable fronts and seek out corrupt or vulnerable charities to raise and move money, to transport operatives and material, to recruit and indoctrinate new members, and to support family members of operatives or deceased suicide bombers.

To my great frustration, there are some that hold onto the erroneous belief that the threat of terrorist financing through non-profits is not very real and not terribly dangerous. Such thinking ignores the critical role that corrupted charities have played in supporting the terrorist operations of groups like al Qaida.

Al Qaida has historically employed a deliberate strategy of infiltrating existing charities and establishing charitable fronts to expand its presence and to raise and move funds, in addition to operatives and material, in support of terrorist operations. As reported by the National Commission on the Terrorist Attacks upon the United States, "charities [for al Qaida] were a source of money and also provided significant cover, which enabled operatives to travel undetected under the guise of working for a humanitarian organization."

Unfortunately, this strategy of abusing charity to support terrorist activity has proven to be effective for organizations like al Qaida. Al Qaida's success in executing the bombings of U.S. embassies in Nairobi and Dar es Salaam in 1998 relied in part on the terrorist organization's ability to infiltrate and establish charities to support development of the terrorist cells that eventually executed these attacks. Al Qaida has also used charitable networks to finance terrorist organizations, such as those operating in the Philippines and Southeast Asia. These examples underscore the importance that groups like al Qaida place upon the charitable sector as a critical means of supporting direct terrorist activity and other terrorist groups.

Other terrorist groups, such as Hamas and Hizballah, hold fundraising events and operate charitable organizations that provide relief to those in need, but for a terrorist ransom that is unacceptable. Charitable operations by terrorist groups such as Hamas and Hizballah manipulate vulnerable populations in a destructive pattern of terrorist support. A key example of this is the policy of such terrorist groups to reward the surviving family members of terrorist suicide bombers. Such a deliberate strategy of terrorist manipulation creates a vicious cycle that encourages more violence, death, and hatred. It also threatens the integrity of charitable giving, and often misappropriates religion as a justification for such atrocities.

A family starving for resources does not have to sacrifice a son or daughter to receive economic assistance. More importantly, economic need can never justify the deliberate and targeted killing of innocent civilians. And perhaps most importantly, terrorism can never be defended in the name of any religion, be it Islam, Catholicism, Judaism, or any other faith. In this sense, terrorist organizations that defend their actions under the proclaimed banner of religion perpetrate a double injustice of murder and a perverse corrosion of religious values common to all faiths that value the sanctity of human life.

Recently, this fundamental point was underscored by the Crown Prince of Saudi Arabia in his inaugural address at a counter terrorism conference hosted earlier this year in Riyadh. The Crown Prince declared that Islam is the religion of wisdom, adding that false slogans raised by deviant groups run counter to the teachings of Islam. Allow me to quote Crown Prince Abdullah when he stated, "Mohammed, the Prophet of Islam (Peace be upon him) is the prophet of mercy, and Islam is the religion of mercy, and it is impossible to link Islam with terrorism."

As we work together to overcome the deliberate terrorist infiltration and manipulation of charity, we must remember these words of wisdom. Our war against terrorism and our efforts to combat terrorist abuse of charity must never be confused as a war against Islam. Al Qaida, Hamas, Hizballah and other such terrorist groups do not represent or speak for Islam, just as the Irish Republican Army does not represent or speak for Catholicism, and just as Kahane Chai and KACH do not represent or speak for Judaism. In our righteous practice of our great faiths, let us never confuse the true nature of our religions with the perversion of those terrorist groups that attempt to usurp our great faiths.

To defeat the continued abuse of charity by these terrorist groups, we must first and foremost recognize the ongoing threat these groups present to our way of life and to our noble charitable intentions. The corruption of terrorist organizations falsely acting in the name religion is particularly acute when terrorism is supported by funds intended for charity. We can and we must take steps to combat this abuse.

Since President Bush signed Executive Order 13224, the U.S. Government has identified, designated and ordered the freezing of assets of 398 individuals and entities - 40 of which are charities that support terrorist activity and organizations.

Although some react critically to the use of designations, I want to make clear that the designation process entails exhaustive research and labor to ensure it is fair and informed by factual evidence - and all challenges to date in federal court have failed. There is no doubt that the designations we have issued against charities established or corrupted by terrorist organizations are a necessary tool in our campaign to combat terrorist financing and protect the charitable sector from continued abuse.

Designations not only freeze the assets of corrupt individuals and organizations that financially support terrorism but they also serve to inform innocent donors of abusive organizations that divert well-intentioned funds to terrorist groups. In addition, designations sound an alarm within both the charitable and financial communities, informing them of the dangerous environment created by terrorist abuse of charity, thereby encouraging greater diligence to ensure the transparency and accountability of charitable funds and services. Finally, designations deter would-be terrorist supporters from financing or otherwise supporting terrorist activity or groups by signaling that such behavior will not be tolerated.

I fully recognize and understand that many charities corrupted or abused by terrorist organizations have solicited funds from well-intentioned donors. Most, if not all, of the charities that we have designated on account of their support for terrorism also administered some form of charitable relief. The administration of charity, however, can never excuse the simultaneous diversion of funds to support terrorism.

It is painful to realize that funds and services donated with the intention of providing legitimate charitable relief do not reach intended and needy beneficiaries. In this sense, I can understand the frustration of legitimate employees and donors who provide valuable time and hard-earned funds for charity, only to have those funds frozen in the possession of an organization designated on account of its support for terrorism. But that frustration must be directed at those who have corrupted the very charities that have - through either willfulness or willful blindness - been used to support terrorism.

Another way to understand the value of designations is to compare the frustration of having well-intentioned donor funds frozen pursuant to the designation of a corrupted or abused charity, with the horror of having well-intentioned donor funds finance terrorism. Given this choice, I have confidence that every single one of us here today would prefer the understandable frustration at having his or her funds frozen to the incomprehensible horror of financing a terrorist agenda with funds intended to help those in need. This is the choice that we in the Government make when we designate charities corrupted or abused by terrorist groups. And it is a choice that we will continue to make in order to save the lives of those victimized by terrorist activity and the ongoing violence that terrorism breeds.

If you are a person who is frustrated by the designations that we have issued against charities corrupted by terrorist organizations, I ask you to carefully consider my words today. I ask you to recognize the fact that freezing funds intended for legitimate charity but destined for terrorist support is a better outcome than allowing even a percentage of those funds to finance terrorist activity. I ask you to re-evaluate any frustration that you may have with our designations against the unacceptable alternative of turning a blind eye towards terrorist financing, regardless of whether such terrorist support is coupled with legitimate relief efforts. I ask you to check your skepticism with public information such as the evidence that has come to light in the conviction of the CEO of Benevolence International Foundation and in the indictments of those who have defrauded your community. Most importantly, I ask you to understand that by working together, we can help prevent the need for such actions. By raising the vigilance of the donor and charitable community, we can take steps to prevent terrorists from preying on donors and charities in the first place. This is the key to eradicating terrorist financing from the charitable sector, and this must be the focus of our energy and efforts.

This is why the National Council is an important development on your part. Through this body, you can empower the American Muslim and Arab communities to establish and implement a global standard of accountability and effectiveness in charitable giving. You can also lead a national demonstration of American concern and support for improving the condition of the Muslim and Arab worlds. You can prove to the world that the American Muslim and Arab commitment to charity is stronger than the attempts of terrorist organizations to corrupt it. And you can demonstrate the true beauty and power of your faith through the noble pillar of Zakat. These opportunities are within your grasp, and will greatly benefit the efforts and interests of Americans, Muslims, Arabs and people everywhere to promote global charity, peace and security.

In order to be as effective as possible, it is important to acknowledge and encourage the ability of the National Council of American Muslim Non-Profits to expand its reach beyond charities. In addition to promoting the development and implementation of safeguards against abuse in Islamic and Arab American charities, the Council can also take steps to protect Islamic schools, mosques and other non-profit ventures from infiltration and abuse by terrorist groups and ideologies.

Realizing such an ambitious vision will require the active participation, cooperation and dedication of the entire Islamic and Arab American community. The Council must be driven by you, the Islamic and Arab American people, to be truly effective, and the U.S. Government must pledge its support.

This is why we will continue to work with you and the charitable community on refining our best practices for charities. We will also continue to make as much information known to the public as we can about the abuse of charities. We will further work collaboratively to determine how best to get aid safely into crisis regions.

The U.S. Government will continue to promote development and charity in regions of the world in need of the hope and aid of America. Americans and the U.S. Government have always been generous, giving billions of dollars of charity each year. This aid is often directed to the Arab and Muslim worlds. Notably, we have demonstrated our strong and true commitment of providing aid to Muslims by allocating $7 billion in USAID money to Muslim nations.

The Muslim American community is an essential fabric in the patchwork of America and a vital voice as we confront the cacophony of hatred in certain extremist corners of the world. All Americans must unite to the fight against terrorism and the extremism that fuels it. The dialogue and work between the American Muslim and Arab communities and the U.S. Government are important elements of this collective effort to overcome those aiming to corrupt our charitable values and destroy the liberties we enjoy every day as Americans.

I look forward to continuing our work together, and am proud of the progress we are achieving. Let us not rest, but rather seize the opportunities presented by the announcement and prospective development of the National Council of American Muslim Non-Profits. I thank you for inviting me to be an active part of this critical dialogue. I especially thank you for your participation, concern, understanding and leadership in moving this dialogue forward.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 28, 2005
JS-2338

**Statement by Treasury Secretary John W. Snow
On Brazil's Announcement concerning the International Monetary Fund**

I was pleased to hear the announcement by my counterpart in Brazil, Finance Minister Antonio Palocci, that Brazil has decided it does not need a new IMF program. This decision reflects the strength of Brazil's economy and of its economic policies. It is terrific news, a hallmark of financial accomplishment for the country, and great credit goes to President Lula for this success. I want to congratulate President Lula and Finance Minister Palocci on their stewardship of the Brazilian economy which has made this milestone possible.

Under President Lula's leadership, Brazil's good macroeconomic policies have brought down inflation, reduced the country's debt, and provided the foundation for solid economic growth in the wake of the 2002 financial crisis. Last year, Brazil's GDP growth was 5.2%-the fastest growth rate in ten years-while its debt-to-GDP ratio registered the first decline since 2000 and inflation fell to 7.6 percent, within the central bank's target band. Brazil has harnessed the opportunities of trade and strong global growth to increase exports by 32% last year.

I am impressed by the agenda that the Lula Administration has laid out for further reducing vulnerabilities and sustaining robust growth. Building on his achievements in reforming the bankruptcy code and judicial sector, the Lula Administration is pursuing microeconomic reforms aimed at streamlining business regulation, simplifying the tax code, and promoting infrastructure development.

Today's good news shows the results that can be achieved when good policies are implemented and adhered to. I'm delighted for our Brazilian friends and look forward to continuing our work together in forums such as the U.S.-Brazil Group for Growth to identify policies for increasing prosperity in both of our countries.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 28, 2005
JS-2339

Statement of Treasury Secretary John W. Snow
On the Departure of Treasury Assistant Secretary John Duncan

Today the Treasury Department says farewell and offers best wishes to one of the most dedicated, skilled public servants I've had the honor to work with. John Duncan, Treasury's Assistant Secretary for Legislative Affairs, is leaving our team after four years of exemplary service.

Since joining the Bush Administration in 2001, Treasury's legislative calendar has been full, and John Duncan was involved in numerous legislative successes, each and every year of his tenure.

In 2001, he helped pass the President's landmark tax cuts and ensured that the Patriot Act would expand Treasury's authorities to freeze terrorist assets.

In 2002, John was part of a team to successfully structure and pass Department of Homeland Security transfer legislation. He also shepherded the Terrorism Risk Insurance bill, which provided a stable and guaranteed insurance market for United States industries laboring under the threat of terrorist attack.

In 2003, John was once again part of a successful effort to reduce taxes. Since the enactment of that bill, the American economy has expanded and grown at a terrific, steady rate, creating over three million new jobs since May of 2003. In 2004, John helped persuade Congress to extend those beneficial tax cuts.

The year 2003 also saw the creation of Treasury's Office of Terrorism and Financial Intelligence (TFI) – a new weapon against terror – as well as the passage and signing of the Fair and Accurate Credit Transactions Act (FACT Act).

Beyond the specific legislative victories – and there were plenty of them – we will all look back on John's contributions as, more broadly, four-plus years of sound, mature advice for Treasury officials on everything from testifying before Congress, to negotiating with Members and staff, to silently securing four years of domestic and international appropriations to pay Treasury's bills and salaries.

All this was done without fanfare, and with tremendous grace. His counsel was sought and valued on matters far beyond the Congress because he always offered an intelligent, fair perspective as well as fresh ideas that never failed to renew our passion for the policy battle of the day.

On behalf of the Treasury team, we wish John very well in his future endeavors; we know how fortunate we were to work by his side, and he will be deeply missed.

REPORTS

- J. Duncan's Letter of Resignation

Monday, March 28, 2005

The President
The White House
Washington, DC 20500

Dear Mr. President:

The purpose of this letter is to announce my decision to resign effective at the end of this month as Assistant Secretary of the Treasury.

It has been a special honor to have held this post for the last four years. I greatly appreciate the confidence you have shown in me and am very pleased to have been part of an administration that has so squarely addressed the pressing issues of our time.

The last four years have passed quickly. As I reflect back on them I am impressed by the breadth of issues and the number of accomplishments. Among those accomplishments are tax cuts that kept the economy from recession and took it on to healthy growth following the attacks of 9/11; accounting reforms that improved the integrity of financial data for investors following the collapse of Enron; new tools to fight the growing problem of identity theft; improvements in World Bank operations to reduce poverty; and new enforcement powers to dry up the money that funds terrorism. Your current agenda to reform Government Sponsored Enterprises, make personal accounts part of the Social Security program, reform the tax code and make pension promises reliable are well launched and I expect will become a reality.

Success in Washington is the work of many. I appreciate the support I have received from the White House Office of Legislative Affairs in advancing initiatives on Capitol Hill, from the Presidential Personnel Office in recruiting so many talented and capable colleagues, and Treasury appointees and career employees who made working in the Department such a pleasure.

Sincerely,

John Duncan

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 28, 2005
js-2340

Secretary John W. Snow Prepared Remarks: FLIR Systems Portland, OR

Thank you so much for having me here; it's great to be in Portland, and I'm delighted to be able to visit FLIR Systems. I want to thank FLIR Senior Vice President Jim Fitzhenry in particular for making this visit so enjoyable.

It has been a privilege to learn more about infrared imaging technology from the men and women who make the systems. Your work helps keep the men and women in our armed forces, federal law enforcement and Secret Service safer, and I certainly appreciate the work you do.

I also appreciate the chance to talk with you today about strengthening the nation's Social Security system. The President's leadership on this issue is providing our country with a tremendous opportunity to save Social Security for current and near retirees and improve it for younger generations. Conversations like this are an important part of reaching decisions as to what, exactly, should be done.

Since March 3rd, Administration officials – from President Bush and Vice President Cheney to Cabinet members like me and policy experts – have been traveling throughout the country as part of a coordinated 60-day tour of at least 60 stops to discuss the President's message of strengthening Social Security with the American people.

I was in Pennsylvania last Thursday, meeting with business leaders to discuss Social Security and that visit marked the 60 stop mark, after less than 30 days on the road. So we know that the final number of stops will be much higher than anticipated.

Right before that trip to Pennsylvania, we were reminded of the serious nature of the Social Security problem yesterday, back in Washington, DC, when the Social Security and Medicare Trustees – for whom I serve as Board Chairman – issued our annual report on the financial health if the programs' trust funds. The numbers contained in the Social Security report leave little doubt that the system is financially unsustainable, and in need of expeditious and lasting change.

The Trustees' report showed that Social Security cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The unfunded obligation, that is, the difference between the present values of Social Security inflows (plus the trust fund) and outflows, is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

Now, the President doesn't believe that we should make up that shortfall with tax increases. The report showed just how much we would have to raise taxes to achieve long-term balance: the payroll tax rate would have to be raised immediately by 3.5 percentage points to make the system whole on a permanent basis. In other words, the payroll tax would have to be increased by nearly 30 percent.

That kind of tax increase would have significant, negative economic repercussions. Every worker – every one of you in this room today – would start taking home less pay, and that's bad for you, it's bad for your families, and it's bad for countless facets of our economy.

FLIR systems would bear a significant cost, as well. Employers would shoulder half of the payroll tax increase because they pay that tax on all of their employees.

For very small employers, I fear that much of a tax increase would force them to make terrible choices, from lay-offs to health benefit cuts. And it would make hiring new people even more difficult... which is worrisome since small business creates most of our nation's new jobs.

Increasing payroll taxes hurts the economy and it hurts job creation, period. That's why the President is against it.

It is also worth noting that payroll tax increases have been the standard "solution" to Social Security's problems, and they have never solved the problem! Payroll taxes have been raised some 20 times since Social Security was established – and it has failed to make the system solvent.

Tax increases aren't the answer, so the President has encouraged the Congress to propose a variety of ideas that might be, and he has put a number of ideas on the table as well.

When the President took this issue to the country in his State of the Union Address, he said his objective was to engender a broad national dialogue to get people talking about this issue. He wanted Americans to talk about Social Security, and a national conversation has begun as a direct result.

Today, people are talking about the issue from the halls of Congress to the halls of local shopping malls! The President's leadership has drawn critical attention to the problem and is creating movement. Progress, real progress, is being made.

Over lunch counters, over breakfast and dinner tables all over America... the topic is Social Security reform. It's the front page story in virtually every newspaper. It's on the evening news. And it's there because of the President of the United States. It's there because of the courage that he's had to directly confront and deal with what so many in political life call the "third rail."

The American people respect leaders who call a spade a spade. The President touched the "third rail" without fear, and now we're moving forward. Neighbors and co-workers are talking about it; families are talking about it; Congress is talking about it.

We've seen a clear shift in the course of the last month or so from the question: "Is there a problem?" to the question: "How do we fix it?"

I imagine that you are talking about it with your spouse and family members, your colleagues and neighbors. Those conversations are critical, and I hope our meeting here today can help make them even more lively, more productive.

I know that you understand that if you are 55 or older your Social Security benefits are solid. They will not change. You know that you don't need to change your retirement plan or strategy because of Social Security reform, period.

But now I'll ask: how many of you have children or grandchildren? It's those children and grandchildren, those young workers and future workers, who we need to be worried about. They are the ones for whom we need to fix this system.

The issue of Social Security is really a matter of basic arithmetic, and the threat to Social Security in the near future makes more sense when you look at the simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system, supporting the retirees drawing benefits.

In 1950, there were 16 workers to support every beneficiary of Social Security - a very comfortable ratio of those paying in versus those drawing benefits. Today there are only 3.3 workers supporting every beneficiary. By the time today's youngest workers – many of you have children in that age group – turn 65, there will only be two workers supporting each retiree.

Just three years from now, in 2008, the first baby boomers will begin to retire. According to the new Trustees' report, the government will begin to pay out more in

Social Security benefits than it collects in payroll taxes in 2017 – that's just 12 years from now. By 2041, when younger workers begin to retire, the system will be bankrupt.

We must make Social Security better for those younger workers.

Raising their payroll taxes won't make it better. What the President would like to see, instead, for future generations is an ability to save some of their payroll taxes, to build a nest egg that belongs to them, not to the government. Something they could pass on to their heirs. A nest egg that would draw on the powerful force of compound interest to give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits.

With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

For the life of me, I can't imagine why anybody would argue against young workers having the ability to invest and build a better retirement for their future. It costs the Social Security system nothing to do so, it will cost current and near-retirees nothing, it gives our children and grandchildren a better retirement, and it helps our country create a larger pool of savings. And as the president has said the retirement security of our young people is too important for partisan politics. Why wouldn't we do this? I have not heard one good reason not to and it's hard to figure out why anybody would oppose it.

Additionally, as former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed recently, "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg." The President and I couldn't agree more.

Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren can be achieved.

We are part of an exciting moment in American history, where a President's courageous leadership has inspired a national discussion and, I'm confident, will lead to historic results. I encourage you to be involved, whether it's talking about the issue with your colleagues, with your children, or writing a letter to your Members of Congress.

If we act now, we can make sure that Social Security, and our economy, are on sound financial footing for our children and grandchildren.

Thanks so much, again, for having me here today.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 29, 2005
2005-3-29-15-13-59-16007

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $79,029 million as of the end of that week, compared to $80,349 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	March 18, 2005			March 25, 2005		
TOTAL		80,349			79,029	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	12,203	15,024	27,227	11,875	14,795	26,670
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,983	3,020	15,003	11,667	2,974	14,641
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			15,345			15,117
3. Special Drawing Rights (SDRs) [2]			11,733			11,559
4. Gold Stock [3]			11,042			11,042
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	March 18, 2005			March 25, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	March 18, 2005			March 25, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 30, 2005
js-2342

Prepared Statement by World Bank President Nominee Paul Wolfowitz in Brussels

I have just had the opportunity to exchange views with some articulate and well-informed European leaders who are strongly committed to the important work of the World Bank.

We have had a constructive and encouraging talk about our shared goals of poverty reduction and international development. I appreciate the invitation to this meeting and I'm grateful to those who participated in today's helpful dialogue.

On a personal note, let me just add that if approved by the World Bank Board as President, I look forward to being an international civil servant with the responsibility for heading the world's leading institution of economic development, an institution whose aim is reducing poverty and developing opportunities for all the people of the world to achieve their full potential.

People who don't know me may not appreciate why I am eager to take on this challenge, so let me explain: I believe deeply in the mission of the World Bank. Helping people to lift themselves out of poverty is a noble mission. Nothing is more gratifying than being able to help people in need, as I experienced once again when I witnessed the tsunami relief operations in Indonesia and Sri Lanka. It is also a critical part of making the world a better place for all of us. It is not just the material side of life that improves; peace and freedom are also advanced when more people can enjoy the benefits of prosperity and human dignity.

I have experienced this closely and personally, for example, as Ambassador to Indonesia where economic development was the most important issue on the agenda. I saw first-hand what the World Bank could accomplish, working in support of dedicated development professionals in the Indonesian government and from many donor countries.

I also saw first-hand the obstacles that corruption and weak institutions present to efforts at development and poverty reduction. That is one of many reasons why I applaud the legacy that Jim Wolfensohn will be leaving at the World Bank. He has deepened the Bank's commitment to poverty reduction. Among his many lasting contributions, Jim Wolfensohn has brought an important focus on issues of transparency, accountability and governance as critical elements of the economic development agenda, and of human progress more broadly.

If approved, I look forward to working with the extraordinary group of professionals at the World Bank. It is exciting to contemplate working with such diverse talents drawn from across Europe and around the world. I look forward to continuing and strengthening their important work for the less fortunate of the world and for economic development across the globe.

I also look forward to hearing the views of the many constituencies of the World Bank, borrowers and donors, governments and NGOs, as we shape a common vision of how to continue the noble work of this important institution. I plan to continue listening and consulting with those who have served the world's poor with skill, devotion and compassion like the officials I met with today.

In closing, let me again thank my hosts from the European community for making this meeting possible. This has been a very short visit, but I look forward to many more visits to Europe and to the opportunity to enjoy Brussels and the hospitality of this historic city.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 30, 2005
js-2343

Remarks by the Honorable Rob Nichols Assistant Secretary of the Treasury for Public Affairs At a Town Hall meeting with Congressman Dave Reichert Bellevue , Washington March 29, 2005

It's great to be home in the Pacific Northwest. Thank you Congressman Reichert for inviting me here today and for your leadership in Congress.

I very much appreciate the chance to talk with you about strengthening the nation's Social Security system. Workshops like this are an important part of the national dialogue.

Last Wednesday, the Social Security and Medicare Trustees issued their annual reports on the financial health of the programs' trust funds. The numbers contained in the Social Security report left little doubt that the system is financially unsustainable, and in need of repair.

The Trustees' report showed that Social Security cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The unfunded obligation, that is, the difference between the present values of Social Security inflows (plus the trust fund) and outflows, is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

Now, the President doesn't believe that we should make up that shortfall with tax increases. The report showed just how much we would have to raise taxes to achieve long-term balance: the payroll tax rate would have to be raised immediately by 3.5 percentage points to make the system whole on a permanent basis. In other words, the payroll tax would have to be increased by nearly 30 percent.

That kind of tax increase would have significant, negative economic repercussions. Americans would start taking home less pay, and that's bad for countless facets of our economy. Small employers would be hit especially hard since they pay payroll taxes on each of their employees. A big tax increase could force them to make terrible choices, from lay-offs to health benefit cuts. And it would make hiring new people even more difficult. That's troublesome since most new jobs are created by small firms.

It is also worth noting that payroll tax increases have been the standard "solution" to Social Security's problems, and they have never solved the problem. Payroll taxes have been raised some 20 times since Social Security was established - and it has failed to make the system solvent.

When the President took this issue to the country in his State of the Union Address, he said his objective was to engender a broad national dialogue to get people talking about this issue. He wanted Americans to talk about Social Security, and a national c onversation has begun as a direct result. This workshop today is a perfect example of the sort of nonpartisan dialogue the President envisioned.

We've seen a clear shift in the course of the last month or so from the question: "Is there a problem?" to the question: "How do we fix it?"

Let me point out the key elements of the President's architecture for reform.

If you are 55 or older your Social Security benefits are solid. They will not change. You know that you don't need to change your retirement plan or strategy because of Social Security reform, period. If you're 55 or older, it's your children and grandchildren that you need to be thinking about. They are the ones for whom we need to fix this system.

The issue of Social Security is really just a matter of basic math, and the threat to Social Security in the near future makes more sense when you look at the simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system, supporting the retirees drawing benefits.

In 1950, there were 16 workers to support every beneficiary of Social Security - a very comfortable ratio of those paying in versus those drawing benefits. Today there are only 3.3 workers supporting every beneficiary. By the time today's youngest workers - many of you have children in that age group - turn 65, there will only be two workers s upporting each retiree. This issue is one of demography, not ideology.

Just three years from now, in 2008, the first baby boomers will begin to retire. According to the new Trustees' report, the government will begin to pay out more in Social Security benefits than it collects in payroll taxes in 2017 - that's just 12 years from now. By 2041, when younger workers begin to retire, the system will be bankrupt.

We must make Social Security better for those younger workers.

Raising their payroll taxes won't make it better. What the President would like to see, instead, for future generations is an ability to save some of their payroll taxes, in a safe and secure nest egg. Something they could pass on to their heirs. A nest egg that would give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits. These safe and secure nest eggs would give younger workers a chance to earn a better rate of return on their money.

With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a safe and secure nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

Additionally, as former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed recently, "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg."

Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren can be achieved.

If we act now, we can make sure that Social Security, and our economy, is on sound financial footing for our children and grandchildren.

I am absolutely convinced we can preserve and protect social security for today's youth through a thoughtful bipartisan dialogue with Congress. Further, I am convinced we can achieve bipartisan results this year.

Congressman Reichert, thank you again for having me here today. I look forward to your questions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 30, 2005
JS-2344

Treasury and IRS Issue Guidance on Spousal Election Rights and Charitable Remainder Trusts

WASHINGTON, DC -- The Treasury Department and Internal Revenue Service issued guidance today to provide a safe harbor procedure to avoid the disqualification of a charitable remainder trust by reason of the existence of a spousal right of election under state law.

The existence of a surviving spouse's right to elect to receive a statutory share of the estate of the grantor of a charitable remainder trust has not been widely recognized by taxpayers as potentially disqualifying the trust. The safe harbor in the revenue procedure issued today provides a method of avoiding the adverse tax consequences arising from such a right under state law. The revenue procedure issued today also provides transition relief for trusts created before June 28, 2005.

A problem exists under current law only if applicable state law gives the grantor's spouse the right to receive a statutory share of the grantor's estate that could be paid from the trust's assets. For trusts created on or after June 28, 2005, this problem can be avoided if the grantor's spouse waives the right of election against trust assets as described in the revenue procedure.

Trusts created before June 28, 2005, may also benefit from this safe harbor procedure. However, as long as the spousal right of election is not actually exercised, the Service will not challenge the qualification of a pre-June 28, 2005, trust solely by reason of the existence of that right, even if such a waiver is not obtained.

REPORTS

- A copy of Revenue Procedure 2005-24

Part III

Administrative, Procedural, and Miscellaneous

26 CFR § 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 664; 1.664-1, 1.664-2, 1.664-3.)

Rev. Proc. 2005-24

SECTION 1. PURPOSE AND SCOPE

.01 This revenue procedure applies to any charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) that is created by the grantor, *G*, if, under applicable state law, *G*'s surviving spouse, *S*, has a right of election exercisable on *G*'s death to receive an elective, statutory share of *G*'s estate, and such share could be satisfied in whole or in part from assets of the CRAT or CRUT in violation of § 664(d)(1)(B) or (d)(2)(B) of the Internal Revenue Code. In general, only *inter vivos* CRATs or CRUTs are within the scope of this revenue procedure.

.02 This revenue procedure provides a safe harbor procedure under which the Internal Revenue Service will disregard the right of election for purposes of determining whether the CRAT or CRUT meets the requirements of § 664(d)(1)(B) or (d)(2)(B) continuously since its creation if *S* irrevocably waives the right of election in the manner prescribed in this revenue procedure. For trusts created before June 28, 2005, the Service will disregard the right of election, even without a waiver, but only if *S* does not exercise the right of election.

.03 The safe harbor procedure provided by this revenue procedure is not available to a CRAT or CRUT if *S* exercises the right of election.

SECTION 2. BACKGROUND

.01 In general, a testator is free to dispose of property in accordance with the testator's own wishes. However, in most jurisdictions, state statutes protect *S* from disinheritance. In most common law jurisdictions, these statutes are in the form of elective share provisions, many of which are based on the elective share provisions of the Uniform Probate Code (UPC), §§ 2-201- 2-214 (amended 1993). Elective share statutes provide *S* the right to elect to receive a statutory share of *G*'s estate, regardless of whether *G* made any bequests to *S*. For purposes of this revenue procedure, *S*'s statutory share of *G*'s estate will be referred to as an "elective share" and the right to elect to receive an elective share will be referred to as a "right of election", regardless of what terms different jurisdictions may use to describe these concepts.

.02 In some states, the elective share is based solely on the probate estate but, in others, *G*'s estate is defined more broadly for purposes of computing the elective share and may include assets of the CRAT or CRUT. In states that have adopted the elective share provisions of the UPC, *S* has the right of election to take a percentage (generally determined by the duration of the marriage, but subject to a minimum dollar amount in some cases) of the "augmented estate" provided that certain requirements are met. UPC § 2-202. The augmented estate includes *G*'s net probate estate, as well as certain nonprobate assets of *G*, certain property transferred by *G* to others (including to *S*) during life, and certain other property. UPC §§ 2-202 and 2-207. The assets of the CRAT or CRUT may be included in the augmented estate and, therefore, may be used to determine and satisfy the elective share amount. UPC § 2-209. In some states, the CRAT or CRUT assets may be used to satisfy the elective share only after other property in the augmented estate first has been exhausted.

.03 Sections 664(d)(1)(B) (in the case of a CRAT) and (d)(2)(B) (in the case of a CRUT) provide that no amount other than the annuity payments described in § 664(d)(1)(A) or the unitrust payments described in § 664(d)(2)(A), respectively, (other than qualified gratuitous payments described in §§ 664(d)(1)(C) and (d)(2)(C)) may be paid to or for the use of any person other than an organization described in § 170(c). The requirements of §§ 664(d)(1)(B) and (d)(2)(B) are not satisfied in situations in which *S* may exercise the right of election to receive an elective share and the share could include assets of the CRAT or CRUT, because the mere existence of the right of election under applicable law, whether or not exercised, and the resulting possibility that the CRAT or CRUT may be invaded for the benefit of *S* , causes the trust to fail to qualify under § 664(d).

.04 The Service believes that, in the interest of sound tax administration and to reduce the burden on taxpayers, it is appropriate to provide a safe harbor procedure that, if followed, will cause the right of election to be disregarded for purposes of determining whether a CRAT or CRUT that is within the scope of this revenue procedure meets the requirements of § 664(d) continuously from the date the trust is created. This procedure generally requires that *S* irrevocably waive the right of election with regard to the assets of the CRAT or CRUT to ensure that no part of the trust will be used to satisfy the elective share.

.05 No waiver of the right of election is required if the applicable state law does not provide *S* with a right of election, exercisable at the time of *G*'s death, to receive an elective share of *G*'s estate. For example, in community property jurisdictions, elective share provisions are generally unnecessary because *S* typically has vested ownership in one-half of the community property. Additionally, no waiver is required if, under applicable state law, *S*'s elective share of *G*'s estate may not include any assets of the CRAT or CRUT (other than the annuity or unitrust interest payable to *S* as the named recipient). For example, no waiver is required if, under applicable state law, the trust's property is excluded from the base for computing the elective share by reason of *G*'s receipt of adequate and full consideration for the transfer or the written consent to or joinder in the transfer by *S* and, in fact, the consideration is paid or the consent or joinder is given.

SECTION 3. APPLICATION OF SAFE HARBOR

.01 *In General.* With respect to any CRAT or CRUT within the scope of this revenue procedure, *S*'s right of election to receive an elective share of *G*'s estate, if the share could include any assets of a CRAT or CRUT created or funded by *G*, will be disregarded for purposes of determining whether the CRAT or CRUT has met the requirements of § 664(d)(1)(B) or (d)(2)(B) continuously since its creation if all of the requirements of section 3 of this revenue procedure are satisfied. For CRATs and CRUTs within the scope of this revenue procedure created by *G* on or after June 28, 2005, the failure of *S* to waive the right of election in accordance with the requirements of this revenue procedure will result in the CRAT or CRUT failing to qualify under § 664(d) continuously since its creation, whether or not *S* exercises the right of election. For CRATs and CRUTs within the scope of this revenue procedure created by *G* before June 28, 2005, the failure of *S* to waive the right of election, combined with *S*'s exercise of that right of election, will result in the CRAT or CRUT failing to qualify under § 664(d) continuously since its creation. Thus, for all CRATs and CRUTs, regardless of when they were created, a waiver under this revenue procedure of *S*'s right of election will provide certainty that the right of election will not cause the trust to fail to qualify under § 664(d) continuously since its creation.

.02 *Waiver Effective Under State Law*. *S* must irrevocably waive the right of election to whatever extent necessary to ensure that no part of the trust (other than the annuity or unitrust interest of which *S* is the named recipient under the terms of the trust) may be used to satisfy the elective share. A valid waiver of the elective share or right of election will satisfy the requirements of the preceding sentence if the waiver is valid under applicable state law, in writing, and signed and dated by *S*. This revenue procedure does not require a waiver of *S*'s right as the named recipient to receive the annuity or unitrust payment from the CRAT or CRUT.

.03 *Timing of Waiver*. For CRATs or CRUTs created by G on or after June 28, 2005, section 3.02 of this revenue procedure must be satisfied on or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of Form 5227, Split-Interest Trust Information Return, for the year in which the later of the following occurs:

(1) the creation of the trust;

(2) the date of G's marriage to S;

(3) the date G first becomes domiciled or resident in a jurisdiction whose law provides a right of election that could be satisfied from assets of the trust; or

(4) the effective date of applicable state law creating a right of election.

.04 *Trustee To Retain Copy*. A copy of the signed waiver must be provided to the trustee of the CRAT or CRUT. The trustee must retain the copy in the official records of the trust so long as the contents thereof may become material in the administration of any internal revenue law. *See* § 1.6001-1(e) of the Income Tax Regulations.

SECTION 4. EXAMPLES

In each of the following examples, *G* created a CRAT that provides an annuity to *G* for *G*'s life. Upon *G*'s death, the remainder of the trust will pass to an organization that meets the requirements of § 170(c). In each example (except *Example 3*), at the time the CRAT is created, applicable state law provides *S* a right of election to receive an elective share of *G*'s estate and the share would include (and could be satisfied from) assets of the trust.

.01 *Example 1.* *G* creates the trust in 2007 while married to *S*. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2007, *S* irrevocably waives *S*'s right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to *G*'s probate estate).

.02 *Example 2.* *G* creates the trust in 2006, and is unmarried on the date the trust is created. On May 1, 2007, *G* marries *S*. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2007, *S* irrevocably waives the right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to *G*'s probate estate).

.03 *Example 3.* *G* creates the trust in 2008 while married to *S*. Under applicable state law in effect on the date that *G* creates the trust, the elective share does not include the assets in the trust. Effective on March 1, 2009, applicable state law is amended to give *S* the right of election to receive an elective share of the "augmented estate," which, by definition, includes the assets of the trust. On or before the date that is 6 months after the due date (excluding extensions of time to file actually granted) of the Form 5227 for the trust for calendar year 2009, *S* irrevocably waives the right of election to receive an elective share with regard to the assets in the trust (but does not waive the right of election with regard to *G*'s probate estate).

In each of *Examples 1* through *3*, assuming that *S*'s timely waiver of the right of election is valid under applicable state law and satisfies the other requirements of this revenue procedure, the existence of the right of election will be disregarded for the purpose of determining whether the trust has qualified continuously since its creation as a CRAT under § 664(d)(1)(B). Further, in each of *Examples 1* through *3*, the result would be the same if, instead of executing only a partial waiver, *S* had waived the full right of election with respect to all assets in *G*'s augmented estate.

.04 *Example 4*. *G* creates the trust in 2007 while married to *S*. Under applicable state law in effect on the date that *G* creates the trust, the elective share includes the assets in the trust. Later in the same year, applicable state law is amended to provide that the augmented estate does not include the assets of a CRAT or CRUT and the amendment applies retroactively to include the trust created by *G*. Accordingly, no waiver of the right of election is required with respect to the assets of the trust in order for the trust to continue to qualify as a CRAT.

.05 *Example 5*. The facts are the same as in *Example 2* except that the waiver is contained in, or is signed pursuant to the requirements of, a prenuptial agreement. Unless the agreement as a whole (or only the waiver) is subsequently found to be invalid or unenforceable, the waiver will satisfy the requirements of this revenue procedure.

.06 *Example 6*. The facts are the same as in *Example 1*, except that *S* dies in 2010. In 2012, *G* marries *S2*. *S2* refuses to waive *S2*'s right to receive an elective share with regard to the assets in the trust. The existence of *S*'s right of election will be disregarded for the purpose of determining whether the trust has qualified continuously since its creation up until *G*'s marriage to *S2*, as a CRAT under § 664(d)(1)(B). However, because *S2* did not timely and irrevocably waive *S2*'s right to receive an elective share with regard to the assets in the trust, the trust does not qualify as a CRAT under § 664(d)(1)(B).

If, in these examples, *G* had instead created a CRUT, the results would be the same for purposes of § 664(d)(2)(B).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective as of March 30, 2005.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1936.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 3. This information is required to be collected and retained in order to ensure that a trust meets the requirements of § 664(d)(1) or (d)(2). This information will be used to determine whether the eligibility requirements under those statutes for treatment as a CRAT or CRUT have been met. The collection of information is required to obtain a benefit. The likely respondents are individuals.

The estimated total annual reporting burden is 150,000 hours.

The estimated annual burden per respondent varies from 1 hour to 2 hours, depending on individual circumstances, with an estimated average burden of 1 1/2 hours to complete the statements required under this revenue procedure. The estimated number of respondents is 100,000.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Susan H. Levy. For further information regarding this revenue procedure contact Susan H. Levy on (202) 622-3090 (not a toll free call) or Bradford R. Poston on (202) 622-3060 (neither a toll free call).

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 30, 2005
JS-2345

Under Secretary Levey Remarks on Providing Banking Services to Money Service Businesses

Stuart Levey, the U.S. Department of the Treasury's Under Secretary for the Office of Terrorism and Financial Intelligence (TFI), made the following remarks today in response to a statement issued earlier today by the Financial Crimes Enforcement Network (FinCEN) and the Federal Banking Agencies on providing banking services to money service businesses (MSBs):

"The policy statement released today is an important step in ensuring that money service businesses (MSBs) have access to banking services and in protecting our financial sector against underground and illicit money flows.

"MSBs provide valuable services to those without ready access to the formal banking sector. As Secretary John Snow has stated on a number of occasions, these businesses are a part of a healthy financial sector and must have access to banking services. As we continue our efforts to combat money laundering and terrorist financing, it is critical that the MSB industry remain within the formal financial sector and not be driven underground.

"We believe that this clear statement of policy, as well as the forthcoming guidance, will help ensure that MSBs have access to banking services and that our financial sector is best protected against illicit money flows. We look forward to the issuance of this guidance and to continuing our strong partnership with U.S. financial institutions," said Levey.

A copy of the statement issued today by FinCEN and the Federal Banking Agencies may be accessed here: http://www.fincen.gov/bsamsbrevisedstatement.pdf.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 30, 2005
JS-2346

Secretary John W. Snow
Prepared Remarks to Bozeman Community Leaders
Bozeman, MT

Thank you so much for having me here; it's great to be in Bozeman!

I really appreciate the chance to talk with you today about strengthening the nation's Social Security system. The President's leadership on this issue is providing our country with a tremendous opportunity to save Social Security for current and near retirees and improve it for younger generations. Conversations like this are an important part of reaching decisions as to what, exactly, should be done.

Since March 3rd, Administration officials - from President Bush and Vice President Cheney to Cabinet members like me and policy experts - have been traveling throughout the country as part of a coordinated 60-day tour of at least 60 stops to discuss the President's message of strengthening Social Security with the American people.

I was in Pennsylvania last Thursday, meeting with business leaders to discuss Social Security and that visit marked the 60 stop mark, after less than 30 days on the road. So we know that the final number of stops will be much higher than anticipated.

Right before that trip to Pennsylvania, we were reminded of the serious nature of the Social Security problem yesterday, back in Washington, DC, when the Social Security and Medicare Trustees - for whom I serve as Board Chairman - issued our annual report on the financial health if the programs' trust funds. The numbers contained in the Social Security report leave little doubt that the system is financially unsustainable, and in need of expeditious and lasting change.

The Trustees' report showed that Social Security cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The unfunded obligation, that is, the difference between the present values of Social Security inflows (plus the trust fund) and outflows, is \$11.1 trillion on a permanent basis, and \$4.0 trillion over the next 75 years.

Now, the President doesn't believe that we should make up that shortfall with tax increases. The report showed just how much we would have to raise taxes to achieve long-term balance: the payroll tax rate would have to be raised immediately by 3.5 percentage points to make the system whole on a permanent basis. In other words, the payroll tax would have to be increased by nearly 30 percent.

That kind of tax increase would have significant, negative economic repercussions. Every worker in America would start taking home less pay, and that's bad for you, it's bad for your families, and it's bad for countless facets of our economy.

Employers would bear a significant cost, as well. Employers would shoulder half of the payroll tax increase because they pay that tax on all of their employees.

For very small employers, I fear that much of a tax increase would force them to make terrible choices, from lay-offs to health benefit cuts. And it would make hiring new people even more difficult... which is worrisome since small business creates most of our nation's new jobs.

Increasing payroll taxes hurts the economy and it hurts job creation, period. That's why the President is against it.

It is also worth noting that payroll tax increases have been the standard "solution" to Social Security's problems, and they have never solved the problem! Payroll taxes have been raised some 20 times since Social Security was established - and it has failed to make the system solvent.

Tax increases aren't the answer, so the President has encouraged the Congress to propose a variety of ideas that might be, and he has put a number of ideas on the table as well.

When the President took this issue to the country in his State of the Union Address, he said his objective was to engender a broad national dialogue to get people talking about this issue. He wanted Americans to talk about Social Security, and a national conversation has begun as a direct result.

Today, people are talking about the issue from the halls of Congress to the halls of local shopping malls! The President's leadership has drawn critical attention to the problem and is creating movement. Progress, real progress, is being made.

Over lunch counters, over breakfast and dinner tables all over America... the topic is Social Security reform. It's the front page story in virtually every newspaper. It's on the evening news. And it's there because of the President of the United States. It's there because of the courage that he's had to directly confront and deal with what so many in political life call the "third rail."

The American people respect leaders who call a spade a spade. The President touched the "third rail" without fear, and now we're moving forward. Neighbors and co-workers are talking about it; families are talking about it; Congress is talking about it.

We've seen a clear shift in the course of the last month or so from the question: "Is there a problem?" to the question: "How do we fix it?"

I imagine that you are talking about it with your spouse and family members, your colleagues and neighbors. Those conversations are critical, and I hope our meeting here today can help make them even more lively, more productive.

I know that you understand that if you are 55 or older your Social Security benefits are solid. They will not change. You know that you don't need to change your retirement plan or strategy because of Social Security reform, period.

But now I'll ask: how many of you have children or grandchildren? It's those children and grandchildren, those young workers and future workers, who we need to be worried about. They are the ones for whom we need to fix this system.

The issue of Social Security is really a matter of basic arithmetic, and the threat to Social Security in the near future makes more sense when you look at the simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system, supporting the retirees drawing benefits.

In 1950, there were 16 workers to support every beneficiary of Social Security - a very comfortable ratio of those paying in versus those drawing benefits. Today there are only 3.3 workers supporting every beneficiary. By the time today's youngest workers - many of you have children in that age group - turn 65, there will only be two workers supporting each retiree.

Just three years from now, in 2008, the first baby boomers will begin to retire. According to the new Trustees' report, the government will begin to pay out more in Social Security benefits than it collects in payroll taxes in 2017 - that's just 12 years from now. By 2041, when younger workers begin to retire, the system will be bankrupt.

We must make Social Security better for those younger workers.

Raising their payroll taxes won't make it better. What the President would like to see, instead, for future generations is an ability to save some of their payroll taxes, to build a nest egg that belongs to them, not to the government. Something they could pass on to their heirs. A nest egg that would draw on the powerful force of compound interest to give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits.

With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

For the life of me, I can't imagine why anybody would argue against young workers having the ability to invest and build a better retirement for their future. It costs the Social Security system nothing to do so, it will cost current and near-retirees nothing, it gives our children and grandchildren a better retirement, and it helps our country create a larger pool of savings. And as the president has said the retirement security of our young people is too important for partisan politics. Why wouldn't we do this? I have not heard one good reason not to and it's hard to figure out why anybody would oppose it.

Additionally, as former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed recently, "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg." The President and I couldn't agree more.

Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren can be achieved.

We are part of an exciting moment in American history, where a President's courageous leadership has inspired a national discussion and, I'm confident, will lead to historic results. I encourage you to be involved, whether it's talking about the issue with your colleagues, with your children, or writing a letter to your Members of Congress.

If we act now, we can make sure that Social Security, and our economy, are on sound financial footing for our children and grandchildren.

Thanks so much, again, for having me here today.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 31, 2005
JS-2347

Secretary John W. Snow
Prepared Remarks to Government Students at Bismarck High School
Bismarck, ND

Thank you so much for having me here at Bismarck High School. It's terrific to be in the great state of North Dakota, and I'm very happy to be able to talk with you today; spending time with sharp students like you is a real pleasure.

I want to commend you for studying government, and for your academic achievements. I know that you study very hard. But even with a lot of studying, sometimes it can be difficult to see the real-life importance of what you are learning. My hope is that our discussion today will help make what you've learned in class more "real."

I know you're studying the political parties right now - isn't it interesting how each party started and evolved?

For so many decades, the parties have fought each other, battled for power and engaged in fascinating philosophical debates. But some of the greatest achievements of the two-party system have occurred when the two parties really work together, without animosity, to achieve great reforms, great good for our country.

Today, President Bush is encouraging the political parties to put aside their partisan bickering for the sake of *your* generation... specifically, so that we can strengthen and preserve the Social Security system for your benefit.

I know that retirement and Social Security must seem like such far-away parts of your life that you barely think about them. And I understand that; it's very natural. But I also hope you know that the national debate, the national dialogue about Social Security reform is really about you! The youngest generations of Americans stand to benefit so much from this debate... so I encourage you to read the newspaper and talk to your parents and teachers about it.

Your grandparents are the ones who receive Social Security benefits now... but reforming the system actually won't impact them. For anyone at or over the age of 55, the President has pledged that the system and its benefits won't change at all.

It could change for you. It must change for you. And it must change for the better. The results of this reform effort will impact the American economy, the amount of taxes you'll pay when you're older, and whether you will be able to look forward to a comfortable retirement when you are done working.

Here's where we are right now: As your parents can tell you, part of each of their paychecks goes to fund Social Security. Workers pay half of the tax, and their employers pay the other half. If they are self-employed, they pay the whole tax themselves. That money goes to pay the Social Security benefits of *their* parents – that's your grandparents' generation.

Right now, this works pretty well because there are more than three people paying that tax for every one person collecting the benefits (receiving a Social Security check).

As you know from buying things to share with your friends – like splitting the cost of a pizza – the more people chipping in, the less each person pays.

When your generation is working and paying those taxes, there will only be two of you paying for the benefits of every retiree. Unless each of you pays a lot more in taxes – something the President doesn't think would be fair – then there won't be enough money to pay the full, promised benefits for your parents.

You see, when your parents' generation – called the baby boomers because there are so many of them – begins to retire, it will dramatically increase the cash flow demands of the system. By the year 2041 – when some of your parents are still collecting benefits and when you yourselves are beginning to approach retirement – if nothing is done to change the system, benefits would have to be cut, abruptly, by 26 percent and would continue to fall thereafter.

The problem only gets worse with every passing year, as generations get smaller in number and people live longer lives. Throughout the future of the system it will be more than $11 trillion short.

This is serious stuff. It can be downright frightening. But the good news is that we don't have to accept that as our future... it doesn't have to be *your* future.

The President wants to work with the Congress to make Social Security solvent - so that it runs "in the black," not in debt. He also wants to see your generation have the ability to save your own money in a personal account. That means you'd be able to build a nest egg of your very own that wouldn't belong to the government.

And, very importantly, the President wants to make sure that the taxes you pay when you are working full-time aren't too high. He wants workers to keep as much of the money they earn as possible. That's good for workers and it's good for our economy, for our prosperity.

I know you are learning in this class that government affects everyone. This issue of Social Security is a very good example of that fact. The decisions made by your government – that means your locally elected leaders, your state legislators, your governor, Congress and the President – really do impact your life. They impact your present and, in this case, they profoundly impact your future.

So while your retirement seems to be a million years away right now... take it from me, the time will go by quickly and it's never too early to think about saving money for the future. I hope that you'll follow the Social Security debate and think about what type of reform would make the future brighter for you.

We are all part of an exciting moment in American history, where a President's courageous leadership has inspired a national discussion and, I'm confident, will lead to historic results. I encourage you to be involved, whether it's talking about the issue with your parents and teachers, or writing a letter to your Members of Congress.

If we act now, we can make sure that Social Security, and our economy, are on sound financial footing for your generation.

I really appreciate the chance to talk with you about this important issue, and would be happy to take your questions. Thanks again for hosting me here in Bismarck.

FROM THE OFFICE OF PUBLIC AFFAIRS

March 31, 2005
JS-2348

Treasury Secretary Snow Congratulates Paul Wolfowitz on Election to Lead World Bank

Treasury Secretary John Snow today congratulated Paul Wolfowitz on his election, by the World Bank's Executive Board, to be World Bank President. "I am tremendously pleased for Secretary Wolfowitz and for the people the Bank serves all over the world. The exceptional mission of the World Bank demands that it be led by an outstanding leader; someone with proven management skills, international diplomatic experience, real vision and, above all, a commitment and passion for development. Paul Wolfowitz is that leader. He will do a terrific job leading an institution whose purpose is noble, unique and represents the hope of impoverished people across the globe. I commend the Board on their selection and look forward to working with President-designate Wolfowitz and the finance ministers and development ministers around the world in our efforts to meet our international development goals."

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

March 31, 2005
JS-2349

Statements on Confirmation of Paul D. Wolfowitz as Tenth World Bank President

WASHINGTON, MARCH 31, 2005--The World Bank's Board of Executive Directors today unanimously confirmed the nomination of Paul D. Wolfowitz to be President of the World Bank. In response to the Board's decision, Mr. Wolfowitz made the following statement:

"I want to thank the Board for their vote of confidence. It is humbling to be entrusted with the leadership of this critically important international institution. Fortunately, I already know I will have a great deal of help from the many people who are deeply committed to the mission of the World Bank. Since my nomination, I have had the opportunity to listen and talk with all 24 Executive Directors, who themselves possess deep knowledge across the broad range of issues facing the Bank.

Yesterday, in Brussels, I had discussions on the Bank's future with the Development Ministers from Denmark, Germany, the Netherlands, Norway, Sweden and the UK. This was followed by a broader meeting hosted by Prime Minister Juncker of Luxembourg with more than 25 European Union representatives. Their advice and questions were constructive, and I know they will continue to provide valuable guidance as I begin my tenure as an international civil servant.

I have also exchanged views with dozens of ministers, ambassadors and even Presidents and Prime Ministers, from every continent. I appreciate their support and their commitment to the vision of the World Bank. As I have said frequently, that mission – helping the poorest of the world to lift themselves out of poverty – is a noble mission or, as former Secretary of State George Shultz said, "a beautiful mission."

I believe deeply in that mission. Nothing is more gratifying than being able to help people in need and developing opportunities for all the people of the world to achieve their full potential.

I would like to take this opportunity to express my appreciation to Jim Wolfensohn who has been extremely helpful to me. His commitment to the Bank's mission will be a hard act to follow and I will be counting on his continued advice and support.

I look forward now to deepening my understanding of the challenges facing the Bank through exchanging views with two key groups: the civil society organizations whose advice and views have become increasingly important in Bank deliberations; and the extraordinary professional staff of the Bank, who constitute the richest body of expertise in the world on the problems of economic development and poverty reduction.

The next six months are a key period of decision making on international development policy, particularly leading up to the UN Summit in September on the Millennium Development Goals.

Beyond the Development Goals, I have been provided with a wealth of advice and information. I have a new appreciation for the urgent need for debt relief, infrastructure and regional integration if poverty is to be reduced. My new colleagues have recommended I review the right balance between loans and grants; the Bank's role as lender versus technical advisor; lending to middle income countries versus support for the poorest nations; and timely, high quality delivery of financial support versus the need for conditions, accountability and safeguards.

Finally, many of my colleagues have pointed out that reducing poverty involves more than the commitment of the Bank's loans and grants. Trade polices and subsidies along with positive conditions for private sector investment are all key factors influencing prospects for the poor.

These are just a few of the challenges which lie ahead. As we take on these concerns, I am excited about the strong contribution the Bank can and must make if we are to create a new era of opportunity for the world's poor.

I look forward to working with the talented Bank staff, all shareholders and supporters as we join together in our noble mission."

Current World Bank President James Wolfensohn also commented:

"I welcome the decision of the Board to appoint Paul Wolfowitz as the next President of the World Bank Group. He is a friend, and I know him to be a person of immense talent and high intellect. He will be an extremely dedicated and strong leader of the Bank. Paul has a long and respected background in academia, diplomacy and international affairs, and his work in the developing world has afforded him a deep understanding of the many challenges of development. He knows what a remarkable institution this is, he appreciates its outstanding team of development professionals, and I know he will bring continuity to its programs and its mission of fighting poverty. I will make every effort to ensure that our transition period is successful, so Paul can hit the ground running on June 1."

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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March 31, 2005
JS-2350

Report on U.S. Holdings of Foreign Securities at End-Year 2003

The findings from an annual survey of U.S. portfolio holdings of foreign securities at year-end 2003 are released today and posted on the U.S. Treasury web site at (www.treas.gov/tic/fpis.html).

The survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. The previous survey was for year-end 2001, and some revisions of that survey are reported in this release. Future surveys are scheduled to be carried out annually and the next report will present results from the survey for year-end 2004.

A complementary survey measuring foreign holdings of U.S. securities is also carried out annually. Data from the most recent such survey, which reports on securities held on June 30, 2004, are currently being processed. Preliminary results are expected to be reported by April 30, 2005.

Overall Results

The survey measured U.S. holdings of foreign securities at year-end 2003 of approximately $3,152 billion, with $2,079 billion held in foreign equities, $874 billion in foreign long-term debt securities (original term-to-maturity in excess of one year), and $199 billion in foreign short-term debt securities. The previous survey, conducted as of year-end 2001, measured U.S. holdings of approximately $2,317 billion, with $1,613 billion held in foreign equities, $557 billion in foreign long-term debt securities (revised from $502 billion), and $147 billion in foreign short-term debt securities (see Table 1).

The surveys are part of an internationally coordinated effort under the auspices of the International Monetary Fund (IMF) to improve the measurement of portfolio asset holdings.

Table 1. U.S. holdings of foreign securities, by type of security, as of survey dates
(Billions of dollars, except as noted)

Type of Security	Dec. 31, 2001	Dec. 31, 2003
Long-term Securities	2,170	2,954
equity	1,613	2,079
long-term debt	557	874
Short-term debt securities	147	199
Total	2,317	3,152

U.S. Portfolio Investment by Country

Table 2. U.S. holdings of foreign securities, by country and type of security, for the countries attracting the most U.S. investment, as of December 31,

2003
(Billions of dollars)

		Total	Equities	Debt securities: Long-term	Debt securities: Short-term
1	United Kingdom	663	421	143	99
2	Japan	307	255	37	14
3	Canada	301	149	139	12
4	Germany	189	103	71	15
5	France	185	131	43	11
6	Netherlands	182	116	58	8
7	Cayman Islands	125	45	76	4
8	Switzerland	120	118	1	1
9	Bermuda	116	108	9	0
10	Australia	91	56	29	5
11	Italy	67	39	25	3
12	Mexico	56	29	28	0
13	South Korea	53	49	4	0
14	Spain	52	44	6	1
15	Brazil	50	32	18	0
16	Sweden	45	28	13	5
17	Finland	41	35	6	0
18	Hong Kong , S.A.R.	38	36	1	0
19	Ireland	33	22	8	3
20	Israel	29	16	12	0
21	Taiwan	27	27	0	0
22	Singapore	25	22	3	0
23	Netherlands Antilles	25	23	1	0
24	Luxembourg	23	6	15	2
25	Denmark	22	10	10	2
	Rest of world	287	159	116	12
	Total value of investment	3,152	2,079	874	199

The stock of foreign securities for December 31, 2003 reported in this survey does not, for a number or reasons, correspond to the stock of foreign securities on December 31, 2001 plus cumulative flows reported in Treasury's transactions reporting system. An analysis of the relation between the stock and flow data is available in Table 5 and the associated text of the final report on U.S. holdings of foreign securities at end-year 2003.

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REPORTS

- Report on U.S. Holdings of Foreign Securities at End-Year 2003

REPORT ON U.S. HOLDINGS OF FOREIGN SECURITIES AT END-YEAR 2003

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6	Netherlands	182	116	58	8
7	Cayman Islands	125	45	76	4
8	Switzerland	120	118	1	1
9	Bermuda	116	108	9	0
10	Australia	91	56	29	5
11	Italy	67	39	25	3
12	Mexico	56	29	28	0
13	South Korea	53	49	4	0
14	Spain	52	44	6	1
15	Brazil	50	32	18	0
16	Sweden	45	28	13	5
17	Finland	41	35	6	0
18	Hong Kong, S.A.R.	38	36	1	0
19	Ireland	33	22	8	3
20	Israel	29	16	12	0
21	Taiwan	27	27	0	0
22	Singapore	25	22	3	0
23	Netherlands Antilles	25	23	1	0
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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 1, 2005
JS-2351

Statement of Treasury Secretary John W. Snow on March Employment Report

This week, the announcement of two vital economic indicators continues to show America's economy is on the right path. Today's announcement that the unemployment rate fell to 5.2% and 110,000 new jobs have been created is good news for the direction of America's economy. That makes for over 3 million new jobs since May 2003. For 2004, the Gross Domestic Product was 3.9 percent, which is yet another sign that America's economy is flourishing.

President Bush is committed to keeping the economy on the path of healthy growth by cutting the deficit in half, enacting an energy policy, and strengthening social security. The President's leadership on economic policy is clearly moving the economy in the right direction.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 1, 2005
JS-2352

Remarks by Anna Escobedo Cabral, Treasurer of the United States before the MANA Annual Conference and Latina Style Business Series

On behalf of the Treasury Department, I am thrilled to be here with you today. It is truly a pleasure to join you for such a magnificent event. It is great to be in a room with so many intelligent, hard-working, and accomplished Latinas – women who have undoubtedly surpassed many hardships to get to where you find yourselves today. Congratulations to all of you.

We, as Hispanic women, have come a very long way in our achievements. To illustrate that point, consider these statistics from the Center for Women's Business Research. For instance, did you know that as of 2004, there are an estimated 553,618 majority-owned, privately-held Hispanic women owned firms in the U.S. generating nearly $44.4 billion in sales? Between 1997 and 2004, the number of Hispanic women-owned firms has increased by 63.9 percent. Isn't that amazing? Another striking fact is that four in ten firms majority-owned by women of color are owned by Hispanics. And firms owned by Hispanic women now represent 8.3 percent of all privately-held, majority women-owned firms in the United States. We have become a vital part of our economy as well as the future of our country. We have an undeniable ability to shape and change our nation today and for future generations.

A critical component to this success, one that I cannot stress enough, is the importance of an education. Education is what will ultimately advance our community as a whole. We need to get more of our kids into the ranks of the college-educated. I congratulate MANA for their programs and initiatives like AvanAmos and Hermanitas for encouraging our young people to further their education in order to better their careers and lives. These younger generations after all are the future of our country. We need to work together in achieving this, because no one person can do it alone.

An educated community is also an economically prosperous community. Financial literacy is crucial to the Hispanic community. One important challenge we share is helping Latino families to become fully integrated in our economic systems. The Treasury Department, together with other agencies, has been working to coordinate financial literacy efforts across the federal government and to identify private-public partnership opportunities. Let me share with you a few facts to put the challenge into perspective:

- When a group of Americans was given a 14-question test of their financial literacy, they answered less than half the questions correctly.
- 40 percent of the so-called "unbanked" are Hispanic – we are not 40 percent of the population.
- 75 percent of Hispanics have not accumulated enough savings for retirement. They rely exclusively on Social Security for their retirement.

According to recent findings, Hispanic women's knowledge about savings and retirement is significantly less than other groups and their retirement confidence level is less than workers overall. They are most likely to rely on Social Security for retirement as well as support from their children and family. This is why Social Security is so important to the future of our community.

The President in his State of the Union Address called on Congress and the American people to work together to fix Social Security. It's a system in desperate need of repair. It was created in 1935 for a world that is very different from today. In 1935, most women did not work outside the home – today, about 60 percent of us do. In 1935, the average American did not live long enough to collect retirement benefits. Today, average life expectancy is now 78 years. The system designed 70 years ago simply does not fit the needs of the 21st Century. If it's not fixed now, we will end up saddling our children and grandchildren with an enormous financial burden.

Changing our Social Security system is a tremendous task that can only be done if we join together to make it happen. We all know that "en la union esta la fureza." One will not make a difference but many will.

It is important for each of you to know and understand this debate and what is at stake. Strong, independent women like you today can change the course of this country and can make this happen by joining together to better the lives of your families and future generations.

As highly successful and influential women who hold a number of competing titles: business owner, mother, daughter, wife, sister, friend, committed citizen and community leader, and the many others that follow, each of you lays the ground work for the generations to come. We share a strong commitment to family and community, across generations.

I, like you, wear a number of those hats as well. Among them, is my current position as Treasurer of the United States which affords me the opportunity to work to make the President's vision of an ownership society a reality. I believe in that vision and the promise it holds for Latino families.

The President has said that if you own something, you have a vital stake in the future of our country. He believes that the federal government should change to help meet the challenges of our times. And strengthening Social Security for future generations is one major contribution that he is committed to.

When he talks about an ownership society, I believe the President is speaking directly to the heart of Latinos. We have enormous faith and commitment in the American dream – to work hard and produce a bounty to share with your family, to own a home, a business, to get our children through college, have access to quality healthcare, to see our parents retire with dignity, and know that our children will be able to do the same.

Social Security provides a critical foundation of income for retired and disabled workers – people we know and care about. Perhaps your mother and father, or an uncle or friend. Indeed, for one third of Americans over age 65, Social Security benefits constitute 90 percent of their total income. Hispanics, African-Americans, and unmarried elderly women are even more reliant on Social Security. As I mentioned earlier, more than 40 percent of Latinos rely on Social Security as their sole source of revenue for retirement.

We know two things - Social Security is safe for today's seniors, but it is in serious danger for our children and grandchildren.

As you may know, Social Security is a pay-as-you-go system with today's workers paying to support today's retirees. But each year, there are more retirees taking money out, and not enough additional workers to support them. In the 1950s there were about 16 workers paying for every beneficiary. Today, there are about 3. Eventually, when today's younger workers retire, there will only be two to support each person on Social Security. Add to this the fact that the first members of the Baby Boom generation turn 60 next year, in 2006, and it becomes clear that this is not a distant problem. It's just around the corner.

By 2017, the government will begin to pay out more in Social Security benefits than it collects in payroll taxes, and shortfalls then grow larger with each passing year. If we don't act now, future generations will face a combination of significant increases in taxes and huge cuts in benefits in order to make up the shortages.

One of the tests of leadership is to confront problems before they become a crisis. President Bush came to Washington to solve problems, not pass them on to future

Presidents and future generations. He knows that the longer we wait to take action, the more difficult and the expensive the changes will be. And doing nothing will cost the most in the long run.

Any fix will require bipartisanship. There are a variety of good ideas that have been proposed in the past to fix Social Security. The President will work with Congress to determine the best elements of the proposals that have been put forward.

This nation must always strive to leave behind a better America for our children and grandchildren. If we invest now and work to fix the problem, we can leave them with a more secure retirement in the future.

There are several principles essential to the President as he works with Congress to find a solution. He is committed to protecting current and near retirees. For those born before January 1, 1950, there will be no changes. Let me be very clear about this: there are 45 million Americans receiving Social Security benefits now and millions more nearing retirement. For these Americans, Social Security benefits are secure and will not change in any way.

The President has also said that he will not raise payroll tax rates because higher taxes will slow economic growth. We all know too well the potential dampening effect of increased taxes.

And the President believes that voluntary personal accounts must be a part of the solution because they give younger workers the option to build a nest egg they can call their own.

Personal retirement accounts are a better deal for younger workers who would be able to choose from a conservative mix of bonds and stocks that would provide a greater opportunity to earn a higher rate of return than anything the current system could provide. A young person who earns an average of $35,000 a year over his or her working career that elects to participate in the personal account option, based on conservative projections, would have nearly $250,000 saved in the account at retirement. That's the power of compound interest.

That money would provide a nest egg for the owner of the account and would supplement their Social Security retirement income. It is money that they can pass on to their loved ones.

You know, my father worked hard all his life, and paid into the Social Security system. He filed the paperwork necessary to begin receiving benefits, but died before receiving his first check. He died the same month the checks were scheduled to start coming. He died too young, of course. We come from a very modest home. He worked hard all his life, but could never really get ahead enough to save money. Social Security was all he had to support himself in retirement. But he died before receiving a single check. He would have given anything to be able to pass those funds on to his children. Instead, the government kept that money.

I know I am constantly telling my kids to "save your money." "Stop spending money on things you don't need" because "el que guarda siempre encuentra." You never know when there will be a rainy day. And it's the same with the Social Security reform. Personal retirement accounts would ensure that Latino families have a chance to save and grow their hard earned money in an account that belongs to them, that they could pass on to their children.

Yes, we are all worried about change, but as we learned during the course of our lives and careers, "para nadar hay que tirarse al agua." I know that you all have had to jump in the water a few times. Here's your opportunity to jump in and make a real difference for your parents, yourselves, and your children. I am very proud of being among so many young, bright, and committed Latinas, because I know that together, we can accomplish remarkable things.

The President has faith in you as well. He is working hard to ensure that all Americans share in his vision of an ownership society and that vision holds great promise for our community.

Thank you to each and every one of you for the hard work you do. I encourage you to continue in your efforts to better the Latino community.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 1, 2005
JS-2353

Taxpayer Advocacy Panel Recruitment
Applications Now Being Accepted
Deadline to Apply is April 29, 2005

WASHINGTON, DC-- The Department of Treasury, along with the Internal Revenue Service, is inviting individuals to help improve the nation's tax agency by applying to be members of the Taxpayer Advocacy Panel. The mission of the Panel is to provide citizen input into enhancing IRS customer satisfaction and service by identifying problems and making recommendations for improvement with IRS systems and procedures; elevating the identified problems to the appropriate IRS official; and referring individual taxpayers to the appropriate IRS office for assistance in resolving their problems. The Panel's subcommittees will consist of 10-19 volunteer members who serve at the pleasure of the Secretary of Treasury and will function solely as advisory bodies.

The TAP program works directly with the National Taxpayer Advocate's Office on issues identified by the IRS and the Taxpayer Advocacy Panel. The National Taxpayer Advocate is the taxpayers' representative within the IRS and reports directly to the Commissioner Internal Revenue and to Congress through an annual report.

"We are committed to working with taxpayers to improve the customer-service focus of the IRS," stated Nina Olson, National Taxpayer Advocate. "Working with taxpayers directly helps us identify issues that may not be on the IRS radar screen. We can also hear their concerns about issues the IRS is already addressing."

Taxpayer Advocacy Panel (TAP) members:

• Get direct input from taxpayers about their experiences with the IRS.
• Identify and prioritize issues of greatest concern to taxpayers.
• Make recommendations to the IRS and Treasury on customer-service issues.
• Work with the IRS to help taxpayers address key issues and concerns.
• Report annually to Treasury, the Commissioner Internal Revenue and the National Taxpayer Advocate.

To qualify as a TAP member, applicants must be U.S. citizens, be able to make a significant time commitment to the panel, and meet certain other eligibility requirements. Further details and the application are available on-line at *www.improveirs.org* or by calling 1-888-912-1227. You can apply on-line or download the form and mail it to:

Milwaukee TAP Office
Stop 1006MIL
310 West Wisconsin Avenue
Milwaukee, WI 53203-2221

Applications must be received by the TAP Office by April 29, 2004.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 1, 2005
js-2354

John B. Taylor, Treasury Under Secretary for International Affairs to visit Cairo, Egypt; Islamabad, Pakistan; and Okinawa, Japan

John Taylor, Treasury Under Secretary for International Affairs, will visit Egypt April 4-5. He will meet with the cabinet's economic team including Finance Minister Boutros Ghali, Investment Minister Mohieldin, Trade Minister Rachid, and Central Bank Governor el-Okdah. He will also meet with American and Egyptian business leaders, visit a USAID-financed enterprise development project, and make a speech at the Egyptian Center for Economic Studies.

The visit provides an opportunity to discuss the market-oriented reforms being pursued by the Egyptian government and review the economic challenges facing Egypt. In particular, he will discuss the government's impressive initiatives to reduce trade barriers, increase exchange rate flexibility, improve the investment climate and reform the financial sector. He will also examine efforts to reduce the fiscal deficit, control spending, and boost the role of the private sector in economic growth. All these measures are vital to producing the sustained, robust growth necessary to reduce unemployment and raise living standards. Under Secretary Taylor's visit underlines the United States' support for Egypt's economy and especially for these reform efforts.

Under Secretary Taylor will visit Pakistan April 6-7. He will meet with Prime Minister Aziz, Finance Advisor Shah, and State Bank Governor Husain. He will also visit a microfinance project financed by the Asian Development Bank, and will meet with other development and finance experts in the country. The visit highlights the strong US support for Pakistan's economic reform efforts, which helped Pakistan achieve strong economic growth in recent years. The visit underscores our bilateral cooperation on important regional issues such as reconstruction efforts in Afghanistan, the G8 Broader Middle East and North Africa (BMENA) initiative, and global efforts to combat money laundering and financial crime.

Under Secretary Taylor will then travel to Okinawa, Japan, on April 8-10 to represent the United States at the Annual Meetings of the Inter-American Development Bank. Further details on Under Secretary Taylor participation in these meetings next week.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 4, 2005
js-2355

Air Transportation Stabilization Board Aloha Airlines Repays ATSB Guaranteed Loan

The Air Transportation Stabilization Board (ATSB) announced today that Aloha Airlines has fully repaid the remaining balance of its ATSB guaranteed loan of $45 million, which was made on December 23, 2002. The loan was backed by a $40.5 million guarantee issued under the Air Transportation Safety and System Stabilization Act. The remaining balance on the loan at the time it was paid off was $24.1 million; the guaranteed portion was $21.7 million.

"The loan guarantee program served its purpose to support Aloha over the past two years when credit was not otherwise reasonably available and the Board is pleased that the company has secured private financing and is now proceeding toward a successful reorganization and exit from bankruptcy," said ATSB Executive Director Mark Dayton.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 4, 2005
JS-2356

Secretary John W. Snow
Prepared Remarks to the Tax Executives Institute
Washington, DC

Thank you so much for having me here, and for being so accommodating with my schedule. I know we've tried to make this work a few times, and I'm thrilled that today worked out... especially since we have so many important things to discuss. I want to share with you the Administration's progress on tax cut permanency, tax code reform and Social Security reform.

I'd like to start out with a quick look at our economy, because it's doing very well and I know that its success is closely tied to good tax policy.

Well-timed tax cuts, combined with sound monetary policy set by the Federal Reserve Board, have resulted in very good economic growth and, most importantly, continual job creation. The economy has created over three million jobs since May of 2003. And while job growth can never be fast enough for those looking for work, the steady pace of job creation has been an unmistakable sign of an economy that has recovered from very tough times, and is now expanding.

In addition to continued job growth, we've also seen new jobless claims decline and productivity continue to expand. GDP growth for 2004 was 3.9 percent. The unemployment rate is down to 5.2 percent - lower than the average rate of the 1970s, 1980s and 1990s. Inflation, interest rates, and mortgage rates remain at low levels. Homeownership rates are at record highs.

This is good news, but important work is still ahead. We need to work on keeping the path clear and solid for an economic future that is as good, or better, than the present. To do that, we've got to keep taxes low; we've got to make the President's tax cuts permanent so that families and small businesses can plan with confidence for their future. Beyond that, we've got to make fundamental, lasting improvements to our tax code. We've got to cut the deficit in half and enact an energy policy. And we've got to save Social Security; I'll get back to that topic shortly.

This country has a wonderfully dynamic, resilient and powerful economy. It is an economy that is ever-changing to keep up with developments in technology, international trade and world events. Unfortunately, our tax code has not kept up with the changing times.

While America remains known for its economic flexibility and dynamism, our tax code has grown larger, bulkier, more burdensome and lethargic with every passing year. No one knows that fact better than the people here in this room today.

The tax code is dreadfully murky in its complexity, but its size is clear and easy to see. More than a million words long, the Internal Revenue Code and regulations has more than doubled in terms of page-length over the past twenty years and today's "short" income tax form takes more than 11 hours to prepare - about the same as the "long form" did a decade ago.

The code is so filled with loopholes, exceptions and lengthy explanations that individuals and businesses spend more than six billion hours every year on paperwork and other tax headaches. Total compliance costs of the income tax are roughly $125 billion annually – about 13 cents for every dollar in income tax revenues collected. Of this $125 billion, individuals have born the brunt, spending about $85 billion trying to comply with our maze of a tax code. In fact, the average

American spends around 25 hours preparing their tax return.

Imagine what this great country could do if we could get a few billion hours back... and a few billion dollars in lower compliance costs as well. And that's why we're here today: to talk about how we can take those billions of hours and dollars away from the tax code nightmare and give them back to the terrific productivity and creativity of the American people.

As you know, the President has asked that a bipartisan panel work together to come up with some options for tax reform. He has asked that the fine people on that panel be guided by the goals of increased fairness, simplicity and ease of understanding, and economic growth and job creation. The President has also asserted that any reform proposal should carry on the good traditions of recognizing the importance of homeownership and charity in our society.

The panel has held six meetings so far... two here in Washington and one apiece in Tampa, Chicago, New Orleans and San Francisco. They are hearing expert testimony at each meeting, and receiving a wide range of critiques and ideas from all over the country. The Panel's executive director, Jeff Kupfer, is looking forward to being here tomorrow to give you more detail on the panel's activities. They're doing great work, and I am looking forward to receiving their recommendations by the end of July.

In the mean time, the nation is moving closer to achieving meaningful reform of our Social Security system.

The President's leadership on this issue is providing our country with a tremendous opportunity to save Social Security for current and near retirees and improve it for younger generations. Since March 3rd, Administration officials – from President Bush and Vice President Cheney to Cabinet members like me and policy experts – have been traveling throughout the country as part of a coordinated 60-day tour of at least 60 stops to discuss the President's message of strengthening Social Security with the American people.

We were almost at the half-way mark of the 60 days, and were about to achieve 60 stops far ahead of schedule, when the Social Security and Medicare Trustees Report was released – another important milestone. This annual report on the financial health of the programs' trust funds left little doubt that the system is financially unsustainable, and in need of expeditious and lasting change.

The Trustees' report showed that Social Security cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. The unfunded obligation, that is, the difference between the present values of Social Security inflows (plus the trust fund) and outflows, is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

The issue of Social Security is really a matter of basic arithmetic, and the threat to Social Security in the near future makes more sense when you look at the simple math. Social Security has enough money now because for decades we have had more than enough workers paying into the system, supporting the retirees drawing benefits.

In 1950, there were 16 workers to support every beneficiary of Social Security - a very comfortable ratio of those paying in versus those drawing benefits. Today there are only 3.3 workers supporting every beneficiary. By the time today's youngest workers – many of you have children in that age group – turn 65, there will only be two workers supporting each retiree.

Now, the President doesn't believe that we should make up the Social Security shortfall with tax increases. The Trustees' report showed just how much we would have to raise taxes to achieve long-term balance: the payroll tax rate would have to be raised immediately by 3.5 percentage points to make the system whole on a permanent basis. In other words, the payroll tax would have to be increased by nearly 30 percent.

I know you appreciate how that kind of tax increase would have significant, negative economic repercussions; it would be bad for countless facets of our economy.

Both workers and employers would bear a significant cost. For very small employers, I fear that much of a tax increase would force them to make terrible choices, from lay-offs to health benefit cuts. And it would make hiring new people even more difficult... which is worrisome since small business creates most of our nation's new jobs.

Increasing payroll taxes hurts the economy and it hurts job creation, period. That's why the President is against it.

It is also worth noting that payroll tax increases have been the standard "solution" to Social Security's problems, and they have never solved the problem! Payroll taxes have been raised some 20 times since Social Security was established – and it has failed to make the system solvent.

Tax increases aren't the answer, so the President has encouraged the Congress to propose a variety of ideas that might be, and he has put a number of ideas on the table as well.

When the President took this issue to the country in his State of the Union Address, he said his objective was to engender a broad national dialogue to get people talking about this issue. He wanted Americans to talk about Social Security, and a national conversation has begun as a direct result.

Today, people are talking about the issue from the halls of Congress to the halls of local shopping malls! The President's leadership has drawn critical attention to the problem and is creating movement. Progress, real progress, is being made.

Over lunch counters, over breakfast and dinner tables all over America... the topic is Social Security reform. It's the front page story in virtually every newspaper. It's on the evening news. And it's there because of the President of the United States. It's there because of the courage that he's had to directly confront and deal with what so many in political life call the "third rail."

The American people respect leaders who call a spade a spade. The President touched the "third rail" without fear, and now we're moving forward. Neighbors and co-workers are talking about it; families are talking about it; Congress is talking about it.

We've seen a clear shift in the course of the last month or so from the question: "Is there a problem?" to the question: "How do we fix it?"

The full question, of course, is "how do we fix it for our children and grandchildren?" Because for Americans 55 or older, of course, the system will not change. It's the young workers and future workers, who will be impacted, who will, I hope, benefit. They are the ones for whom we need to fix this system.

Raising their payroll taxes won't make it better. What the President would like to see, instead, for future generations is an ability to save some of their payroll taxes, to build a nest egg that belongs to them, not to the government. Something they could pass on to their heirs. A nest egg that would draw on the powerful force of compound interest to give workers the prospect of a retirement that is far better than the rapidly-weakening promise of Social Security benefits.

With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

For the life of me, I can't imagine why anybody would argue against young workers having the ability to invest and build a better retirement for their future. In fact, it is the only way to make sure that Social Security reform and putting Social Security on a sound fiscal basis is fair to young workers and future generations. It costs the Social Security system nothing to do so, it will cost current and near-retirees nothing, it gives our children and grandchildren a better retirement, and it helps our country create a larger pool of savings over time.

Additionally, as former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed recently, "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg."

The President and I couldn't agree more with Congressmen Penny and Stenholm.

Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren can be achieved.

We are part of an exciting moment in American history, where a President's courageous leadership has inspired a national discussion and, I'm confident, will lead to historic results. I encourage you to be involved, whether it's talking about the issue with your colleagues, with your families, or your Members of Congress!

If we act now, we can make sure that Social Security, and our economy, are on sound financial footing for our children and grandchildren.

Thanks so much, again, for having me here today. I'd love to take your questions now.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 4, 2005
JS-2357

Harold Damelin Sworn in as Treasury Inspector General

Harold Damelin, a Washington, D.C. attorney and graduate of Boston College Law School, was sworn in today as the Inspector General of the Department of the Treasury. President Bush nominated him for this position on January 24, 2005, and the Senate confirmed him on March 17, 2005.

As Inspector General, Damelin will lead the efforts of the Office of Inspector General to keep the Secretary and the Congress informed on the effectiveness and efficiency of Treasury programs and operations, to conduct audits and to investigate allegations of waste, fraud and abuse.

Prior to becoming the Inspector General of the Department of the Treasury, Damelin served as Inspector General of the Small Business Administration for the past two years. Damelin came to the Inspector General community with over thirty years of litigation experience in the Federal government and in private practice. Before entering private practice in 1986, Damelin served for thirteen years as a Federal prosecutor with both the Criminal Division of the Department of Justice, and as an Assistant United States Attorney in the District of Columbia. From 1986 to 1995, he was a partner in two law firms where he specialized in white collar criminal defense.

In 1995 Damelin rejoined the public sector, serving for two years as Staff Director and Chief Counsel for the U. S. Senate Permanent Subcommittee on Investigations, and then for a year as Senior Counsel to the U. S. Senate's Special Investigation Committee which examined allegations of wrongdoing surrounding the 1996 federal election campaigns. In 1999, Damelin returned to private practice for five years with the Washington, D.C. firm of Powers, Pyles, Sutter and Verville, where he headed the firm's fraud and abuse practice group. He left that firm in 2003 to become the Inspector General at the Small Business Administration.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 4, 2005
2005-4-4-16-1-47-3443

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $78,759 million as of the end of that week, compared to $79,029 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	March 25, 2005			April 1, 2005		
TOTAL		**79,029**			**78,759**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,875	14,795	26,670	11,851	14,623	26,474
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,667	2,974	14,641	11,619	2,939	14,558
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			15,117			15,122
3. Special Drawing Rights (SDRs) [2]			11,559			11,563
4. Gold Stock [3]			11,042			11,042
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	March 25, 2005			April 1, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	March 25, 2005			April 1, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 5, 2005
JS-2358

Monetary Policy in Emerging Market Countries with Implications for Egypt
Remarks at the Egyptian Center for Economic Studies
John B. Taylor
Under Secretary for International Affairs
United States Treasury
Cairo
April 5, 2005

Thank you for inviting me to speak today about monetary policy in emerging market countries and the implications for Egypt. One of the most rewarding parts of my job as U.S. Treasury Under Secretary has been working with officials in emerging market countries on the formulation and implementation of monetary policy. I particularly welcome the opportunity to speak here in Egypt today, because Egypt is not only making noteworthy changes on economic reforms in reducing tariffs and taxes, but also on monetary policy operations.

In recent years, a number of other countries have adopted monetary policies similar to those which Egypt is heading toward, and their experience is very encouraging.

First, inflation has come down significantly in countries that have followed these policies. Instead of spiraling upwards, nearly out of control, prices have become much more stable. We can call this the new era of price stability.

Second, recessions have become less frequent and milder and economic expansions have gotten longer. In other words, the new era of price stability has been accompanied by a new era of overall economic growth and stability.

I began studying this connection between price stability and economic stability back when I was a professor in the mid 1990s and I concluded that this connection is causal, not accidental. Why? Simply put, the improvement in price stability has virtually flattened the boom-bust cycles in which inflationary booms inevitably were followed by recessionary busts. In any case, by studying the experiences in other countries, I believe one can find important implications for Egypt.

Improvements in Price Stability

Figure 1 shows this reduction in inflation, or, in other words, the increase in price stability. Starting about 20 years ago, and then gaining momentum, the rate of inflation has fallen in every region of the world. This contrasts with the much higher inflation around the world from the late 1960s through the 1970s. The reduction in inflation in the United States in the late 1970s and early 1980s was one of the first successful attempts to move toward price stability and it ushered in a period of price stability that has been the subject of an enormous amount of research.

But while the movement toward price stability may have begun in the United States, the movement is clearly not confined to the United States, as Figure 1 shows. Inflation has declined for every region. Moreover, if you look at data for individual countries within the regions, you see the same phenomena. For example, looking at the data for countries in the Middle East, we see trends toward price stability in many countries in recent years. In 1990, six of the 12 countries in the Middle East, for which data are available, had inflation rates in double digits; and now, according to the most recent data, only three of 16 countries had inflation in double digits.

What brought about this reduction in inflation? I believe it can be traced to two factors. First, central banks began to focus more seriously on the goal of price stability, or low inflation. Second, and equally important, they developed more effective and systematic procedures for changing the instruments of monetary policy to bring about the price stability goal. Consider each of these factors in more detail.

Price Stability Goals

The increased emphasis on price stability first began in the late 1970s and early 1980s and now commands worldwide respect. This emphasis followed from the growing consensus that no long-run trade-off exists between inflation and unemployment or economic growth. In the 1960s and 1970s, economists thought a trade-off existed. The more recent view is that inflation is harmful to economic growth. It creates volatility, raises real interest rates, and reduces private investment. Inflation also hurts the poor, who are least able to hedge.

I recall best the change in focus in the United States. The intellectual forces included Milton Friedman's work on the inflation-unemployment trade off and the new *rational expectations* school of monetary policy, which lowered the estimated costs of reducing inflation. The practical implementation was, of course, the job of the Federal Reserve, and under Paul Volker's leadership polices were put in place to bring inflation down by radically changing how the instruments of policy responded to inflation. Since then, under Alan Greenspan's leadership, price stability has remained the goal. While not setting a specific numerical definition of price stability, Chairman Greenspan's statements that price stability occurs at a level of inflation at which inflation does not distort decisions suggest an inflation level of around two percent. Indeed, two percent was the target inflation rate I suggested as a benchmark in designing the *Taylor rule*.

As the importance of the goal of price stability spread around the world, a number of countries found setting a numerical target, or target ranges, to be useful. For example in the early 1990s Chile and New Zealand adopted specific numerical targets for inflation. In New Zealand, they even used the target as part of an official performance agreement between the governor of the central bank and the minister of finance. The Bank of England adopted numerical inflation targets in the mid-1990s. Since then, a number of other central banks--Canada, Brazil, Turkey, for example--have found setting numerical targets for inflation to be useful. Except for transition periods, the target for inflation is in all cases very low, and not too far from the two percent benchmark.

There has been some debate about whether setting a formal numerical target for inflation is useful. Clearly it is possible to achieve the goal of low inflation without setting a numerical target, as the Federal Reserve has shown, so the answer depends on circumstances in each country. Whether a numerical target is used or not, it is essential that the central bank takes the goal seriously and that it is understood to be a very low rate of inflation. It is easy to say that the goal is price stability, or to post such a goal on a central bank web page, but it is much different to actually make the decisions that will bring it about.

Systematic, Transparent Procedures for Setting Policy Instruments

A second important change in monetary policy is in the way central banks set their instruments of policy as they endeavor to achieve the goal of price stability. There are two main choices for the instrument of monetary policy: the interest rate, or a monetary aggregate such as the monetary base. Either type of instrument can be used to achieve an inflation target, but in recent years there has been an increased focus on the interest rate.

Increased focus on the interest rate has encouraged policy makers and economists to think more *systematically and transparently* about central bank decisions. They need to consider whether the change in the interest rate instrument is large enough, or too large. For example, they need to decide how much to raise interest rates when inflation picks up, and they need to know whether lowering interest rates when there is a recession is consistent with the goal of price stability. Furthermore, each adjustment decision and the policy instrument should not be viewed as an isolated one-time adjustment, but rather as part of a multi-period strategy taking expectations and their long-term effects into account. This is where the use of policy rules can be helpful.

The Taylor rule, for example, sets out certain principles that help policy makers determine whether the instruments are changed in a way that will achieve price stability. For example, it calls for increasing the interest rate instrument *by more* than an increase in inflation. This principle, which is imbedded in the Taylor rule, aims at increasing the *real* interest rate in the face of an increase in inflation. The Taylor rule also calls for lowering interest rates when there is a recession. And the use of such a policy rule emphasizes the importance of transparency and clear communications because it implies that these same principles will be applied in future decisions.

Experience has shown that central banks that have been successful in lowering inflation have followed these principles, and central banks that have not been successful in achieving price stability have not followed these principles. For example, during the late 1960s and 1970s when the Fed was not successful in achieving price stability, interest rates did not rise by more than increases in the rate of inflation.

As part of the effort to be more systematic and transparent, central banks now reveal much more information about how they arrive at their policies and what effects those policies have. They now release information about monetary policy meetings more quickly, and communicate to the public through speeches and press releases more than ever before. Effective central banks use these channels of information to inform the public of their strategy for monetary policy. It is especially useful for the public to know that the central bank remains committed to a long-term strategy for achieving price stability in the face of temporary ups and downs in inflation.

An important aspect of a transparent monetary policy is a unified exchange rate. A unified rate sends the clearest market signal and is far likelier than dual or multiple rates to be free of corruption and other distorting influences. In 2001, Egypt established a unified official rate. More recently, it eliminated differences between the official rate and the unofficial parallel rate. These are praiseworthy steps.

The Exchange Rate Question

When capital markets are open internationally the interest rate decisions described above have obvious implications for the exchange rate and exchange rate policy. There are two viable approaches to exchange rate policy. One is to adopt a flexible exchange rate so that the central bank is free to make the interest rate decisions according to the policy principles discussed above that are needed for price stability. The other choice, more relevant to small countries, is to join a currency union or adopt the currency of another central bank that follows good policy principles. An intermediate case is to adopt a pegged exchange rate, which does not create a permanent tie to another currency. But the lack of permanence has led to credibility problems and the frequent collapse of such pegs. The Bretton Woods system was based on such pegs and it indeed collapsed.

More recently there has been movement away from such intermediate exchange rate arrangements so that now many countries have flexible exchange rates. Among them are the United States, the United Kingdom, the euro area as a whole, as well as large emerging market economies such as Brazil and South Africa. The movement away from intermediate exchange rate arrangements is also visible to some extent in the Middle East. Egypt, Yemen, and Turkey have flexible exchange rates. Alternatively, some other countries have dollarized, adopting a foreign currency as their official national currency. By the IMF's count, 46 countries had flexible exchange rates at the end of 2003. There are also 50 countries and 30 or more territories that have monetary unions, dollarization, currency boards, or currency board-like systems.

Some Implications for Monetary Policy in Egypt

Having considered the principles of price stability and exchange rate regimes, how could these lessons be applied to Egypt? In 2004, inflation in consumer prices was 11.3 percent in Egypt. The rise in inflation from the low single digits that prevailed for several years previously is related to two factors. One factor is the gradual passing through of higher prices resulting from the depreciation of the Egyptian pound in 2003. The other factor is the revision of the consumer price index in 2004 to reflect prices more accurately. Appropriate monetary policy--emphasizing the principles that have worked in other countries--can ensure that these factors remain one-time occurrences. But, as our review of the experiences of other countries has shown, this requires (1) a strong commitment to price stability and (2) a policy for the instruments to achieve price stability.

Egypt is following a flexible exchange rate route, so it should be able to adjust interest rates by the right amount to achieve price stability. In this regard the change the Egyptian government undertook in the second half of 2004 to make Egypt's foreign exchange market more efficient are most welcome. The decisions to rescind the foreign exchange surrender requirement and to launch an interbank foreign exchange market have boosted foreign currency liquidity. Delays in obtaining foreign exchange for imports or profit remittances were a staple of the Egyptian business environment in recent years. They have disappeared, as has the parallel market for foreign currency. Removing these distortions will do much to promote sustained growth. The Egyptian pound has appreciated by seven percent against the dollar and by 12 percent against the euro since late December. It is the first appreciation since the pound broke its ten-year peg to the dollar in 2000. Confidence in the Egyptian pound reflects increased confidence in Egypt's economic policymaking.

The Central Bank of Egypt, under the leadership of Governor el-Okdah, has introduced more coherence into monetary management. Interest rates on Treasury bills and other savings instruments have been raised in an effort to counter inflation. And later this month, for the first time, the Monetary Policy Committee will meet to discuss a monetary policy framework, including goals and strategies to achieve those goals. Here it is important to state publicly a clear goal for price stability or low inflation whether stipulated as a formal numerical target of not. Here also is the time to be specific that the policy instruments--whether an interest rate or a monetary aggregate--be set in a way that will achieve this goal. There is no reason to postpone such actions while preparations to get better measures of inflation or better ways to forecast are underway. It may be sufficient for now to state what the instrument of policy will be and if it is the interest rate that it should change by enough to avoid reducing real interest rates when inflation rises.

To be sure, implementing a coherent monetary policy framework is particularly challenging in an emerging market country like Egypt. I reviewed some of these challenges in a paper I presented at a conference at the Bank of Mexico several years ago. It is often difficult to estimate the potential growth rate, the output gap, or the equilibrium interest rate. These challenges are greater where the informal sector is large and statistical coverage is limited. But none of the obstacles need be fatal to implementing a monetary policy framework oriented toward price stability, as I have discussed here.

Measures of inflation such as the consumer price index are never perfect. They are measures of where inflation has been rather than where it is going, and therefore need to be supplemented with forecasts of futures data. Judiciously used, these indicators offer information about the direction prices more generally are likely to take. Another way of dealing with lack of a reliable measure of inflation is to widen the target range for inflation, if an explicit numerical target for the rate of inflation is being used.

Fiscal dominance can also be a problem if the central bank is reluctant to raise interest rates when necessary because the government relies heavily on debt finance. There are two main ways to address the problem. One is to reduce government debt. Egypt's debt to GDP ratio is high. Restraint on spending combined with faster growth would reduce the ratio to a more comfortable level. The other way to address the problem is to make the central bank more independent. Changes to the banking law in Egypt in 2003 moved in that direction, but a more independent central bank would have a greater ability to make interest rate changes when appropriate.

To reduce government debt, and enhance economic growth, Egypt must focus on reforming its banking system. Like many other countries, Egypt nationalized its banking system, and it has paid a heavy price. Directed lending channeled funds to state-owned enterprises, depriving viable private sector firms of credit. Almost everywhere, government-dominated banking systems have been a hindrance rather than a help to economic growth. The government recently adopted a plan to reform the financial sector. Plans to reduce nonperforming loans at the state banks, the commitment to privatize the Bank of Alexandria by the end of this year, and the sale of state shares in some joint venture banks are tangible signs of the government's belief that the state's role in the financial sector must be reduced. Privatizing other state banks would also be beneficial. By providing greater efficiency in providing credit, a liberalized financial system will spur growth. It will also help monetary policy by providing market-based information that is critical for helping the central bank to make good decisions.

Other Recent Economic Reforms in Egypt

Moreover, the changes in monetary policy that I have focused on here serve as part of a broader set of reforms now being undertaken in Egypt. The United States supports President Mubarak and Prime Minister Nazif's joint vision of a more competitive, dynamic economy that meets the growing employment needs of the Egyptian population. The Prime Minister and his cabinet have already established their reform credentials by enacting a number of significant measures, including trade and tariff reform; foreign exchange market reform; and adjustments in administered prices. These market-oriented reforms have already paid dividends by boosting investor confidence in Egypt. Foreign direct investment in Egypt and portfolio inflows are on the rise. The Egyptian stock market has outperformed almost every other equity market in the world, rising more than 100 percent in the last nine months.

The reforms enacted to date are just the first stage of those necessary to bring about the growth Egypt needs. Nor will reform be quick and painless. Fulfilling Prime Minister Nazif's vision will require sustained strong, and at times difficult, actions by the cabinet and the People's Assembly. Plans to reduce personal and corporate income tax rates, reform the financial sector, and privatize many state-owned firms are welcome. The subsidies distort the economy and place a heavy burden on government finances, which also need sustained reform. Carrying out reforms will further improve investor confidence in Egypt and improve the nation's ability to compete in the global economy.

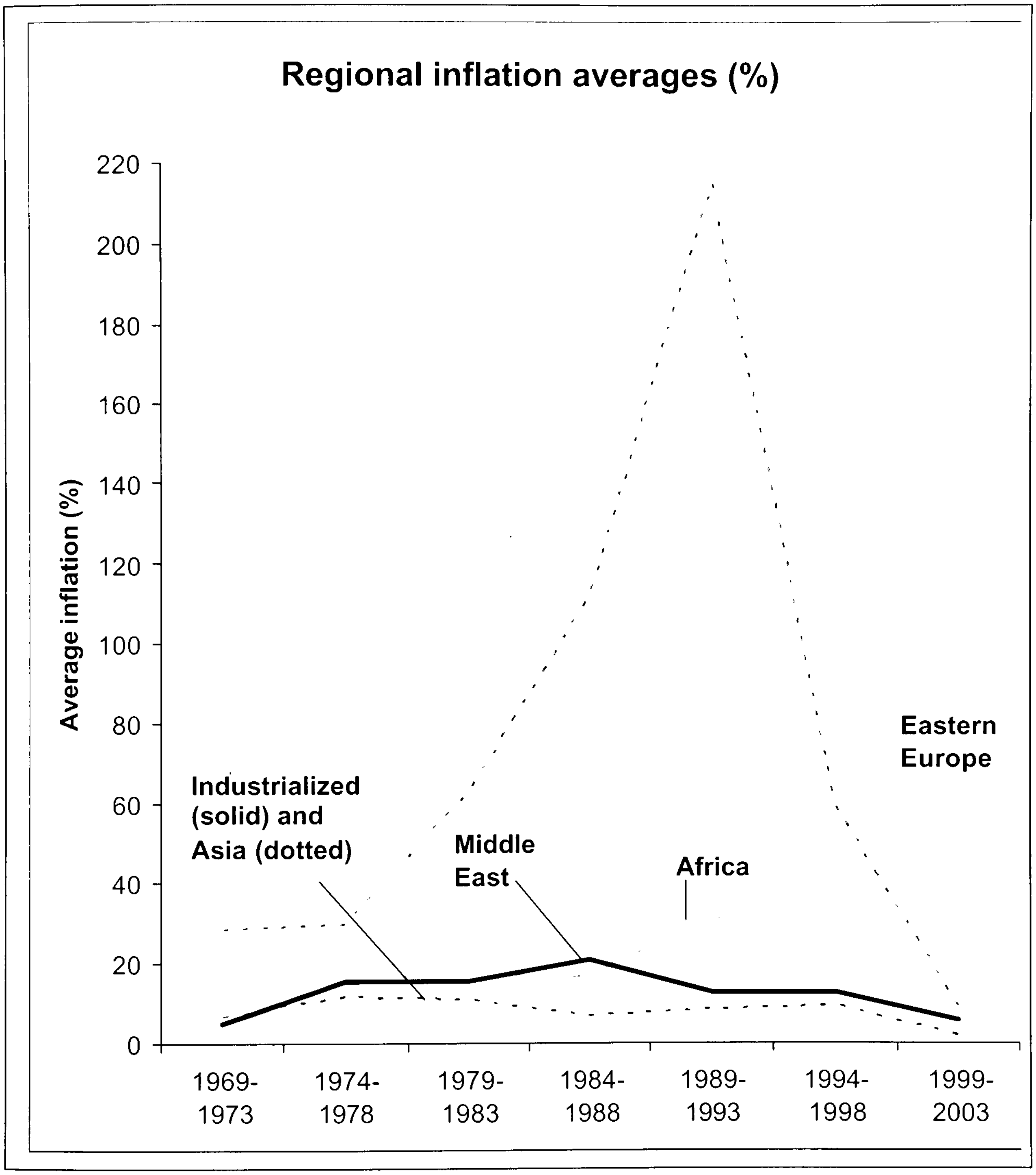
Conclusion

Other countries have faced challenges similar to Egypt's and have addressed them. As I mentioned, price stability is being achieved in many countries around he world. Price stability has proved to be a robust framework capable of operating in a variety of environments. So, even though Egypt faces a variety of challenges in implementing monetary policy, it can employ solutions successfully applied elsewhere. And, success in monetary policy will contribute enormously to Egypt's fundamental economic challenges of economic growth, job creation and raising living standards.

REPORTS

- Regional Inflation Averages

Figure 1



Source: International Monetary Fund, *International Financial Statistics* database, March 2004.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 6, 2005
js-2359

MEDIA ADVISORY: Social Security Radio Day Schedule for Treasury Officials

Secretary of Treasury John Snow
8:00am – 9:00am, 3:15pm – 4:15pm

8:00am KVI-AM – Seattle, WA
LIVE

8:15am Fox News Radio
Taped

8:30am CNN En Espanol
Taped

8:45am WTOP
WTOP-AM – Washington, DC
Taped

3:15pm WPTT – Pittsburgh, PA
LIVE

3:30pm Radio One/XM
Taped

3:45pm Radio America
Taped

4:00pm WNDA/WNDB – FL, TN, VA
LIVE

Assistant Secretary of Treasury Tim Bitsberger
10:00am – 11:00am

10:00am WDEV-AM - Vermont
Taped

10:15am KVI-AM – Seattle, WA
LIVE

10:30am WFOB – Bowling Green, OH
LIVE

10:45am Radio Bilingue/Latino USA (NPR)
Taped

U.S. Treasurer Anna Cabral
12:00pm – 2:00pm

12:00pm Univision Radio
Taped

12:15pm La Mega
Taped

12:30pm Radio One/XM
Taped

12:45pm WTOP
WTOP-AM – Washington, DC
Taped

1:00pm Nuevo Vida
Taped

1:15pm Fox News Radio
Taped

1:30pm KVI-AM – Seattle, WA
LIVE

1:45pm Capitol 730 AM
Taped

Assistant Secretary of Treasury Rob Nichols
11:00am – 12:45pm

11:00am WDUN-AM – Atlanta, GA
LIVE

11:15am WFOB – Bowling Green, OH
LIVE

11:30am Metronews – Morgantown, WV
LIVE

11:45am Radio America
LIVE

12:00pm Radio Bilingue/Latino USA (NPR)
Taped

12:15pm Fox News Radio
Taped

12:30pm WTOP
WTOP-AM – Washington, DC
Taped

Assistant Secretary of Treasury Mark Warshawsky
9:00am – 10:45am

9:00am WDUN-AM – Atlanta, GA
LIVE

9:15am WFOB – Bowling Green, OH
LIVE

9:30am Univision Radio
Taped

9:45am WDEV-AM - Vermont
Taped

10:00am Metronews – Morgantown, WV
LIVE

10:15am WNDA/WNDB – FL, TN, VA
LIVE

10:30am WHO-AM – Des Moines, IA
LIVE

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 6, 2005
js-2360

Financial Services Working Group to Aid Efforts of SPP

President George W. Bush joined Canadian Prime Minister Paul Martin and Mexico's President, Vicente Fox, on March 23, 2005 to announce the Security and Prosperity Partnership of North America (SPP), a trilateral effort to increase security and to enhance prosperity among the United States, Canada and Mexico through greater cooperation and information-sharing.

The SPP is based on the principle that prosperity is dependent on security, and recognizes that these three great nations are bound by a shared belief in freedom, economic opportunity and strong democratic institutions.

The SPP will help integrate security efforts to better protect citizens from terrorism and promote the safe and efficient movement of people and goods. Additionally, the SPP will expand economic opportunities for the people of the U.S., Canada and Mexico by making businesses and the business environment more competitive in the global market place. It will also enhance mutual efforts to protect the environment, improve food safety and consumer choice, improve abilities to combat infectious disease and develop responses to cross-border man-made or natural disasters.

The SPP will complement ongoing efforts, such as the Partnership for Prosperity and the Smart Border Accord, and will help promote the safe movement of people and goods within North America. The Partnership also helps protect our continent from transnational threats, such as terrorism, organized crime, smuggling and trafficking.

Agencies throughout the U.S. Government, including the Departments of Treasury, Commerce and State, the United States Trade Representative and U.S. financial regulatory agencies will play a critical role in the SPP. Notably, Randy Quarles, the Treasury's Assistant Secretary for International Affairs, has been selected to chair the SPP's Financial Services Working Group (FSWG).

The FSWG will focus on enhancing processes for addressing banking, securities and insurance issues. U.S. representatives of the FSWG will first meet among themselves to further develop these views, and then with their Canadian and Mexican counterparts to expand and move forward on these efforts. The FSWG will reach out to the private sectors and legislatures in the three countries to ensure their interests and concerns are appropriately reflected in the working plan compiled by the FSWG.

The FSWG has already achieved consensus on several areas critical to all three countries, including:

· Well-developed, efficient capital markets are essential for economic growth and national security;

· The identification and discussion of issues in regard to banking, securities and insurance will further facilitate the free flow of capital and the efficient provision of financial services throughout the three countries; and

· Financial regulators play an important role in addressing many issues important to the FSWG, and therefore participation by the regulators is critical.

The Financial Services Working Group, together with other trilateral working groups, will develop a work plan by June 23, 2005 to begin moving forward on its important duties to help bolster the overall success of the SPP.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 6, 2005
JS-2361

Treasury and IRS Issue New Regulations Relating to U.S Possessions

WASHINGTON, DC – Today the Treasury Department and IRS announced temporary and proposed regulations to provide guidance relating to U.S. possessions under section 937 and other Code sections to reflect amendments made by the American Jobs Creation Act of 2004 (AJCA) and the Tax Reform Act of 1986. The income tax laws of the United States have long contained special provisions for the taxation of individuals residing in U.S. possessions and corporations created or organized in U.S. possessions. The Tax Reform Act of 1986 substantially revised these provisions. AJCA further revised certain aspects of these provisions to prevent individuals who live and work in the United States from taking advantage of these provisions to inappropriately reduce their combined U.S. and possessions tax.

The regulations update the existing regulations to conform with the new laws and provide additional guidance on the proper application of the statutory provisions. The regulations provide guidance under section 937(a) for determining whether an individual is a bona fide resident of the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands. The regulations also provide rules under section 937(b) for determining whether income is derived from sources within the above-mentioned U.S. possessions, and whether income is effectively connected with the conduct of a trade or business within such a U.S. possession. Lastly, the regulations provide updated guidance under various other Code sections to reflect changes made by the Tax Reform Act of 1986 and AJCA.

REPORTS

- Final Possession Fact Sheet 46
- RIN 1545-BC86
- RIN 1545-BE22

DEPARTMENT OF THE TREASURY
Office of Public Affairs

April 6, 2005

FACT SHEET:

New Temporary and Proposed Regulations on U.S. Possessions Residency and Source Rules

Overview

In the American Jobs Creation Act of 2004 (AJCA), Congress clarified and supplemented the U.S. tax rules dealing with U.S. possessions in particular the determination of: (1) residency in a possession, and (2) whether income is possession source or effectively connected with the conduct of a possession trade or business.

The temporary and proposed regulations generally provide guidance with respect to American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands under the new possession rules in AJCA and update guidance under other sections of the Internal Revenue Code to reflect amendments made by AJCA and the Tax Reform Act of 1986.

Residency Rules

- Under the regulations announced today, an individual is generally considered a bona fide resident of a possession if (1) he or she is physically present in the possession for 183 days during the taxable year and (2) meets certain other conditions.
- The regulations provide certain exceptions to the183-day test. Individuals who meet the following requirements will be considered to have met the183-day test:
  - Individuals who spend no more than 90 days in the United States during the taxable year;
  - Individuals who spend more time in a possession than in the United States and do not have any U.S. earned income; or
  - Individuals who have no permanent connection to the United States.
- There are days of presence in the United States that are not counted for purposes of these three exceptions. For example, time spent in the U.S. as part of an individual's official duties as a government official or employee of a possession is not counted.

Effective date: These regulations generally apply to taxable years ending after October 22, 2004. However, the 183-day test and the exceptions to it are effective for taxable years beginning after October 22, 2004.

****MORE****

Source Rules

- Generally, the regulations provide that the principles for determining whether income is U.S. source are applicable for determining whether income is possession source. Similarly, the principles for determining whether income is effectively connected with the conduct of a U.S. trade or business are applicable for purposes of determining whether income is effectively connected to a possession trade or business. However, the regulations also generally provide that:
    1. Income from U.S. sources is not considered income that is possession source or effectively connected with the conduct of a possession trade or business; and
    2. Income that is effectively connected with the conduct of a U.S. trade or business is not treated as possession source income or effectively connected with the conduct of a trade or business in a possession (the U.S. income rule).

- The regulations provide the following exceptions to these rules:

    - The regulations preserve the existing treatment of income from the sale of goods manufactured in a possession, which provide for the allocation of this income between U.S. and possession sources;
    - The regulations provide rules to prevent U.S. citizens and residents from avoiding U.S. tax on appreciated property by becoming resident in a possession prior to the property's disposition in certain instances;
    - The regulations also provide certain anti-abuse rules for determining the source of dividends and interest from possession corporations.

Effective date: These regulations are generally effective for income earned after October 22, 2004 or after the publication of the regulations. The U.S. income rule is effective for income earned after December 31, 2004.

END

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

REG-159243-03

RIN 1545-BC86

Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking, notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations that provide rules under section 937(a) of the Internal Revenue Code (Code) for determining whether an individual is a bona fide resident of the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands. The temporary regulations also provide rules under section 937(b) for determining whether income is derived from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business within a U.S. possession. Section 937 was added to the Code by section 908 of the American Jobs Creation Act of 2004 (2004 Act).

The temporary regulations also provide updated guidance under sections 1, 876, 881, 884, 931, 932, 933, 934, 935, 957, and 6688 of the Code to reflect amendments made by the Tax Reform Act of 1986 (1986 Act) and the 2004 Act.

Conforming changes are also made to regulations under sections 170A, 861, 871, 901, 1402, 6038, 6046, and 7701 of the Code. The text of the temporary regulations on this subject in this issue of the **Federal Register** also generally serves as the text of these proposed regulations set forth in this cross-referenced notice of proposed rulemaking.

This notice of proposed rulemaking also contains proposed regulations that are in addition to the text of the temporary regulations. These provisions that are issued only as proposed regulations contain additional conforming changes to the regulations under sections 1, 861, 871, and 7701.

DATES: Written or electronic comments must be received by July 11, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for July 21, 2005, at 10:00 a.m., must be received by June 30, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-159243-03) room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-159243-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS and REG-159243-03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, J. David Varley at (202) 435-5165; concerning submissions, Treena Garrett at (202) 622-3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by July 11, 2005. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in the proposed and temporary regulations is in §1.937-1T. Section 937(a) of the Code provides rules for determining whether an individual is a bona fide resident of Guam, Puerto Rico, American Samoa, the USVI, or the Northern Mariana Islands. Section 937(c) requires an individual who claims to become, or cease to be, a resident of a U.S. possession to file notice of such claim in such manner as the Secretary prescribes.

Accordingly, §1.937-1T(g) requires individuals claiming to become, or cease to be, a resident of a U.S. possession to file notice of such claim with the Internal Revenue Service in accordance with section 937(c) of the Code. Individuals subject to this reporting requirement must retain information to establish their residency as required by section 937(c) of the Code and 1.937-1T.

The collection of information is mandatory. The likely respondents are individuals who become (or cease to be) bona fide residents of a U.S. possession.

Estimated total annual reporting burden: 75,000 hours.

Estimated average annual burden hours per respondent: 1.5 hours.

Estimated number of respondents: 50,000

Estimated annual frequency of responses: annually

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Background and Explanation of Provisions

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend 26 CFR parts 1, 301, and 602. The temporary regulations provide rules concerning issues relating to U.S. possessions, including rules for determining whether an individual is a bona fide resident of a U.S. possession under section 937(a). The temporary regulations also provide rules under section 937(b) for determining whether income is derived from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business in a U.S. possession and rules under section 937(c) pertaining to certain reporting requirements for individuals who become (or cease to be) bona fide residents of a U.S. possession. Further, a number of sections in the Code relating to possessions were substantially revised by the 1986 Act. The temporary regulations amend regulations under affected and related sections to conform them to statutory revisions enacted by the 1986 Act and to other legislative amendments. Except as otherwise specified in this notice of proposed rulemaking, the text of the temporary regulations also serves as the text of these proposed regulations. This notice of proposed rulemaking also contains proposed regulations that are in addition to the text of the temporary regulations. These provisions that are issued only as proposed regulations contain additional conforming changes. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Proposed Effective Date

These regulations are generally proposed to apply for taxable years ending after October 22, 2004. For specific applicability dates, see the temporary regulations in the Rules and Regulations section of this issue of the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing has been scheduled for July 21, 2005, at 10 a.m. in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 30, 2005. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Comments are requested on all aspects of the proposed regulations, including those aspects for which specific requests for comments are set forth above.

Drafting Information

The principal authors of these regulations are W. Edward Williams and J. David Varley, Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

<u>26 CFR Part 1</u>

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.931-1 also issued under 26 U.S.C. 7654(e).
Section 1.932-1 also issued under 26 U.S.C. 7654(e).
Section 1.935-1 also issued under 26 U.S.C. 7654(e). * * *
Section 1.937-1 also issued under 26 U.S.C. 937(a).
Section 1.937-2 also issued under 26 U.S.C. 937(b).
Section 1.937-3 also issued under 26 U.S.C. 937(b). * * *
Section 1.957-3 also issued under 26 U.S.C. 957(c). * * *

Par. 2. In §1.1-1, the second sentence of paragraph (b) is revised to read as follows:

§1.1-1 Income tax on individuals.

* * * * *

(b) * * * Pursuant to section 876, a nonresident alien individual who is a bona fide resident of a section 931 possession (as defined in §1.931-1T(c)(1) of this chapter) or Puerto Rico during the entire taxable year is, except as provided in section 931 or 933 with respect to income from sources within such possessions, subject to taxation in the same manner as a resident alien individual. * * *

* * * * *

Par. 3. In §1.170A-1, paragraph (j)(9) is revised to read as follows:

§1.170A-1 Charitable, etc., contributions and gifts; allowance of deduction.

* * * * *

(j) * * *

(9) [The text of the proposed amendment to §1.170A-1(j)(9) is the same as the text of §1.170-1T(j)(9) published elsewhere in this issue of the **Federal Register**].

Par. 4. In §1.861-3, paragraph (a)(2) is revised to read as follows:

§1.861-3 Dividends.

* * * * *

(a) * * *

(2) [The text of the proposed amendment to §1.861-3 is the same as the text of §1.861-3T(a)(2) published elsewhere in this issue of the **Federal Register**].

Par. 5. In §1.861-8, paragraphs (f)(1)(vi)(E), (F) and (H) are revised to read as follows:

§1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

* * * * *

(f) * * *

(1) * * *

(vi) * * *

(E) The tax base for individuals entitled to the benefits of section 931 and the section 936 tax credit of a domestic corporation which has an election in effect under section 936;

(F) The exclusion for income from Puerto Rico for bona fide residents of Puerto Rico under section 933;

* * * * *

(H) The income derived from the U.S. Virgin Islands or from a section 935 possession (as defined in §1.935-1T(a)(3)(i)).

* * * * *

Par. 6. Section 1.871-1 is amended as follows:

1. Revise paragraph (b)(1)(iii).

2. Revise the last two sentences of the undesignated paragraph following paragraph (b)(1)(iii).

The revisions are as follows:

<u>§1.871-1 Classification and manner of taxing alien individuals</u>.

* * * * *

(b) * * *

(1) * * *

(iii) Nonresident alien individuals who are bona fide residents of a section 931 possession (as defined in §1.931-1T(c)(1) of this chapter) or Puerto Rico during the entire taxable year.

* * * The provisions of subpart A do not apply to individuals described in paragraph (b)(1)(iii) of this section, but such individuals, except as provided in section 931 or 933, are subject to the tax imposed by section 1 or 55. See §1.876-1.

Par. 7. Section 1.876-1 is revised to read as follows:

§1.876-1 Alien residents of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands.

[The text of the proposed amendment to §1.876-1 is the same as the text of §1.876-1T published elsewhere in this issue of the **Federal Register**].

Par. 8. Section 1.881-5 is added to read as follows:

§1.881-5 Exception for certain possessions corporations.

[The text of the proposed §1.881-5 is the same as the text of §1.881-5T published elsewhere in this issue of the **Federal Register**].

Par. 9. In §1.884-0, paragraph (b) is redesignated as paragraph (c), and a new paragraph (b) is added to read as follows:

§1.884-0 Overview of regulation provisions for section 884.

* * * * *

(b) [The text of the proposed amendment to §1.884-0 is the same as the text of §1.884-0T published elsewhere in this issue of the **Federal Register**].

Par. 10. In §1.901-1, paragraph (g) is revised to read as follows:

§1.901-1 Allowance of credit for taxes.

(g) [The text of the proposed amendment to §1.901-1(g) is the same as the text of §1.901-1T(g) published elsewhere in this issue of the **Federal**

Register].

Par. 11. Section 1.931-1 is revised to read as follows:

§1.931-1 Exclusion of certain income from sources within Guam, American Samoa, or the Northern Mariana Islands.

[The text of the proposed amendment to §1.931-1 is the same as the text of §1.931-1T published elsewhere in this issue of the **Federal Register**].

Par. 12. Section 1.932-1 is revised to read as follows:

§1.932-1 Coordination of United States and Virgin Islands income taxes.

[The text of the proposed amendment to §1.932-1 is the same as the text of §1.932-1T published elsewhere in this issue of the **Federal Register**].

Par. 13. Section 1.933-1 is amended by revising paragraphs (a) and (c) and adding paragraphs (d) and (e) to read as follows:

§1.933-1 Exclusion of certain income from sources within Puerto Rico.

(a) [The text of the proposed amendment to §1.933-1(a) is the same as the text of §1.933-1T(a) published elsewhere in this issue of the **Federal Register**].

* * * * *

(c) [The text of the proposed amendment to §1.933-1(c) is the same as the text of §1.933-1T(c) published elsewhere in this issue of the **Federal Register**].

(d) [The text of the proposed amendment to §1.933-1(d) is the same as the text of §1.933-1T(d) published elsewhere in this issue of the **Federal Register**].

(e) [The text of the proposed amendment to §1.933-1(e) is the same as the text of §1.933-1T(e) published elsewhere in this issue of the **Federal Register**].

Par. 14. Section 1.934-1 is revised to read as follows:

§1.934-1 Limitation on reduction in income tax liability incurred to the Virgin Islands.

[The text of the proposed amendment to §1.934-1 is the same as the text of §1.934-1T published elsewhere in this issue of the **Federal Register**].

Par. 15. Section 1.935-1 is amended is amended as follows:

1. Revise paragraphs (a)(1) through (a)(3).

2. Revise paragraphs (b)(1) and (b)(3), and add paragraphs (b)(5) through (b)(7).

3. Revise paragraphs (c) through (f).

4. Add paragraph (g).

The revisions and additions are as follows:

§1.935-1 Coordination of individual income taxes with Guam and the Northern Mariana Islands.

(a)(1) through (a)(3) [The text of the proposed amendment to §1.935-1(a)(1) through (3) is the same as the text of §1.935-1T(a)(1) through (a)(3) published elsewhere in this issue of the **Federal Register**].

(b)(1) [The text of the proposed amendment to §1.935-1(b)(1) is the same as the text of §1.935-1T(b)(1) published elsewhere in this issue of the **Federal Register**].

* * * * *

(b)(3) [The text of the proposed amendment to §1.935-1(b)(3) is the same as the text of §1.935-1T(b)(3) published elsewhere in this issue of the **Federal Register**].

* * * * *

(b)(5) through (b)(7) [The text of the proposed §1.935-1(b)(5) through (b)(7) is the same as the text of §1.935-1T(b)(5) through (b)(7) published elsewhere in this issue of the **Federal Register**].

(c) [The text of the proposed amendment to §1.935-1(c) is the same as the text of §1.935-1T(c) published elsewhere in this issue of the **Federal Register**].

(d) [The text of the proposed amendment to §1.935-1(d) is the same as the text of §1.935-1T(d) published elsewhere in this issue of the **Federal Register**].

(e) [The text of the proposed amendment to §1.935-1(e) is the same as the text of §1.935-1T(e) published elsewhere in this issue of the **Federal Register**].

(f) [The text of the proposed amendment to §1.935-1(f) is the same as the text of §1.935-1T(f) published elsewhere in this issue of the **Federal Register**].

(g) [The text of the proposed §1.935-1(g) is the same as the text of §1.935-1T(g) published elsewhere in this issue of the **Federal Register**].

Par. 16. Section 1.937-1 is added to read as follows:

<u>§1.937-1 Bona fide residency in a possession</u>.

[The text of the proposed §1.937-1 is the same as the text of §1.937-1T published elsewhere in this issue of the **Federal Register**].

Par. 17. Section 1.937-2 is added as follows:

§1.937-2 Income from sources within a possession.

[The text of the proposed §1.937-2 is the same as the text of §1.937-2T published elsewhere in this issue of the **Federal Register**].

Par. 18. Section 1.937-3 is added to read as follows:

§1.937-3 Income effectively connected with the conduct of a trade or business in a possession.

[The text of the proposed §1.937-3 is the same as the text of §1.937-3T published elsewhere in this issue of the **Federal Register**].

Par. 19. Section 1.957-3 is revised to read as follows:

§1.957-3 United States person defined.

[The text of the proposed amendment to §1.957-3 is the same as the text of §1.957-3T published elsewhere in this issue of the **Federal Register**].

Par. 20. Section 1.1402(a)-12 is revised to read as follows:

§1.1402(a)-12 Continental shelf and possessions of the United States.

[The text of the proposed amendment to §1.1402(a)-12 is the same as the text of §1.1402(a)-12T published elsewhere in this issue of the **Federal Register**].

Par. 21. In §1.6038-2, paragraph (d) is revised to read as follows:

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.

* * * * *

(d) [The text of the proposed amendment to §1.6038-2(d) is the same as the text of §1.6038-2T(d) published elsewhere in this issue of the **Federal Register**].

Par. 22. In §1.6046-1, paragraph (f)(3) is revised to read as follows:

§1.6046-1 Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.

* * * * *

(f) * * *

(3) [The text of the proposed amendment to §1.6046-1(f)(3) is the same as the text of §1.6046-1T(f)(3) published elsewhere in this issue of the **Federal Register**].

PART 301 -- PROCEDURE AND ADMINISTRATION

Par. 23. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 24. Section 301.6688-1 is revised to read as follows:

§301.6688-1 Assessable penalties with respect to information required to be furnished with respect to possessions.

[The text of the proposed amendment to §301.6688-1 is the same as the text of §301.6688-1T published elsewhere in this issue of the **Federal Register**].

Par. 25. In §301.7701-3, paragraph (c)(1)(i) is amended by adding a final sentence to read as follows:

§301.7701-3 Classification of certain business entities.

* * * * *

(c) * * *

(1) * * *

(i) * * * For entity status consistency rules with respect to certain possessions of the United States, see §§1.932-1T(h) and 1.935-1T(e).

* * * * *

Par. 26. In §301.7701(b)-1, paragraph (d) is revised to read as follows:

§301.7701(b)-1 Resident alien.

* * * * *

(d) [The text of the proposed amendment to §301.7701(b)-1(d) is the same as the text of §301.7701(b)-1T(d) published elsewhere in this issue of the **Federal Register**].

/s/ Linda M. Kroening
Deputy Commissioner for Services and Enforcement.

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 301, and 602

[TD 9194]

RIN 1545-BE22

Residence and Source Rules Involving U.S. Possessions and Other Conforming Changes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations that provide rules under section 937(a) of the Internal Revenue Code (Code) for determining whether an individual is a bona fide resident of the following U.S. possessions: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands. The temporary regulations also provide rules under section 937(b) for determining whether income is derived from sources within a U.S. possession and whether income is effectively connected with the conduct of a trade or business within a U.S. possession. Section 937 was added to the Code by section 908 of the American Jobs Creation Act (2004 Act).

The temporary regulations also provide updated guidance under sections 876, 881, 884, 931, 932, 933, 934, 935, 957, and 6688 of the Code to reflect amendments made by the Tax Reform Act of 1986 (1986 Act) and the 2004 Act. Conforming changes are also made to regulations under sections 170A, 243, 702, 861, 863, 871, 901, 1402, 6038, 6046, and 7701 of the Code. The text of

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 7, 2005
JS-2362

Testimony of Secretary John W. Snow
Before the
U.S. Senate Committee on Banking, Housing and Urban Affairs
Proposals for Housing GSE Reform

Thank you Chairman Shelby, Ranking Member Sarbanes, and members of the Committee for inviting me to appear before you today.

The United States has the broadest, deepest, most successful housing markets in the world, supported by an interdependent financial services infrastructure. That financial services infrastructure includes institutions such as federally insured depositories, mortgage banks, private mortgage insurers, and Wall Street investment banking firms. And a unique and prominent role in that infrastructure is performed by the housing government-sponsored enterprises (GSEs) – Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLB).

With the aid of these financial institutions, Americans have ready access to a wide array of mortgage finance options. Our national system of housing finance plays an important role in promoting home ownership – a key priority of this Administration. We have seen tremendous progress in increasing home ownership in America, which now stands at 69 percent. Secretary Jackson and I share the commitment made by the President to expand home ownership to 5.5 million more minority homeowners by the end of the decade.

Our national system of housing finance needs to remain strong and healthy so that it can continue to make mortgage credit available and provide financing opportunities for new homeowners. Secretary Jackson and I are here today to discuss reforms for the GSEs that will achieve these objectives. These reforms are intended to ensure greater regulatory oversight, enhanced market discipline, and appropriate capital requirements for the GSEs. As we consider these reforms, we are guided by two core objectives: the need for a sound and resilient financial system and increased opportunities for home ownership, especially for less advantaged Americans.

Secretary Jackson will describe in greater detail the role that the GSEs were created to perform, and the home ownership goals we have set forth for them. Allow me to state succinctly why the Administration is so committed to bring about real reform. The risks undertaken by the GSEs, if not properly managed, may pose a threat to their solvency, the stability of other financial institutions and the strength of our economy.

Essential Elements of GSE Regulatory Reform

In 2003, the Administration set forth what we consider to be essential elements for creating a new, stronger, more credible regulatory system for the GSEs. The Administration's position is that without these essential reforms, any new regulatory system would be little improved from the inadequate system we have today. In light of the recent events at the GSEs, the need for meaningful reform has become even more clear. Half-measures will only exacerbate the risks to our financial system.

As we outlined in detail in 2003, the regulator for the GSEs should have powers comparable in scope and force to those of other world-class financial supervisors and fully sufficient to carry out the agency's mandate. The regulator must have clear general regulatory, supervisory, and enforcement powers with respect to the

GSEs. These powers must include the authority to set both minimum capital standards and risk-based capital standards; the power to assess the entities for independent funding outside of the appropriations process; and the ability to place a failed GSE in receivership. An effective receivership mechanism, similar to that held by other safety-and-soundness regulators, should help bring about critical market discipline to ward off the prospect of a GSE falling into significant financial distress. In addition, I wish to note the interplay between an effective FDIC-like receivership mechanism and the so-called line of credit that exists between the Treasury and the GSEs. As members of this Committee are aware, the Treasury Secretary has discretion to issue debt in the amount of $2.25 billion to each of Fannie Mae and Freddie Mac and $4 billion to the FHLBs. Some commentators believe that this credit availability reinforces the perception that the Federal government backs the debt obligations of the Enterprises. This perception is false. In fact, I would exercise the line of credit (which pales in comparison to the size of the debt obligations of the GSEs today) only in the event that a GSE was in significant financial distress and needed the capital to emerge successfully through the receivership process. Congress may wish to consider reforms in this area as well.

As I said in my testimony of September 10, 2003 before the House Committee on Financial Services, in order to address the unique mission of these enterprises as chartered by Congress, an effective regulator must have an integrated package of authorities. The package must empower the regulator to address problems that may arise (like those which we have witnessed in the last two years) before they cause damage to the financial system.

Another key power for the new regulator is the ability to review the activities of a regulated entity, whether they be new activities or those in which the regulated entity already participates. We need to strengthen the activity review process, including greater public participation through notice and comment rulemaking. Meaningful reform will also give greater clarity to the types of activities that fall within the GSEs' mission, thus ensuring that new and existing activities focus the GSEs on promoting housing opportunities. These tools should be a meaningful part of the oversight of the housing GSEs.

Events that have transpired since I testified before this Committee in 2003 reinforce concerns over the systemic risks posed by the GSEs and further highlight the need for real GSE reform to ensure that our housing finance system remains a strong and vibrant source of funding for expanding homeownership opportunities in America. The Administration remains troubled that neither Fannie Mae nor Freddie Mac has financial statements filed with the SEC that can be relied upon. Freddie Mac has yet to file any financial statements in conformity with the securities laws, and Fannie Mae is not expected to be able to issue financial restatements for many months or even years. We recognize some of the unique characteristics of the GSEs, but believe strongly that they, as well as the Federal Home Loan Banks, should be held to public reporting requirements with the SEC comparable to other large, complex public companies.

We believe that reform legislation must provide the regulator with the authority, tools, and guidance from Congress as to what is expected of the GSEs going forward. Consistent with the Administration's vision for strong and effective regulatory and market discipline, I would like to expand on some other key elements that are needed in order to adequately protect the stability of our housing markets, our financial system, and our overall economy. Most notably, I would like to describe the need to control the size and scope of the GSEs' investment portfolios.

Financial and Accounting Problems at the Housing GSEs

The Administration's proposal in 2003 was presented against the background of serious financial and accounting problems at the housing GSEs, including the June 2003 Freddie Mac announcement that it would restate its 2000-2001 financial statements and further delay the release of its 2002 financial statements. Since the last time I appeared before you, the following events have transpired:

- OFHEO released a report of initial findings on Fannie Mae in September 2004 citing improper accounting procedures and practices, internal control deficiencies and questionable management oversight.
- The SEC concurred in the findings of inappropriate accounting practices,

and directed Fannie Mae to restate its earnings for 2001-2003. Fannie Mae, then, estimated that it would be forced to recognize $9 billion in losses.

- OFHEO concluded in December 2004 that Fannie Mae was "significantly undercapitalized" in the third quarter of 2004, and demanded that the minimum capital requirement be increased by 30 percent to ensure that the Enterprise strengthened its financial position.
- And just three weeks ago, Fannie Mae disclosed to the SEC that it could be forced to recognize an additional $2.4 billion of losses, stating that it is unable to reasonably estimate the effect of these issues on reported results of operations.
- In 2004 the FHLBanks of Chicago and Seattle entered into written agreements with their regulator, the Federal Housing Finance Board (Finance Board), to implement changes to enhance their risk management, capital structure, governance and other practices and procedures. In March of 2005, ten FHLBanks implemented new risk-based and leverage requirements. The others are expected to comply soon.

These events demonstrate that the GSEs do not have reliable financial controls to manage their operations risk. Such failures in controls, particularly in such highly leveraged institutions, jeopardizes not only the GSEs' safety and soundness, but also poses risks to the entire financial system.

Limitations on the GSEs' Debt-Financed Portfolio Investments

As additional financial and accounting problems have surfaced with the GSEs, and as the Administration has continued to evaluate the overall structure of the GSEs' operations in relation to their mission, we believe that meaningful reform of the regulatory structure of the GSEs must include mechanisms to protect our broader financial markets from unnecessary risks. More than six out of ten institutions in the banking industry hold as assets GSE debt in excess of 50 percent of their capital. We share the view expressed by Chairman Greenspan and others that the sheer size of the mortgage-based investment portfolios of the GSEs has grown well beyond anything needed in carrying out their housing mission. As Chairman Greenspan has stated:

"... these institutions, if they continue to grow, continue to have the low capital that they have, continue to engage in the dynamic hedging of their portfolios, which they need to do for interest rate risk aversion, ... create ever growing potential risks down the road."

Fannie Mae and Freddie Mac operate two independent main business lines today: (1) a credit guarantee business associated with securitizing mortgages; and (2) a portfolio investment business that involves purchasing mortgages and various mortgage-related securities (including their own mortgage-backed securities) and non-mission related assets. The first of these--the guarantee and securitization of mortgages--is integral to the operation of an effective secondary market for mortgages. The business of investing and holding an investment portfolio of mortgages and other higher-risk assets for its own proprietary trading account and inventory, however, has a much more tenuous connection to the housing mission of the GSEs.

Freddie Mac and Fannie Mae, as we know them, were largely a product of the turbulent financial period of the late 1960s and early 1970s. One of the primary goals of creating Fannie Mae and Freddie Mac was "... to provide supplementary assistance to the secondary market for home mortgages by providing a degree of liquidity for mortgage investments, thereby improving the distribution of investment capital available for home mortgage financing." Initially, Fannie Mae provided this assistance primarily by buying mortgages while Freddie Mac concentrated on securitizing mortgages, a pattern that continued throughout the 1980s.

Since 1990, however, the mortgage portfolio business of both of the housing GSEs has grown rapidly, much to the financial benefit of the Enterprises' management and shareholders. From 1990 through 2003, Fannie Mae's mortgage investments increased from $114 billion to $902 billion, and the ratio of mortgage investments to outstanding guaranteed mortgage-backed securities increased from 40 percent to 69 percent. Freddie Mac's growth in mortgage investments was even more dramatic. From 1990 through 2003, Freddie Mac's mortgage investments increased from $22 billion to $660 billion, and the ratio of mortgage investments to outstanding guaranteed mortgage-backed securities increased from 7 percent to 88 percent.

In general, the risks of the mortgage investment business are more complex to manage than the risks of the credit guarantee business. For example, with the rising interest rates in the early 1980s, Fannie Mae's cost of funds rose above the interest rate it was earning on its long-term, fixed-rate mortgages. This interest rate mismatch was similar to that faced by the savings and loan industry, and Fannie Mae became insolvent on a mark-to-market basis. Only a combination of legislative tax relief, regulatory forbearance, and a decline in interest rates allowed Fannie Mae to grow out of its problem.

The mortgage investment portfolio of the housing GSEs has grown rapidly, beginning in the 1990s, motivated by high profit margins and made possible by a substantial debt funding advantage. This funding advantage arises because markets incorrectly assume that the Federal government provides some form of guarantee to GSE debt. This rapid growth has created a new dimension of risk, one that not only involves our national system of housing finance, but the potential for systemic risk to financial markets in general. The potential for systemic risk is associated with Fannie Mae's and Freddie Mac's large portfolios of mortgages and mortgage-backed securities and other non-related assets, funded at extremely high rates of leverage. The GSEs hold less than one-half the capital of similarly sized financial institutions. The value of these large portfolios can fall dramatically when interest rates change because individuals can prepay their mortgages.

Some of this risk can be hedged through the use of derivatives and other risk transfer mechanisms. Nevertheless, the risk does not disappear altogether, and in the event of an unforeseen problem, the GSEs might not have the funds to pay off their debtholders, which could lead to ripple effects throughout our entire financial system. For example, GSE debt is widely held by banks, so that if this debt declined in value, some banks could find their solvency endangered. Concerns about the GSEs' hedging strategies are reinforced by the regulatory enforcement actions of recent months. Neither Fannie Mae nor Freddie Mac has been able to put forth fair and accurate financial statements. Given this lack of accurate and reliable information, Congress and the Administration are correct in worrying whether the risks that have been undertaken by the GSEs are properly understood, measured, and made public.

These portfolio holdings thus raise fundamental concerns. Are there benefits that outweigh the potential costs? Neither the Treasury nor the Federal Reserve has found evidence that these portfolio holdings (above some minimum threshold) provide meaningful benefits to borrowers. We believe that Congress could usefully consider whether there are meaningful benefits to such holdings, and whether such benefits outweigh the costs.

In order to protect against the systemic risks posed by the GSEs' mortgage investment business, the Administration recommends that limitations be placed on the size of the GSEs' retained mortgage investment portfolios. An appropriate phase-in period for the reduction of the existing portfolios would be needed so as not to disrupt mortgage or financial markets. After the appropriate phase-in period, given the overall advances in securitization, the large amount of data available on mortgages, and the increased sophistication of mortgage investors, we believe that our capital markets could adjust to a significant reduction in the presence of the GSEs as mortgage investors.

In addition to protecting our financial system against potential systemic risk, it is also very important that our national housing finance system continues to function smoothly and that the GSEs are able to accomplish their missions – in particular their support for affordable housing. Our recommendation to limit the investment portfolios of Fannie Mae and Freddie Mac does not in any way limit their ability to guarantee mortgage-backed securities. In that regard, it is worth noting that Freddie Mac operated a successful credit guarantee business throughout the 1980s with a retained mortgage portfolio that was only a small fraction of its current size. Therefore, given that these core functions of the GSEs are preserved, we see no reason why limits on the GSEs' retained mortgage portfolios should impair their ability to provide support for affordable housing, including the ability of Fannie Mae and Freddie Mac to meet their affordable housing goals set by HUD.

Location of the New Regulatory Agency

While the powers and authorities of the new regulator remain of paramount importance to the Administration, Congress should also continue to consider the location of the new regulator. In 2003, the Administration said it was open to making the new regulatory agency a part of the Treasury Department, provided that there were adequate elements of policy accountability to the Secretary of the Treasury. The advantages of placing the new regulator within the Treasury should not be overlooked. First, the start-up time and transition issues related to setting up the new agency would be lessened; housing another agency within Treasury, which is familiar with such relationships, is less time consuming than creating an entirely new agency, which would facilitate effectively transferring existing OFHEO and Federal Housing Finance Board operations to Treasury. Second, addressing issues associated with systemic risk is an important aspect of our proposal, and the Treasury Department is the Executive Branch agency with responsibility to adopt a holistic approach to systemic risk and oversee the proper functioning of financial markets. Third, improving market discipline is important, and the Treasury Department is in the best position to monitor the new regulator's activities while ensuring that investors have a proper understanding of GSE securities. Finally, we believe that there would be less opportunity for regulatory capture were the new regulator housed in Treasury, given the diversity and size of the interests which regularly appear before the Department.

However, as we described in detail last year, there are conditions that need to be met in order for the Administration to support establishing the new regulator as a part of Treasury. The new agency should be required to clear new regulations and policy statements to Congress through the Treasury Department. The Treasury Department and OMB should also have review authority over the new agency's budget to ensure that resources are being properly allocated. Nevertheless, in any such arrangement, the new regulatory agency should have independent responsibility over specific matters of supervision, enforcement, and access to the Federal courts. By housing the new regulator in Treasury with adequate oversight authority, we can achieve the best of both worlds: ensuring a strong, independent regulator while providing for accountability and expertise from the Executive Branch.

The Appropriate Role of the Federal Home Loan Banks

Over the last decade the Federal Home Loan Bank System has undergone considerable change. Membership in the System was extended to commercial banks and they now make up the overwhelming number of members of the System. The Federal Home Loan Banks greatly expanded their investment portfolios and some Banks aggressively moved into the mortgage investment business, types of activities that moved the Banks away from their traditional wholesale funding activities for members. And while perhaps not particularly new, large financial institutions account for the bulk of borrowing from many of the Federal Home Loan Banks.

The Administration continues to believe that the Federal Home Loan Banks should be placed under the same regulator with Fannie Mae and Freddie Mac, and that this new regulatory regime should be structured to take into account certain special differences between the Federal Home Loan Banks and the other GSEs. Consistent with the primary goal of creating an effective regulatory regime for Fannie Mae and Freddie Mac, I believe constructive steps can be taken in this context toward also improving the regulation of the Federal Home Loan Banks. To reach that goal, the regulatory structure of the system should be examined with a careful eye to converging regulation of all of the GSEs to the same extent that their operations (and the risks they present) have likewise converged. In particular, the Administration believes regulation of the Federal Home Loan Banks would be enhanced if Congress were to delineate an explicit mission for them. In addition, we believe that Congress should consider reforming the appointment of directors to the boards of the banks to ensure that the best corporate governance practices are employed. And while progress is being made to ensure that the Federal Home Loan Banks file their financial statements with the SEC much like other large financial institutions with outstanding public debt, Congress should formalize such obligations by statute.

Conclusion

In conclusion, our primary goals in developing our GSE reform proposal are to promote the strength and resilience of our housing finance markets, lessen the potential for systemic risk, and continue our progress in meeting the mortgage credit needs of all our Nation's homebuyers. To accomplish those purposes, the fundamental elements of reform that the Administration has proposed are essential.

In addition, events at the GSEs over the course of the last year reinforce the need for a strengthened regulatory regime. There are a range of other reforms which would also advance our common interest in ensuring the resiliency of the financial system and the robustness of the housing finance system. The Administration is open to consider additional ideas for reform.

I look forward to working with you on this important issue.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 6, 2005
JS-2363

Deputy Assistant Secretary Iannicola Speaks to Savings Group about Strengthening Social Security

Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. today spoke to financial education public policy leaders at the American Savings Education Council (ASEC) General Meeting in Washington, D.C. Iannicola told today's participants that the President's efforts to strengthen the Social Security system are consistent with the group's work to increase personal financial security through increased savings.

"For many years the American Savings Education Council has encouraged Americans to plan for their financial futures," said Iannicola. "By working to strengthen Social Security the President is also looking ahead to help Americans secure their financial futures."

Dallas Salisbury, President and CEO of the Employment Benefit Research Institute, introduced Iannicola and also unveiled a new *Choose to Save* public service announcement, which will feature the www.mymoney.gov Web site and 1-888-mymoney toll-free number recently launched by the Financial Literacy and Education Commission. Iannicola praised ASEC and its partners' dedication to improving financial education across the country. He also updated the participants on the progress of the commission to develop a national strategy for financial education, which will be released in June of 2005. Rep. Judy Biggert (IL) also participated in today's event to help promote the month of April as Financial Literacy Month.

ASEC is a nonprofit national coalition of public- and private-sector institutions undertaking initiatives to raise public awareness about what is needed to ensure long-term personal financial independence. ASEC's goal is to make saving and planning a vital concern of all Americans.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The Office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 8, 2005
js-2364

Prepared Remarks from the
General Counsel and Acting Deputy Secretary of the Treasury Arnold I. Havens
Committee of 100 14th Annual Conference

Good afternoon. It's wonderful to be with you today. I bring with me the greetings and best wishes of Secretary Snow, who is sorry he couldn't be here himself. It's a great honor and privilege to serve the President and Secretary Snow as the General Counsel and Acting Deputy Secretary of the Treasury.

And of course I am honored to speak before the Committee of 100 at your 14th annual conference. The Chinese-American experience has been an authentic American Dream, and the members and leaders of this organization are true success stories. Many of you here today may be first or second generation Americans. Like so many others who have come to America, your parents and grandparents--and many of you--found in this country a new opportunity to build better lives for themselves, their children, and grandchildren. In that sense, the American Dream is a gift to the future.

I would like to talk about two opportunities we all have to give gifts to future generations of Americans. I'd like to share with you the President's visionary ideas to reform our tax code and strengthen Social Security.

Need for Comprehensive Tax Reform

While the American economy remains known for its flexibility, resiliency, and dynamism, our tax code has grown longer, bulkier, and more burdensome every year.

The tax code is dreadful in its complexity. More than a million words long, the Internal Revenue Code and regulations have more than doubled in terms of page-length over the past twenty years. The code is so filled with exceptions and lengthy explanations that individuals and businesses spend more than six billion hours every year on paperwork and other tax headaches. Total compliance costs of the income tax are estimated at roughly $125 billion annually.

Imagine, if you would, a tax system that was less complicated. Imagine what this great country could do if we could get back a few billion hours, or a few billion dollars, every year! Next Friday is tax day, so you I know you can relate to what I'm talking about.

To help advance this worthwhile goal, the President created a bipartisan panel earlier this year to develop revenue neutral policy options. The President asked the panel to be guided by a few core principles: increased fairness, simplicity, and ease of understanding, and economic growth and job creation.

The panel is preparing recommendations that will be delivered to the Secretary of the Treasury by July 31. Tax reform is a key priority for the President, and simplifying the tax code is a key to lasting reform.

In addition to achieving fundamental reform, taxes also need to remain low for our continued economic growth. We know this from recent experience. Well-timed tax cuts, combined with sound monetary policy set by the Federal Reserve Board, have produced good economic growth and continual job creation. The economy has created over three million jobs since May 2003. In addition to continued job growth, productivity continues to expand. GDP growth for 2004 was 3.9 percent.

Our economy is dynamic and resilient – the envy of the world. We need to keep taxes low and stay on this path of economic growth and job creation. We also need to continue looking down the field and make sure that our economy is not disrupted by things that we can avoid -- things that we can fix, today.

Need for Social Security Reform

Of course, in this regard, I'm talking about Social Security. Let me be clear: the current Social Security system is financially unsustainable, and in need of expeditious and lasting change. On March 23, the Board of Trustees of Social Security and Medicare issued its annual report. This report showed that Social Security cash flows will peak in 2008 and turn negative in 2017. The trust fund itself will be exhausted in 2041, when today's younger workers are beginning to retire. The unfunded obligation--that is, the difference between Social Security's income and assets on the one hand, and its outflows on the other--is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

President Bush has shown real leadership on this issue. For many years, the conventional wisdom in Washington was that Social Security reform was a conversation stopper, the "third rail" of politics. The President had the courage to touch the "third rail," and now we're moving forward. People recognize there is a problem in our Social Security system. The President has called on Congress to help find a permanent fix.

Fixing it is quite simply our responsibility to our children and grandchildren. This is a matter of simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system and supporting the retirees who draw benefits. But you know the demographic trends. In 1950, there were 16 workers to support every beneficiary of Social Security. Today there are only 3.3 workers per beneficiary. By the time one of today's youngest workers turns 65, there will be just two workers to support his or her benefits. That's why we're facing the multitrillion dollar shortfall identified in the recent Trustees' report.

For those of us who are 55 or older, the President has made clear that our Social Security benefits are solid. They will not change. We don't need to change our retirement plans or strategy because of Social Security reform, period. But it's those children and grandchildren, those young workers and future workers, who we need to worry about. They are the ones for whom we need to save and strengthen this system.

The President would like younger workers and future generations to have the ability to save some of their payroll taxes they're already paying, to build a nest egg that belongs to them, not to the government. With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

Personal accounts would give young workers more options to invest and build a better retirement for their future. Personal accounts can be implemented in a way that costs the current Social Security system nothing; current and near-retirees would not be affected. But they would give our children and grandchildren the promise of a better retirement, and they would help our country create a larger pool of savings.

Some have argued that we can save the system by increasing the payroll tax. But this multi-trillion dollar shortfall cannot be reasonably fixed by raising taxes. The recent trustees' report showed that the payroll tax would have to be increased by nearly 30 percent to achieve long-term balance. A 30 percent hike in the payroll tax would of course have significant, negative economic consequences. American workers would be taking home less pay, and we mustn't forget that their employers would shoulder half of that tax increase. For small businesses especially, a tax increase of that size could require terrible choices, from lay-offs to cuts in health benefits. And it would make hiring new people even more difficult. Quite simply, increasing payroll taxes hurts the economy and it hurts job creation. That's why the

President is against it.

We're making progress. We believe that Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren can be achieved. I encourage you to become involved in this national discussion.

Conclusion

I would like to close with an analogy I recently heard Secretary Snow use. Many of you in this room own your own businesses, and you probably worked hard over your lives to build them up. You probably want to pass your business on to your children or grandchildren. And you'll want your business to be in top shape, financially, when that time comes.

Let's do the same with our tax system and Social Security system. If we make responsible decisions now, we can make sure that Social Security, and our broader economy, are on sound financial footing for our children and grandchildren.

Thanks again for giving me the opportunity to speak with you today.

I would be pleased to take your questions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 11, 2005
JS-2365

Remarks of
Treasury Acting Deputy Secretary Arnold I. Havens
on Tax Reform and Social Security Reform
Rotary Club
Aiken, South Carolina

Good afternoon. It's wonderful to be with you today here in Aiken. I'd like to speak with you about the President's leadership on two matters of long-term importance to our economy: reforming the tax code, and strengthening Social Security.

Need for Comprehensive Tax Reform

While the American economy remains known for its flexibility, resiliency, and dynamism, our tax code has grown longer, bulkier, and more burdensome every year.

The tax code is dreadful in its complexity. More than a million words long, the Internal Revenue Code and regulations have more than doubled in terms of page-length over the past twenty years. The code is so filled with exceptions and lengthy explanations that individuals and businesses spend more than six billion hours every year on paperwork and other tax headaches. Total compliance costs of the income tax are estimated at roughly $125 billion annually.

Imagine, if you would, a tax system that was less complicated. Imagine what this great country could do if we could get back a few billion hours, or a few billion dollars, every year. Friday is tax day, so I know you can relate to what I'm talking about.

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The panel is preparing recommendations that will be delivered to the Secretary of the Treasury by July 31. Tax reform is a key priority for the President, and simplifying the tax code is a key to lasting reform.

In addition to achieving fundamental reform, taxes also need to remain low for our continued economic growth. We know this from recent experience. Well-timed tax cuts, combined with sound monetary policy set by the Federal Reserve Board, have produced good economic growth and continual job creation. The economy has created over three million jobs since May 2003. In addition to continued job growth, productivity continues to expand. GDP growth for 2004 was 3.9 percent.

Our economy is dynamic and resilient – the envy of the world. We need to keep taxes low and stay on this path of economic growth and job creation. We also need to continue looking down the field and make sure that our economy is not disrupted by things that we can avoid -- things that we can fix, today.

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President Bush has shown real leadership on this issue. For many years, the conventional wisdom in Washington was that Social Security reform was a conversation stopper, the "third rail" of politics. The President had the courage to touch the "third rail," and now we're moving forward. People recognize there is a problem in our Social Security system. The President has called on Congress to help find a permanent fix.

Some Members of Congress have put some ideas on the table already. The people of South Carolina are lucky in that your delegation has taken a real interest in Social Security reform and offered some serious proposals. I know Congressmen Gresham Barrett and Joe Wilson recently hosted a series of town hall meetings here in Aiken and in other communities in this part of the state. Senator Lindsey Graham has experienced firsthand the benefits of our Social Security system and he has helpfully contributed to the national conversation on this issue by starting a dialogue with his Senate colleagues. Senator Jim DeMint also has been a leading voice in the Senate on the importance of fixing the Social Security system.

Fixing it is quite simply our responsibility to our children and grandchildren. This is a matter of simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system and supporting the retirees who draw benefits. But you know the demographic trends. In 1950, there were 16 workers to support every beneficiary of Social Security. Today there are only 3.3 workers per beneficiary. By the time one of today's youngest workers turns 65, there will be just two workers to support his or her benefits. That's why we're facing the multi-trillion dollar shortfall identified in the recent Trustees' report.

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The President would like younger workers and future generations to have the ability to save some of their payroll taxes they're already paying, to build a nest egg that belongs to them, not to the government. With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

Personal accounts would give young workers more options to invest and build a better retirement for their future. Personal accounts can be implemented in a way that costs the current Social Security system nothing; current and near-retirees would not be affected. But they would give our children and grandchildren the promise of a better retirement, and they would help our country create a larger pool of savings.

Some have argued that we can save the system by increasing the payroll tax. But this multi-trillion dollar shortfall cannot be reasonably fixed by raising taxes. The recent trustees' report showed that the payroll tax would have to be increased by nearly 30 percent to achieve long-term balance. A 30 percent hike in the payroll tax would of course have significant, negative economic consequences. American workers would be taking home less pay, and we mustn't forget that their employers would shoulder half of that tax increase. For small businesses especially, a tax increase of that size could require terrible choices, from lay-offs to cuts in health benefits. And it would make hiring new people even more difficult. Quite simply, increasing payroll taxes hurts the economy and it hurts job creation. That's why the President is against it.

We're making progress. We believe that Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for our children and grandchildren can be achieved. I encourage you to become involved in this national discussion.

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I would like to close with an analogy I recently heard Secretary Snow use. Many of you in this room may own your own businesses, and you probably worked hard over your lives to build them up. You probably want to pass your business on to your children or grandchildren. And you'll want your business to be in top shape, financially, when that time comes.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 11, 2005
JS-2366

Remarks of
Treasury Acting Deputy Secretary Arnold I. Havens
before the School of Business Administration
University of South Carolina Aiken

Good afternoon, and thank you for inviting me to be here with you today. It is always wonderful to visit a university in the springtime, because there is a palpable sense of freedom and possibility in the air. Many of you are preparing to graduate in a few weeks. Others are gearing up for summer jobs, summer internships, and summer travels. And virtually all of you are dreaming big dreams--which is exactly what you should be doing-- about what you will eventually accomplish in the big world beyond this campus.

That kind of freedom – to follow your dreams, and to do what you want -- is at the core of our democracy and our economic system. But as we have heard many times, real freedom comes hand-in-hand with a sense of responsibility. When people are not responsible about exercising their freedoms, there can be tragic consequences for individuals, companies, and even the broader economy.

I am encouraged that the organizers of this event--Dr. Ralph Byington and Dr. Rich Waugh--have asked me to speak about corporate responsibility and business ethics. I also have a few remarks about Social Security reform, an important current topic that implicates our collective responsibilities to society and to future generations, and I will return to that subject in a few moments.

In recent years, we have seen a series of very serious abuses of our freedoms in the world of business. Corporate scandals erupted in the headlines in late 2001 and early 2002, starting with Enron and followed quickly by Worldcom, Global Crossing and others. Those headlines exposed a serious problem in our free market system. Chairman Greenspan coined the term "infectious greed" to describe the attitude that had led some of our corporate leaders to falsify and inflate corporate results for their own substantial personal gain.

By doing so, they violated a sacred trust that is so important for leaders to maintain in all walks of life, whether they have the privilege of serving as I do at this level of government or they hold important responsibilities in the private sector.

One response to the wave of corporate scandals--as all of you Business School students know--was the Sarbanes-Oxley Act of 2002, which was passed by an overwhelming vote of the United States Congress and signed into law by President Bush on July 30 of that year. At the risk of over-generalizing, Sarbanes-Oxley did two important things. First, it significantly increased the criminal penalties for anyone who perpetrates a fraud on the securities market. The second thing it did was to create a vigorous and robust system for auditing and reporting on corporate conduct, designed to insure that the financial information furnished to our securities markets is honest and reliable.

Another major response also occurred in July 2002, and that was when President Bush created the Corporate Fraud Task Force chaired by the Deputy Attorney General. The Treasury Department contributes to this task force, which coordinates the investigation and prosecution of crimes like securities and accounting fraud committed by businesses and their executives. Under the leadership of the task force, the Justice Department has obtained over 500 corporate fraud convictions or guilty pleas since its inception. About 1000 people have been charged, including almost 100 corporate CEOs and presidents.

I don't want to risk overstating the problem. Even at the worst of the crisis, the vast majority of corporate leaders were honest and ethical. They worked hard to earn and deserve the trust of employees and shareholders. But selfish irresponsibility caught up with the few who perpetrated these high-profile frauds, and many innocent parties suffered the consequences. Some were affected directly, such as the rank-and-file employees of companies like Enron who lost both their jobs and in some cases much of the value of their pensions as inflated stock values plummeted. Others were hit indirectly as the scandals caused ripples throughout our economy. Confidence in our markets was shaken, and, with over 50 percent of Americans owning stock, that was significant.

Coming just months after the tragic events of September 11th, which had their own negative impact on our economy, the corporate scandals shook Americans' trust in the capital markets, in corporate leadership, and in the whole system of corporate governance.

That's why the Congress and the President moved so quickly to take the kind of corrective action that was needed. Not only did we have a need to address the immediate problems, but perhaps more importantly, we needed to restore confidence and faith in our system of corporate governance. The Sarbanes-Oxley Act and the Corporate Fraud Task Force showed every executive in every board room in America that none were above or beyond the law.

Today, the law holds accountants more accountable, and it subjects auditors to audit. It gives shareholders greater confidence that the financial information they receive from a company is reliable, because CEOs and financial managers who fudge the numbers will be held accountable.

Sarbanes-Oxley and the Corporate Fraud Task Force sent a message to every American: that there cannot be a different ethical standard for corporate America. Business executives are expected to operate with the same high level of honesty and accountability as any small business, family, or community.

I don't want to pretend that this increased vigilance does not come with a cost. The very substantial effort and expense that goes into monitoring and reporting on corporate activity is effort and expense that is not available for more productive uses. But the ultimate costs of letting the public's confidence in our economic system be eroded would be even greater.

This Administration takes corporate governance and responsibility seriously. One aspect of corporate responsibility that is particularly important to those of us in the Treasury Department is the misuse of our tax code.

Aggressive and improper tax shelters have been a problem for years. Some taxpayers thought they could engage in these transactions with little risk of detection. And if they were caught, some thought there was little risk of owing anything more than the correct tax payment plus interest.

The Bush Administration's approach to tax shelters has changed that risk-reward calculus. We have made it harder for taxpayers and shelter promoters to avoid detection. The Treasury Department and the IRS are continuing to take the steps necessary to shut down tax shelters -- including appropriate but aggressive enforcement action against taxpayers and promoters -- as they are identified.

And these efforts are working. In March, the IRS announced that it had collected $3.2 billion in taxes, interest, and penalties from about 1100 taxpayers who took part in just one form of bogus tax shelter, known as "Son of Boss." As I'm sure you business students already calculated in your heads, that works out to an average payment of $2.7 million per tax cheat. And of course responsibility wasn't distributed evenly--one individual paid a $100 million settlement in that case, and 18 people paid about $20 million apiece.

In another example, the Internal Revenue Service recently publicly announced a settlement offer to corporate executives who had used a popular scheme in which the executives tried to realize the economic benefits of stock options while delaying the tax on those benefits, sometimes for up to 30 years. To accept the IRS offer, taxpayers will need to pay the full tax on the whole amount, plus all interest, plus a 10 percent penalty, which is one-half of the normal 20 percent penalty that could be imposed if the cases were litigated. The offer is still open, so we don't have final figures on the number of taxpayers who will ultimately accept, but preliminary numbers indicate that it will be a very substantial percentage.

But government enforcement cannot be the only solution to problems in business ethics and corporate responsibility. We cannot impose ethics and good behavior by legislation or prosecution. To help solve these problems at their root, we depend on citizens who know the difference between right and wrong and who decide to do what's right. Treasury Secretary Snow once observed, "there is earning, and there is stealing. There isn't a whole lot of gray in between... and we all know it, in our hearts and our guts. So never stop listening to those places inside yourself."

Ethics is not simply a set of rules written in a book, but rather a sense of character you carry in your heart. It is a sense of moral duty that one individual owes to the greater community. Most of us would agree that this is a moral duty owed not only to ourselves but to future generations. In that sense, America is facing a moral and ethical issue with regard to our Social Security system. We cannot continue to simply operate a system that benefits ourselves at the expense of those coming into the workforce, including most of you. It isn't sound economics, but more importantly, it isn't honest and it isn't fair.

In Washington right now, your elected leaders have a real opportunity to give a gift to future generations, and I would like to spend just a few moments to talk with you about strengthening the nation's Social Security system.

Let me be clear: the current Social Security system is financially unsustainable, and in need of expeditious and lasting change. On March 23, the Board of Trustees of Social Security and Medicare issued its annual report. This report showed that Social Security cash flows will peak in 2008 and turn negative in 2017. The trust fund itself will be exhausted in 2041, when today's younger workers--including many of you--are beginning to retire. The unfunded obligation--that is, the difference between Social Security's income and assets on the one hand, and its outflows on the other--is $11.1 trillion on a permanent basis, and $4.0 trillion over the next 75 years.

President Bush has shown real leadership on this issue. For many years, the conventional wisdom in Washington was that Social Security reform was a conversation stopper, the "third rail" of politics. The President had the courage to touch the "third rail," and now we're moving forward. People recognize there is a problem in our Social Security system. The President has called on Congress to help find a permanent fix.

Some Members of Congress have put some ideas on the table already. The people of South Carolina are lucky in that your delegation has taken a real interest in Social Security reform and offered some serious proposals. I know Congressmen Gresham Barrett and Joe Wilson recently hosted a series of town hall meetings here in Aiken and in other communities in this part of the state. Senator Lindsey Graham has experienced firsthand the benefits of our Social Security system and he has helpfully contributed to the national conversation on this issue by starting a dialogue with his Senate colleagues. Senator Jim DeMint also has been a leading voice in the Senate on the importance of fixing the Social Security system.

The details of the different ideas that have been raised to date--and their pros and cons--will be fleshed out in the weeks and months ahead. As the President said when he raised this issue to the country in his State of the Union Address, his first objective was to start a broad national dialogue to get people talking creatively about this issue.

And Americans are talking about Social Security, from the National Mall in Washington to the local shopping mall. It's in the local newspapers and on the TV news. People have moved beyond the first question--"Is there really a problem?"--to the more important one--"How do we fix it?"

Fixing it is quite simply our responsibility to the next generation and beyond. This is a matter of simple arithmetic. Social Security has enough money now because for decades we have had more than enough workers paying into the system and supporting the retirees who draw benefits. But you know the demographic trends.

In 1950, there were 16 workers to support every beneficiary of Social Security. Today there are only 3.3 workers per beneficiary. By the time one of you students turns 65, there will be just two workers to support your benefits. That's why we're facing the multi-trillion dollar shortfall identified in the recent trustees' report.

For those of us who are 55 or older, the President has made clear that our Social Security benefits are solid. They will not change. We don't need to change our retirement plans or strategy because of Social Security reform, period. But it's you, the young workers and future workers, who we need to worry about. You are the ones for whom we need to save and strengthen this system.

The President would like younger workers and future generations to have the ability to save some of their payroll taxes they're already paying, to build a nest egg that belongs to them, not to the government. With voluntary personal accounts, younger workers would have the chance to learn about their financial choices, build a nest egg and benefit from sound long-term investment in the free market system without disrupting the system of benefits for today's retired beneficiaries.

Personal accounts would give young workers more options to invest and build a better retirement for their future. Personal accounts can be implemented in a way that costs the current Social Security system nothing; current and near-retirees would not be affected. But they would give the next generation the promise of a better retirement, and they would help our country create a larger pool of savings.

Some have argued that we can save the system by increasing the payroll tax. But this multi-trillion dollar shortfall cannot be reasonably fixed by raising taxes. The recent trustees' report showed that the payroll tax would have to be increased by nearly 30 percent to achieve long-term balance. A 30 percent hike in the payroll tax would of course have significant, negative economic consequences. American workers would be taking home less pay, and we mustn't forget that their employers would shoulder half of that tax increase. For small businesses especially, a tax increase of that size could require terrible choices, from lay-offs to cuts in health benefits. And it would make hiring new people even more difficult. Quite simply, increasing payroll taxes hurts the economy and it hurts job creation. That's why the President is against it.

We're making progress. We believe that Social Security reform that doesn't raise payroll tax rates, that protects benefits for today's seniors, and that improves the system dramatically for the next generation of workers can be achieved.

I would like to close with an analogy I recently heard Secretary Snow use. Someday, many of you in this room will own your own businesses, and you can expect to work hard over your lives to build them up. It may seem a long way away, but I bet you probably want to pass your business on to your own children or grandchildren. And you'll want your business to be in top shape, financially, when that time comes.

Let's do the same with our Social Security system. If we make responsible decisions now, we can make sure that Social Security, and our broader economy, are on sound financial footing for the next generation.

Thank you for having me here today. I'd be happy to take your questions now.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 12, 2005
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Testimony of Assistant Secretary of Treasury
Mark J. Warshawsky
before the
United States Senate Special Committee on Aging

Good afternoon Chairman Smith, Ranking Member Kohl and members of the Committee. I appreciate the opportunity to discuss the Administration's proposal to reform and strengthen the single-employer defined benefit pension system against the background of the larger issue of promoting national saving.

As far back as 1776, Adam Smith identified capital accumulation as the key force in promoting growth in the wealth of nations. Smith also identified the key force in capital accumulation: increasing national savings. Since Smith's time, almost all economists have come to understand the vital nature of national saving, and increasing saving has become a standard policy prescription for enhancing economic growth and raising living standards.

REPORTS

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We know the U.S. faces a challenge as the economy works through the implications of the retirement of the Baby Boom generation. With the growth in the workforce set to slow and the average age of the population rising, maintaining steady growth in the standard of living will become more difficult. The Smith prescription shows the way out. Increase our savings, which will increase our accumulated capital, which will give each worker more and better tools to work with, which will raise productivity and secure a growing standard of living.

Despite the fact that this prescription is well-known, the evidence suggests it is exceptionally hard to follow. Net private saving (gross private saving less depreciation on plant, equipment, and housing stock) as a share of national income averaged about 11 percent from 1955 through 1985, but since then has trended steadily down. Over the past ten years, it has averaged about 5-1/2 percent of GDP, or about 5 percentage points below where it was during the decades of the 1950s, 60s, 70s, and most of the 80s.

One reason the saving prescription is difficult to follow is that incentives work against it. Our tax system, for example, has, for a long time, encouraged Americans to spend first and save second. To reverse, this, the Administration has worked hard to set in place the incentives that encourage saving. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) cut the top tax rates which raised the after-tax rate of return on capital income – encouraging savings. The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) cut taxes on capital income.

But even with these positive changes, the Federal income tax code still discourages saving. To combat this, the President has proposed Retirement Savings Accounts, which would replace the complex array of retirement saving incentives currently in the tax code, such as IRAs, Roth IRAs, and similar saving vehicles. The President has also proposed Employer Retirement Savings Accounts to simplify the saving opportunities individuals have through their employers. The President's Lifetime Savings Accounts would, for the first time, allow individuals to save on a tax-preferred basis for any purpose. This can be especially important to low-income individuals and families who need to save, but cannot afford to lock up funds for retirement that may be needed for an emergency in the near-term. The President also proposed Individual Development Accounts that would give extra financial incentive to certain low-income families to set aside funds for major purchases, such as a first home.

Pensions also play a critical role in saving. Accumulating financial assets for future retirement is one of the main reasons households save at all. If individuals and households believe they will receive a pension in retirement, that influences their saving and asset accumulation behavior. If, in fact, those promised benefits not available because of pension underfunding, then the household's saving, and aggregate national saving, is less than it otherwise would have been had their pension been adequately funded.

I am pleased to have this opportunity to address you here today to discuss the Administration's pension reform proposal for single-employer defined benefit plans. Today I'll provide an overview of the pension reform proposal and describe how it fits into an agenda for enhancing national saving. I'll also address some recent criticism and discuss how, contrary to that criticism, the proposal is unlikely to have any negative short-term macroeconomic consequences.

The Administration's proposal

The single-employer defined benefit pension system is in serious financial trouble. Many plans are badly underfunded, jeopardizing the pensions of millions of American workers. The insurance system protecting these workers in the event that their own pension plans fail has a substantial deficit. Such a deficit means that although the PBGC has sufficient cash to make payments in the near-term, without corrective action the insurance system ultimately will have inadequate resources to pay all future benefits owed to participants of failed plans. Currently, the PBGC is responsible for making benefit payments to more than one million participants of such plans.

The Administration believes that current problems in the system are not transitory, nor can they be dismissed as simply the result of restructuring in a few industries. These problems have been caused by the regulatory structure of the defined benefit system itself. Correcting these problems and securing the retirement benefits of workers and retirees requires that the system be restructured. If we want to retain defined benefit plans as a viable option for employers and employees, fundamental changes must be made to the system's regulatory structure to make it financially sound. Minor tinkering with existing rules will not be sufficient.

A defined benefit pension plan is a trusteed arrangement under which an employer makes a financial commitment to provide a reliable stream of pension payments to employees in exchange for their service to the firm. One cannot expect that such obligations will be honored consistently if they are allowed to remain chronically underfunded as they are under current law. The incentives for financially sound plan funding must be improved or we will continue to see pension plans terminating with massive amounts of unfunded benefits.

When pension plans default on their obligations participants often suffer lost benefits. For many retirees and near retirees these losses come at a time when they are unable to make up the shortfall through other means. In all cases, this Administration is committed to ensuring that pension promises made are pension promises kept. The goal of the Administration's proposed defined benefit pension reform is to enhance retirement security. The reforms are designed to ensure that plans have sufficient funds to meet accurately and meaningfully measured accrued obligations to participants and to ensure the financial solvency of the PBGC.

The current defined benefit pension funding rules – which focus on micromanaging annual cash flows to the pension fund -- are in need of a complete overhaul. These rules are needlessly complex and fail to ensure that many pension plans remain prudently funded. The current rules:

- Measure plan assets and liabilities inaccurately.
- Fail to ensure adequate plan funding.
- Fail to allow sufficient contributions by plans in good economic times, making minimum required contributions rise sharply in bad economic times.
- Permit excessive risk of loss to workers.
- Are burdensome and unnecessarily opaque and complex.
- Do not provide participants or investors with timely, meaningful information on funding levels.
- Do not generate sufficient premium revenues to sustain the PBGC.
- Create a moral hazard by permitting financially troubled companies with underfunded plans to make benefit promises they cannot keep.

The President's solution to these issues is to fundamentally reform the rules governing pension plan funding, disclosure and PBGC premiums, based on the following three simple principles:

- Funding rules should ensure pension promises are kept by improving incentives to fund plans adequately.
- Workers, investors and pension regulators should be fully aware of pension plan funding status.
- Premiums should reflect a plan's risk and ensure the pension insurance system's financial solvency.

Such changes will increase the likelihood that workers and retirees actually receive the benefits that they have earned and will moderate future insurance costs borne by sound plan sponsors. Today I am going to discuss how the Administration's initiative improves incentives for adequate plan funding.

Meaningful and Accurate Measures of Assets and Liabilities

Some argue that the best way to enhance retirement security is to create the appearance of well funded pension plans through the use of asset and liability smoothing and increased amortization periods for actuarial losses.

Our view is there are significant risks associated with masking the underlying financial and economic reality of underfunded pension plans. Failure to recognize risk because of the use of smoothing mechanisms results in transfers of risk among parties, in particular from plan sponsors to plan participants and the PBGC. One need only look at the losses incurred by many steel and airline plan participants and PBGC's net position to see this is so.

The first step in improving funding incentives, therefore, is to measure plan assets and liabilities accurately. We propose measuring liabilities on an accrual basis using a single standard liability measurement concept with minimal smoothing. The measure of accrued liability reflects whether plans are likely to remain ongoing or pose a risk of termination.

Ongoing liability is defined as the present value on the valuation date of all benefits that the sponsor is obligated to pay. Salary *projections* would not be used in determining the level of accrued benefits. Expected benefit payments would be discounted using the corporate bond spot yield curve that will be published by the Treasury Department based on market bond rates. Retirement assumptions will be developed using reasonable methodologies, based on the plan's or other relevant recent historical experience. Finally, unlike the *current liability* measure under current law, plans would be required to recognize expected lump sum payments in computing their liabilities.

At-risk liability measures liabilities that would accrue as a plan heads towards termination. At-risk liability would include accrued benefits for an ongoing plan, plus additional costs that arise when a plan terminates. These costs include acceleration in early retirements, increases in lump sum elections when available and the administrative costs associated with terminating the plan.

The following table provides a summary overview of the critical differences between the ongoing and at-risk liability assumptions.

	Ongoing Liability	At-Risk Liability
Discount Rate	------------- Yield Curve -------------	
Mortality Assumptions	------------- Set by Law -------------	
Retirement Assumptions	Developed using relevant recent historical experience.	Acceleration in retirement rates – individuals retire at the earliest early retirement opportunity.
Lump Sum Payments	Developed using relevant recent historical experience.	Acceleration in lump-sum election.
Transaction Costs	Not included	Included. Calculated by formula.

Under our proposal, asset values used in determining minimum required and maximum allowable contributions will be based on market prices on the valuation date. No smoothed actuarial values of assets will be used as they mask the true financial status of the pension plan.

One aspect of our liability measurement approach that has received a fair amount of attention is the use of the yield curve to discount pension plan liabilities. Accuracy requires that the discount rates used in calculating the present value of a plan's benefit obligations satisfy two criteria: they must reflect the timing of the future payments, and they should be based on current market-determined interest rates for similar obligations. The Administration proposes to replace the current law method with a schedule of rates drawn from a spot yield curve of high grade (AA) corporate bonds averaged over 90 business days. Discounting future benefit cash flows using the rates from the spot yield curve is the most accurate way to measure a plan's liability because, by matching the maturity of the discount rate with the timing of the obligation, it properly computes today's cost of meeting that obligation. Use of a yield curve is a prudent and common practice; yield curves are regularly used in valuing other financial instruments including mortgages, certificates of deposit, etc.

The Treasury Department has developed a corporate bond yield curve that is appropriate for this purpose. Our methodology allows spot yield curves to be estimated directly from data on corporate AA bonds. The process incorporates statistically unbiased adjustments for bonds with embedded call options, and allows for statistically unbiased projections of yields beyond a 30-year maturity. We recently published a white paper detailing our methodology (Creating a Corporate Bond Spot Yield Curve for Pension Discounting Department of The Treasury, Office of Economic Policy, White Paper, February 7, 2005) that is available on the Treasury Department web site.

Our budget proposal to reform the calculation of lump-sum benefits also uses the yield curve for calculating the minimum lump sums. We propose to replace the 30-year Treasury rates used in determining lump sum settlements under qualified plans. Using the yield curve to compute lumps sums and the funding required for an annuity eliminates any distortions that would bias the participant's payout decision. Under our proposal, lump sum settlements would be calculated using the same interest rates that are used in discounting pension liabilities: interest rates that are drawn from a zero-coupon corporate bond yield curve based on the interest rates for high quality corporate bonds. This reform includes a transition period, so that employees who are expecting to retire in the near future are not subject to an abrupt change in the amount of their lump sums as a result of changes in law. The new basis would not apply to distributions in 2005 and 2006 and would be phased in for distributions in 2007 and 2008, with full implementation beginning only in 2009. 1[1]

Funding Targets

Under the Administration's proposal, the appropriately measured accrued liability serves as a plan's funding target. A plan's target funding level for minimum required contributions will depend on the financial health of the plan sponsor. Plans sponsored by financially healthy firms (investment grade rated) will have a funding target of 100 percent of ongoing liability. Less healthy plan sponsors (below investment grade rated) will have a funding target of 100 percent of at-risk liability.

A sponsor is considered financially weak if the plan sponsor OR any significant member of the sponsor's controlled group has NO senior unsecured debt that is classified as investment grade by at least one of the nationally recognized rating agencies.

Because at risk funding targets are likely to be significantly higher than ongoing targets, we provide a five year phase in period to the higher target for any plan whose sponsor becomes financially weak. The funding target during the phase-in period will be a weighted average of the ongoing and at-risk targets. 2[2]

Accrued Benefits Funded

Under the proposal, sponsors that fall below minimum funding levels would be required to fund up towards their appropriate target in a timely manner. If the market value of plan assets is less than the funding target for the year, the minimum required contribution for the year would be equal to the sum of the applicable normal cost for the year and the amortization payments for the shortfall. Amortization payments would be required in amounts that amortize the funding shortfall over a 7-year period. The initial amortization base is established as of the valuation date for the first plan year and is equal to the excess, if any, of the funding target over the market value of assets as of the valuation date. The shortfall is amortized in 7 annual level payments. For each subsequent plan year, if the sum of the market value of assets and the present value of future amortization payments is less than the funding target, that shortfall is amortized over the following 7

1[1] This is a different yield curve phase-in schedule than proposed for the use of the yield curve in discounting pension liabilities for minimum funding purposes.
2[2] The proposal includes a detailed description of the transition rules that govern the phase-in of the higher funding target when a plan changes status from ongoing to at-risk. See the Treasury Blue Book for more information at http://www.treas.gov/offices/tax-policy/library/bluebk05.pdf.

years. If the sum of the market value of assets and the present value of future amortization payments exceeds the funding target, no new amortization base would be established for that year and the total amortization payments for the next year would be the same as in the prior year. When, on a valuation date, the market value of the plan's assets equals or exceeds the funding target, then the amortization charges would cease and all existing amortization bases would be eliminated.3[3]

Benefit Limitations

The reform proposal will include benefit limitations for seriously and severely underfunded plans. Benefit restrictions serve three critical purposes. First, they will limit liability growth as a plan becomes progressively underfunded relative to its funding target. It is important to arrest the growth of unfunded liabilities in order to ensure that plan participants will collect benefits that they accrue. Under current law, sponsors of all but the most severely underfunded plans can allow additional benefits to accrue and in many situations, even make benefit improvements. Plan sponsors in financial trouble have an incentive to provide generous pension benefits, rather than increase current wages, and employees may go along because of the PBGC guarantee. This increases the likely losses faced by participants and large claims to the PBGC. The second purpose of benefit restrictions is to guard against this type of moral hazard. Third, but certainly not least importantly, I believe benefit restrictions will serve as a very powerful incentive for plan sponsors to maintain well funded plans.

Plans with financially weak sponsors that are funded at a level of between 60 and 80 percent of their targets will be prohibited from offering lump sums or increasing benefits. If funding falls below 60 percent of target liabilities accruals will also stop and there will be no preferential funding of executive compensation. Plans with healthy sponsors will be prohibited from increasing benefits or providing lump sum payments if they are funded at less than 60 percent of their target. Underfunded plans with sponsors in bankruptcy will also be subject to benefit limits.

Increased Deductibility

The Administration proposed reforms provide real and meaningful incentives for plans to adequately fund their accrued pension obligations. The Administration plan matches these new funding responsibilities with new opportunities – an enhanced ability to pre-fund obligations on a tax-preferred basis. Under the Administration's proposal, plans will be able to build two separate funding cushions. The first is equal to 30 percent of ongoing liability and the second allows for prefunding of some expected salary increases for final pay plans, and expected future plan amendments, based on the amendment experience of the last six years, for flat dollar plans. In addition, plans will always be able to deduct contributions that bring a plan's funding level up to at-risk liability.

3[3] This description draws on the description in the Treasury Blue

Higher limits for deductible contributions, along with existing authority to allocate plan assets and hedge investment and interest rate risk, will provide sponsors with the tools they need to smooth contributions over time. We believe that providing sponsors these tools will not only allow for more effective contribution smoothing than is accomplished using the mechanisms embodied in current law, but it will also allow sponsors to optimally balance contribution smoothing with other investment objectives.

Disclosure

The financial health of defined benefit plans must be transparent and fully disclosed to the participants and their families who rely on the promised benefits. While ERISA includes a number of reporting and disclosure requirements that provide workers with information about their employee benefits, the timeliness and usefulness of that information must be improved.

The President's proposal would change the disclosures required on the annual report filed with the government, Form 5500 and the Summary Annual Report provided to participants (SAR). On the Form 5500, plans would be required to disclose the plan's ongoing liability and at-risk liability whether or not the plan sponsor is financially weak. The Schedule B actuarial statement would show the market value of the plan's assets, its ongoing liability and its at-risk liability.

Information provided in the SAR to workers and retirees would be more meaningful and timely. It would include a presentation of the funding status of the plan for each of the last three years. The funding status would be shown as a percentage based on the ratio of the value of the plan's assets to its funding target. In addition, the SAR would include information on the company's financial health and on the PBGC guarantee. The due date for furnishing the SAR for all plans would be accelerated to 15 days after the filing date for the Form 5500.

The proposal also would provide for more timely disclosure of Schedule B information for plans that cover more than 100 participants and that are subject to the requirement to make quarterly contributions for a plan year (i.e., a plan that had assets less than the funding target as of the prior valuation date). The deadline for the Schedule B report of the actuarial statement would be shortened for those plans to the 15th day of the second month following the close of the plan year, or February 15 for a calendar year plan. If any contribution is subsequently made for the plan year, the additional contribution would be reflected in an amended Schedule B that would be filed with the Form 5500.

Another important aspect of the proposal is allowing broader access to data submitted to PBGC. Under our proposal, the Section 4010 information filed with the PBGC would be made public, except for the information subject to Freedom of Information Act protections for corporate financial information, which includes confidential "trade secrets and commercial or financial information."

PBGC Premiums

The pension insurance premium structure also is in need of reform. Our plan increases incentives for plan funding and provides the pension insurance system with adequate revenues to eventually restore it to financial health. The flat rate premium will be immediately increased from $19 to $30 per participant to reflect wage growth since 1991 when the $19 rate was set. In the future, the flat premium rate will be updated annually using the same index that is used to update PBGC's maximum guarantee limits. This provision will allow the price and level of insurance coverage to grow at the same rate in the future.

The proposal will also introduce a more robust system of risk-based premiums. Risk based premiums will be charges levied on unfunded target liabilities for all plans. Two key differences distinguish risk-based premiums under the proposal from the variable rate premiums of current law. First, the liability on which underfunding is measured for premium purposes is the same liability measure used for the plan's funding target. Second, all plans with unfunded liabilities will pay risk-based premiums. This feature of risk-based premiums should provide a much stronger incentive to maintain adequately funded plans.

Credit Balances

I'd like to say a few words about credit balances. Credit balances are created when a plan makes a contribution that is greater than the required minimum. Under current law, the credit balance, plus an assumed rate of return, can be drawn down to satisfy future minimum contribution requirements. Credit balances that allow underfunded plans are undesirable and dangerous because they create funding holidays as plans become increasingly underfunded and prolong the amount of time that such plans can remain below their funding targets, leaving participants at greater risk. One need only consider the case of Bethlehem Steel to see how significant an issue this is. Just marking credit balances to market is not sufficient to solve the problem if underfunded plans are still able to take funding holidays.

It is critical to note that while our proposal does away with "credit balances" as currently construed, it does not reduce the incentives for plan sponsors to contribute above the minimum. In the Administration's proposal, the focus of the reformed funding rules on assets and accrued liabilities means that pre-funding pays off in a reduction in future required minimum payments. Plans that have made higher than minimum contributions in past years do not lose the value of such contributions. These contributions increase the value of plans assets relative to liabilities and, other things equal, reduce plan underfunding and decreases future amortization payments. In combination with the rest of the proposal, there is more than adequate incentive for plan sponsors to fund above the minimum. In fact here are four other reasons that employers might choose to contribute more than the minimum: (1) The increased deductibility provisions allow sponsors to accumulate on a pre-tax basis; (2) Disclosure of funded status to workers will encourage better funding; (3) A better funded status results in lower PBGC premiums, and (4) A better funded status make benefit restrictions less likely.

Saving and Macroeconomic Effects

National Saving

As I have described, one important goal of the Administration's proposal is to ensure that plans have sufficient funds on hand to meet accurately and meaningfully measured accrued obligations to participants.

The current rules often fail to ensure adequate plan funding – recent history has made this obvious. Formally we might say that the current set of rules has created a partially *pay-as-you* go private pension system by allowing some accrued liabilities to be unfunded. That is, in general, because when plans are not fully funded, the system basically operates by transferring contributions associated with younger workers to the current retired workers.

The funding rules proposed by the Administration, whereby sponsors that fall below the accurately measured minimum funding levels are required to fund up towards their target in a timely manner, move the system in the direction of being *fully-funded*. In a fully-funded system the contributions associated with each generation of workers are invested and fund their own retirements. A basic result in macroeconomics is that a pay-as-you-go system results in less saving, a slower rate of capital accumulation, and a lower steady state capital stock. Therefore the Administration's proposal – through the move towards more fully funded private defined benefit pensions – is consistent with the Administration goal of increasing saving and greater capital accumulation.

Macroeconomic Effects

Recently some analysts have expressed concern that the Administration pension funding proposal could have negative macroeconomic effects. They suggest these effects will come through depressed business investment by underfunded plan sponsors, some of whom will face higher contributions under the Administration's proposal.

I understand that these concerns may be widely held – and are likely to be repeated by the proposals detractors. In fact, in my opinion, sound economic analysis strongly suggests that there are no short- or long-term macroeconomic risks associated with reforming pension funding rules. Quite the contrary, the proposal's long-term economic effects will be positive.

Well-functioning capital markets allow companies to finance attractive investments even if they face short-term demands on their current cash flows. For that reason, many economists believe that there is little link between a company's cash flows – including its pension funding requirements – and its investment decisions. This suggests that as a general matter, pension contributions are unlikely to cause a reduction in the plan sponsor's investment pattern.

There is a strand of economic literature that suggests there is a link between short-term cash flow demands and investment decisions. However, I believe that some of the analysts who have referenced this literature in analyzing a highly stylized and in many respects inaccurate version of the Administration's proposal have misused the literature's results and overstated the effects – if any – of the proposal on plan sponsor investment behavior.

More importantly, it is critical to recognize that pension contributions finance investment throughout the economy. The monies directed into pension accounts are invested in stocks and bonds, thereby deploying these resources throughout the economy. I believe some analysts who have expressed concern about the macroeconomic effects of the Administration's proposal are mistakenly considering only investment by affected plan sponsors, and thus fail capture this additional investment. This may lead them to mistakenly attribute negative macroeconomic effects to the Administration's proposal.

As I have described, I believe there will be no negative short-term macroeconomic effects of the Administration's pension proposal. If there were effects, I am confident that these *de minimus* short-term effects of the proposal would be outweighed by its long-term beneficial effects of increasing saving and capital accumulation.

Conclusion

Defined benefit plans are a vital source of retirement income for millions of Americans. The Administration is committed to ensuring that these plans remain a viable retirement option for those firms that wish to offer them to their employees. The long run viability of the system, however, depends on ensuring that it is financially sound. The Administration's proposal is designed to put the system on secure financial footing in order to safeguard the benefits that plan participants have earned and will earn in the future. We are committed to working with Congress to ensure that effective defined benefit pension reforms that protect worker's pensions are enacted into law.

It has been my pleasure to provide this discussion of the proposal. I look forward to discussing the proposal and the motivations for the proposal further and answering any additional questions you may have.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 13, 2005
JS-2368

Treasury and IRS Issue Ruling on Contributions of Spouses to HSA Accounts

WASHINGTON, DC -- The Treasury Department and IRS today announced a ruling confirming that an individual can be eligible to contribute to a Health Savings Account (HSA) even if his or her spouse has nonqualifying family coverage, provided the spouse's coverage does not cover the individual. In addition, the ruling clarifies how much the eligible spouse can contribute to an HSA in such a situation.

For example, Steve and Mary Jones are married with three children. Steve has a low deductible family health plan that covers him and the Jones children. His plan *does not* qualify for an HSA. The ruling clarifies that Mary, who is not covered under Steve's family plan, may have her own separate high-deductible health plan that *does* qualify for an HSA.

HSAs were created by the Medicare bill signed by President Bush on December 8, 2003, and are designed to expand access to health care by helping individuals save for future qualified medical and retiree health expenses on a tax-free basis. An individual who is covered by a high deductible health plan can make a tax-deductible contribution to an HSA, and use it to pay for out-of-pocket medical expenses. This will help more American families get the health care they need at a price they can afford. More information about HSAs is available at Treasury's HSA web site: www.treas.gov/offices/public-affairs/hsa/

REPORTS

- A copy of the ruling

Part I

Section 223 – Health Savings Accounts—HDHP Family Coverage

Rev. Rul. 2005-25

ISSUES

1. Is a married individual who otherwise qualifies as an "eligible individual" eligible to contribute to a Health Savings Account (HSA) under section 223 of the Internal Revenue Code (the Code) if the individual's spouse has non-HDHP family coverage that does not cover the individual?

2. If the individual is eligible to contribute to an HSA, what is the maximum contribution limit?

FACTS

Situation 1

H and W are a married couple and both are age 35. Throughout 2005, H has self-only coverage under a high deductible health plan (HDHP) as defined in section 223(c)(2) with an annual deductible of $2,000. H has no other health coverage, is not enrolled in Medicare and may not be claimed as a dependent on another taxpayer's return. W has non-HDHP family coverage for W and H's and W's two dependents, but H is excluded from W's coverage.

Situation 2

The same facts as *Situation 1*, except that H has HDHP family coverage as defined in section 223(c)(2) for H and one of H's and W's dependents with an annual deductible of $5,000. W has non-HDHP family coverage for W and H's and W's other dependent. H is excluded from W's coverage.

Situation 3

The same facts as *Situation 1*, except that H has HDHP family coverage for H and H's and W's two dependents with an annual deductible of $5,000. W is not covered under H's health plan and has no other health plan coverage.

LAW AND ANALYSIS

Section 223(a) allows a deduction for contributions to an HSA for an "eligible individual." Section 223(c)(1)(A) defines "eligible individual" with respect to any month, as an individual who, in addition to other requirements, is covered under an HDHP on the first day of such month and is not, while covered under an HDHP, "covered under any health plan which is not a high deductible health plan, and which provides coverage for any benefit which is covered under the high deductible health plan." An eligible individual may also have permitted insurance, and certain disregarded coverage in addition to an HDHP. A plan does not fail to be treated as an HDHP merely because it covers preventive care without a deductible.

An HDHP is a health plan that satisfies certain requirements with respect to minimum annual deductibles and maximum annual out-of-pocket expenses. Section 223(c)(2)(A). Family coverage is any coverage other than self-only coverage (e.g., an HDHP covering one eligible individual and at least one other individual (whether or not the other individual is an eligible individual)). Section 223(c)(4); Q&A-12 of Notice 2004-50, 2004-33 I.R.B. 196.

Only eligible individuals may contribute to an HSA. The maximum annual contribution limit is the sum of the limits determined separately for each month. For an individual who is eligible during the entire calendar year 2005, the contribution limit is the lesser of the annual deductible under the HDHP (minimum of $1,000 for self-only coverage and $2,000 for family coverage) or $2,650 for self-only coverage and $5,250 for family coverage. Rev. Proc. 2004-71 § 3.22, 2004-49 I.R.B. 1184.

Section 223(b)(5) provides special rules for married individuals. In general, if either spouse has family coverage, both spouses are treated as having only such family coverage. Also, if each spouse has family coverage under different health plans, both spouses are treated as having family coverage under the plan with the lowest deductible. However, if a spouse has HDHP family coverage and the other spouse has non-HDHP self-only coverage, the spouse with the HDHP family coverage is an eligible individual and may contribute to an HSA up to the amount of the annual contribution limit. Because the other spouse is covered by a non-HDHP and is therefore not an eligible individual, the other spouse may not contribute to an HSA, notwithstanding the special rule in section 223(b)(5) treating both spouses as having family coverage. Q&A-31 of Notice 2004-50.

An eligible individual who attains age 55 before the close of the calendar year may make a catch-up HSA contribution (up to $600 in 2005). Section 223(b)(3).

In *Situation 1*, H has HDHP self-only coverage and no other health coverage, is not enrolled in Medicare and may not be claimed as a dependent on another taxpayer's return. Although W has non-HDHP family coverage, H is not covered under that health plan. H is therefore an eligible individual as defined in section 223(c)(1). The special rules for married individuals under section 223(b)(5) do not apply because W's non-HDHP family coverage does not cover H. Thus, H remains an eligible individual and H may contribute up to $2,000 to an HSA (lesser of the HDHP deductible for self-only coverage or $2,650) for 2005. H may not make the catch-up contribution under section 223(b)(3) because H is not age 55 in 2005. W has non-HDHP coverage and is therefore not an eligible individual.

In *Situation 2,* H has HDHP family coverage for one of H's and W's dependents and W has non-HDHP family coverage for W and H's and W's other dependent. Because the non-HDHP family coverage does not cover H, the special rules in section 223(b)(5) do not affect H's eligibility to make HSA contributions up to H's annual HSA contribution limit. H may therefore contribute up to $5,000 to an HSA (the lesser of the family HDHP deductible or $5,250). W has non-HDHP coverage and is therefore not an eligible individual.

In *Situation 3*, H has HDHP family coverage for H and H's and W's two dependents. H may contribute to up to $5,000 to an HSA (the lesser of the family HDHP deductible or $5,250). Because H's family coverage does not cover W, the special rules under section 223(b)(5) do not apply to treat W as having family coverage. W has no health plan coverage and is therefore not an eligible individual.

HOLDINGS

1. An individual who otherwise qualifies as an eligible individual does not fail to be an eligible individual merely because the individual's spouse has non-HDHP family coverage, if the spouse's non-HDHP does not cover the individual. Accordingly, that individual may contribute to an HSA.

2. The maximum amount under section 223(b) that an eligible individual may contribute to an HSA is based on whether the individual has self-only or family HDHP coverage.

DRAFTING INFORMATION

The principal author of this revenue ruling is Elizabeth Purcell of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Purcell at (202) 622-6080 (not a toll-free call).

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 13, 2005
JS-2369

Testimony of Secretary John W. Snow
Before the
U.S. House Financial Services Committee
Proposals for Housing GSE Reform

Thank you Chairman Oxley, Ranking Member Frank, and members of the Committee for inviting me to appear before you today.

The United States has the broadest, deepest, most successful housing markets in the world, supported by an interdependent financial services infrastructure. That financial services infrastructure includes institutions such as federally insured depositories, mortgage banks, private mortgage insurers, and Wall Street investment banking firms. And a unique and prominent role in that infrastructure is performed by the housing government-sponsored enterprises (GSEs) – Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLB).

With the aid of these financial institutions, Americans have ready access to a wide array of mortgage finance options. Our national system of housing finance plays an important role in promoting home ownership – a key priority of this Administration. We have seen tremendous progress in increasing home ownership in America, which now stands at 69 percent. Secretary Jackson and I share the commitment made by the President to expand home ownership to 5.5 million more minority homeowners by the end of the decade.

Our national system of housing finance needs to remain strong and healthy so that it can continue to make mortgage credit available and provide financing opportunities for new homeowners. Secretary Jackson and I are here today to discuss reforms for the GSEs that will achieve these objectives. These reforms are intended to ensure greater regulatory oversight, enhanced market discipline, and appropriate capital requirements for the GSEs. As we consider these reforms, we are guided by two core objectives: the need for a sound and resilient financial system and increased opportunities for home ownership, especially for less advantaged Americans.

Secretary Jackson will describe in greater detail the role that the GSEs were created to perform, and the home ownership goals we have set forth for them. Allow me to state succinctly why the Administration is so committed to bring about real reform. The risks undertaken by the GSEs, if not properly managed, may pose a threat to their solvency, the stability of other financial institutions and the strength of our economy.

Essential Elements of GSE Regulatory Reform

In 2003, the Administration set forth what we consider to be essential elements for creating a new, stronger, more credible regulatory system for the GSEs. The Administration's position is that without these essential reforms, any new regulatory system would be little improved from the inadequate system we have today. In light of the recent events at the GSEs, the need for meaningful reform has become even more clear. Half-measures will only exacerbate the risks to our financial system.

As we outlined in detail in 2003, the regulator for the GSEs should have powers comparable in scope and force to those of other world-class financial supervisors and fully sufficient to carry out the agency's mandate. The regulator must have clear general regulatory, supervisory, and enforcement powers with respect to the GSEs. These powers must include the authority to set both minimum capital standards and risk-based capital standards; the power to assess the entities for independent funding outside of the appropriations process; and the ability to place a failed GSE in receivership. An effective receivership mechanism, similar to that held by other safety-and-soundness regulators, should help bring about critical market discipline to ward off the prospect of a GSE falling into significant financial distress. In addition, I wish to note the interplay between an effective FDIC-like receivership mechanism and the so-called line of credit that exists between the Treasury and the GSEs. As members of this Committee are aware, the Treasury Secretary has discretion to issue debt in the amount of $2.25 billion to each of Fannie Mae and Freddie Mac and $4 billion to the FHLBs. Some commentators believe that this credit availability reinforces the perception that the Federal government backs the debt obligations of the Enterprises. This perception is false. In fact, I would exercise the line of credit (which pales in comparison to the size of the debt obligations of the GSEs today) only in the event that a GSE was in significant financial distress and needed the capital to emerge successfully through the receivership process. Congress may wish to consider reforms in this area as well.

As I said in my testimony of September 10, 2003 before this Committee, in order to address the unique mission of these enterprises as chartered by Congress, an effective regulator must have an integrated package of authorities. The package must empower the regulator to address problems that may arise (like those which we have witnessed in the last two years) before they cause damage to the financial system.

Another key power for the new regulator is the ability to review the activities of a regulated entity, whether they be new activities or those in which the regulated entity already participates. We need to strengthen the activity review process, including greater public participation through notice and comment rulemaking. Meaningful reform will also give greater clarity to the types of activities that fall within the GSEs' mission, thus ensuring that new and existing activities focus the GSEs on promoting housing opportunities. These tools should be a meaningful part of the oversight of the housing GSEs.

Events that have transpired since I testified before this Committee in 2003 reinforce concerns over the systemic risks posed by the GSEs and further highlight the need for real GSE reform to ensure that our housing finance system remains a strong and vibrant source of funding for expanding homeownership opportunities in America. The Administration remains troubled that neither Fannie Mae nor Freddie Mac has financial statements filed with the SEC that can be relied upon. Freddie Mac has yet to file any financial statements in conformity with the securities laws, and Fannie Mae is not expected to be able to issue financial restatements for many months or even years. We recognize some of the unique characteristics of the GSEs, but believe strongly that they, as well as the Federal Home Loan Banks, should be held to public reporting requirements with the SEC comparable to other large, complex public companies.

We believe that reform legislation must provide the regulator with the authority, tools, and guidance from Congress as to what is expected of the GSEs going forward. Consistent with the Administration's vision for strong and effective regulatory and market discipline, I would like to expand on some other key elements that are needed in order to adequately protect the stability of our housing markets, our financial system, and our overall economy. Most notably, I would like to describe the need to control the size and scope of the GSEs' investment portfolios.

Financial and Accounting Problems at the Housing GSEs

The Administration's proposal in 2003 was presented against the background of serious financial and accounting problems at the housing GSEs, including the June 2003 Freddie Mac announcement that it would restate its 2000-2001 financial statements and further delay the release of its 2002 financial statements. Since the last time I appeared before you, the following events have transpired:

- OFHEO released a report of initial findings on Fannie Mae in September 2004 citing improper accounting procedures and practices, internal control deficiencies and questionable management oversight.
- The SEC concurred in the findings of inappropriate accounting practices, and directed Fannie Mae to restate its earnings for 2001-2003. Fannie

Mae, then, estimated that it would be forced to recognize $9 billion in losses.

- OFHEO concluded in December 2004 that Fannie Mae was "significantly undercapitalized" in the third quarter of 2004, and demanded that the minimum capital requirement be increased by 30 percent to ensure that the Enterprise strengthened its financial position.
- And just a few weeks ago, Fannie Mae disclosed to the SEC that it could be forced to recognize an additional $2.4 billion of losses, stating that it is unable to reasonably estimate the effect of these issues on reported results of operations.
- In 2004 the FHLBanks of Chicago and Seattle entered into written agreements with their regulator, the Federal Housing Finance Board (Finance Board), to implement changes to enhance their risk management, capital structure, governance and other practices and procedures. In March of 2005, ten FHLBanks implemented new risk-based and leverage requirements. The others are expected to comply soon.

These events demonstrate that the GSEs do not have reliable financial controls to manage their operations risk. Such failures in controls, particularly in such highly leveraged institutions, jeopardizes not only the GSEs' safety and soundness, but also poses risks to the entire financial system.

Limitations on the GSEs' Debt-Financed Portfolio Investments

As additional financial and accounting problems have surfaced with the GSEs, and as the Administration has continued to evaluate the overall structure of the GSEs' operations in relation to their mission, we believe that meaningful reform of the regulatory structure of the GSEs must include mechanisms to protect our broader financial markets from unnecessary risks. More than six out of ten institutions in the banking industry hold as assets GSE debt in excess of 50 percent of their capital. We share the view expressed by Chairman Greenspan and others that the sheer size of the mortgage-based investment portfolios of the GSEs has grown well beyond anything needed in carrying out their housing mission. As Chairman Greenspan has stated:

"... these institutions, if they continue to grow, continue to have the low capital that they have, continue to engage in the dynamic hedging of their portfolios, which they need to do for interest rate risk aversion, ... create ever growing potential risks down the road."

Fannie Mae and Freddie Mac operate two independent main business lines today: (1) a credit guarantee business associated with securitizing mortgages; and (2) a portfolio investment business that involves purchasing mortgages and various mortgage-related securities (including their own mortgage-backed securities) and non-mission related assets. The first of these--the guarantee and securitization of mortgages--is integral to the operation of an effective secondary market for mortgages. The business of investing and holding an investment portfolio of mortgages and other higher-risk assets for its own proprietary trading account and inventory, however, has a much more tenuous connection to the housing mission of the GSEs.

Freddie Mac and Fannie Mae, as we know them, were largely a product of the turbulent financial period of the late 1960s and early 1970s. One of the primary goals of creating Fannie Mae and Freddie Mac was "... to provide supplementary assistance to the secondary market for home mortgages by providing a degree of liquidity for mortgage investments, thereby improving the distribution of investment capital available for home mortgage financing." Initially, Fannie Mae provided this assistance primarily by buying mortgages while Freddie Mac concentrated on securitizing mortgages, a pattern that continued throughout the 1980s.

Since 1990, however, the mortgage portfolio business of both of the housing GSEs has grown rapidly, much to the financial benefit of the Enterprises' management and shareholders. From 1990 through 2003, Fannie Mae's mortgage investments increased from $114 billion to $902 billion, and the ratio of mortgage investments to outstanding guaranteed mortgage-backed securities increased from 40 percent to 69 percent. Freddie Mac's growth in mortgage investments was even more dramatic. From 1990 through 2003, Freddie Mac's mortgage investments increased from $22 billion to $660 billion, and the ratio of mortgage investments to outstanding guaranteed mortgage-backed securities increased from 7 percent to 88 percent.

In general, the risks of the mortgage investment business are more complex to manage than the risks of the credit guarantee business. For example, with the rising interest rates in the early 1980s, Fannie Mae's cost of funds rose above the interest rate it was earning on its long-term, fixed-rate mortgages. This interest rate mismatch was similar to that faced by the savings and loan industry, and Fannie Mae became insolvent on a mark-to-market basis. Only a combination of legislative tax relief, regulatory forbearance, and a decline in interest rates allowed Fannie Mae to grow out of its problem.

The mortgage investment portfolio of the housing GSEs has grown rapidly, beginning in the 1990s, motivated by high profit margins and made possible by a substantial debt funding advantage. This funding advantage arises because markets incorrectly assume that the Federal government provides some form of guarantee to GSE debt. This rapid growth has created a new dimension of risk, one that not only involves our national system of housing finance, but the potential for systemic risk to financial markets in general. The potential for systemic risk is associated with Fannie Mae's and Freddie Mac's large portfolios of mortgages and mortgage-backed securities and other non-related assets, funded at extremely high rates of leverage. The GSEs hold less than one-half the capital of similarly sized financial institutions. The value of these large portfolios can fall dramatically when interest rates change because individuals can prepay their mortgages.

Some of this risk can be hedged through the use of derivatives and other risk transfer mechanisms. Nevertheless, the risk does not disappear altogether, and in the event of an unforeseen problem, the GSEs might not have the funds to pay off their debtholders, which could lead to ripple effects throughout our entire financial system. For example, GSE debt is widely held by banks, so that if this debt declined in value, some banks could find their solvency endangered. Concerns about the GSEs' hedging strategies are reinforced by the regulatory enforcement actions of recent months. Neither Fannie Mae nor Freddie Mac has been able to put forth fair and accurate financial statements. Given this lack of accurate and reliable information, Congress and the Administration are correct in worrying whether the risks that have been undertaken by the GSEs are properly understood, measured, and made public.

These portfolio holdings thus raise fundamental concerns. Are there benefits that outweigh the potential costs? Neither the Treasury nor the Federal Reserve has found evidence that these portfolio holdings (above some minimum threshold) provide meaningful benefits to borrowers. We believe that Congress could usefully consider whether there are meaningful benefits to such holdings, and whether such benefits outweigh the costs.

In order to protect against the systemic risks posed by the GSEs' mortgage investment business, the Administration recommends that limitations be placed on the size of the GSEs' retained mortgage investment portfolios. An appropriate phase-in period for the reduction of the existing portfolios would be needed so as not to disrupt mortgage or financial markets. After the appropriate phase-in period, given the overall advances in securitization, the large amount of data available on mortgages, and the increased sophistication of mortgage investors, we believe that our capital markets could adjust to a significant reduction in the presence of the GSEs as mortgage investors.

In addition to protecting our financial system against potential systemic risk, it is also very important that our national housing finance system continues to function smoothly and that the GSEs are able to accomplish their missions – in particular their support for affordable housing. Our recommendation to limit the investment portfolios of Fannie Mae and Freddie Mac does not in any way limit their ability to guarantee mortgage-backed securities. In that regard, it is worth noting that Freddie Mac operated a successful credit guarantee business throughout the 1980s with a retained mortgage portfolio that was only a small fraction of its current size. Therefore, given that these core functions of the GSEs are preserved, we see no reason why limits on the GSEs' retained mortgage portfolios should impair their ability to provide support for affordable housing, including the ability of Fannie Mae and Freddie Mac to meet their affordable housing goals set by HUD.

Location of the New Regulatory Agency

While the powers and authorities of the new regulator remain of paramount importance to the Administration, Congress should also continue to consider the location of the new regulator. In 2003, the Administration said it was open to making the new regulatory agency a part of the Treasury Department, provided that there were adequate elements of policy accountability to the Secretary of the Treasury. The advantages of placing the new regulator within the Treasury should not be overlooked. First, the start-up time and transition issues related to setting up the new agency would be lessened; housing another agency within Treasury, which is familiar with such relationships, is less time consuming than creating an entirely new agency, which would facilitate effectively transferring existing OFHEO and Federal Housing Finance Board operations to Treasury. Second, addressing issues associated with systemic risk is an important aspect of our proposal, and the Treasury Department is the Executive Branch agency with responsibility to adopt a holistic approach to systemic risk and oversee the proper functioning of financial markets. Third, improving market discipline is important, and the Treasury Department is in the best position to monitor the new regulator's activities while ensuring that investors have a proper understanding of GSE securities. Finally, we believe that there would be less opportunity for regulatory capture were the new regulator housed in Treasury, given the diversity and size of the interests which regularly appear before the Department.

However, as we described in detail last year, there are conditions that need to be met in order for the Administration to support establishing the new regulator as a part of Treasury. The new agency should be required to clear new regulations and policy statements to Congress through the Treasury Department. The Treasury Department and OMB should also have review authority over the new agency's budget to ensure that resources are being properly allocated. Nevertheless, in any such arrangement, the new regulatory agency should have independent responsibility over specific matters of supervision, enforcement, and access to the Federal courts. By housing the new regulator in Treasury with adequate oversight authority, we can achieve the best of both worlds: ensuring a strong, independent regulator while providing for accountability and expertise from the Executive Branch.

The Appropriate Role of the Federal Home Loan Banks

Over the last decade the Federal Home Loan Bank System has undergone considerable change. Membership in the System was extended to commercial banks and they now make up the overwhelming number of members of the System. The Federal Home Loan Banks greatly expanded their investment portfolios and some Banks aggressively moved into the mortgage investment business, types of activities that moved the Banks away from their traditional wholesale funding activities for members. And while perhaps not particularly new, large financial institutions account for the bulk of borrowing from many of the Federal Home Loan Banks.

The Administration continues to believe that the Federal Home Loan Banks should be placed under the same regulator with Fannie Mae and Freddie Mac, and that this new regulatory regime should be structured to take into account certain special differences between the Federal Home Loan Banks and the other GSEs. Consistent with the primary goal of creating an effective regulatory regime for Fannie Mae and Freddie Mac, I believe constructive steps can be taken in this context toward also improving the regulation of the Federal Home Loan Banks. To reach that goal, the regulatory structure of the system should be examined with a careful eye to converging regulation of all of the GSEs to the same extent that their operations (and the risks they present) have likewise converged. In particular, the Administration believes regulation of the Federal Home Loan Banks would be enhanced if Congress were to delineate an explicit mission for them. In addition, we believe that Congress should consider reforming the appointment of directors to the boards of the banks to ensure that the best corporate governance practices are employed. And while progress is being made to ensure that the Federal Home Loan Banks file their financial statements with the SEC much like other large financial institutions with outstanding public debt, Congress should formalize such obligations by statute.

Conclusion

In conclusion, our primary goals in developing our GSE reform proposal are to promote the strength and resilience of our housing finance markets, lessen the potential for systemic risk, and continue our progress in meeting the mortgage credit needs of all our Nation's homebuyers. To accomplish those purposes, the fundamental elements of reform that the Administration has proposed are essential.

In addition, events at the GSEs over the course of the last year reinforce the need for a strengthened regulatory regime. There are a range of other reforms which would also advance our common interest in ensuring the resiliency of the financial system and the robustness of the housing finance system. The Administration is open to consider additional ideas for reform.

I look forward to working with you on this important issue.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 13, 2005
JS-2370

Al-Zarqawi Financier Designated by the Treasury

The U.S. Department of the Treasury today designated Bilal Mansur Al-Hiyari for providing financial support to the Zarqawi Network, an al Qaida-affiliated terrorist group active in the insurgency in Iraq.

"By designating financiers like Al-Hiyari, we're making it harder and riskier for the Zarqawi Network to raise and move money in support of its brutal attacks against U.S. troops, coalition partners and the Iraqi people," said Robert Werner, Director of the Treasury's Office of Foreign Assets Control (OFAC). "Today's action is the third in a series of strikes by the U.S. Government to undercut the financial foundations of the Zarqawi Network."

The U.S. and Iraq are submitting Al-Hiyari to the United Nations 1267 Committee, which will consider adding him to the consolidated list of terrorists tied to al Qaida, UBL and the Taliban.

Al-Hiyari became acquainted with Abu Mus'ab al-Zarqawi, the Zarqawi Network's notorious leader, in 1989 when they met in Afghanistan. According to information available to the U.S. Government, their relationship continued through the mid-1990s, when Al-Hiyari returned to Jordan where al-Zarqawi was serving out a sentence in Jordanian prison.

According to information available to the U.S. Government, Al-Hiyari traveled to Iraq in 2003 where he sent funds to support al-Zarqawi's operations through several of al-Zarqawi's messengers.

In October 2004, the State Security Court of Jordan convicted Al-Hiyari of providing funds to the Zarqawi Network. At the conclusion of his trial, however, he was released from prison.

Al-Zarqawi was named a Specially Designated Global Terrorist (SDGT) on September 23, 2003. The Zarqawi Network, also know as Jama'at al Tawhid wal Jihad and Tanzim Qa'idat al-Jihad fi Bilad al-Rafidayn, was designated as a Foreign Terrorist Organization (FTO) and a SDGT on October 15, 2004.

Identifying Information
Bilal Mansur Al-Hiyari

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Nationality: Jordanian
Address: Suwaylah, Jordan

Al-Hiyari was designated today pursuant to Executive Order 13224 chiefly pursuant to paragraphs (d)(i) and (d)(ii) based on a determination that he assists in, sponsors or provides financial, material, or technological support for, or financial or other services to or in support of, or is otherwise associated with, persons listed as subject to E.O. 13224. This individual also meets the standard for inclusion in the UN 1267 Sanctions Committee's consolidated list because of the support provided to UBL, al Qaida or the Taliban.

Inclusion on the 1267 Committee's list triggers international obligations on all member countries, requiring them to freeze the assets and prevent the travel of listed individuals and to block the sale of arms and military equipment. Publicly identifying these supporters of terrorism is a critical part of the international campaign to counter terrorism. Additionally, other organizations and individuals are put on notice that they are prohibited from doing business with them.

Blocking actions are critical to combating the financing of terrorism. When an action is put into place, any assets existing in the formal financial system at the time of the order are to be frozen. Blocking actions serve additional functions as well, acting as a deterrent for non-designated parties who might otherwise be willing to finance terrorist activity; exposing terrorist financing "money trails" that may generate leads to previously unknown terrorist cells and financiers; disrupting terrorist financing networks by encouraging designated terrorist supporters to disassociate themselves from terrorist activity and renounce their affiliation with terrorist groups; terminating terrorist cash flows by shutting down the pipelines used to move terrorist-related assets; forcing terrorists to use alternative, more costly and higher-risk means of financing their activities; and engendering international cooperation and compliance with obligations under UN Security Council Resolutions.

RESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 13, 2005
2005-4-13-16-31-35-26262

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $78,528 million as of the end of that week, compared to $78,759 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	April 1, 2005			April 8, 2005		
TOTAL		78,759			78,528	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,851	14,623	26,474	11,881	14,530	26,411
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,619	2,939	14,558	11,638	2,921	14,559
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			15,122			15,027
3. Special Drawing Rights (SDRs) [2]			11,563			11,490
4. Gold Stock [3]			11,042			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	April 1, 2005			April 8, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	April 1, 2005			April 8, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 10, 2005
JS-2371

Economic Growth and Friendship
Address at the Annual Meeting of the Inter-American Development Bank
John B. Taylor
Under Secretary for International Affairs
United States Treasury
Okinawa, Japan April 10, 2005

President Iglesias, fellow Governors, ladies and gentlemen: on behalf of President Bush and Secretary Snow, I would like to thank the people of Japan for hosting our meeting. It is fitting that Okinawa is the site for these meetings, showcasing the increasing integration of Latin America and the Caribbean with Asia, and the role of migration and remittances in economic development, as many Japanese migrants to Latin America came from Okinawa.

I join President Iglesias and the other Governors in welcoming the Republic of Korea into the Bank. Korea's rich economic growth experience and renowned leadership in technology will be a tremendous benefit to the countries of Latin America and the Caribbean.

U.S. Engagement with the Hemisphere

Much has changed since the last meeting hosted by Japan in 1991 in Nagoya. At that time, some economies were reeling from the effects of raging triple-digit inflation and economic and financial strains were inevitably reflected in U.S. relations with countries of the region.

Economic conditions are much better now. Growth has been close to six percent during the last year, the fastest growth in twenty-five years. Inflation is only a small fraction of what it was then and economic stability is the rule rather than the exception. Moreover, regional integration has increased significantly. U.S. exports and imports with the countries of Latin America and the Caribbean now account for nineteen percent of total U.S. trade. We also share an ambitious trade liberalization agenda based on a growing consensus that such integration is critical economic growth.

The United States remains strongly committed to economic development in the region. Through the IDB and many bilateral dialogues such as the U.S.-Mexico Partnership for Prosperity and the U.S.-Brazil Group for Growth, we work together on issues ranging from remittance flows, to financial market integration, to lending to small businesses.

We are delighted to be working with some of the poorest countries – Bolivia, Honduras and Nicaragua -- on the new Millennium Challenge Account. The theme of ensuring measurable results that improve people's lives has been a common focus of our efforts. And we will work hard to ensure that the Summit of the Americas in November in Argentina also yields measurable results. We hope to see real progress on small business lending, remittances, reducing the time to start a business, and promoting high-return infrastructure projects.

Strong Economic Growth in the Region

Improved economic policies and strong economic leadership in Latin America is clearly the reason for the improvement in economic growth and economic stability. Improvements in fiscal policies have reduced debt levels. Monetary authorities are pursuing price stability and exchange rate regimes that better reflect fundamentals.

These reforms build financial stability and confidence, leading to increasing capital flows, higher levels of investment, and rapid export growth.

And economic expansion is expected to continue. Private forecasters are expecting growth of 4 percent this year. This is good news, but we all know the region can and should do better. Decades of sustained high growth are needed to bring down poverty rates.

I see two major challenges for sustained growth. The first challenge is to lock-in the recent improvements in macroeconomic policy by putting in place fiscal responsibility regimes that discipline budget planning and execution and by supporting the successful low inflation monetary policies. The second challenge is to build on the macroeconomic foundation and concentrate on microeconomic reform including trade liberalization and the reduction of burdensome regulation in order to unleash job creation by entrepreneurs both small and large.

Progress at the ID

The IDB plays a critical role in the region. I am delighted with the replenishment of the MIF and the major improvements in procurement and internal controls. As I said at the signing ceremony, MIF is taking the lead in remittances, which are a source for investment in the region. I welcome the new Private Sector Coordinator, who is off to a fast start in his work to help us improve the Bank group's private sector efforts. And we are very pleased to have reached agreement on a New Lending Framework, which provides needed resources while committing to results measurement, robust fiduciary controls, and sound macroeconomic policies.

The new procurement policies adopted by the IDB this year represent an important reform, as do increasing transparency, improving efficiency by promoting competition, aligning the Bank with best practices. In addition, the Bank has made commendable progress in improving information disclosure, internal and external audits, and internal controls. The IDB led the way among the multilateral development banks with the disclosure of Board minutes. The United States will continue to urge for more progress in other areas, such as the prior disclosure of Board documents.

The Private Sector

We believe that the role of the Bank in supporting economic growth in Latin America and the Caribbean must focus even more on the private sector to remain relevant. The Bank must continue with vigor the efforts begun last year to improve the coordination, efficiency and effectiveness of the Group's private sector activities.

Within the private sector small and medium businesses create the most jobs, but small business growth is frequently undermined by inadequate access to the credit needed for investment or startup. The leaders at the 2004 Summit of Americas urged the IDB to help triple credit for small business. The MOU between the IIC and the MIF was signed to facilitate the achievement of this goal. We strongly support expanded MIF efforts in microfinance and urge the IIC to work with its commercial bank partners to help them profitably make smaller loans to smaller clients.

A flourishing private sector requires a pro-business microeconomic environment unencumbered by the barriers of corruption. I welcome the IDB's Business Climate Initiative and the private sector focus in Country Strategies. We also support IDB's work on countries' governance reform efforts.

Conclusion

In conclusion let me say that I have greatly enjoyed working with the IDB and the people in the region during the past four years. In our mutual quest for higher growth and poverty reduction, I have renewed old friendships and made new ones.

As I reflect on what we as a hemisphere have experienced together, the IDB has been a constant and active participant in both word and deed. Its willingness to engage in challenging situations is widely recognized and I appreciate the important changes, especially the greater focus on economic growth through economic freedom. The United States will continue to work with our regional partners and the IDB. The IDB is critical to the success of the region, and its active engagement and leadership is fundamental during the upcoming period of political transition and economic expansion.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 10, 2005
JS-2372

U.S. Applauds MIF Replinishment
"A model for effective private sector development."

John Taylor, U.S. Under Secretary of the Treasury, today hailed the signing of an agreement to reform and substantially increase funding for private sector development in Latin America and highlighted the large contribution from the United States.

"President Bush recognizes how essential the private sector is to development in Latin America and that's why the United States is making such a substantial commitment to this fund," said Taylor. "The United States is deeply committed to increasing economic opportunity and freedom and improving living conditions in the entire hemisphere. Business development is essential to this goal because businesses create jobs. With the new reforms and increased funding, I believe that we will see important improvements in job creation and greater economic opportunity for many people in Latin America."

Under Secretary Taylor and the other Governors of the Inter-American Development Bank signed the Multilateral Investment Fund II (MIF II) agreements at the Bank Group's annual meeting in Okinawa, Japan. The agreement replenishes the fund by more than $500m while at the same time strengthening the institution to make it a more effective tool for the assistance of the private sector in Latin America and the Caribbean. The U.S. is the largest donor to the replenishment, pledging $150m to the fund. In recognition of MIF's successful results, a number of new donors, including the United Kingdom, France, Switzerland, and Korea, are joining MIF II.

The Multilateral Investment Fund was established in 1993 under the auspices of Japan and the United States who donated one billion out of the initial $1.2b funding. The MIF was established as part of President George H.W. Bush's Enterprise for Americas Initiative. The MIF has demonstrated its effectiveness in promoting the creation and growth of micro and small and medium enterprises (SMEs) throughout Latin America and the Caribbean. Providing 75% of its assistance in grants, it has shown innovation, creativity, and nimbleness in its work with private firms, banks, public-sector entities, and NGOs to foster an environment where the private sector can flourish.

A very important example of MIF's innovation is its identification of remittances as a source of economic growth and development in the region. Under Secretary Taylor highlighted the importance of action on remittances:

"Remittance flows are a very essential factor in economic development in the region because they come directly from Americans working in the United States to people who can really use the money in central and south America and the Caribbean. If we can make it easier and cheaper to allow these huge flows of funds from the United States get to families in the region, millions of people will helped."

More than $45 billion of remittances now flow annually to the region and MIF has pioneered efforts to harness these flows for growth through efforts to reduce transaction costs, channel them into the formal financial system, and provide recipients to options to use them to finance job and growth producing activities.

A constant focus of MIF's work is micro and small business. Last year, in response to the region's commitment to SMEs at the Nuevo Leon summit in 2003, MIF entered an agreement with the Inter-American Investment Corporation (IIC) to help the IDB Group meet its goal of tripling credit for SMEs by 2007. The agreement will allow MIF to fund technical assistance for IIC SME financing, thereby increasing the impact and likelihood of success.

The MIF II agreements continue to build on the success of MIF I, and in so doing reflects many of the key tenets of the Bush Administrations core principles of development. It includes a set of twelve concrete, time-bound commitments to fortify and expand MIF's results measurement mechanisms and requirements, to be implemented within a year. The agreements retains the focus on grants at MIF I historical levels (75%) while also permitting it to continue other innovative financing modalities – including equity investments – that stimulate and build the private sector. MIF II also contains a sunset clause, reflecting the conviction that development institutions should always focus on the ultimate objective: the day when their success will make them obsolete.

In all, this is a very positive development in the effort to provide focused, effective aid designed to create the foundations of lasting, private sector led growth that is the only sure way to lift people permanently out of poverty. President Bush's pledge to MIF II represents its continued strong commitment to the region.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 9, 2005
JS-2373

Press Statement by John B. Taylor
United States Under Secretary of the Treasury for International Affairs
Annual Meetings of the Inter-American Development Bank
Okinawa, Japan
April 9, 2005

I would like to begin today by thanking the Minister Tanigaki, the government of Japan, and our hosts here in Okinawa. All of the governors and staff in attendance are impressed with the hospitality we've received on this beautiful island.

For President Bush, the economic achievement of countries in our hemisphere is – and will continue to be – among the highest international priorities of the United States. During the past four years I have had the opportunity to represent the President's commitment to the region as the United States has provided growing support for development funding, collaborative efforts to support sound economic policies, and critical assistance when countries have experienced acute times of need.

There is a great deal of positive economic news in our hemisphere. The U.S. economy continues to post strong, steady growth and job creation, which we know is very important for economic growth in the hemisphere. And it's exciting to see that Latin America last year posted the most rapid economic growth in decades, thanks to strong leadership and good economic policies in a number of countries. There are other examples, but this improved environment can be highlighted by Brazil's recent announcement that it does not need to renew its IMF program.

The IDB plays a critical role in helping countries in the region reach their economic potential and improve the standards of living for their people, and so I will be very happy to report back to the President and Treasury Secretary Snow that the Bank, the donors, and – most importantly – the countries themselves are demonstrating a strong commitment to achieve these goals. There exists a consensus on the most effective ways for development institutions like the IDB to help countries achieve growth: increased development assistance; the use of grants; and emphasis on measurable results; and a stronger focus on development of the private sector, particularly small businesses. I am pleased that each of these principles is embedded in the recent successful replenishment of the Multilateral Investment Fund (MIF). The United States is proud to be the largest donor of the MIF because we appreciate the valuable contribution of business development.

This weekend I also have bilateral meetings with representatives from a number of countries. I was fortunate to meet with President Uribe of Colombia and I look forward to my meetings with President Mesa of Bolivia, and President Maduro of Honduras. I appreciate the chance to discuss their achievements and their continued efforts to improve economic opportunities in their respective countries. On behalf of President Bush I renew the commitment of the United States people to helping them raise living standards and reduce poverty.

President Bush's focus on economic development has been to provide extra assistance to for poor countries that are working to put in place good policies – investing in its people, enforcing the rule of law, and promoting economic freedom. These principles define President Bush's Millennium Challenge Account (MCA) program. Nicaragua, Honduras and Bolivia have qualified for the program and are developing their proposals for funding. I look forward to discussing the program in my meetings here.

The best time to implement and lock-in economic reforms is when economies are strong, so we must be vigilant in forging ahead with this agenda now, and not let the seeds of complacency take root. Despite recent success there is still much to accomplish in institutionalizing macroeconomic improvements and strengthening the environment for entrepreneurs and investment. The United States looks forward to continued cooperation with our partners at the IDB and with economic leaders in the hemisphere to achieve economic growth and opportunity for our citizens.

I'll be happy to take your questions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 9, 2005
JS-2374

Latin America: From Crisis to Growth
John B. Taylor
Under Secretary of Treasury for International Affairs
Remarks to Investors at the Annual Meetings of the Inter-American Development Bank
Okinawa, Japan
April 9-10, 2005

I am very pleased to be here to discuss financial and economic developments in Latin America. There has been a lot of good news lately on the economic front in Latin America, and indeed for the global economy as a whole. I would like to discuss some of the reasons for this strong performance and how the United States is working with the countries of the region to sustain it and translate it into substantial reductions in poverty in the coming years.

Restoring Economic and Financial Stability

When I first started in this job in 2001-2002, the news in Latin America was not so good. Leaders in Argentina struggled to contain an expanding financial crisis, Brazil's high debt levels combined with electoral uncertainties generated growing market concerns, Uruguay's banking system faced a run sparked by the turbulence in Argentina, and Colombia lost market access as investors anticipated imminent fiscal gaps. Of course these difficulties came in the wake of the turbulent 1990s, when Mexico and Brazil experienced full-blown crises of the kind that buffeted emerging markets from East Asia to Russia.

Periodic crises and financial market instability in the region have had profound effects in terms of social dislocation and lost economic growth. Firms have scaled back investment and financial markets demanded higher risk premia, discouraging innovation and retarding productivity growth that is the engine of sustained improvements in living standards. The stresses of crisis management also distract policy makers from addressing the critical microeconomic impediments to higher growth.

I am pleased to say that there are no financial crises in the region today. Risk spreads for the region have fallen sharply and remain near their seven-year lows, capital flows have risen, and investment is growing. Foreign direct investment increased by $16 billion last year. I am also pleased to see that there is less contagion. Following Argentina's default at the end of 2001, we did not see a repeat of the contagion that afflicted global capital markets following the East Asia and Russia crises.

Economic growth has responded vigorously. Real GDP for the region as a whole grew almost 6 percent in 2004--the fastest rate in a quarter century. This has translated into millions of new jobs and higher incomes for workers and their families.

What accounts for this turnaround? First and foremost, macroeconomic policies are better. Countries are resisting the tendency to overspend during the fat years. Strong political and economic leadership has enabled countries to improve their fiscal balances to bring down debt levels. Improvements in debt management policies lowered foreign currency-denominated and exchange linked-debt in countries like Brazil and Mexico. Many countries have taken advantage of favorable market conditions to pre-finance a large portion of their obligations coming due in 2005 and build foreign exchange reserves as a cushion against future financial market turbulence.

We have seen a virtual revolution in monetary policy in the region. The last time the IDB annual meetings were in Japan in 1991, regional inflation was raging in the triple digits. In many countries, monetary policies are more focused on price stability combined with either flexible exchange rates or dollarization. During my visits to the region, I have seen first-hand the technical improvements in the operational tools used to conduct monetary and exchange rate policy in countries like Peru and Chile. Dollarized Ecuador enjoyed a sharp drop in inflation last year following several years of inflationary inertia.

These good economic policies have positioned Latin America to seize the opportunities of strong global growth--which, I might add, was also the product of well-timed fiscal and monetary policies in the United States. The rapid export growth we have seen in the region is not just a commodity price phenomenon; export *volumes* were up a robust 11 percent last year. Strong improvements in trade balances led to the second consecutive year with a current account surplus for the region as a whole.

Better policies--defined and implemented by political leaders across the region--have been the key to restoring economic stability and setting the stage for the rapid economic growth we are now witnessing.

At the same time, the United States has played an important role in bolstering these policies and helping countries improve stability through assistance from the international financial institutions. We strongly supported Brazil's IMF program in 2002 to back the solid economic program endorsed by the leading candidates during the lead-up to the presidential elections in the fall. This gave President Lula and his economic team the opportunity to show their leadership, and through a solid economic strategy, pull Brazil back from the brink and lay the basis for the rapid growth and large improvements in indicators of financial vulnerability. Last year Brazil turned in the strongest growth performance in a decade. As Secretary Snow recently noted, Brazil's announcement that it does not need a new IMF agreement represents the hallmark of financial accomplishment.

There are other examples. When Uruguay experienced a run on deposits associated with the crisis in neighboring Argentina, we worked to coordinate an assistance package from the IMF, World Bank, and IDB and provided a short-term bridge loan from Treasury's Exchange Stabilization Fund to help Uruguayan authorities implement a strategy for halting the bank run and restoring growth. We also backed an IMF program and rapid multilateral development bank assistance for Colombia, when that country faced financial turbulence in 2002 but outlined a solid fiscal program--including important structural fiscal reforms--to stabilize the situation. In Bolivia, we supported an IMF program that has helped the government achieve significant reductions in the fiscal deficit and shore up the financial sector during a period of political uncertainty.

In all of these instances, U.S. and international assistance was used to support good economic policies. Because there was tangible policy progress, the support could have a real confidence-building effect, and it helped the governments quickly restore economic stability and generate a return to robust growth. They are clear examples of the U.S. commitment to Latin America and the Bush Administration's commitment to working closely with the governments in the region to implement policies that improve stability and increase prosperity.

Sustaining Economic Growth and Reducing Poverty

A focus on microeconomic reforms to clear the way for higher levels of productivity growth is critical to the long-term prospects for the region. Private forecasters are expecting growth of just 4 percent in 2005. The region can do better--it should aim to sustain the 2004 performance. Decades of high growth are needed to bring down the poverty rates that are polarizing societies.

I see two major challenges for turning economic stability into sustained growth. They are, first, institutionalizing the important improvements in macroeconomic policy that have been achieved recently and, second, addressing the business climate problems needed to spur higher productivity growth.

While the fiscal improvements in the last several years have been instrumental to the region's stability and recent growth, continued strong fiscal performance is needed bring down debt levels further and build a stronger buffer against shocks. Overall debt levels are still too high and represent a continued vulnerability for the region.

Countries can do this by institutionalizing structural fiscal reforms in order to lock-in a continued strong fiscal effort. This means improving the efficiency of tax policies--for example, by streamlining complicated systems of rates and exemptions--and strengthening tax administration to reduce evasion. Broadening the tax base and improving compliance produces tax systems that are fairer and allow scope for rate reductions that improve incentives. It means improving the flexibility of public finances by reforming outmoded pension systems and reducing automatic revenue earmarking, so that limited government resources can be channeled to the highest priority uses.

Particularly important for long-term fiscal stability is putting in place strong fiscal responsibility regimes that discipline budget planning and execution, including at the sub-national level where deficit spending and debt accumulation has undermined national governments' efforts at fiscal consolidation. The clearest example here is Argentina, where the provincial overborrowing in the 1990s and the federal government's bailout of the provinces contributed significantly to the country's ultimate default in 2001.

In the area of monetary policy, countries can further bolster the institutional underpinnings of good policy by increasing central bank independence in order to lend greater credibility to their price stability mandates--as countries like Mexico, Chile, and Peru have done.

The other main challenge is to tackle the microeconomic impediments to sustained economic growth. The key to higher growth and living standards is productivity growth, which leads to higher wages and decreases in poverty. However, productivity growth in Latin America has been far too low, especially when compared with the productivity growth that has enabled such large reductions in poverty that we have seen in East Asia. As the IDB points out in its "The Business of Growth" study, Latin America's productivity growth averaged only 0.7 percent of GDP in the 1990s, compared to 1.7 percent in developed countries and 2.7 percent in East Asia.

The reasons for this disappointing performance are clear. Low trade integration with the rest of the world--total trade was only 45 percent of the region's GDP, compared to nearly 80 percent in East Asia--rigid labor markets, weak property rights and judicial systems, and lack of access to credit particularly for small businesses all hold the region back.

As a result of these distortions, a disproportionately high share of the region's economy operates in the informal sector. According to the World Bank's "Doing Business" survey, the informal sector accounts for 42 percent of the region's gross national income, compared to 24 percent in East Asia and 17 percent in the OECD countries. This is hugely inefficient, as fewer new businesses are created, and the firms that do exist are less likely to expand, hire more people, and become engines of growth. Resources are wasted evading overly burdensome regulations, and tax bases are overly concentrated and narrow. According to the World Bank's indicators, the 70 days in Latin America is the longest amount of time to start a business in any other region of the world.

We know the agenda that must be pursued to address the impediments to higher productivity growth. It basically involves attacking the problems that prevent investors from risking their capital. Markets for products, labor, and capital have to be open and competitive. Governments and the private sector have to invest in high-return projects to build infrastructure and widen access to education. Property rights have to be protected. And citizens have to be protected from corruption. Experience in this region and elsewhere shows that, when these elements are in place, entrepreneurs will invest and create jobs.

U.S. Commitment to Latin America

Just as the United States has played a strong leadership role in assisting the region through its difficulties of the last several years, we are committed to helping translate the current economic recovery into the sustained growth that the region is capable of.

As I described earlier, trade has played a significant role in the recent strong economic performance in the region. The United States continues to advance an ambitious agenda for reducing barriers to trade in this hemisphere, so that trade can continue to serve as a driver of economic growth for years to come. The free trade agreements (FTAs) that we have concluded or are in the process of concluding will cover 90 percent of U.S. trade with the region. These include the U.S.-Chile FTA, the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) as well as Panama and the Andean region that are under negotiation. Our efforts also continue toward a Free Trade Area of the Americas that would encompass all countries in the Hemisphere in an integrated market.

We are also using multilateral fora to advance a bold development agenda. At the 2004 Special Summit of the Americas, the hemisphere's leaders launched a broad array of initiatives to achieve objectives such as halving the cost of remittance transfers, tripling bank lending to small businesses, and significantly reducing the time and cost of starting a new business. We continue our bilateral efforts and cooperation with the IDB to implement these initiatives and achieve the ambitious goals the leaders have laid out. As the 2005 Summit of the Americas approaches--to be held in November 2005 in Argentina--we look forward to working with others to launch new initiatives to increase economic growth, for example, by promoting more productive investment in infrastructure. We also continue to work intensively with the World Bank and IDB to continue with their efforts to show measurable results in their activities by demonstrating that their budget and project lending is reaching quantifiable targets, while strong controls are in place to track where the money goes.

In our bilateral dialogues with individual countries we have advanced ideas for raising productivity growth and launched joint efforts in particular areas. Through the U.S.-Mexico Partnership for Prosperity launched in 2001, we have seen the cost of sending remittances between the U.S. and Mexico fall substantially. Through the U.S.-Brazil Group for Growth, we have targeted areas like small business lending and business regulation and yielded concrete results: our Brazilian counterparts told us that the Group's discussions have helped shape legislation submitted to the Brazilian Congress that reduces taxation and streamlines labor and pension regulations for Brazilian small business. Most recently, we launched the Security and Prosperity Partnership of North America with Mexico and Canada, which will improve the legitimate flow of people and cargo at our shared borders and improve productivity through regulatory cooperation to generate growth.

I would like to see a further deepening of this type of dialogue with the other countries in the hemisphere. There is certainly a large agenda to discuss for a broader Latin American group focused on economic growth.

Finally, through the Millennium Challenge Account (MCA) we are working with countries to help the poorest countries increase growth and productivity. This Bush Administration initiative is aimed at countries advancing the right policies--in the areas of ruling justly, investing in people, and promoting economic freedom. MCA assistance is designed to boost their efforts through well-targeted financial support. I am pleased that three countries in Latin America, Bolivia, Honduras, and Nicaragua, have the opportunity to benefit from MCA assistance this year by developing proposals for use of MCA funds.

Conclusion

I am proud to have had to the opportunity to work on challenging economic and financial issues, as well as with my regional colleagues, over the past four years. Together, we have gone from crisis to growth. That growth will help reinforce the merits of good policy. I am confident that in its second term the Bush Administration is focused on the type of engagement with the region needed to build on this success, help the region and substantially raise its living standards and lay the groundwork for deeper cooperation between the U.S. and Latin America.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 13, 2005
js-2375

MEDIA ADVISORY: Public Schedule for Secretary John W. Snow During the G7 Meeting of Finance Ministers and Central Bank Governors, IMF and World Bank Annual Meeting, and Related Events

REPORTS

- Secretary Snow's Public Schedule for G7-Related Events

Thursday, April 14

11:30 AM Under Secretary for International Affairs John Taylor
Pre-G7 Press Briefing
Treasury Department
Room 4121 (Media Room)
1500 Pennsylvania Ave., NW
Washington, DC
* *Open Press – pre-set may begin at 10 am*
* ***Media without Treasury press credentials must contact Frances Anderson at 202-622-2960 or e-mail their name, organization, date of birth and Social Security number to frances.anderson@do.treas.gov for clearance by 9 AM on 4/14/2005***

Friday, April 15

Secretary Snow's bilateral meetings: Brazil, France, Japan, Russia, United Kingdom
Treasury Department
1500 Pennsylvania Ave., NW
Washington, DC
* *Pool photo at top of meetings, if requested*

African Roundtable
Treasury Department
1500 Pennsylvania Ave., NW
Washington, DC
* *Pool photo at top of meeting, if requested*

Saturday, April 16

Secretary Snow's bilateral meetings: Canada, India, Iraq, Mexico
IMF Building
700 19th Street, NW
Washington, DC
* *Pool photo at top of meetings, if requested*

7:00 AM Stake-out begins for photos of arriving officials
Daughters of the American Revolution (DAR) Headquarters
17th Street entrance – circular driveway
17th & D Sts., NW
Washington, DC

7:45 – 11:00 AM Meetings of G7 Finance Ministers and Central Bank Governors
Daughters of the American Revolution (DAR) Headquarters
17 & D Sts., NW
Washington, DC

9:00 AM — G7 Group Photo
Daughters of the American Revolution (DAR) Headquarters
National Officers Club Assembly Room
1776 D St., NW
Washington, DC
**Open photo, pool reporter.*
**Photographers should arrive at DAR loading dock on D St. no later than 8:00 AM for security sweep and escort to Assembly Room.*
**Treasury, White House, IMF/WB Annual Meetings press credentials accepted – no additional clearance is needed.*

11:00 AM — G7 communiqué released; will be posted on www.Treasury.gov

11:15 AM — Treasury Secretary John W. Snow
Post G7 Press Conference
Daughters of the American Revolution (DAR) Headquarters
National Officers Club Assembly Room
1776 D St., NW
Washington, DC
**Open Press*
** Media should arrive at DAR loading dock on D St. no later than 10:15 am for security sweep and escort to Assembly Room.*
**Text for release; will be posted on www.Treasury.gov*
**Treasury, White House, IMF/WB Annual Meetings press credentials accepted – no additional clearance is needed.*

Sunday, April 17

9:00 AM – 1:00 PM — Secretary John Snow
Meetings of Development Committee
World Bank
701 18th Street, NW
Washington, DC
**Text for release; will be posted on www.Treasury.gov*

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 13, 2005
JS-2376

Deputy Assistant Secretary Iannicola Promotes Financial Literacy Month in Rhode Island

Treasury's Deputy Assistant Secretary for Financial Education, Dan Iannicola, Jr., today participated in several financial education events in Providence, Rhode Island, to promote April as Financial Literacy Month. Iannicola keynoted at the Rhode Island Financial Literacy Leaders' Luncheon, delivering a presentation to state policymakers and community leaders. While in Providence, Iannicola also delivered remarks at the Financial Literacy Month Proclamation Ceremony alongside Governor Donald Carcieri and several other state dignitaries.

At the luncheon, Iannicola thanked financial education leaders for their hard work. "Your grassroots involvement in financial education is making a difference here in Rhode Island," said Iannicola.

At the proclamation ceremony, he also thanked Governor Carcieri and Rhode Island Jump$tart staff for encouraging financial education efforts in the state year round. "Today's impressive showing by so many state-wide office holders reflects a true commitment to raise financial literacy across the state."

Today's financial education events were organized by the Rhode Island Jump$tart for Personal Financial Literacy with the purpose of increasing awareness among policy makers and the public about significant personal finance issues in the marketplace, and informing people about financial education resources available free from the government. The Jump$tart Coalition for Personal Financial Literacy seeks to improve the personal financial literacy of young adults.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The Office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 14, 2005
JS-2377

FACT SHEET: Millions of American Families Are Benefiting from Tax Relief

"No one looks forward to tax day, but for millions of taxpayers across the country, this April 15 will be less painful thanks to the President's tax cuts. Nationwide, 110 million taxpayers will see their tax bill reduced thanks to the tax relief supported by President Bush and enacted by Congress. That extra money in the hands of America's families has helped to fuel the economic recovery. Now, to continue this period of economic growth, we must make tax relief permanent so families can plan ahead for the future. We must also reform the tax code to make it simpler, fairer and more growth oriented."
-- Secretary of the Treasury John Snow

Background: The President's Tax Relief is Benefiting Millions of American Families
As a result of the President's Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs & Growth Tax Relief Reconciliation Act of 2003, and the Working Families Tax Relief Act of 2004 every taxpayer who paid income taxes will get tax relief this year.

- 110 million American taxpayers will see their taxes decline by an average of $1,716.
- A family of four earning $40,000 will receive tax relief of $1,985.
- Over 5 million individuals and families will see their income tax liabilities completely eliminated.
- 44 million families with children will receive an average tax cut of $2,300.
- 14 million elderly individuals will receive an average tax cut of $1,879.
- 25 million small business owners will save an average of $3,235.
- 24 million investors will save an average of $947 from lower rates on dividends and capital gains, including 7 million seniors who will save an average of $1,231.
- Low-income families will also benefit from provisions that make the child credit refundable for more families and reduce marriage penalties.

President Bush has called on Congress to act now to prevent tax increases. If Congress does not act, failure to extend these tax cuts permanently would raise taxes on American taxpayers in future years:

- In 2006, the small business expensing limit will shrink from $100,000 to just $25,000, increasing the cost of capital investments for America's small businesses;
- In 2009, the top tax rate on dividends will increase from 15 to 35 percent, while the tax on capital gains will climb from 15 to 20 percent, raising the tax burden on retirees and families investing for their future; and
- In 2011, the tax rate relief, new 10-percent tax bracket, death tax repeal, marriage penalty relief, small business expensing, and all the remaining tax relief enacted over the past few years will sunset, resulting in tax increases for every individual American man or woman who pays income taxes.

The economy is stronger today because of the timely tax relief measures enacted during President Bush's administration. The success of the President's economic program, including tax relief, can be seen throughout the economy.

- Economic growth has averaged more than 4 percent during the last two years.
- The economy has generated 2.1 million net new jobs in the year ending

March 2005 and more than 3 million since May 2003, when the last tax relief package was enacted.

- At 5.2 percent, the unemployment rate remains below its average of the 1970s, 1980s, and 1990s.
- Real after-tax incomes are up more than 12 percent since December 2000, and are up more than 3 percent in the last year alone.
- Aided by a recovering stock market and strong home values, household wealth is at a record high.
- Homeownership is at an all-time high at more than 69 percent.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 14, 2005
JS-2378

**Hearing Testimony
the Honorable Timothy S. Bitsberger
assistant Secretary of the Treasury for
Financial Markets
on Reform of the United States Postal Service
Before the
committee on Homeland Security and
GovernmentAL Affairs
United States Senate**

Madam Chairman and distinguished Members of the Committee, thank you for the opportunity to testify today on the need for comprehensive postal reform. I welcome this opportunity to underscore the Administration's strong interest in enacting comprehensive legislation to reform the United States Postal Service.

The Administration Supports Enactment of Postal Reform

The President has consistently articulated the need for comprehensive reform to set the Postal Service on sound, long-term operational and financial footing. The Administration has been holding regular meetings with Congress and many stakeholders to ensure that we hear everyone's perspective and that our message is heard as well. I would like to extend the Administration's thanks to the Members and leadership of this Committee for working with us on postal reform legislation and we look forward to continuing that productive dialogue going forward. The Administration also appreciates Postmaster General Jack Potter's strong leadership and hard work to drive change within the Postal Service, and we have enjoyed working closely with him and his staff.

I would like to begin my testimony by outlining the five principles of reform that the Administration has supported. These principles are as follows:

- Self-Financing - The Postal Service should be self-financed. This was the intent of the 1970 Postal Reorganization Act, but thus far it has never been accomplished. Today we are at a point, due in no small part to the Postal Civil Service Retirement System Funding Reform Act of 2003 (hereafter "the Postal CSRS Funding Reform Act"), P.L. 108-18, where we can ensure that the Postal Service covers all of its costs, including its massive unfunded liabilities, without potentially crippling effects on ratepayers.
- Transparency - The Postal Service should be a model of transparency. The past few years have highlighted the necessity for financial transparency in our nation's capital markets. We are all familiar with the limitations of the accounting standards that have been brought to light through the corporate accounting issues of the late 1990's and the collective responses from Congress, the Administration, regulators, and self-regulatory organizations over the past three years. While the Postal Service is a governmental entity, it operates as a monopoly. It has an enormous public trust and thus must not be exempt from the financial transparency requirements that we place on investor owned corporations. The public trust that the Postal Service holds demands a higher standard.
- Flexibility - The Postal Service should have the flexibility to operate as a business, including the ability to set prices, reduce costs, and adjust key aspects of its business in order to meet the challenges of a dynamic marketplace.
- Accountability - The Postal Service should be more accountable to all stakeholders. In order to protect ratepayers, mail recipients, taxpayers and universal mail service, there is a vital need for greater independent

oversight given that the Postal Service is a monopoly that would be operating with greater commercial flexibility.

- Corporate Best Practices - The Postal Service should implement best practices of the corporate sector. This includes ensuring that the governing board is equipped to meet the responsibilities and objectives of an enterprise of its size and scope.

To more clearly outline the Administration's position in these areas, we provided a white paper in the 108th Congress listing a number of crucial long-term reforms. In this Congress, we took the further step of offering proposed legislative language to implement some of the more technical proposals. The Administration appreciates the Committee's willingness to address many of our concerns and include a number of our reform principles, and we look forward to working with you to further refine aspects of postal reform legislation consistent with these principles.

Reform must be Comprehensive

The Administration has always believed that reform must focus on the long-term health and viability of the Postal Service. There is an understandable temptation by some to tailor reform around the next rate case, but our horizon must be longer. Recognizing the importance of the Postal Service to our nation's citizens and commercial enterprises, the Administration is committed to ensuring the long-term financial and operational success of the Postal Service. We also recognize the systemic and structural challenges that the Postal Service faces in its business and believe that long-term reform will assist with both. The Postal Service faces an era of great change in which many believe that declining first-class volumes are unlikely to return. However, through reform and other initiatives collaboratively involving the Postal Service and mailers, it is entirely possible that new mail streams can be generated that provide a high value proposition to mailers. It is clear that the Postal Service must have a governing body, management team, and employees that are capable of recognizing the challenges and opportunities ahead with the insight, flexibility and skill to capitalize on them.

Flexibility

Pricing is a key part of the flexibility that the Administration believes the Postal Service needs. We support a hard rate cap, which provides that rates for any class of mail cannot rise more than the Consumer Price Index ("CPI") in any given year. The decision to support CPI as opposed to some other index was, in part, grounded on four factors:

1. the knowledge that overall postage rates have basically tracked CPI since 1972;

2. that productivity at the Postal Service has lagged the private sector by large margins since 1972 and therefore significant opportunities for a more productive Postal Service exists and this would enable it to operate within CPI;

3. to give the Postal Service stronger incentives to control its costs by discouraging it from simply passing costs on to ratepayers through a cost-based regulatory structure ; and

4. that wages generally rise faster than prices over time. This is largely due to increases in labor productivity. This difference in productivity allows firms to raise real wages without passing along costs to consumers through price increases. Generally, productivity improvements are expected to reduce prices.

We support the Committee's intent to establish a hard cap at CPI, and further support the Senate's version of an "escape clause," or exigency rate case, which establishes a very high bar to increase rates above CPI. This pricing flexibility will undò the current practice of irregular and lengthy rate cases that offer the Postal Service little managerial discretion and little or no predictability for the ratepayers.

We also seek to provide the Postal Service with flexibility on its cost side as well. We note that the Postal Service's $66 billion cost base provides significant opportunity for cost reductions without jeopardizing service quality or its universal service obligation. While some may dispute the absolute size of the potential reductions, it is indisputable that productivity at the Postal Service has lagged the private sector by large margins and that more effective management practices should be able to make significant progress in this area. One opportunity is in the underlying processing and distribution network and the potential to use this network in a more efficient manner.

Flexibility is not a blank check though. The Postal Service currently has the ability to negotiate its portion of the premiums for health and life insurance for its employees. The Postal Service has taken advantage of this ability and negotiated benefits beyond those offered by the U.S. Government. For instance, the Federal government pays 72 percent of an employee's health insurance premium while the Postal Service pays 85 percent of an employee's health insurance premium. Through this flexibility, the Postal Service has increased its costs by an additional $734 million. With respect to Basic life insurance, the Federal government pays 33 percent of an employee's Basic life insurance premium while the Postal Service pays 100 percent of an employee's Basic life insurance premium. Combined, the Postal Service has increased its costs for health and life insurance premiums by over $870 million annually above what the Federal government pays for most of its other employees.

We believe that it would be counter-productive to provide a list of specific cost reductions in statute, and instead have focused on a model where management has the flexibility to operate as a business within the constraints of a rate cap. This provides the right incentives for management without Congress or the Executive Branch micro-managing the business. In this way, the rate cap also drives greater board and management accountability, which is an important principle for the Administration.

Ensuring Self-Financing – Unfunded Liabilities

The Administration believes that comprehensive postal reform must require the Postal Service to cover all of its financial obligations, including its on and off-balance sheet unfunded liabilities. This is consistent with the statutory requirement that the Postal Service meet its responsibilities in a businesslike fashion by ensuring that revenues from the sale of products and services are sufficient to cover all operating costs. This concept of self-financing ensures that the Postal Service will operate in a manner that strengthens the financial and operational health of the Postal Service. It is important to recognize that since the 1970 Postal Reorganization Act, the Postal Service has never satisfied the statutory mandate of being fully self-financed. The Postal Service has accumulated approximately $75 billion of unfunded post-retirement health, pension and workers' compensation liabilities. Additionally, the Postal Service received approximately $27 billion of taxpayer funded appropriations since the 1970 Postal Reorganization Act.

While this may seem to paint a bleak picture of Postal finances, the Postal CSRS Funding Reform Act has provided a unique opportunity to substantially improve the financial health of the Postal Service. Specifically, the Administration has proposed to dedicate all the escrow created by the Postal CSRS Funding Reform Act to fund the unfunded post-retirement health obligations, which are approximately $64 billion. Without action, these unfunded liabilities grow to almost $100 billion in 2011, $208 billion in 2022, $422 billion in 2032 and over $1 trillion in 2045. We believe that the Postal Service should have a financing plan in place to ensure it can cover its post-retirement healthcare costs, and our proposal does that.

Some have said that the private sector does not pre-fund post-retirement health liabilities in the manner that we have proposed. We agree that the private sector generally has not fully pre-funded these liabilities, but note two important distinctions. First, in recent years, many firms that offer post-retirement health benefits have in fact established dedicated trusts to fund these liabilities as the seriousness of these obligations became apparent. More importantly, we recognize that the private sector has the ability to eliminate these, and other obligations either voluntarily or through a bankruptcy proceeding. These changes generally take the form of reduced or eliminated benefits.

We also recognize concerns from ratepayers over the 2006 rate case. The Postal Service has indicated that the need for the 2006 rate case is necessitated by the escrow established by the Postal CSRS Funding Reform Act and that without access to the escrow, rates must rise to compensate.

We believe that this analysis excludes the real reasons for the 2006 rate case. The reality is that any additional financial requirements of the Postal Service can be directly attributed to its inability to sufficiently reduce its costs since 2002, which is the date of the last rate increase. It is interesting to note that, if the Postal Service had the authority to raise rates under the CPI cap being proposed, the rates that would be in place today and in 2006 would be higher than what the Postal Service is currently proposing. While there are a lot of "puts" and "takes" in a business plan, I would like to address two components. Personnel will cost the Postal Service over $6.9 billion more in 2006 than it did in 2002 despite lower headcounts. This is based on actual results from 2002 and the Postal Service's projections included in its 2005 rate case filing. Fuel is also a significant component. We note that fuel costs for 2006 are projected to be over $700 million higher than in 2001, when the Postal Service filed its last completed rate case. The point of highlighting these two line items, which combined are well over two times the $3.1 billion rate increase that the Postal Service is asking for, is to demonstrate that the rate increase has its roots in the Postal Service's general cost structure and not linked to the escrow.

It is also important to realize that the Postal Service has already factored into rates, through the CSRS funding formula, the amounts that constitute the escrow, and therefore these amounts do not represent a "new" cost to be recovered. In other words, our reform proposal essentially replaces the "CSRS" expense line item with a new expense line item named "post-retirement health liabilities."

The Administration understands the concern over the 2006 rate case, but we also believe that all escrow funds should be committed to paying down unfunded liabilities rather than diverted in order to minimize a near-term rate increase. But the Administration does not view this as an either/or proposition, and we should consider exploring other alternatives to fully achieve both objectives. Before such alternatives can be considered, however, the Administration needs to see a clear path to enactment of postal reform legislation that includes the fundamental reforms that we have advocated.

Ensuring Self-Financing – Military Service

There has been a great deal of discussion about the Administration's position on the military service issue, and this hearing provides an opportunity to set the record straight. The decision in the Postal CSRS Funding Reform Act to allocate the $27 billion in retirement costs for the military service of the Postal Service retirees was justified for many reasons which are being addressed by OPM's Acting Director Blair in his testimony.

In addition to the arguments that Acting Director Blair addresses in his testimony, I would also like to note that the allocation of military service retirement costs is fair and equitable because the Postal Service has been the beneficiary of significant taxpayer funded appropriations, which more than cover any perceived "unfair" attribution of the $27 billion of military retirement costs to the Postal Service. In addition to the $78 billion credited to the Postal Service through the Postal CSRS Funding Reform Act, the Postal Service has received approximately $27 billion in taxpayer-funded appropriations from the Federal government since enactment of the 1970 Postal Reorganization Act. If the goal is to revisit all of the assumptions that were the underpinnings of the 1970 Postal Reorganization Act and decades of Congressional decisions, it would be fair and equitable to revisit the appropriateness of the taxpayer-funded appropriations that the Postal Service has received. Using the same investment rates that OPM used in calculating the figure for CSRS over-funding, and based on the timing of these yearly Federal government transfers to the Postal Service, Treasury has calculated that the Postal Service would owe more than $200 billion to the Treasury for the use of the appropriations through FY 2003. We could elaborate on many other unique benefits the Postal Service accrues as a result of its special relationship with the Federal government, which include the ability to borrow up to $15 billion from the Department of the Treasury at below-market rates; exemption from federal income taxes, exemption from state and local taxation, and the power of eminent domain. So, during a period when the Postal Service has a statutory mandate to be self-financing, the Postal Service's cumulative performance has been bolstered enormously and in an extraordinary way by U.S. taxpayers, and as a direct benefit to ratepayers. I do not raise this point to call these transfers into question. However, I bring up this fact to further underscore the point that the Postal Service has benefited greatly during the past three decades, in an amount far exceeding the $27 billion currently under debate.

Transparency

The Administration believes that real financial and operational transparency is essential to postal reform. In the case of the Postal Service, the public interest and trust demands a very high level of transparency. We seek to obtain this enhanced transparency through SEC reporting standards and a robust, independent regulator. We are pleased that the Senate has seen fit to adopt many of the Administration's recommendations in this area.

Financial transparency is important for ratepayers, taxpayers, competitors, employees and management. The Administration believes that the Postal Service should be given great flexibility to set prices and to provide work-sharing discounts and enter into negotiated service agreements. While the Administration has dropped its requirement for audited product-line financial statements, we do believe that the Postal Service needs to develop and instill a culture that measures and understands its costs at a very fine level, which is consistent with the best practices in the private sector. While it is true that private sector companies generally do not issue product-line financial statements, they do in fact have them for internal purposes, which include performance measurement and the pricing of products, services and contracts. With the expanded flexibility that the Postal Service has on pricing, discounts and service agreements, the Postal Service needs to fully understand the true financial implications of its decisions.

In lieu of product-line financial statements, we have sought segment reporting which is consistent with SEC requirements. Given the uniqueness of the Postal Service, we have sought to define the segments. We believe that five segments represent a reasonable requirement based on today's business and would lead to segment reporting on First Class Mail, Standard Mail, Competitive Products, Periodicals, and Other. It is important to note that our language, while defining the segments, narrowed the reportable information by eliminating the SEC requirement to report "total assets." We did this because of recognition of the difficulty that this would pose for the Postal Service to establish what assets belong to which segments. Beyond the narrow issues that we have addressed, we are comfortable that the SEC's requirements and the exceptions that it provides for all registrants when items do not apply are sufficient for the Postal Service. It is unnecessary and unwise to allow the regulator to relax the SEC requirements.

Another aspect of financial transparency is the recognition of all of the Postal Service's liabilities, including those that are currently not on the balance sheet. The post-retirement health liability is the single largest liability excluded from the Postal Service's financial statements and the one that causes the most concern. This is because the Postal Service has excluded approximately $64 billion in costs from the rate base. We are also concerned by the Postal Service's acknowledgement that it has included the workers' compensation liabilities in its rate base yet it still has $7.6 billion of unfunded workers' compensation liabilities. The Postal Service has used funds that were part of its workers' compensation expense requirements in previous rate cases for non-workers' compensation related expenses.

The issue of what information is confidential and who determines whether it is confidential is an important issue of transparency. We fully understand that certain information of the Postal Service is confidential as is common in both the government and private sectors. We agree with the Senate's approach to this matter: to allow the regulator to be the final arbiter of what materials should be confidential rather than the regulated entity.

Accountability

Accountability will result in many ways through our reform efforts. A hard rate cap that has a strict escape mechanism will drive management accountability. A strong regulator will drive accountability, and real financial transparency will drive accountability.

We also believe that a revised compensation structure for senior management will help drive accountability. It is critical to provide flexibility to the Board of Governors to fairly compensate senior executives in a manner that will help attract and retain the very best. We all recognize that even with this flexibility, it is not possible to provide the same private sector compensation opportunities. But it is a step in the right direction as we demand a more private sector like focus on business operations, productivity and financial performance. In another accountability measure, we believe that the regulator should have a review role in the new compensation flexibility.

Conclusion

Congress now has a unique opportunity to take decisive action on a comprehensive postal reform bill that will set the Postal Service on the course to financial and operational stability. We believe that the five principles discussed will align the incentives, create a performance oriented culture, and ensure the proper accountability for the largest monopoly in the world. Thank you for the attention you are paying to this critical aspect of our country's economy. The Administration remains prepared to actively work with you to craft a comprehensive reform bill that will stand the test of time in an enormously dynamic market. We believe it critical that reform legislation result in a sharing of sacrifice with all stakeholders, and characterized by the five principles we have articulated.

Once again, I thank you for your kind invitation to appear today.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

To view or print the Microsoft Word content on this page, download the free Microsoft Word Viewer.

April 14, 2005
JS-2379

Treasury Releases State by State Fact Sheets on the Benefits of the President's Tax Relief

WASHINGTON, DC – The Treasury Department today released state specific data illustrating the benefits of the tax relief on all Americans. Millions of taxpayers will feel a lighter burden on tax day thanks to the Economic Growth and Tax Relief Reconciliation Act Of 2001 (EGTRRA) and The Jobs and Growth Tax Relief Reconciliation Act Of 2003 (JGTRRA).

"No one looks forward to tax day, but for millions of taxpayers across the country, this April 15 will be less painful thanks to the President's tax cuts," stated Treasury Secretary John Snow. "Nationwide, 110 million taxpayers will see their tax bill reduced thanks to the tax relief supported by President Bush and enacted by Congress. That extra money in the hands of America's families has helped to fuel the economic recovery. Now, to continue this period of economic growth, we must make tax relief permanent so families can plan ahead for the future. We must also reform the tax code to make it simpler, fairer and more growth oriented."

State by State Fact Sheets on the Benefits of the President's Tax Relief

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 15, 2005
JS-2380

Treasury International Capital Data for February

Treasury International Capital (TIC) data for February are released today and posted on the U.S. Treasury web site (\
which will report on data for March, is scheduled for May 16, 2005.

Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,376.3 billion in February, exceeding gross sales of don
billion during the same month.

Foreign purchases of domestic securities reached $98.3 billion on a net basis in February, relative to $91.8 billion dur
reached $79.7 billion in February. Net private purchases of Treasury Bonds and Notes increased to $31.2 billion from
private purchases of Government Agency Bonds were $11.0 billion, down from $19.9 billion the previous month. Net
were $30.0 billion, up from $17.3 billion the previous month. Net private purchases of Equities were $7.4 billion down

Official net purchases of U.S. securities were $18.6 billion in February, relative to $14.4 billion in January. Official net
of $11.3 billion accounted for the bulk of official inflows in February, up from $7.6 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $281.1 billion in February, relative to gross sales
$294.9 billion during the same month.

Gross sales of foreign securities to U.S. residents exceeded purchases by $13.8 billion, highlighting a net U.S. acquis
and net U.S. sales of $1.5 billion in Foreign Bonds.

Net Long-Term Securities Flows

Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $84.5 billion in Feb
January. Net foreign purchases of long-term securities were $830.6 billion in the twelve months through February 20(
the twelve months through February 2004.

The full data set, including adjustments for repayments of principal on asset-backed securities, as well as historical se
http://www.treas.gov/tic/.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

Foreigners' Transactions in Long-Term Securities with U.S. R
(Billions of dollars, not seasonally adjusted)

				12 Months Through	
		2003	2004	Feb-04	Feb-05
1	Gross Purchases of Domestic Securities	14,383.6	15,269.8	14,805.7	15,642.3
2	Gross Sales of Domestic Securities	13,644.9	14,365.8	13,970.7	14,708.8
3	**Domestic Securities Purchased, net** (line 1 less line	**738.8**	**904.0**	**835.0**	**933.5**

4	**Private, net /2**	**595.7**	**669.9**	**657.5**	**718.9**
5	Treasury Bonds & Notes, net	163.2	150.9	197.7	177.7
6	Gov't Agency Bonds, net	135.1	206.1	151.1	198.4
7	Corporate Bonds, net	261.5	286.5	254.5	305.1
8	Equities, net	35.9	26.4	54.1	37.7
9	**Official, net**	**143.1**	**234.1**	**177.6**	**214.5**
10	Treasury Bonds & Notes, net	113.5	201.1	151.1	175.4
11	Gov't Agency Bonds, net	24.3	20.3	21.8	23.8
12	Corporate Bonds, net	5.6	11.4	5.5	14.1
13	Equities, net	-0.3	1.4	-0.8	1.2
14	Gross Purchases of Foreign Securities	2,893.8	3,119.1	3,039.1	3,108.5
15	Gross Sales of Foreign Securities	2,959.7	3,228.6	3,114.8	3,211.4
16	**Foreign Securities Purchased, net** (line 14 less line	**-65.9**	**-109.5**	**-75.8**	**-102.9**
17	Foreign Bonds Purchased, net	18.9	-26.1	14.0	-15.1
18	Foreign Equities Purchased, net	-84.8	-83.4	-89.8	-87.8
19	**Net Long-Term Flows** (line 3 plus line 16)	**672.9**	**794.6**	**759.3**	**830.6**

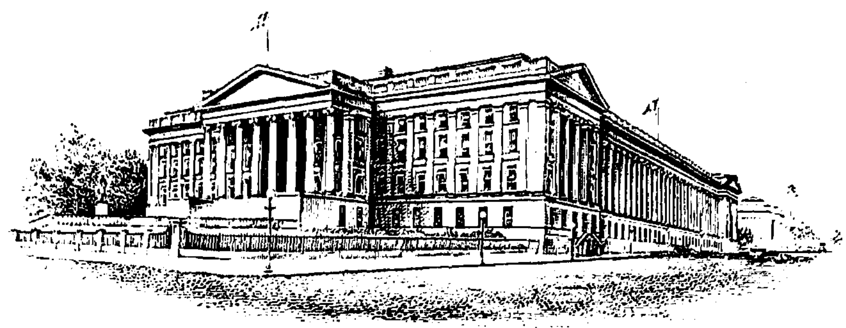
/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. acquisitions of foreign securities (-)

Source: U.S. Department of the Treasury

REPORTS

- (PDF) Foreigners' Transactions in Long-Term Securities with U.S. Residents (Billions of dollars, not seasonall

Full chart attached



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

April 15, 2005 **Contact: Tony Fratto**
EMBARGOED UNTIL 9:00 AM **202-622-2910**

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Long-Term Domestic Securities

Gross purchases of domestic securities by foreigners were $1,376.3 billion in February, exceeding gross sales of domestic securities by foreigners of $1,278.0 billion during the same month.

Foreign purchases of domestic securities reached $98.3 billion on a net basis in February, relative to $91.8 billion during the previous month. Private net flows reached $79.7 billion in February. Net private purchases of Treasury Bonds and Notes increased to $31.2 billion from $23.1 billion the preceding month. Net private purchases of Government Agency Bonds were $11.0 billion, down from $19.9 billion the previous month. Net private purchases of Corporate Bonds were $30.0 billion, up from $17.3 billion the previous month. Net private purchases of Equities were $7.4 billion down from $17.1 billion.

Official net purchases of U.S. securities were $18.6 billion in February, relative to $14.4 billion in January. Official net purchases of Treasury Bonds and Notes of $11.3 billion accounted for the bulk of official inflows in February, up from $7.6 billion the previous month.

Long-Term Foreign Securities

Gross purchases of foreign securities owned by U.S. residents were $281.1 billion in February, relative to gross sales of foreign securities to U.S. residents of $294.9 billion during the same month.

Gross sales of foreign securities to U.S. residents exceeded purchases by $13.8 billion, highlighting a net U.S. acquisition of $15.3 billion in Foreign Equities and net U.S. sales of $1.5 billion in Foreign Bonds.

Net Long-Term Securities Flows

Net foreign purchases of both domestic and foreign long-term securities from U.S. residents were $84.5 billion in February compared with $92.5 billion in January. Net foreign purchases of long-term securities were $830.6 billion in the twelve months through February 2005 as compared to $759.3 billion during the twelve months through February 2004.

The full data set, including adjustments for repayments of principal on asset-backed securities, as well as historical series, can be found on the TIC web site, http://www.treas.gov/tic/.

Foreigners' Transactions in Long-Term Securities with U.S. Residents
(Billions of dollars, not seasonally adjusted)

				12 Months Through					
		2003	2004	Feb-04	Feb-05	Nov-04	Dec-04	Jan-05	Feb-05
1	Gross Purchases of Domestic Securities	14,383.6	15,269.8	14,805.7	15,642.3	1,409.9	1,318.1	1,305.3	1,376.3
2	Gross Sales of Domestic Securities	13,644.9	14,365.8	13,970.7	14,708.8	1,308.9	1,234.7	1,213.5	1,278.0
3	**Domestic Securities Purchased, net** (line 1 less line 2) /1	**738.8**	**904.0**	**835.0**	**933.5**	**101.0**	**83.5**	**91.8**	**98.3**
4	**Private, net /2**	**595.7**	**669.9**	**657.5**	**718.9**	**73.1**	**73.2**	**77.5**	**79.7**
5	Treasury Bonds & Notes, net	163.2	150.9	197.7	177.7	12.7	1.4	23.1	31.2
6	Gov't Agency Bonds, net	135.1	206.1	151.1	198.4	24.3	25.6	19.9	11.0
7	Corporate Bonds, net	261.5	286.5	254.5	305.1	23.6	39.2	17.3	30.0
8	Equities, net	35.9	26.4	54.1	37.7	12.5	7.0	17.1	7.4
9	**Official, net**	**143.1**	**234.1**	**177.6**	**214.5**	**27.9**	**10.2**	**14.4**	**18.6**
10	Treasury Bonds & Notes, net	113.5	201.1	151.1	175.4	21.0	7.0	7.6	11.3
11	Gov't Agency Bonds, net	24.3	20.3	21.8	23.8	3.5	1.0	6.1	5.2
12	Corporate Bonds, net	5.6	11.4	5.5	14.1	1.9	1.6	1.3	2.1
13	Equities, net	-0.3	1.4	-0.8	1.2	1.5	0.6	-0.7	0.0
14	Gross Purchases of Foreign Securities	2,893.8	3,119.1	3,039.1	3,108.5	272.2	261.5	250.6	281.1
15	Gross Sales of Foreign Securities	2,959.7	3,228.6	3,114.8	3,211.4	277.9	282.6	249.9	294.9
16	**Foreign Securities Purchased, net** (line 14 less line 15) /3	**-65.9**	**-109.5**	**-75.8**	**-102.9**	**-5.7**	**-21.1**	**0.7**	**-13.8**
17	Foreign Bonds Purchased, net	18.9	-26.1	14.0	-15.1	2.0	-7.0	5.8	1.5
18	Foreign Equities Purchased, net	-84.8	-83.4	-89.8	-87.8	-7.7	-14.0	-5.1	-15.3
19	**Net Long-Term Flows** (line 3 plus line 16)	**672.9**	**794.6**	**759.3**	**830.6**	**95.3**	**62.4**	**92.5**	**84.5**

/1 Net foreign purchases of U.S. securities (+)
/2 Includes International and Regional Organizations
/3 Net U.S. acquisitions of foreign securities (-)

Source: U.S. Department of the Treasury

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 15, 2005
JS-2381

Assistant Secretary for International Affairs Randal K. Quarles
U.S.-Russia Banking Conference
Washington, D.C
"Russian Integration in the Global Financial System"

I would like to thank the U.S.-Russia Business Council and the Russian Banking Association for sponsoring this timely and useful conference. Russia needs a high quality financial sector, which is integrated into the global financial system, to sustain its prosperity over the long term. An event like this can help Russia's banking system move closer to that goal.

Why Russia Needs A Top-Notch Financial Sector

To be sure, Russia's strong growth in recent years has come without a substantial contribution from the financial sector, so it may not be obvious why a first-class banking sector is so important. But we should not forget that the commodity export boom of recent years has obscured Russia's relatively low investment level – just 18 percent of GDP (i.e., gross fixed capital formation) – compared to 25-30 percent of GDP in other dynamic emerging markets. Moreover, the high proportion of natural resource exports makes the economy vulnerable to commodity price swings and, in the current high oil price environment, to Dutch disease, with real exchange rate appreciation sapping the competitiveness of the non-oil sector.

To reduce vulnerability and increase investment and growth rates, the economy needs greater economic diversification. A sound, competitive, and private financial sector open to foreign participation is the most efficient means for reallocating natural resource profits and household savings to the most productive uses outside of the oil sector. It is also important for getting credit to small and medium-sized businesses. Economic research has found that an open financial sector is associated with increased lending to small- and medium-sized enterprises, with the larger foreign presence associated with better access to credit.[1] The crucial role of small business in a country's economic success is well documented, accounting for roughly 50% of GDP and 50% of employment in developed economies. Not surprisingly, the more advanced transition economies in Central Europe, which have implemented successful banking reform, also enjoy a higher contribution of small businesses to economic output.

[1] See, for example, George R. G. Clarke, Robert Cull and Maria Soledad Martinez Peria, World Bank Development Research Group.

Reform Effort to Date

The importance of a vibrant banking sector that meets international standards of transparency and governance has not been lost on the Russian authorities. At their summit in September 2001, Presidents Putin and Bush launched the U.S.-Russia Banking Dialogue to solicit reform recommendations from private Russian, U.S. and other bankers. With these recommendations in hand, the current team of Chairman Sergei Ignatiev and Deputy Governor Andrei Kozlov at the Central Bank of Russia initiated important reforms. In particular, the creation of the deposit insurance system has elevated the regulatory and supervisory standards of the banking system. With the initial round of deposit insurance entry complete, the results are encouraging. Still, the full benefit of the reform will be realized only if it continues to encourage further consolidation of the sector and helps level the playing field between public and private banks.

Separately, the Russian government, led by the Financial Monitoring Service, has made significant strides in establishing a robust anti-money laundering regime in a relatively short period. Russia went from the Financial Action Task Force (FATF) blacklist in June 2000 to FATF member in June 2003. This "conversion" was real. Between January 2002 and April 2003 alone, over 1,405 money laundering cases resulted in the seizure of funds and property worth over 1 billion rubles (~$33 million). From October 2002 to June 2003, Russia detected 369 cases of terrorist financing, freezing over 500 million rubles (~$16 million) in related funds and property. And now Russia is becoming a regional leader by establishing a FATF-style regional body in Central Asia, which will build standards and capacity in a region crucial to the fight against money laundering and terrorist financing.

Assessment of Banking Sector Performance

The authorities should be commended for their efforts in the last several years, which have helped foster the rapid growth of the banking sector (assets grew on average 31%; deposits 40% since 2002). However, a quick snapshot of the sector reveals that much work remains. Particularly striking features are:

- Out of more than 1,200 banks, just 400 have authorized capital above $6 million (Euro 5 million), or the minimum required by the EU.
- Foreign participation is low at an estimated 10-12% of total sector capital. That compares to well over 50% in Central Europe.
- Not surprisingly, the banking sector fails to intermediate savings and investment effectively, providing just 5% of total capital investment for the economy. In the more advanced transition economies, banks provide closer to 40% of investment finance.

Five state banks control over 40% of sector assets. State-owned Sberbank accounts for roughly 25% of sector assets, controls an estimated 60% of the retail deposit market and is responsible for around a third of all the bank branches in the system. State-owned Vneshtorgbank (VTB), the second largest bank, is the largest commercial lender in the country. Again, in Central Europe, the state bank share of assets ranges from 1.5% in Slovakia to 25% in Poland.

- Despite strong growth over the last several years, deposits and credit to the private sector are just under 20% of GDP. This compares unfavorably to the more advanced transition economies in Central Europe where deposit and credit levels are at least twice as high as a share of GDP.

All this suggests that the Russian banking sector is functioning well below its potential. Moreover, confidence remains fragile. The closure of two small banks because of anti-money laundering regulations in June 2004 sparked deposit runs on healthy domestic banks. While the Central Bank did its best to contain the fallout, the episode raised questions about the capacity of the authorities to facilitate a much needed consolidation of the sector. Not surprisingly, the state banks – enjoying a blanket deposit guarantee at the time – appeared to have benefited.

Banking Reform and WTO Accession

Part of the weakness of the banking sector can be attributed to its lack of integration with the global economy. The agenda going forward, therefore, should focus on closing the gap. In the view of the U.S., this should include openness to foreign participation, elimination of state ownership and the continued development of anti-money laundering and terrorist financing standards.

Foreign banks bring best practices, technology, and competition. It stands to reason that if Russia wants a world class economy, it needs world class companies that have access to the same financial services available to their competitors in other countries. The best means to secure this resource for Russia's businesses and households is the completion of WTO financial services negotiations on standards comparable to industrial nations and other recent WTO members. In this context, removing limits on foreign bank branching has become a standard for WTO accession. Foreign bank branches with their direct access to a more global pool of capital can have a stabilizing effect on the domestic economy during a downturn. For example, the share of commercial lending attributable to branches of foreign banks in the U.S. is normally around 20%, but rose to 25% during the savings and loan crisis in the late-1980's.

Reforms needed for WTO membership require adjustment and some costs to uncompetitive parts of the economy. However, the benefits for Russian households and businesses are potentially huge. In a report issued last month, the World Bank estimated that 99% of Russian households will see as much as an 18% consumption gain over the medium-term as result of WTO membership. This translates into total income growth of $64 billion per year. A separate 2003 study suggests that about a third of these gains will result from financial services liberalization alone.

Much of the Russian leadership understands the tremendous gains involved with WTO membership and have made accession a top priority. It is important, therefore, that the priorities of the Russian leadership are reflected at the negotiation table, particularly in financial services. The U.S. stands ready to admit Russia on the same terms applied to everyone else. Those terms include removing limits on foreign participation in financial service sectors.

We are aware that the specter of greater foreign competition in the financial sector has drawn concerns from some domestic interests in Russia. However, it is our firm belief that worries about a lack of Russian competitiveness in the financial sector are exaggerated and, ultimately, misplaced. Rather, state banks are the greatest single obstacle to the international competitiveness of Russian domestic banks. International experience shows that state-owned banks cannot become the basis for building a world-class banking system. State banks are less efficient and less effective at intermediating savings and investment. They distort financial sector development by providing subsidized credit or politically directed lending or weakening judgments of creditworthiness. The longer-term health of the sector is hampered by the accumulation of contingent liabilities arising from explicit guarantees or the implicit assumption that these banks are "too big to fail". For these reasons, various researchers have found a negative correlation between the level of state ownership in the banking sector and a country's rate of economic growth.[2] Notably, efforts by governments to improve state bank performance have not succeeded while privatization has led to greatly improved performance.

Fighting Money Laundering and Terrorist Financing

Russia's anti-money laundering regime is still relatively new while Russia's reputation for under-regulation in this area was many years in the making. We are aware that this often has real practical consequences to the business environment in which Russian banks operate. It will take time and aggressive implementation of Russia's laws and regulations on money laundering and terrorist financing to overcome. Russian financial institutions themselves have a strong interest in taking all appropriate steps to ensure that they are not being abused for illicit purposes. This involves instituting world-beating standards of transparency and corporate governance.

Moving forward, the U.S. is committed to continued cooperation with Russia. There are many opportunities to take bilateral and multilateral actions to attack money laundering and terrorist financing. For example, the U.S. has targeted corrupt financial institutions, especially in Eastern Europe. In August 2004, the Treasury Department designated Infobank of Belarus under Section 311 of the USA PATRIOT Act as a "primary money laundering concern". These types of actions would certainly be more powerful if done in concert with our partner nations, and in particular with Russia, which has such financial and political importance in the region.

Conclusion

It is important to applaud the authorities for the progress they have made over the last few years on banking reform and the fight against money laundering, which have brought the Russian financial sector closer to best international practice. However, without additional reforms, the full benefits of integration will not be realized and Russia's banking sector will contribute little to Russia's growth and living standards. WTO membership is within Russia's reach. International experience has shown that the most competitive economies are underpinned by a sound, competitive and *private* financial sector. Anti-money laundering standards must continue to evolve such that Russia's regime is second-to-none. These efforts present tough challenges, no doubt, and will require strong leadership. But, at the end of the day, Russian households and businesses will be the big winners as they gain access to the best financial services the world has to offer.

[2] For example, see Caprio, Fiechter, Litan, Pomerleano, eds. (2004), *The Future of State-Owned Financial Institutions*, Brookings Institution Press.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 15, 2005
JS-2382

Statement by Treasury Secretary John Snow on Tax Day

"No one looks forward to tax day, but for millions of taxpayers across the country, today will be less painful thanks to the President's tax cuts. Nationwide, 110 million taxpayers will see their tax bill reduced thanks to the tax relief supported by President Bush and enacted by Congress. That extra money in the hands of America's families has helped to fuel the economic recovery. Now, to continue this period of economic growth, we must make tax relief permanent so families can plan ahead for the future. We must also reform the tax code to make it simpler, fairer and more growth oriented."

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 16, 2005
js-2383

Statement by G-7 Finance Ministers and Central Bank Governors

Since our meeting in February, the global expansion has remained robust and the outlook continues to point to solid growth for 2005. Subdued inflationary pressures, appropriate monetary policies and favorable financing conditions are supporting the outlook. But challenges remain. Higher oil prices are a headwind and the expansion is less balanced than before. We welcome efforts to improve oil market data, increase medium-term energy supply and efficiency. We will review the progress made at our next meeting. Vigorous action is needed to address global imbalances and foster growth: fiscal consolidation in the United States; further structural reforms in Europe; and further structural reforms, including fiscal consolidation, in Japan.

We reaffirm that exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth. We continue to monitor exchange markets closely and cooperate as appropriate. In this context, we emphasize that more flexibility in exchange rates is desirable for major countries or economic areas that lack such flexibility to promote smooth and widespread adjustments in the international financial system, based on market mechanisms.

Building on the way forward on development we agreed in London, we made progress in preparation for the Gleneagles Summit, including on a case-by-case analysis of HIPC countries, based on our willingness to provide as much as 100% reduction of HIPC countries' IDA and African Fund debt without reducing the resources available to the poorest countries through these institutions. We thank the Managing Director for his papers exploring the role of the IMF related to debt relief and we look forward to discussing this with the full membership. We discussed the work program initiated in London on the IFF and its pilot, the IFF for immunization; some of the revenue proposals from the Landau Report brought forward by France and Germany which could also refinance the IFF; the Millennium Challenge Account; and other financing measures. We agree that the IMF and the World Bank have a role to play in helping developing countries address the impact of higher energy prices.

We reviewed progress of the Strategic Review of the Bretton Woods Institutions. We support the creation of a policy monitoring arrangement in the IMF to allow low income countries to engage the Fund when they do not need Fund finance, alongside the PRGF which is the IMF's principal instrument for providing resources to low-income countries. The PRGF should be adequately equipped to meet future demand as assessed by the IMF and be responsive to short-term adjustment needs. We believe rapid progress can be made to improve IMF surveillance, including through independence of debt sustainability analysis from lending decisions. Prioritization of work and strict budget discipline are critical for the effectiveness of all IFIs.

We thank Jim Wolfensohn for his extraordinary service as President of the World Bank. We welcome Paul Wolfowitz as the new President. We look forward to working with him to: reinforce the Bank's implementation of country-led poverty reduction programs, including building public financial management and anti-corruption capacity; mobilize increased resources for development; increase the focus on growth strategies; and enhance accountability and incentives through results management, reform of the budget process to control costs, and greater transparency.

We commend the Brazilian authorities for their able economic stewardship and successful cooperation with the IMF, and we welcome their recent decision to continue these strong policies without an additional IMF program. Following the debt exchange, Argentina needs to address the remaining defaulted debt, in line with the lending into arrears policy of the IMF, and undertake structural reforms to ensure sustainable growth. We welcome the efforts of donor countries to help the reconstruction of tsunami-ravaged countries and urge all donors to move quickly from pledges to action. We look forward to meeting our counterparts from the Broader Middle East and North Africa later today.

An ambitious result of the Doha Development Round is key for global growth. Countries with open and well-supervised financial services sectors, especially emerging markets and developing countries, have achieved significantly higher growth rates. A strong WTO agreement on financial services at the Hong Kong ministerial is in the best interests of the global community.

In our fight against terrorist financing, we agreed on the importance of improving the process of freezing terrorist assets in line with UN resolutions; improving information sharing between jurisdictions and with the private sector; and exploring the possibility of extending financial tools to disrupt criminality and terrorism.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 16, 2005
js-2384

Secretary John W. Snow Prepared Statement following the Meeting of the G-7 Finance Ministers and Central Bank Governors

I was delighted to host G-7 Finance Ministers and Central Bank Governors over the last two days; we've had a very successful meeting.

We are pleased to see the global economy continuing its expansion. The outlook continues to be favorable for 2005, despite the unwelcome news of oil prices, and we all agreed that improving growth must be our top priority.

The United States remains a leading contributor to the global expansion. Real GDP rose 4.4 percent in 2004 on an average annual basis, the largest in five years. Evidence so far on the first quarter points to continued strength. Job growth has been revitalized, with the economy creating 3.1 million new jobs since the employment trough of May 2003. Inflation remains moderate. These achievements reflect well-timed execution of carefully-designed monetary and fiscal policies.

The U.S. is strongly committed to reducing the budget deficit. We recognize that this is vital for continued robust growth for the U.S. economy as well as for the international financial system. We are also committed to reducing the longer term deficit which reflects our unsustainable, unfunded obligations such as Social Security.

The Administration expects a deficit of $427 billion this fiscal year. At 3.5 percent of GDP, this is substantially lower than the 4.5 - 6 percent experienced at times in the 1980s and 1990s, but still too large. Deficits matter, they are unwelcome, and must come down. And with tight controls on discretionary spending and increased revenue stemming from the expanding economy, we expect to cut the deficit in half to well under 2% of GDP by 2009.

Colleagues have asked me about the President's effort to reform our retirement system. The President's initiative to reform the Social Security system is an important part of the United States' economic future. We must plan for the future and that means dealing with looming financial threats when we see them. In the case of Social Security, there is no denying the demographic reality that will lead to insolvency of the system. The President has initiated a national dialogue that we hope will encourage the Congress to enact swift and meaningful reform to preserve, protect and strengthen Social Security for all generations of American workers.

The Bush Administration is also pursuing reform of the U.S. tax code, which has grown too long, complicated and cumbersome - a poor match for our flexible, free-market economy. The President has appointed an advisory panel to study the problems of the current code and propose potential solutions, keeping in mind that any new system of taxation must achieve increased fairness, simplicity and ease of understanding, as well as promote economic growth and job creation.

We each face our own challenges and responsibilities, like Social Security and tax code reform, but global adjustment is a shared responsibility. The United States is doing its part to reduce the fiscal deficit. Growth in parts of Europe and in Japan remain modest, leaving the global recovery less balanced than it had been. Europe and Japan must step up to the challenges of structural reform in order to build up the foundation for growth. The G7 Ministers agree on the need for greater growth in the world economy particularly among the large industrialized economies. We are committed to reducing the barriers to growth which we find in each of our economies as reflected in our Agenda for Growth. This is an action-oriented program for reforms to which we are all committed.

I want to comment specifically on China in this context. China's strong economic growth has made a tremendous contribution to the global economy. China has taken numerous steps over the last few years, including preparing for greater flexibility in their exchange rate, introducing foreign exchange market financial products and strengthening banks and bank supervision. With this groundwork in place, China is ready now to adopt a more flexible exchange rate.

Energy issues were a subject of intense discussion during our meetings. High energy prices act as a drag on the global expansion. In the United States, President Bush is concerned about the impact of high gas prices on American families and our economy. We feel strongly that the U.S. Congress must act to pass comprehensive energy legislation. President Bush put forth a national energy policy four years ago that addresses both supply and demand, and America has waited long enough for Congress to act. It is time to put partisanship aside and enact energy legislation.

Extending the benefits of growth to all the world's citizens remains a key priority for the United States and for the G-7. The U.S. commitment is clear - for instance, we have nearly doubled our development assistance since 2000 to help boost growth and reduce poverty in developing countries and tripled aid to sub-Saharan Africa. The next step, in our view, is to extend 100 percent reduction of HIPC countries' IDA and African Fund debt. We believe that the tide is shifting in favor of such a cancellation approach.

For its part, the IMF needs to substantially improve its engagement in low-income countries. A major step forward in this regard is the agreement among the G-7 this weekend to support a new policy monitoring arrangement in the IMF. This type of facility would allow low income countries to engage intensively with the Fund, even when they do not face balance of payments financing needs and without increasing their debt. I urge the IMFC to move forward on this important step later today. We also called for the IMF to make its low income lending more responsive to short-term adjustment needs.

More broadly with respect to the Bretton Woods institutions, we had the opportunity to assess progress under the Strategic Review that was initiated in the G-7 and that is now being carried through in the institutions themselves. Fundamental for both institutions is the need to clarify the underlying missions, to set priorities in line with their missions so that they can deliver results while avoiding budget creep. In the IMF, surveillance can and must be further improved, and we all agreed to work together to accomplish this in particular by pushing for the IMF to provide debt sustainability assessments separately from proposed lending programs. In the World Bank, key concerns are enhancing transparency and accountability, particularly with respect to internal controls, and implementing improvements in results measurement.

We are grateful to Jim Wolfensohn for the extraordinary leadership he has provided for the World Bank. I was pleased by the welcome my colleagues extended to Paul Wolfowitz as the new President. Paul is an outstanding leader whose proven management skills, vision and commitment to development I believe can and will take the Bank and the international effort to promote development to a new level. We laid out some shared priorities today that we believe provide an ambitious agenda for the Bank.

Another key item on our agenda was fighting the financing of terrorism. We agreed on the importance of strengthening the process of multilateral asset freezing, in line with UN resolutions, improving information sharing, and exploring the possibility of broadening the application of new financial tools to disrupt all illicit activity.

Before closing, I want to note that I look forward to meeting later today with G-7 Ministers and our counterparts from Russia and the Broader Middle East and North Africa. This is an important initiative that has generated promising energy. I expect that we will continue our constructive dialogue on how the G8/BMENA partnership can promote job creation, private investment, and economic prosperity.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 16, 2005
js-2385

Statement by the Honorable John W. Snow U.S. Secretary of the Treasury International Monetary and Financial Committee Meeting

As we meet today, the global economic expansion remains on track and the outlook is favorable. Growth remains strong overall, and inflation is moderate. But the world economy faces challenges: high oil prices are a headwind, and global growth is not sufficiently broad-based. This is a time of opportunity for all of us – to act to strengthen growth in our own economies and the international financial system as well.

The United States continues to do its part. Economic growth was 4.4 percent last year, the strongest in five years. The economy has created 3.1 million new jobs since May 2003. Manufacturing production is on the upswing, and a revival in U.S. exports begun in mid-2003 is also contributing to rising output.

The President has made clear the U.S. commitment to strengthen our economy further. This includes reducing the budget deficit – as well as reforming Social Security and the tax system, reducing the regulatory burden on business, and passing energy legislation. We expect the deficit to total 3.5 percent of GDP this fiscal year. Tight controls on discretionary spending and increased revenue as a result of economic expansion are expected to cut the deficit by more than half, to 1.5 percent of GDP, by fiscal year 2009.

But the challenge of strengthening growth is one that we all must take up. The major economies, particularly continental Europe and Japan, need to act more resolutely to increase economic potential. The G-7 Agenda for Growth has helped boost the priority on structural reforms and supply-side policies. Progress is being made, but far more remains to be done. Such steps to increase growth, along with deficit reduction in the United States, and greater and more widespread exchange rate flexibility, particularly in emerging Asia, are key to fulfilling the international community's shared responsibility to promote global adjustment. In this latter regard, through its mandate to exercise surveillance over members' exchange rate policies, the IMF has a continuing central role to play.

Free trade is an essential component of the drive for stronger global economic growth. Completion of the Doha Development Round before the end of 2006 is an important, though challenging, goal. We need to intensify the pace of the negotiations and commit to meeting key milestones along the way. Developed and developing countries alike need to be prepared to reduce their trade barriers and subsidies. Financial services liberalization offers particular promise, and I look for good offers in this area as a key ingredient for a successful conclusion of the Round.

The IMF's Strategic Direction

We are very pleased to see the IMF undertaking a review of its role and strategy for the medium-term. Like any other institution, maintaining the Fund's vitality depends on self-assessment and planning to ensure that it remains sharp and well-focused on its core competencies. The IMF's mission is clear – to foster international monetary cooperation and balance of payments adjustment to support international financial stability and economic growth.

The IMF has a unique opportunity through its surveillance to assess risks, influence policy and prevent crises. The IMF can and must do better in carrying out this function. Surveillance needs to be more focused on the Fund's core areas of expertise – monetary policy, fiscal policy, the balance of payments, exchange rates, and the financial sector. Integrating capital market and financial sector analysis more fully into the daily life of the Fund will also be important to executing more effective surveillance. And for the debt sustainability assessment framework to make its full contribution, this analysis must be separate and distinct from lending decisions.

The United States strongly believes that there is a need for a new tool between surveillance and funded programs to provide for structured engagement with the IMF in the absence of a need for borrowing. Such a policy monitoring arrangement would be voluntary and country-led and would allow for close engagement between IMF staff and authorities as they work to enhance the macroeconomic policy framework and strengthen macroeconomic institutions. I understand a number of countries have expressed interest in such a tool and urge the Committee to endorse creation of a policy monitoring arrangement today.

The IMF and World Bank's Financial Sector Assessment Program (FSAP) has been very successful, helping authorities become better aware of potential vulnerabilities and contributing to improved financial sector supervision in a number of countries. We look forward to further improvements in coordination on this issue. We also underscore the importance of the ongoing work on standards and codes, including the provision of technical assistance to facilitate adherence, as part of the work to strengthen surveillance. We welcome the recent review of remittances issues in the World Economic Outlook. Remittances provide a stable flow of funds that impact development, and we urge continued Fund attention to this issue.

The strategic review is an important exercise for refining the IMF's role and priorities. This will help guide the effort to modernize the IMF's operations and help align its limited resources to deliver results. We welcome the progress being made in updating the IMF's compensation and personnel management systems and look forward to further work in this area. The review of IMF finances that is now underway is also critical to our shared goal of equipping the Fund for the future. Accelerated accumulation of IMF reserves remains appropriate, given today's modern capital markets. Increased incentives for rapid repayment of the Fund would be a step forward.

The IMF's Role in Low-Income Countries

The Bush Administration believes that good economic policy is the fundamental prerequisite for economic growth and poverty reduction, and we are committed to working with low-income countries to develop strong policies. All of us support these goals. The international debate should focus on how to achieve results.

We are convinced that the IMF has a critical role to play in low-income countries. Macroeconomic stability is a necessary but not sufficient condition for growth, and engaging low-income countries to achieve this goal – through policy advice, technical assistance, surveillance, and lending – is a vital part of the IMF's mission.

However, we believe that the rationale for IMF engagement in low-income countries needs to be better articulated with a view to achieving better results. The standards for reform need to be higher. Moreover, the distinction between macroeconomic support and development finance must be far better clarified, for example to permit the PRGF to address short-term adjustment needs, as the General Resources Account meets such needs for middle-income country borrowers. The IMF's existing financing facilities could be sufficient to meet the diverse needs of low-income borrowers if the PRGF were made more flexible. We believe that the proposed policy monitoring arrangement could be particularly helpful for low-income countries that have progressed through stabilization and no longer need to rely on IMF financing. Countries with a PMA would be well-positioned to have access to PRGF financing should country circumstances change.

Helping low-income countries depends on ending the lend-and-forgive cycle and moving into an era of sustainable debt. We applaud the implementation of the new debt sustainability framework (DSA), and encourage the Fund and other lenders to consider how to integrate the goals of the new framework into their own operations. Effective implementation of the new DSA framework, along with increased use of grants in IDA and the AfDF, as well as further bilateral and multilateral debt relief in those institutions for the HIPC countries, can provide a clear path to end the cycle of repeat lending and debt problems holding back the poorest countries. We are not persuaded by arguments for IMF debt relief, and we do not believe market or "off-market" gold sales are necessary or warranted.

Modernizing the IMF's Governance

Last fall in my statement to this group I emphasized that the IMF is a financial and shareholder institution whose governance should evolve along with the world economy so that countries' positions better reflect their global weights and so that all members are more effectively represented. At that time, I underscored the reality that change in the world economy has outpaced that at the IMF, particularly given fast-paced GDP growth in emerging market economies and the advent of currency union in Europe. The IMF should recognize the enormous strides made by many fast-growing countries, particularly in Asia.

We believe the time is ripe to start considering how to address these inter-related issues. The IMF's liquidity is at an all-time high. But the fact that the IMF does not need an increase in its resources need not impede change. A rebalancing of quotas from "over-represented" countries to the "under-represented" within the existing total could yield substantial progress. This will not be an easy task, but it can be achieved with boldness and vision to help modernize the Fund.

These are clearly complex issues, and careful consideration and consultation is needed to address the full range of concerns. This is important to preserving the global character of the IMF, so that all countries feel they have a rightful stake in the institution.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 16, 2005
JS-2386

Secretary Snow G8/BMENA statement

Today I attended a meeting with my colleagues from the G8, the Broader Middle East and North Africa (BMENA) and key international institutions. We continued what has developed into an energetic dialogue on how we can harness more economic freedom to bring greater prosperity in the region. More than ever, I was impressed by the consensus that the region must lead the reform effort and encouraged by the building momentum for market-oriented reform. Many countries spoke of new reforms and plans; Egypt's Minister Moheildin spoke particularly impressively.

Our discussion also focused on the progress on the several pragmatic initiatives of the G8/BMENA partnership. Ministers welcomed the first meeting of the Network of Funds -- a collaborative initiative amongst multilateral and regional financial institutions to better coordinate development finance and provide policy advice to governments. I joined my colleagues in thanking the Arab Monetary Fund for leading the initiative and in looking forward to a concrete work program for these efforts at our next meeting.

My fellow ministers and I were pleased to hear about the progress made on the Private Enterprise Partnership facility of the International Finance Corporation. This initiative is already providing valuable technical assistance to governments, financial institutions and small businesses in support of more vibrant private sectors in BMENA countries. The region's governments stress that private sector growth is the best means to meet the job aspirations of their growing young populations. The IFC is setting measurable output targets for itself in the implementation of its project activities. I supported this and encouraged the IFC to achieve these targets. I am also very encouraged by the financial support for this initiative coming from the region; I thanked Kuwait and the Islamic Development Bank in particular.

We recognized the good work of the Consultative Group to Assist the Poor (CGAP) in promoting best-practice microfinance in the region through programs supported by the G8/BMENA partnership. CGAP is continuing with assessment missions throughout the region and has established a microfinance training center in Jordan.

The World Bank presented its excellent work on the investment climate in the region. Doing more to welcome private investment – both domestic and foreign – is a key to more rapid growth and job creation. This presentation was complemented by a presentation by Mr. Shafik Gabr, an Egyptian businessman and head of the Arab Business Council. This Council is also spearheading a private sector and G8/BMENA initiative – the Investment Task Force. Together with the regional governments and the OECD, the task force is working on investment policy reform. Ministers look forward to continuing our dialogue on these issues.

We agreed to come together again later this year. Our next meeting will be another opportunity to review progress of all these initiatives towards promoting economic prosperity in the region. It is very encouraging to partner with the region and my G8 colleagues in these exciting initiatives.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 17, 2005
JS-2387

U.S. Treasury Secretary John W. Snow World Bank Development Committee Statement

We come together at an important moment in the history of the World Bank. The transition in the leadership of this institution is occurring at a time of tremendous gains in living standards around the world, the depth and breadth of which we have not witnessed in decades. Yet the challenges before us, particularly with respect to Sub-Saharan Africa, have never been clearer. The reports provided to the Development Committee this year, in particular the Global Monitoring Report, reflect the enormity, complexity and profundity of the road ahead.

The Primacy of Growth
Economic growth, led by the private sector, is the most effective means of promoting sustainable development and reducing poverty. Therefore, with the United States and China leading the way, 2004 was enormously important to the development aspirations of the world's poor, with growth of 5.1%. Moreover, world economic growth continues to be strong overall and the outlook for this year and next is very positive. We are particularly pleased to see the strong results in emerging market and sub-Saharan African economies and a strong recovery in Latin America led by private consumption and business investment. We note that while increased growth rates in sub-Saharan Africa are welcome, high and sustained growth rates are needed over an extended period of time to reduce poverty significantly.

The Role of ODA
We recognize that official development assistance can play a critical role in economic and social development, particularly in assisting those who have shown the capacity and willingness to use aid effectively. The Monterrey Consensus exemplifies this approach for it recognizes that aid can complement other sources of financing for development, especially in those countries with the least capacity to attract private direct investment and other sources of financing.

The United States has already followed through on our Monterrey promise to increase official development assistance by 50 percent over the 2000 levels by 2006. This commitment was met in 2003, three years ahead of schedule. In 2004, our ODA increased another $2.7 billion to reach $19 billion, a near doubling since 2000. These dramatic increases illustrate that we do not need to resort to innovative financing mechanisms to deliver critical resources to developing countries. Moreover, our assistance to sub-Saharan Africa has tripled over this period and it is on track to increase even further. The first Millennium Challenge Corporation compact, with Madagascar, has been approved and another seven of the other 16 eligible countries are from sub-Saharan Africa. With respect to HIV/AIDS, President Bush has requested nearly $3.2 billion in FY06 from our Congress, which would represent the third year of steadily increasing funding toward the President's pledge of $15 billion in 5 years. We are committed to reach our goals of preventing 7 million new infections, supporting treatment for 2 million people, and caring for 10 million people, including orphans and vulnerable children.

With respect to the multilateral development banks, we are pleased to have participated in the successful conclusions to the IDA-14, AsDF-9 and AfDF-10 replenishments. We are particularly pleased with donors' leadership in: improving transparency and accountability at the World Bank; implementing a robust measurable results system; and substantially increasing grant financing for poor countries which will have lasting effects. In this manner, these replenishments will strengthen the institutions not just in terms of financial capacity, but also in terms of delivering effective assistance on the ground.

Aid is most effective when it is aligned with recipients' priorities, when it reduces transaction costs through harmonized procedures and donor coordination, and when there is a clearer focus on managing for results. The Paris High Level Forum was a significant step toward action on harmonization and alignment, and we look forward to further progress on aid effectiveness as donors implement the Paris Declaration. We also welcome the IDA-14 results measurement framework and believe it can serve as a model for bilateral and multilateral donors alike.

Other Financial Flows

While ODA can play a critical role in advancing efforts to attain our common development goals, it is just one part of the total picture. In fact, private sector resources – both domestic and international - dwarf traditional development assistance. From an international policy perspective, two areas in particular hold great promise for developing countries, trade and remittances.

The U.S. government strongly supports multilateral, reciprocal trade liberalization under the Doha Development Agenda and is working toward that goal. An ambitious result to liberalize agriculture, industrial and consumer goods, and services would promote growth and development. We believe the Bank and the Fund should continue to emphasize the gains from liberalizing trade, not only with respect to the policies and practices of developed countries, but also the benefits accruing to developing countries from taking action to liberalizing their own barriers. In today's global economy, an internationally competitive services sector, including financial services, is essential. A World Bank study found that countries with fully open financial services sectors grow 1.0% faster, on average, than other countries. Another study suggests that financial development alleviates poverty beyond its affect on aggregate growth. Thus, financial sector liberalization can have a disproportionately positive effect on the poor and should be a primary component of national development strategies. There is also an urgent need for greater support for trade capacity building. The U.S. has provided substantial bilateral assistance for trade-related capacity building, and we would like to see more mainstreaming of such support by the World Bank and other international organizations.

As we have noted before, remittance flows can be a critical contributor to poverty reduction and locally-driven private sector-led growth. Global remittances have grown dramatically in recent years, climbing to an estimated $126 billion in 2004. Despite technological advances, the vast majority of remittance flows continue to travel through slow and/or expensive formal channels or informal networks. The World Bank has been leading the international effort to improve remittance statistics, identify barriers to the provision of competitive remittance services, develop strategies to address those impediments, and enhance the development impact of remittance flows. We urge the Bank to continue its leading role and work closely with member clients, other MDBs and the private sector on this important cross-cutting issue.

Policy Reform

From a domestic perspective, financial flows, official or private, will provide little benefit without the proper foundation for economic growth and prosperity. It is private sector investment, both domestic and foreign, that has historically been the factor that has ensured sustainable growth in developing countries. Firms create jobs, provide goods and services, and contribute to the tax revenues that provide public funding for health and education. The Bank's 2005 World Development Report provided clear evidence that the lack of a conducive climate has been the main impediment to investment in most parts of the developing world. We are pleased that the World Bank is giving increased attention to this issue through its analytical work such as the Doing Business series, and its lending and policy advice. We urge that this issue be given even greater priority in the future.

A number of recent reports have stressed the importance of improved public sector management to development in general, and Sub-Saharan Africa's development in particular. As we have repeatedly stressed in terms of the Bank's internal operations, increased transparency with respect to both fiscal revenues and expenditures, when coupled with increased participation, can help to make institutions more accountable and public spending more responsive to public demand. More attention to this issue is needed. In addition to further information on measurable development results, we suggest a sharply focused Global Monitoring Report for next year devoted to public sector financial management and combating corruption.

Debt Forgiveness
We believe the international community needs to take prudent and appropriate steps to ensure long term debt sustainability for low-income countries. The shift to greater use of grant financing by IDA and the AfDF will help to reduce the continued accumulation of unsustainable debts. However, the existing debt burdens in Heavily Indebted Poor Countries (HIPCs) remain high and will continue to act as a constraint on economic growth for years to come. Consequently, the international community needs to go further by providing up to 100 percent debt stock relief of IDA and AfDF obligations for HIPCs. In addition, those bilateral creditors not providing 100 percent relief on pre-Cologne Summit (June 20, 1999) debt should take steps immediately to do so.

These actions, combined with the new increases in grants going forward, will put these poor countries on a sustainable path immediately. Our proposal not only drops the debt of yesterday, but prevents debt from burdening countries again well into the future. Furthermore, it does so without risking the IFIs' capacity to provide net resource transfers to deserving countries going forward. However, in providing this much needed relief, we must be careful not to divert resources that would otherwise have gone to increase direct aid flows. We must also be careful not to subvert the performance based allocation of resources, which would reduce the delivery of resources to countries where they could be used most effectively.

Sub-Saharan Africa
We strongly support the increased focus of the international development community on the challenges faced in sub-Saharan Africa. This region typifies many of the development challenges that the international community is seeking to remedy. We recognize and support the commendable recent strides made by many of Africa's countries. The average of 5% growth, represents an eight-year high, and 2005 is expected to be at a similar level. Single digit inflation across the continent is another welcome accomplishment which will help create a more stabile macro-environment. These results are the product of improved policies, but also exogenous impacts such as high commodity prices. Given that growth rates higher than 5% are needed to make the desired significant impact in poverty, we urge countries to further deepen reforms and continue efforts underway at macroeconomic stabilization so that higher rates can be achieved in coming years.

Regarding some of the specific changes needed for Africa's growth to accelerate and poverty levels to fall significantly, we strongly support the attention the Global Monitoring Report and the International Financial Institutions have directed towards fiscal management improvements and the structure and quality of public spending, improvements in the enabling business environment – Africa's economic output could increase by more than $70 billion over the next ten years if the average African country's quality of business regulations equaled that of the average OECD country -- and public sector governance. We also welcome the increased attention being paid by a number of African countries to managing for results.

The African Peer Review Mechanism is an important effort designed to catalyze an ownership and accountability culture in all of Africa. Its success depends on all countries taking it seriously. Africa's recent improved growth is also the result of a decrease in conflicts on the continent. The overall trend in reduction in conflict means that businesses can restart, governments should have more funds available for social services and donors will be more inclined to provide assistance. While the trend is positive, continued progress is still needed to make Africa conflict-free. While some of the news in Africa is very positive, it remains a very poor continent, very vulnerable to many types of shocks. While we all would like change in Africa to be as rapid as possible, as the Commission for Africa report states, donors must recognize that in most African countries change will be long, slow and complicated.

Voice and Participation
Governance of the IFIs is a very important issue. The United States attaches a high priority to preserving the global character of these institutions. Careful consideration and consultation is needed to address the complex issues involved and we believe the time is ripe.

Transition
In closing, I would like to praise President Wolfensohn for his extraordinary service during his tenure as President of the World Bank. His many accomplishments – from dealing early-on and forcefully with corruption to his steadfast interest in increasing the focus on the results of the Bank's operations – will have a lasting and

positive impact. We look forward to working with President-designate Wolfowitz as he leads the institution in the fight against poverty through economic growth in furtherance of our common development goals.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 18, 2005
JS-2388

Treasury and IRS Provide Guidance on Pension Plan Amendments

The IRS issued a revenue procedure today that addresses the application of a recent Supreme Court decision relating to pension benefits, Central Laborers' Pension Fund v. Heinz, 541 U.S. 739 (June 7, 2004). This case held that ERISA generally prohibits an amendment that imposes additional conditions on the right to receive early retirement benefits for benefits accrued before the amendment. However, there may be a number of retirement plans that have adopted such an amendment and the retroactive application of the Supreme Court's opinion would put these plans' tax-qualified status in jeopardy as a result of violating the parallel tax-qualification requirement. Recognizing this, the Supreme Court recommended that the IRS use its authority under Internal Revenue Code section 7805(b)(8) to provide relief to plans in order for them to avoid disqualification. The revenue procedure issued today generally provides relief from the risk of disqualification for a suspension of benefits amendment that is not permissible under the Supreme Court decision, assuming that the plan takes corrective action for early and normal retirement benefits retroactive to the June 7, 2004 date of the case.

The text of the revenue procedure is attached. In addition, a detailed example that illustrates compliance with the revenue procedure has been posted on the IRS website at http://www.irs.gov/retirement/article/0,,id=137638,00.html

REPORTS

- Rev. Proc.2005-25

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also Part I, §§ 411, 7805; §§ 1.411(d)-4, 301.7805-1.)

Rev. Proc. 2005-23

SECTION 1. PURPOSE

.01 In general. The purpose of this revenue procedure is to limit the retroactive application of the decision in Central Laborers' Pension Fund v. Heinz, 124 S.Ct. 2230 (June 7, 2004) for retirement plans qualified under § 401(a) of the Internal Revenue Code (Code).

.02 Scope of treatment. With regard to qualified retirement plans that adopted certain amendments before June 7, 2004, section 3 of this revenue procedure generally provides that the Service will not disqualify a plan solely on account of a plan amendment adding or expanding a suspension of benefit provision, as prohibited under Central Laborers'. The treatment under this revenue procedure applies only with respect to amendments described in section 3.01 and not to other plan amendments that may violate § 411(d)(6). The limitation on the retroactive application of Central Laborers' under this revenue procedure has no effect on the rights of any party under section 204(g) of the Employee Retirement Income Security Act of 1974 (ERISA) or any other law.

SECTION 2. BACKGROUND

Section 411 requires a qualified plan to meet certain minimum vesting standards. Under § 411(a), an employee's right to the accrued benefit derived from employer contributions must become nonforfeitable within a specified period of service, and certain other conditions must also be met. Section 411(a)(3) provides circumstances under which an employee's benefit is permitted to be forfeited without violating § 411(a). In particular, § 411(a)(3)(B) provides that a right to an accrued benefit derived from employer contributions is not treated as forfeitable solely because the plan provides that the payment of benefits is suspended for such period as the employee is employed, subsequent to the commencement of payment of such benefits—

(i) in the case of a plan other than a multiemployer plan, by the employer who maintains the plan under which such benefits were being paid; and

(ii) in the case of a multiemployer plan, in the same industry, the same trade or craft, and the same geographic area covered by the plan as when such benefits commenced.

This definition of employment for which benefit payments are permitted to be suspended is further described in 29 CFR § 2530.203-3, which interprets section 203(a)(3)(B) of ERISA, the counterpart to § 411(a)(3)(B) of the Code. Employment that satisfies the conditions described in the statute and regulations is referred to as "section 203(a)(3)(B) service." See 29 CFR § 2530.203-3(c).

Section 411(d)(6)(A) generally provides that a plan is not treated as satisfying the requirements of § 411 if the accrued benefit of a participant is decreased by a plan amendment. Under § 411(d)(6)(B) and regulations thereunder, a plan amendment that has the effect of eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit, with respect to benefits attributable to service before the amendment, is treated as reducing accrued benefits for any employee who satisfies the pre-amendment conditions for that benefit (either before or after the amendment).

Under § 7805(b)(8), the Commissioner is authorized to prescribe the extent, if any, to which a judicial decision relating to the internal revenue laws is to be applied without retroactive effect.

In Central Laborers', the plaintiffs were two inactive participants in the Central Laborers' Pension Fund, a multiemployer pension plan. The two participants commenced payment of their benefits in 1996 after accruing enough pension credits to qualify for early retirement payments under a plan provision that paid them the same monthly benefit they would have received had they commenced payment at normal retirement age. The plan terms required that payments be suspended if a participant engaged in "disqualifying employment." At the time the two participants commenced payment, the plan defined disqualifying employment to include only employment covered by the plan. At that time, employment covered by the plan (and thus, disqualifying employment) did not include work as a construction supervisor, the position in which the two participants were employed after they commenced benefits. Accordingly, the participants' benefit payments were not suspended in 1996. However, in 1998, the plan was amended to expand its definition of disqualifying employment to include any employment in the construction industry in the geographic area covered by the plan, and the plan stopped payments to the two participants on account of their disqualifying employment as construction supervisors. The two participants sued to recover the suspended payments, claiming that the amendment expanding the plan's suspension provisions violated section 204(g) of ERISA (the counterpart to § 411(d)(6) of the Code).

The Supreme Court, holding for the two participants, ruled that section 204(g) prohibits a plan amendment expanding the categories of post-retirement employment that results in suspension of the payment of early retirement benefits already accrued. The Court found that while ERISA permits certain conditions that are elements of the benefit itself (such as suspensions under § 411(a)(3)(B) of the Code or section 203(a)(3)(B) of ERISA), such a condition may not be imposed after a benefit has accrued and that the right to receive benefit payments on a certain date may not be limited by a new condition narrowing that right. The Court agreed with the 7^{th} Circuit that "[a] participant's benefits cannot be understood without reference to the conditions imposed on receiving those benefits, and an amendment placing materially greater restrictions on the receipt of the benefit 'reduces' the benefit just as surely as a decrease in the size of the monthly benefit payment." Central Laborers', 124 S.Ct. at 2235-36, quoting Heinz v. Central Laborers' Pension Fund, 303 F.3d 802, 805 (7^{th} Cir. 2002). However, the Court stated:

> Nothing we hold today requires the IRS to revisit the tax-exempt status in past years of plans that were amended in reliance on the agency's representations in its manual by expanding the categories of work that would trigger suspension of benefit payments as to already-accrued benefits. The Internal Revenue Code gives the Commissioner discretion to decline to apply decisions of this Court retroactively. 26 U.S.C. § 7805(b)(8) . . . This would doubtless be an appropriate occasion for exercise of that discretion.

Central Laborers', 124 S.Ct. at 2238, n.4.

SECTION 3. EXERCISE OF AUTHORITY UNDER § 7805(b)(8)

.01 In general. Pursuant to the Commissioner's authority under § 7805(b)(8), a plan will not be treated as having failed to satisfy the requirements of § 401(a) merely because an amendment adopted before June 7, 2004, violated § 411(d)(6) by adding or expanding a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service. This treatment applies only if a reforming amendment, as described in section 3.02, is adopted and the plan complies operationally with that amendment, as described in sections 3.02, 3.03, and 3.04. For purposes of this revenue procedure, an amendment adopted before June 7, 2004, that violated § 411(d)(6) by adding or expanding a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service is referred to as the original amendment, and the amendment required under section 3.02 is referred to as the reforming amendment. This section 3.01 applies to any such original amendment regardless of whether the amendment provided for a suspension of payment of the accrued benefit or for a suspension of the payment of early retirement benefits or retirement-type subsidies such as those at issue in Central Laborers', and regardless of whether the plan as amended by the original amendment provided that subsequent benefit payments under the plan were actuarially adjusted to take into account the fact that benefits were not paid during the suspension period. For purposes of this revenue procedure, a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service includes a provision that results in a plan not providing actuarial increases as a result of such service after normal retirement age. If a plan has more than one original amendment that violated § 411(d)(6) by adding or expanding a provision under which a suspension of benefits occurs on account of section 203(a)(3)(B) service, this revenue procedure applies separately to each amendment.

.02 Reforming amendment. (1) General requirements. The reforming amendment must provide that, beginning on June 7, 2004, the provisions of the original amendment that suspend benefits do not apply with respect to benefits that had accrued as of the applicable amendment date for the original amendment and must provide certain participants with an option to commence payment of their benefits, as described in section 3.04. For purposes of this revenue procedure, the applicable amendment date for a plan amendment is the later of the effective date of the amendment or the date the amendment is adopted. However, the reforming amendment is permitted to provide that the suspension of benefit provisions of the original amendment will continue to apply with respect to benefits that had accrued after the applicable amendment date for the original amendment. Further, a plan may continue to apply the suspension of benefit provision as in effect immediately prior to the original amendment with respect to all accrued benefits (accruing both before and after the original amendment).

(2) Broader reforming amendments permitted. The reforming amendment is permitted to provide greater benefits to participants than the minimum required under section 3.02(1). For example, in addition to satisfying the minimum requirements of this section 3, a reforming amendment might provide that the suspension of benefit provisions of the original amendment cease to apply beginning on a date earlier than June 7, 2004, and might also provide a corresponding opportunity for participants to apply for retroactive benefits commencing on that earlier date. Similarly, the reforming amendment might apply to the entire accrued benefit of those participants with an accrued benefit on the applicable amendment date of the original amendment, rather than just to benefits that had accrued as of the applicable amendment date, so that the suspension of benefit provisions of the original amendment as reformed only apply to those participants who commence participation after that applicable amendment date.

(3) Effective date and remedial amendment period. The reforming amendment must be effective as of a date not later than June 7, 2004. Section 4 provides a remedial amendment period for the reforming amendment.

.03 Payment of retroactive benefits requirement. (1) In general. In order for a plan to obtain the treatment provided in section 3.01, the reforming amendment described in section 3.02 must provide for the payment of retroactive benefits (beginning as of June 7, 2004, or such earlier date on which the reforming amendment is made effective pursuant to section 3.02(3)) to an affected plan participant (including any appropriate interest or actuarial increase) with respect to benefits that had accrued as of the applicable amendment date for the original amendment. For purposes of this section 3.03, an affected plan participant means (a) a participant who commenced receipt of benefits and whose benefits were suspended on account of the original amendment or (b) a participant who applied to commence benefits, whose application (including the form of payment) was approved, and whose benefits were suspended before payments commenced.

(2) Effective date for retroactive payment of benefits for affected participants. The plan must provide for the payment of retroactive benefits described in section 3.03(1) effective not later than January 1, 2006. The plan must be in operational compliance with the reforming amendment by January 1, 2006, with respect to benefits payable through December 31, 2005, and must maintain compliance for all periods on or after that date.

.04 Option to commence payment. (1) In general. In order for a plan to obtain the treatment provided in section 3.01, a participant described in section 3.04(2) must be given an opportunity to elect retroactively the commencement of payment of benefits as of the first date on which (a) the reforming amendment is made effective and (b) the participant was eligible to commence receipt of benefits. See § 1.417(e)-1 for rules relating to retroactive annuity starting dates.

(2) Eligibility for option. A participant who is eligible for the option described in section 3.04(1) is one who --

(a) at any time after the applicable amendment date of the original amendment, was eligible to commence the receipt of benefits under the plan, determined without regard to the suspension of benefit provisions of the original amendment,

(b) at the same time, engaged in section 203(a)(3)(B) service for which benefits were not permitted to commence, as determined taking into account the original amendment, and

(c) is not an affected participant as defined in section 3.03 (e.g., is a participant who did not apply for benefits).

(3) Election period. The election period for the option set forth in section 3.04(1) begins within a reasonable time period after participants described in section 3.04(2) have received notification of the option in accordance with section 3.04(4) and ends no sooner than six months after notification. Reasonable efforts must be taken to notify all such participants. For those participants not located after a mailing to the last known address, reasonable efforts include the use of the Internal Revenue Service Letter Forwarding Program (see Rev. Proc. 94-22, 1994-1 C.B. 608) or the Social Security Administration Employer Reporting Service.

(4) Notification requirement. The plan must provide notice of the option set forth in section 3.04(1) to each participant described in section 3.04(2). In addition to satisfying any generally applicable notice requirements, the notice of the option to commence payment of benefits must be designed to be readily understandable by the average plan participant. The notice must explain the option to commence retroactive payment of benefits, as described in section 3.04(1), and the period for making the election, as described in section 3.04(3). The notice must be sent on or before January 1, 2006.

.05 Terminated plans. A plan that was terminated with a termination date before June 7, 2004, is not required to adopt a reforming plan amendment or take the actions required in sections 3.02 through 3.05 in order to receive the treatment provided in section 3.01.

SECTION 4. EFFECT ON DETERMINATION LETTERS AND REMEDIAL AMENDMENT PERIOD

For purposes of any previously issued determination letter and for purposes of applying the rules in § 401(b), the Central Laborers' decision constitutes a change in law under § 401(a) that is effective on June 7, 2004 (the date of the Central Laborers' decision). Thus, if a favorable determination letter was issued with respect to a plan amendment that is adversely affected by the Central Laborers' decision, the plan sponsor cannot rely on the determination letter from and after June 7, 2004.[1] Further, a plan provision that is an original amendment as defined in section 3.01 is designated under § 1.401(b)-1(b)(3)(i) as a disqualifying provision resulting from a change in the qualification requirements under § 401(a). The last day of the remedial amendment period for this disqualifying provision is the same as the last day of the EGTRRA remedial amendment period for the plan.[2]

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[1] See section 21 of Rev. Proc. 2005-6, 2005-1 I.R.B. 200.

[2] Pursuant to Notice 2001-42, 2001-2 C.B. 70, the EGTRRA remedial amendment period will not end earlier than December 31, 2005. Announcement 2004-71, 2004-40 I.R.B. 569, includes a proposed revenue procedure which, if finalized, would extend this remedial amendment period.

SECTION 5. PROPOSED REGULATION

The Treasury Department and the Service intend to propose regulations that reflect the holding in Central Laborers'. It is expected that the proposed regulations will provide guidance on when an amendment may add a benefit entitlement condition that is permitted under the vesting rules (e.g., a condition described in § 411(a)(3)) with respect to benefits accrued before the date of the amendment. It is further expected that, with respect to the types of benefits protected under § 411(d)(6), the proposed regulations will provide that such an amendment is not permitted with respect to benefits accrued before the applicable amendment date, but is permitted to the extent that the amendment applies with respect to benefits accrued after the applicable amendment date.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective April 18, 2005.

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1938.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 3.04(4). This information is required to notify certain participants of the opportunity to elect retroactively the commencement of benefits. The collection of information is required to obtain a benefit. The likely respondents are retirement plan sponsors, administrators, and trustees.

The estimated total annual reporting and/or recordkeeping burden is 142,500 hours.

The estimated annual burden per respondent/recordkeeper varies from 250 hours to 750 hours, depending on individual circumstances, with an estimated average of 500 hours. The estimated number of respondents and/or recordkeepers is 285.

The estimated annual frequency of responses (used for reporting requirements only) is one.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Kathleen J. Herrmann and Diane S. Bloom of the Employee Plans, Tax Exempt and Government Entities Division. Ms. Herrmann may be reached at (202) 283-9888 (not a toll-free number).

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 202-622-2960
FFB 202-622-2450

FEDERAL FINANCING BANK April 2005

Brian D. Jackson, Chief Financial Officer, Federal Financing Bank (FFB) announced the following activity for the month of March 2005.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $27.4 billion on March 31, 2005, posting a decrease of $716.8 million from the level on February 28, 2005. This net change was the result of decreases in holdings of agency assets of $535.0 million and in net holdings of government-guaranteed loans of $181.8 million. The FFB made 31 disbursements and received 35 prepayments during the month of March. The FFB also extended the maturities of 210 loans guaranteed by the Rural Utilities Service ("RUS") during the month.

Attached to this release are tables presenting FFB March loan activity and FFB holdings as of March 31, 2005.

JS-2389

FEDERAL FINANCING BANK
MARCH 2005 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
GOVERNMENT-GUARANTEED LOANS				
GENERAL SERVICES ADMINISTRATION				
San Francisco OB	3/01	$55,897.68	8/01/05	3.086% S/A
San Francisco OB	3/09	$34,363.79	8/01/05	3.058% S/A
San Francisco OB	3/11	$49,363.79	8/01/05	3.061% S/A
San Francisco OB	3/18	$146,865.36	8/01/05	3.073% S/A
RURAL UTILITIES SERVICE				
Central Georgia Elec. #2010	3/01	$2,779,000.00	6/30/10	4.003% Qtr.
West Carolina Tele. #406	3/01	$3,830,197.00	1/02/29	4.720% Qtr.
Baldwin Telecom, Inc. #2192	3/03	$6,888,386.33	12/31/15	4.135% Qtr.
Roanoke Electric Mem. #820	3/03	$500,000.00	12/31/36	4.670% Qtr.
Decatur County #2188	3/07	$2,000,000.00	12/31/36	4.597% Qtr.
Valley Rural Elec. Coop. #884	3/07	$2,500,000.00	12/31/36	4.596% Qtr.
Little Ocmulgee Electric #816	3/08	$2,200,000.00	12/31/36	4.573% Qtr.
Darien Telephone Co. #719	3/10	$333,000.00	6/30/05	2.822% Qtr.
Pemiscot-Dunklin Elec. #853	3/10	$500,000.00	12/31/36	4.781% Qtr.
Brazos Electric #2086	3/11	$9,450,000.00	6/30/05	2.804% Qtr.
Northern Electric #666	3/11	$1,187,000.00	1/02/35	4.705% Qtr.
Ravalli #641	3/11	$964,800.00	12/31/29	4.680% Qtr.
Gunnison County Electric #2036	3/15	$500,000.00	12/31/36	4.746% Qtr.
United Power Assoc. #721	3/16	$6,000,000.00	12/31/30	4.706% Qtr.
Hamilton County Elec. #2129	3/17	$1,400,000.00	12/31/37	4.756% Qtr.
Minnkota Power #2115	3/18	$4,753,000.00	1/02/29	4.683% Qtr.
Missouri Rural Elec. #2120	3/21	$400,000.00	1/03/39	4.726% Qtr.
Red River Rural Tel. #2113	3/21	$560,000.00	6/30/05	2.838% Qtr.
Johnson County Elec. #2085	3/24	$1,000,000.00	12/31/37	4.836% Qtr.
Central Iowa Power Coop. #2094	3/25	$1,500,000.00	12/31/31	4.765% Qtr.
Cental Virginia Elec. #2126	3/25	$1,000,000.00	1/03/39	4.818% Qtr.
Blue Ridge Elec. #897	3/28	$2,000,000.00	12/31/36	4.819% Qtr.
Cotton Electric Coop #2038	3/28	$1,362,000.00	12/31/37	4.818% Qtr.
Oneida-Madison Elec. #2144	3/28	$164,000.00	1/03/39	4.782% Qtr.
York Electric Coop. #848	3/28	$3,100,000.00	12/31/31	4.816% Qtr.
*Adams Rural Electric #706	3/31	$480,467.74	6/30/05	2.828% Qtr.
*Adams Rural Electric #706	3/31	$480,673.68	6/30/05	2.828% Qtr.
*Adams Rural Electric #706	3/31	$623,214.31	6/30/05	2.828% Qtr.
*Amicalola Electric #664	3/31	$4,685,699.48	1/02/35	4.776% Qtr.
*Amicalola Electric #664	3/31	$6,507,986.80	1/02/35	4.776% Qtr.
*Atlantic Telephone Mem. #805	3/31	$5,395,898.42	6/30/05	2.828% Qtr.
*Bailey County Elec. #856	3/31	$1,839,111.04	6/30/05	2.828% Qtr.
*Bailey County Elec. #856	3/31	$596,547.11	6/30/05	2.828% Qtr.
*Bailey County Elec. #856	3/31	$727,634.04	6/30/05	2.828% Qtr.

FEDERAL FINANCING BANK
MARCH 2005 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
*Big Sand Elec. #540	3/31	$727,928.57	6/30/05	2.828% Qtr.
*Big Sand Elec. #540	3/31	$545,946.41	6/30/05	2.828% Qtr.
*Big Sand Elec. #540	3/31	$912,703.84	6/30/05	2.828% Qtr.
*Big Sand Elec. #540	3/31	$2,122,708.67	6/30/05	2.828% Qtr.
*Big Sand Elec. #540	3/31	$2,651,742.86	6/30/05	2.828% Qtr.
*Blue Grass Energy #674	3/31	$4,688,545.66	6/30/05	2.828% Qtr.
*Blue Grass Energy #674	3/31	$1,873,086.10	6/30/05	2.828% Qtr.
*Blue Grass Energy #674	3/31	$4,773,015.29	6/30/05	2.828% Qtr.
*Blue Grass Energy #674	3/31	$4,871,789.35	6/30/05	2.828% Qtr.
*Blue Grass Energy #674	3/31	$2,832,990.86	6/30/05	2.828% Qtr.
*Brazos Electric #561	3/31	$9,418,184.41	12/31/24	4.679% Qtr.
*Brazos Electric #2086	3/31	$5,000,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2086	3/31	$5,000,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2086	3/31	$5,000,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2086	3/31	$5,000,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2086	3/31	$5,000,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2086	3/31	$3,200,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2181	3/31	$20,000,000.00	3/31/25	4.708% Qtr.
*Brazos Electric #2181	3/31	$8,186,000.00	3/31/25	4.708% Qtr.
*Brazos Electric #2182	3/31	$5,000,000.00	4/02/35	4.770% Qtr.
*Brazos Electric #2182	3/31	$2,180,000.00	4/02/35	4.770% Qtr.
*Brown County Elec. #687	3/31	$232,755.60	6/30/05	2.828% Qtr.
*Brown County Elec. #687	3/31	$558,613.50	6/30/05	2.828% Qtr.
*Brown County Elec. #687	3/31	$279,351.76	6/30/05	2.828% Qtr.
*Brown County Elec. #687	3/31	$438,484.91	6/30/05	2.828% Qtr.
*Brown County Elec. #687	3/31	$345,673.97	6/30/05	2.828% Qtr.
*Central Texas Elec. #523	3/31	$469,101.25	1/03/33	4.778% Qtr.
*Citizens Tel (VA) #680	3/31	$1,404,877.89	6/30/05	2.828% Qtr.
*Citizens Tel (VA) #680	3/31	$691,292.68	6/30/05	2.828% Qtr.
*Clark Energy Coop. #611	3/31	$2,738,111.54	6/30/05	2.828% Qtr.
*Clark Energy Coop. #611	3/31	$1,819,544.08	6/30/05	2.828% Qtr.
*Clark Energy Coop. #611	3/31	$4,060,671.09	6/30/05	2.828% Qtr.
*Clark Energy Coop. #611	3/31	$3,395,922.06	6/30/05	2.828% Qtr.
*Clark Energy Coop. #611	3/31	$2,459,816.75	6/30/05	2.828% Qtr.
*Clark Energy Coop. #2087	3/31	$2,500,000.00	6/30/05	2.828% Qtr.
*Clark Energy Coop. #2087	3/31	$2,500,000.00	6/30/05	2.828% Qtr.
*Clark Energy Coop. #2087	3/31	$1,000,000.00	6/30/05	2.828% Qtr.
*Clark Energy Coop. #2087	3/31	$1,845,000.00	6/30/05	2.828% Qtr.
*Cumberland Valley #668	3/31	$3,910,294.50	6/30/05	2.828% Qtr.
*Cumberland Valley #668	3/31	$4,696,258.12	6/30/05	2.828% Qtr.
*Cumberland Valley #2118	3/31	$2,200,000.00	6/30/05	2.828% Qtr.
*Cooper Valley Tel. #648	3/31	$897,352.21	6/30/05	2.828% Qtr.
*Cooper Valley Tel. #648	3/31	$204,191.74	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$1,588,579.34	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$365,947.96	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$176,380.34	6/30/05	2.828% Qtr.

FEDERAL FINANCING BANK
MARCH 2005 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
*Darien Telephone Co. #719	3/31	$208,524.41	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$151,654.10	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$225,008.56	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$185,283.61	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$1,259,112.46	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$234,902.12	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$463,522.68	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$337,621.91	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$418,411.88	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$587,452.04	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$658,324.64	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$705,385.22	6/30/05	2.828% Qtr.
*Darien Telephone Co. #719	3/31	$538,790.30	6/30/05	2.828% Qtr.
*East River Power #453	3/31	$350,265.49	6/30/05	2.953% Qtr.
*East River Power #453	3/31	$172,740.28	6/30/05	2.953% Qtr.
*East River Power #601	3/31	$2,954,879.41	12/31/19	4.521% Qtr.
*East River Power #793	3/31	$600,041.72	1/02/35	4.776% Qtr.
*Fairfield Elec. #684	3/31	$3,010,682.98	6/30/05	2.828% Qtr.
*Fairfield Elec. #684	3/31	$88,292.64	6/30/05	2.828% Qtr.
*Farmer's Rural Elec. #2046	3/31	$5,000,000.00	12/31/37	4.770% Qtr.
*Farmer's Rural Elec. #2046	3/31	$1,000,000.00	12/31/37	4.770% Qtr.
*Farmer's Rural Elec. #2046	3/31	$1,000,000.00	12/31/37	4.770% Qtr.
*Farmer's Rural Elec. #2046	3/31	$2,000,000.00	12/31/37	4.770% Qtr.
*Farmer's Telephone #459	3/31	$19,034.66	6/30/05	2.953% Qtr.
*Farmer's Telephone #459	3/31	$179,627.46	6/30/05	2.953% Qtr.
*Fleming-Mason Energy #644	3/31	$2,373,030.00	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$1,277,785.35	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$1,369,055.78	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$2,007,948.46	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$1,277,785.35	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$2,768,742.09	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$2,743,847.19	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$2,899,174.67	6/30/05	2.828% Qtr.
*Fleming-Mason Energy #644	3/31	$2,407,405.73	6/30/05	2.828% Qtr.
*Farmers Telephone #476	3/31	$8,360,801.25	6/30/05	2.953% Qtr.
*Farmers Telephone #476	3/31	$6,228,200.14	6/30/05	2.953% Qtr.
*Farmers Telephone #476	3/31	$4,836,535.08	6/30/05	2.953% Qtr.
*Farmers Telephone #476	3/31	$4,320,816.01	6/30/05	2.953% Qtr.
*FTC Communications #709	3/31	$2,312,864.46	6/30/05	2.828% Qtr.
*FTC Communications #709	3/31	$2,957,940.31	6/30/05	2.828% Qtr.
*FTC Communications #709	3/31	$1,042,378.13	6/30/05	2.828% Qtr.
*FTC Communications #709	3/31	$1,241,989.22	6/30/05	2.828% Qtr.
*FTC Communications #2101	3/31	$425,179.00	6/30/05	2.828% Qtr.
*Georgia Trans. Corp. #446	3/31	$9,098,723.51	1/02/18	4.446% Qtr.
*Grayson Rural Elec. #619	3/31	$1,095,244.63	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$547,622.32	6/30/05	2.828% Qtr.

FEDERAL FINANCING BANK
MARCH 2005 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
*Grayson Rural Elec. #619	3/31	$912,703.84	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$1,182,435.93	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$934,002.49	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$2,365,382.05	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$966,391.57	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$987,150.88	6/30/05	2.828% Qtr.
*Grayson Rural Elec. #619	3/31	$1,663,911.58	6/30/05	2.828% Qtr.
*Greenbelt Elec. #743	3/31	$1,652,056.93	6/30/05	2.828% Qtr.
*Greenbelt Elec. #743	3/31	$476,901.99	6/30/05	2.828% Qtr.
*Greenbelt Elec. #743	3/31	$698,925.28	6/30/05	2.828% Qtr.
*Grundy Elec.Coop. #744	3/31	$1,180,135.41	6/30/05	2.828% Qtr.
*Grundy Elec.Coop. #744	3/31	$944,235.45	6/30/05	2.828% Qtr.
*Grundy Elec.Coop. #744	3/31	$481,216.17	6/30/05	2.828% Qtr.
*Grundy Elec.Coop. #744	3/31	$487,683.47	6/30/05	2.828% Qtr.
*Grundy County Elec. #689	3/31	$193,531.81	6/30/05	2.828% Qtr.
*Harrison County #532	3/31	$908,992.16	6/30/05	2.828% Qtr.
*Harrison County #532	3/31	$818,092.96	6/30/05	2.828% Qtr.
*Harrison County #532	3/31	$915,124.84	6/30/05	2.828% Qtr.
*Harrison County #532	3/31	$1,492,257.93	6/30/05	2.828% Qtr.
*Harrison County #532	3/31	$1,606,597.72	6/30/05	2.828% Qtr.
*Hudson Valley Datanet #833	3/31	$4,739,718.35	6/30/05	2.828% Qtr.
*Hudson Valley Datanet #833	3/31	$3,454,200.00	6/30/05	2.828% Qtr.
*Hudson Valley Datanet #833	3/31	$1,895,887.34	6/30/05	2.828% Qtr.
*Inter-County Energy #592	3/31	$1,363,488.23	6/30/05	2.828% Qtr.
*Inter-County Energy #592	3/31	$1,817,984.33	6/30/05	2.828% Qtr.
*Inter-County Energy #592	3/31	$2,369,742.55	6/30/05	2.828% Qtr.
*Inter-County Energy #592	3/31	$201,707.54	6/30/05	2.828% Qtr.
*Inter-County Energy #850	3/31	$3,879,981.11	6/30/05	2.828% Qtr.
*Inter-County Energy #850	3/31	$1,939,990.54	6/30/05	2.828% Qtr.
*Inter-County Energy #850	3/31	$1,940,112.42	6/30/05	2.828% Qtr.
*Inter-County Energy #850	3/31	$3,442,070.62	6/30/05	2.828% Qtr.
*Ironton Telephone Co. #888	3/31	$3,065,606.99	6/30/05	2.828% Qtr.
*Ironton Telephone Co. #2051	3/31	$2,956,000.00	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$3,800,015.98	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$2,850,011.98	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$4,465,018.77	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$1,900,007.98	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$2,375,009.97	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$1,900,065.62	6/30/05	2.828% Qtr.
*Jackson Energy #794	3/31	$7,073,400.68	6/30/05	2.828% Qtr.
*Jackson Energy #2133	3/31	$3,000,000.00	6/30/05	2.828% Qtr.
*Jackson Energy #2133	3/31	$5,000,000.00	6/30/05	2.828% Qtr.
*Karnes Elec. #568	3/31	$1,319,091.34	1/03/34	4.777% Qtr.
*Kenergy Corp. #2068	3/31	$6,000,000.00	6/30/05	2.828% Qtr.
*Kenergy Corp. #2068	3/31	$5,000,000.00	6/30/05	2.828% Qtr.
*Licking Valley Elec. #522	3/31	$2,498,819.45	6/30/05	2.828% Qtr.

FEDERAL FINANCING BANK
MARCH 2005 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
*Licking Valley Elec. #854	3/31	$1,952,656.14	6/30/05	2.828% Qtr.
*Magnolia Electric #560	3/31	$4,555,150.26	6/30/05	2.953% Qtr.
*North Carolina RSA 3 Tel #2009	3/31	$9,280,597.96	6/30/05	2.828% Qtr.
*North Carolina RSA 3 Tel #2009	3/31	$4,586,262.69	6/30/05	2.828% Qtr.
*North Carolina RSA 3 Tel #2009	3/31	$5,374,845.73	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$1,960,524.78	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$1,325,809.50	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$1,625,279.55	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$996,760.99	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$970,898.72	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$1,456,369.33	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$978,984.19	6/30/05	2.828% Qtr.
*New Horizon Elec. #791	3/31	$2,680,543.91	6/30/05	2.828% Qtr.
*Nolin Rural Elec. #528	3/31	$1,720,722.13	6/30/05	2.828% Qtr.
*Nolin Rural Elec. #577	3/31	$2,347,926.77	6/30/05	2.828% Qtr.
*Nolin Rural Elec. #577	3/31	$2,347,926.77	6/30/05	2.828% Qtr.
*Nolin Rural Elec. #840	3/31	$3,879,981.11	6/30/05	2.828% Qtr.
*Nolin Rural Elec. #840	3/31	$2,859,546.07	6/30/05	2.828% Qtr.
*Northstar Technology #811	3/31	$1,656,885.05	6/30/05	2.828% Qtr.
*Northstar Technology #811	3/31	$903,677.27	6/30/05	2.828% Qtr.
*Owen Electric #525	3/31	$1,820,522.55	6/30/05	2.828% Qtr.
*Owen Electric #525	3/31	$1,816,845.96	6/30/05	2.828% Qtr.
*Owen Electric #525	3/31	$916,631.74	6/30/05	2.828% Qtr.
*Owen Electric #525	3/31	$1,848,491.57	6/30/05	2.828% Qtr.
*Owen Electric #525	3/31	$1,883,427.11	6/30/05	2.828% Qtr.
*Owen Electric #525	3/31	$3,111,909.06	6/30/05	2.828% Qtr.
*Pennyrile Elec. #513	3/31	$5,561,468.46	6/30/05	2.953% Qtr.
*Pennyrile Elec. #513	3/31	$5,264,595.47	6/30/05	2.953% Qtr.
*Piedmont Rural Telephone #2002	3/31	$2,286,217.57	6/30/05	2.828% Qtr.
*PRTCommunications #798	3/31	$4,338,870.44	6/30/05	2.828% Qtr.
*PRTCommunications #798	3/31	$1,626,398.75	6/30/05	2.828% Qtr.
*PRTCommunications #798	3/31	$722,608.47	6/30/05	2.828% Qtr.
*PRTCommunications #798	3/31	$966,666.67	6/30/05	2.828% Qtr.
*Red River Valley Elec. #2095	3/31	$3,000,000.00	12/31/37	4.770% Qtr.
*Red River Rural Tel. #2113	3/31	$400,000.00	1/03/23	4.623% Qtr.
*Runestone Electric Ass. #886	3/31	$1,464,492.11	12/31/36	4.772% Qtr.
*Runestone Electric Ass. #886	3/31	$341,727.59	12/31/36	4.772% Qtr.
*Runestone Electric Ass. #886	3/31	$988,696.52	12/31/36	4.772% Qtr.
Runestone Electric Ass. #886	3/31	$750,000.00	12/31/36	4.772% Qtr.
*San Miguel Electric #919	3/31	$6,539,720.39	6/30/05	2.828% Qtr.
*San Miguel Electric #919	3/31	$6,866,782.93	6/30/05	2.828% Qtr.
*Southeastern Indiana #2062	3/31	$2,650,000.00	6/30/05	2.828% Qtr.
*Southeastern Indiana #2062	3/31	$2,650,000.00	6/30/05	2.828% Qtr.
*Southeastern Indiana #2062	3/31	$3,700,000.00	6/30/05	2.828% Qtr.
*Southeastern Indiana #2062	3/31	$2,000,000.00	6/30/05	2.828% Qtr.
*Socorro Elec. #869	3/31	$1,254,579.18	6/30/05	2.828% Qtr.

FEDERAL FINANCING BANK
MARCH 2005 ACTIVITY

Borrower	Date	Amount of Advance	Final Maturity	Interest Rate
Surry-Yadkin Elec. #534	3/31	$888,691.95	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$888,691.95	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$444,345.99	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$888,691.95	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$888,691.95	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$903,262.58	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$909,142.81	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #534	3/31	$2,100,202.65	6/30/05	2.828% Qtr.
Surry-Yadkin Elec. #852	3/31	$976,328.07	6/30/05	2.828% Qtr.
*Surry-Yadkin Elec. #852	3/31	$1,952,656.14	6/30/05	2.828% Qtr.
*Surry-Yadkin Elec. #852	3/31	$488,164.03	6/30/05	2.828% Qtr.
*Surry-Yadkin Elec. #852	3/31	$1,988,722.34	6/30/05	2.828% Qtr.
*Tri-County Electric Ass. #830	3/31	$488,415.76	6/30/05	2.828% Qtr.
*Tri-County Electric Ass. #830	3/31	$499,582.89	6/30/05	2.828% Qtr.
*Twin Valley-Ulen Tel. #2177	3/31	$8,164,237.63	6/30/05	2.828% Qtr.
*Virgin Islands Telephone #2089	3/31	$64,655,000.00	6/30/05	2.828% Qtr.
W. Farmers Elec. Coop. #701	3/31	$615,000.00	12/31/25	4.703% Qtr.
*Webster Electric #705	3/31	$2,050,749.10	6/30/05	2.828% Qtr.
*West Plains Elec. #501	3/31	$2,139,063.17	6/30/05	2.953% Qtr.

S/A is a Semiannual rate.
Qtr. is a Quarterly rate.
* maturity extension or interest rate reset

FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	March 31, 2005	February 28, 2005	Monthly Net Change 3/1/05- 3/31/05	Fiscal Year Net Change 10/1/04- 3/31/05
SOT				
Agency Debt:				
U.S. Postal Service	$0.0	$0.0	$0.0	-$1,800.0
Subtotal*	$0.0	$0.0	$0.0	-$1,800.0
Agency Assets:				
FmHA-RDIF	$85.0	$170.0	-$85.0	-$115.0
FmHA-RHIF	$230.0	$680.0	-$450.0	-$450.0
Rural Utilities Service-CBO	$4,270.2	$4,270.2	$0.0	$0.0
Subtotal*	$4,585.2	$5,120.2	-$535.0	-$565.0
Government-Guaranteed Lending:				
DOD-Foreign Military Sales	$1,354.7	$1,365.6	-$10.9	-$110.2
DoEd-HBCU+	$119.5	$119.7	-$0.2	$1.5
DHUD-Community Dev. Block Grant	$0.2	$0.2	$0.0	-$0.2
DHUD-Public Housing Notes	$971.9	$971.9	$0.0	-$82.9
General Services Administration+	$2,139.4	$2,141.9	-$2.5	-$1.9
DOI-Virgin Islands	$6.1	$6.1	$0.0	-$1.5
DON-Ship Lease Financing	$487.7	$487.7	$0.0	-$10.9
Rural Utilities Service	$17,693.0	$17,859.9	-$166.8	$732.0
SBA-State/Local Development Cos.	$47.1	$48.5	-$1.4	-$9.5
DOT-Section 511	$2.8	$2.8	$0.0	-$0.1
Subtotal*	$22,822.5	$23,004.3	-$181.8	$516.3
Grand total*	$27,407.7	$28,124.6	-$716.8	-$1,848.7

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

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 8, 2005
JS-2390

Designation of Acting General Counsel

Treasury Secretary John Snow today designated Deputy General Counsel Jim Carroll to act as General Counsel of the Treasury Department. The designation of Mr. Carroll shall be effective immediately and shall continue until Arnie Havens, who is acting as Deputy Secretary of the Treasury, returns to his duties as the General Counsel.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 18, 2005
JS-2391

**Statement of Treasury Secretary John W. Snow
On the Departure of Acting Treasury Assistant Secretary
for Management
Jesus H. Delgado-Jenkins**

In a few days, the Treasury Department will bid farewell to one of its most admired leaders and dedicated servants. Since May of 2003, Jesus Delgado-Jenkins has served the Treasury Department, and his country, well and honorably.

Jesus' work to help realize the President's management vision for the federal government through the President's Management Agenda was invaluable, and he will be missed by his Treasury colleagues.

Of his many accomplishments at Treasury, Jesus' assistance with the creation of the new Office of Terrorism and Financial Intelligence (TFI) stands out as one that presented special challenges and great rewards. I know that Jesus is proud to have played a part in protecting our country through the successful launch of this new office.

Dedicated to promoting economic opportunity and ownership and to building an effective, results-driven government, Jesus has been a valued member of the Bush Administration. Under his management leadership, the Office of Management and Budget designated Treasury as a Center of Excellence for the Financial Services Line of Business – a reflection of the leadership and skill demonstrated by the financial and accounting professionals at the department, and the successful guidance that Jesus provided them with. In addition, he renewed our budgeting and financial management strategies as well as our acquisition strategies to improve the Department's cost of operations.

Jesus has much to be proud of as he leaves this department for the private sector. On behalf of my Treasury colleagues, I extend gratitude for his service and best wishes for the future to Jesus.

REPORTS

- Acting Asst. Secretary Delgado-Jenkins' Resignation Letter"

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

APR 15 2005

The President
The Whitehouse
Washington, D.C. 20500

Dear Mr. President,

It has been my honor and privilege to serve you and our country at the Department of Treasury since May 2003. It is with mixed emotions that I now tender my resignation to return home to my family in Chicago and the private sector. To ensure a smooth transition, I have consulted with Secretary Snow over the last few months to effect my resignation on April 29th.

I thank you for giving me the opportunity to be a part of your management team and help realize your management vision in the federal government through the President's Management Agenda. With the help of many dedicated political and career civil servants, I was pleased to lead the management and CFO functions at the department in support of your priorities to protect America, promote economic opportunity and ownership, and build an effective results-driven government. I was especially honored to have the opportunity to contribute to the defense of our nation by supporting the creation of the new Office of Terrorism and Financial Intelligence (TFI).

During my service, I was very honored and fortunate to have the support and confidence of Secretary Snow and Secretary Bodman. With their leadership, and the hard work of my Treasury colleagues, we helped build an improved, more responsive and transparent management platform. From this platform the Department will continue to make progress on important management challenges with successful programs. These include a new Human Capital Strategy which links executive compensation with results; continued financial integrity through successive unqualified audit opinions; initiatives to move Treasury's Financial Controls toward Sarbanes Oxley standards; budget and Capital Investment formulations aligning expenditures with programs that demonstrate results; successes in E-Government with more than 70 Million taxpayers filing on-line; the use of Competitive Sourcing as a way to explore and enable new business models for getting our work done; and developing new procurement strategies to effect category spend controls that deliver significant value.

Of particular note, I was pleased to learn that OMB recently designated Treasury as a Center of Excellence in 2004 for the Financial Services Line of Business. This achievement is a reflection of the leadership and skill demonstrated by the financial and accounting professionals at the Department. Beginning with the Treasury Franchise Fund and Administrative Resource Center, the Department demonstrated that new and innovative business models can thrive in the public sector and provide Centers of Excellence to serve other agencies without duplicative time and capital.

I have truly enjoyed the privilege, honor and responsibility of public service under your leadership, and I thank you for the opportunity to have served America in support of Treasury's vital mission.

Very Respectfully,

Jesus Delgado-Jenkins

Jesus H. Delgado-Jenkins
Assistant Secretary for Management
(Acting)

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 18, 2005
JS-2393

Statement by Secretary Snow on James Gilleran

James Gilleran has been a dedicated leader at the Office of Thrift Supervision for over three years as well as an outstanding Chairman for the Federal Financial Institutions Examination Council for the past two years. His efforts in both capacities have gone a long way toward strengthening the U.S. banking system. He has worked diligently to maintain safety and soundness at the nation's banking institutions and to ensure the industry's ability to meet the financial needs of Americans. A dedicated public servant, Director Gilleran has made innumerable contributions to the Treasury Department during his tenure here. His colleagues and I wish him well in his future endeavors. He departs with the sincere appreciation and best wishes of all of us here at Treasury.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 15, 2005
JS-2394

Deputy Assistant Secretary Iannicola Addresses State Legislators on Financial Literacy

Treasury's Deputy Assistant Secretary for Financial Education, Dan Iannicola, spoke today to state legislators and staff at the National Conference of State Legislators Spring Forum in Washington, D.C. about the Treasury's and the Financial Literacy and Education Commission's initiatives to improve financial education across the country. During a panel discussion entitled Money + Knowledge = Financial Literacy, Iannicola asked the participants' to encourage Financial education in their states.

"Improving the financial literacy of the people in your states is not easy, but we can help," said Iannicola. He told the legislators about the broad array of financial education resources available from the federal government through the MyMoney Web site and hotline (www.mymoney.gov and 1-888-mymoney), in both English and Spanish. "MyMoney puts the best the federal government has to offer in one place. It's all here and it's all free."

The National Conference of State Legislators (NCSL) is a bipartisan organization serving the legislators and staffs of the nation's 50 states, its commonwealths and territories. The NCSL provides research, technical assistance and opportunities for policymakers to exchange ideas on the most pressing state issues. Today's panel discussion on financial literacy constitutes part of a broader NCSL financial education effort.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The Office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: www.treas.gov/financialeducation.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 18, 2005
2005-4-18-17-21-56-8262

Federal Reserve Board Chairman Alan Greenspan, Treasury Secretary John Snow and Treasury Under Secretary John Taylor

Federal Reserve Board Chairman Alan Greenspan, Treasury Secretary John Snow and Treasury Under Secretary John Taylor participate in a meeting of the G-7 finance ministers and Central Bank governors, April 16

All media queries should be directed to
The Press Office at (202) 622-2960.
Only call this number if you are a member of the media.

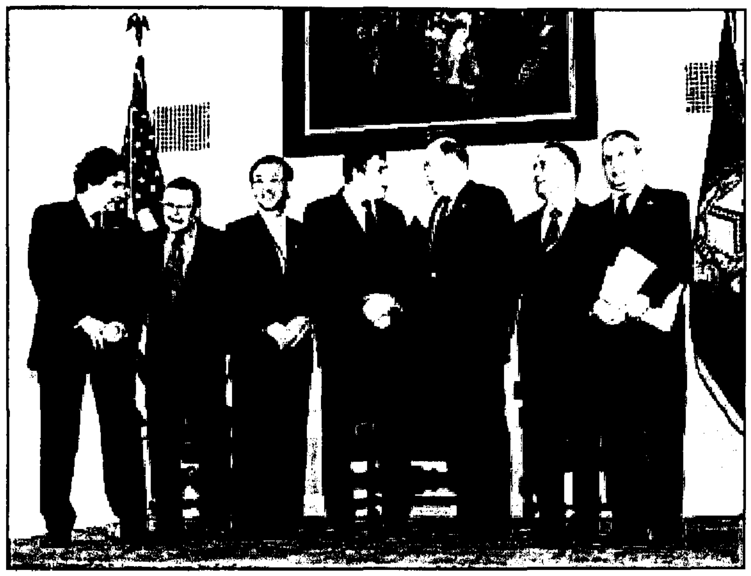
High Resolution Image

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 18, 2005
2005-4-18-17-28-37-8870

G-7 Finance Ministers pose for the traditional group photo, April 16



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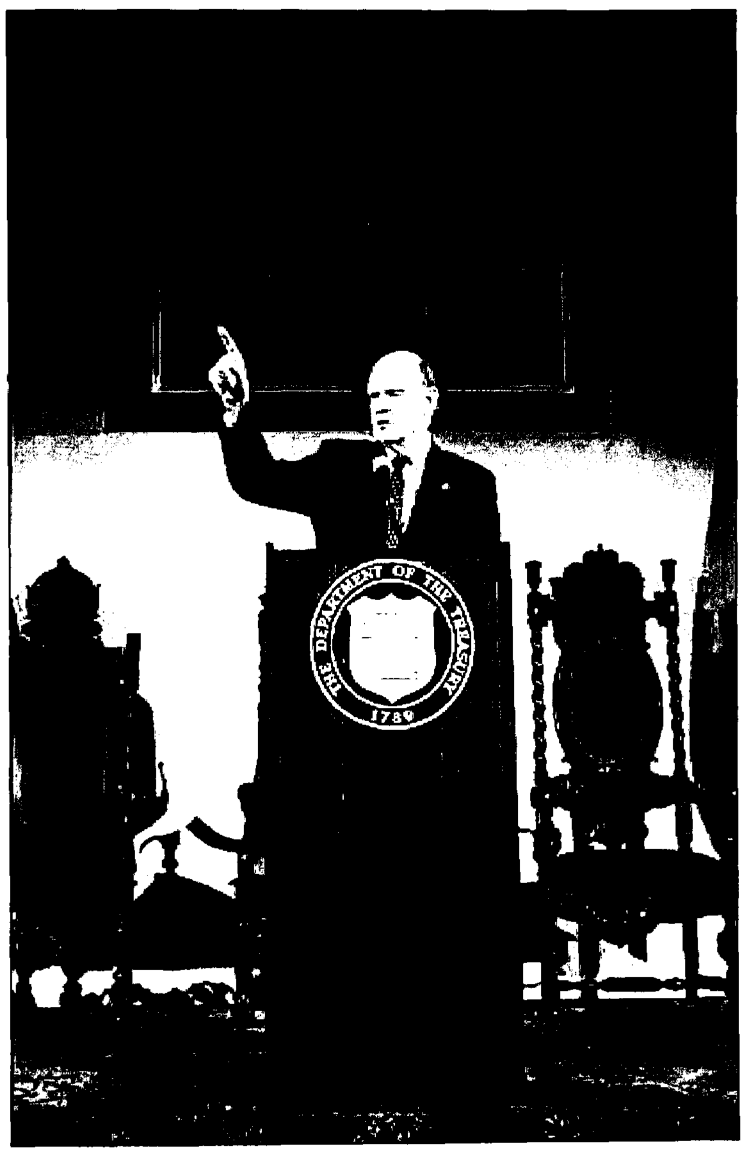
High Resolution Image

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 18, 2005
2005-4-18-17-32-55-9279

Secretary John Snow takes media questions at the post- G-7 press conference, April 16



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High Resolution Image

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 19, 2005
JS-2395

Secretary John W. Snow
Prepared Remarks
Mortgage Bankers Association
Washington, DC

Thank you so much for having me here today; I hope you're having a great meeting and are going to have some time to spend on the Hill with your Congressional Representatives. They need to hear from you! You're a very important part of the free-market system that makes this great American economy so strong, and your perspective on financial policy issues is invaluable.

In recent years your industry played a key role in some really terrific economic recovery and growth. Despite today's numbers, the housing market has been strong, with 1.2 million new homes and 6.8 million existing homes sold over the past year alone.

You should be very proud of your success for two important reasons: first, housing market activity is an important part of economic strength and growth, which has led to steady job creation; and second that nearly 70 percent of Americans today own their own homes – more than ever before.

Well-timed tax cuts, combined with sound monetary policy set by the Federal Reserve Board, got our economy moving when we needed it most. They gave industries like yours the room you needed to grow, and you took over from there. As a result, economic growth was 4.4 percent last year, the strongest in five years. The economy has created 3.1 million new jobs since May 2003.

Manufacturing production is on the upswing, and a revival in U.S. exports begun in mid-2003 is also contributing to rising output.

The President has made clear his commitment to strengthen our economy further. This includes reducing the budget deficit – as well as reforming Social Security and the tax system, reducing the regulatory burden on business, and passing energy legislation. We expect the deficit to total 3.5 percent of GDP this fiscal year. Tight controls on discretionary spending and increased revenue as a result of economic expansion are expected to cut the deficit by more than half, to well under two percent of GDP, by fiscal year 2009.

Reducing the tax burden proved to be a successful economic stimulus. Today, high energy prices are acting like a tax on our economy, and relieving that burden is extremely important. The first order of business for Congress in the coming days and weeks needs to be passage of an energy policy that reflects the demands of a new century.

The President has called on Congress to send him a bill that meets four important objectives: First, the energy bill must encourage the use of technology to improve conservation. Second, it must encourage more production at home in environmentally sensitive ways. Third, the bill must diversify our energy supply by developing alternative sources of energy like ethanol or bio-diesel. Promoting safe, clean nuclear power, providing tax credits for renewable power sources such as wind, solar, and landfill gas and continuing our clean coal technology projects are all part of that essential diversification. The bill must also support pollution-free cars and trucks, powered by hydrogen fuel cells instead of gasoline.

Finally, the energy bill must help us find better, more reliable ways to deliver energy to consumers. We must modernize our infrastructure to make America's energy more secure and reliable.

The job of keeping our economy unencumbered is a never-ending one, indeed. From tax cuts to regulations and energy policy, we need to work on it every day, and we need to work on keeping it strong for the future, for the long-term. Reforming our Social Security and tax systems addresses some critical long-term economic issues.

For example, the President's Advisory Panel on Tax Reform is working right now to come up with some options that will encourage growth and save Americans much of the time and headache that they currently spend complying with the tax code. American taxpayers and businesses spend an estimated $130 billion dollars in lost time and money trying to comply with our increasingly unwieldy tax code. That's $130 billion in resources that could be used to create jobs, invest in new business, or spur consumer spending. The $130 billion burden our code places on the American people is a drag on economic growth and an unnecessary headache for Americans.

The President has asked that the fine people on the advisory panel be guided by the goals of increased fairness, simplicity and ease of understanding, and economic growth and job creation. He has also asserted that any reform proposal should carry on the good traditions of recognizing the importance of homeownership and charity in our society.

The panel has held seven meetings so far... two here in Washington, one yesterday at the University of Maryland, and one apiece in Tampa, Chicago, New Orleans and San Francisco. They are hearing expert testimony at each meeting, and receiving a wide range of critiques and ideas from all over the country. They're doing great work, and I am looking forward to receiving their recommendations by the end of July.

You should also know that the panel recently asked the public to submit proposals for reform. Those proposals are due next Friday, April 29th. Please take a look at their website for more information. The site, www.taxreform.gov, includes instructions on where comments can be mailed or e-mailed. There is also a great new summary of the issues and key themes the panel is considering.

I appreciate the President's leadership on tax reform, and I deeply admire his leadership when it comes to the national discussion on Social Security reform.

Social Security is sound for today's retirees, but the system must be fixed to keep the promise of Social Security for our children and grandchildren. Because of the President's leadership, the national dialogue on Social Security is ubiquitous. Saving and strengthening Social Security is the topic at lunch counters and kitchen tables, college dining halls and office water coolers all over the country.

Ideas are coming forward, and this is an important time to remember that reform of the Social Security system must be lasting, permanent, not just a temporary `band-aid.'

It takes courage to do more than patch up a system that affects every citizen's life. But it's what Americans expect of their leaders; they expect elected officials like the President and the Congress to really solve problems, not just tinker with them.

That's why the President has said that Social Security must be put on solid financial ground permanently, for the long haul. He believes that it would be an injustice to the American people if Washington, DC simply put a band-aid on the problem. Because then the whole country would be back at the starting line in a few years.

So if someone promises you a 75-year fix, I encourage you to read the fine print. In 1983 we were promised a "75-year fix" – but 2 years later, the system was headed out of balance again.

Americans born before 1950 won't be affected by any reform that we achieve, but that doesn't mean they shouldn't be involved in this critical debate. In fact, current and near-retirees have an incredible opportunity: to be the ones to usher in a new generation of shareholders in the American Dream.

President Bush has established some basic principles for Social Security reform, and I'd like to go over them with you quickly today.

He wants a permanent solution, as I mentioned already, not a band-aid.

He wants to preserve benefits for current and near-retirees while saving and strengthening the system for future generations. Specifically, Social Security will not be changed for those 55 or older (born before 1950). For the more than 45 million Americans who are currently receiving Social Security benefits, and those nearing retirement, benefits are secure and will not change in any way, period.

The President has also said that he won't raise the payroll tax rate. Payroll taxes have been raised some 20 times since Social Security was established – and it has failed to make Social Security solvent. Raising the payroll tax will harm our economy, hurt job growth and fail to achieve the President's goal to create a permanent fix for Social Security. As you well know, even the most resilient economy can be devastated by dramatic tax increases.

For future generations of retirees, the President believes an awful lot of hope lies in personal accounts – something that would allow younger workers to build a nest egg that they own and control, something the government could never take away from them, and that would tap into the great force of compound interest – something you, as bankers, understand very well.

Albert Einstein believed, and the President and I agree, that compound interest is one of the most powerful forces in the universe. It's why a personal account nest egg would have a real return on investment that is far better than the rapidly-weakening promise of Social Security benefits.

Former Democratic Congressmen Tim Penny and Charlie Stenholm wrote in an op-ed a few weeks ago that "opposing personal accounts is not a substitute for offering a positive solution for dealing with the challenges that face Social Security." They went on to say, astutely, that they "believe that if Social Security were being created from scratch today, Americans would want to include a way to help everyone build up a nest egg." The President and I couldn't agree more.

I know that this audience understands and appreciates what I'm saying here today. You understand the value of ownership, and how sound investments and savings lead to a financially independent future.

You've seen your customers improve the quality of their lives as well as their financial futures through investing in their homes. The goal of owning your own retirement savings speaks to the same benefits as owning your own home, and it's exciting to see a national dialogue on such a promising issue.

It would be impossible to talk about increasing ownership, and homeownership, without discussing the current activity surrounding government-sponsored enterprises (GSEs). Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLB) play a unique and prominent role in the market in which you all operate, so I want to talk a little bit about the Administration's proposals to strengthen their regulation. We're having an ongoing conversation with the Congress about this matter – I imagine you heard about that from Senator Hagel earlier, and we appreciate his efforts to move reform forward. For now, I'd like to tell you a little bit about what we're asking of Congress.

Our national system of housing finance needs to remain strong and healthy so that it can continue to make mortgage credit available and provide financing opportunities for new homeowners. The Administration's proposed reforms are intended to ensure greater regulatory oversight, enhanced market discipline, and appropriate capital requirements for the GSEs. As we consider these reforms, we are guided by two core objectives: the need for a sound and resilient financial system and increased opportunities for home ownership, especially for less advantaged Americans.

In light of the recent events at the GSEs, the need for meaningful reform has become even more clear. We believe strongly that half-measures will only exacerbate the risks to our financial system.

As we originally outlined in detail in 2003, the regulator for the GSEs should have powers comparable in scope and force to those of other world-class financial supervisors and fully sufficient to carry out the agency's mandate. The regulator must have clear general regulatory, supervisory, and enforcement powers with respect to the GSEs. These powers must include the authority to set both minimum capital standards and risk-based capital standards; the power to assess the entities for independent funding outside of the appropriations process; and the ability to place a failed GSE in receivership.

In order to protect against the systemic risk posed by the housing GSEs' mortgage investment business, the Administration also recommends that limitations be placed on the size of the housing GSEs' retained mortgage investment portfolios. After the appropriate phase-in period, given the overall advances in securitization, the large amount of data available on mortgages, and the increased sophistication of mortgage investors, we believe that our capital markets could adjust to a significant reduction in the presence of the GSEs as mortgage investors.

Our primary goals in developing our GSE reform proposal are to promote the strength and resilience of our housing finance markets, lessen the potential for systemic risk, and continue our progress in meeting the mortgage credit needs of all our Nation's homebuyers. To accomplish those purposes, the fundamental elements of reform that the Administration has proposed are essential.

Thank you so much for having me here today to talk about this set of really historic policy efforts that are underway right now. This is an exciting time to be in government, and I'm extremely proud to be helping the President as we seek to achieve a safe and promising financial future for all Americans.

Thank you again; have a great meeting.

FROM THE OFFICE OF PUBLIC AFFAIRS

April 19, 2005
2005-4-19-14-37-35-26878

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $78,711 million as of the end of that week, compared to $78,528 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	April 8, 2005			April 15, 2005		
TOTAL		78,528			78,711	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,881	14,530	26,411	11,914	14,612	26,526
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,638	2,921	14,559	11,657	2,937	14,554
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			15,027			15,045
3. Special Drawing Rights (SDRs) [2]			11,490			11,504
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	April 8, 2005			April 15, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	April 8, 2005			April 15, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 19, 2005
JS-2396

John W. Snow
Secretary of the Treasury
Testimony Before the House Committee on Financial Services
The State of the International Economy

Thank you, Chairman Oxley, Ranking Member Frank, and other members of the Committee.

Let me begin with the goals of the Bush Administration's international economic policy. They are threefold:

- *Increasing economic growth*, because strong growth creates jobs, raises incomes, and reduces poverty over time,
- *Increasing economic stability*, because financial crises and recessions cause hardship and suffering, and impede economic progress,
- *Advancing U.S. foreign policy*--in coordination with our international political and security policy--because this will make America and the world safer and more secure.

Our international economic agenda includes opening markets and integrating the global economy, and the Treasury has a key role in formulating and implementing this agenda. That is why the Congress has required this annual testimony by the Secretary of the Treasury, and it is a pleasure to be here again today.

How are we doing in achieving these goals? I am happy to report that as a whole the global economy is performing very well:

- Global economic growth is as strong as it has been in thirty years, and, with inflation historically low, the expansion is expected to continue this year and beyond.
- The news about economic stability is equally good: there are no major recessions, no financial crises, and interest rate spreads, which measure risk, are historically low.
- And on the foreign policy front, our economic efforts are achieving important successes in combating terrorist financing, in the financial reconstruction in countries such as Afghanistan and Iraq, and in promoting economic freedom in the Broader Middle East and North Africa and other regions.

What are the reasons for this excellent economic performance? In my view good economic policies in the United States and other countries deserve much of the credit. To show this, I will highlight important events in three areas: (1) the developed economies, (2) the emerging market economies, and (3) the international financial system as a whole. In doing so it becomes clear that, despite the remarkable policy accomplishments of the last several years, this is no time to be complacent. There are challenges to address if we are to continue to see more growth, stability, and economic freedom around the world.

1. The Developed Economies

Among the large industrial economies, the United States is leading the way. Economic growth was 4.4 percent last year, the strongest in five years. The addition of 2.4 million jobs in the last twelve months alone attests to the continuing recovery from the slowdown of 2000-2001.

I believe that the first and most important part of an international economic policy is good policy at home, and here we have been successful. Well-timed fiscal policy changes--including the tax cuts of 2001 and 2003--and well-timed monetary policy changes restored stability, made the recession one of the shortest and mildest in United States history, and created the right incentives for strengthening the private sector led expansion. With inflation low, the expansion is expected to continue, even though oil prices remain a drag on the rate on economic growth. To make economic growth stronger, we must reduce the budget deficit, reform Social Security and the tax system, reduce the regulatory burden on business, and pass energy legislation--all high priorities of President Bush in his second term. Our efforts to reduce the fiscal deficit will be important for promoting greater stability of the international financial system.

The second largest economy, Japan, has also shown important improvements. The 1990s in Japan is frequently called the lost decade because of near zero economic growth, persistent deflation, and instability. Thus it is good news that Japan grew at about 2-1/2 percent on average in 2003 and 2004, and, despite the pause in the later part of last year, Japan's economic recovery appears to be continuing. As in the United States policy changes in Japan have been an important factor, including a monetary policy aimed at ending deflation and a large reduction in non-performing loans. Despite these improvements, however, Japan's longer-term economic growth is being held back by structural rigidities, which must be addressed if Japan is to reach its full potential

Unfortunately, economic recovery has not yet taken hold in the Euro area as a whole. Economic growth in the Euro area was less than 2 percent last year, close to the low average of the last ten years. While growth remains strong in the U.K. and the Scandinavian countries, it is very low in Germany and Italy. These important industrial economies confront the task of generating economic growth in the face of changing demographics and structural impediments.

Current Account Imbalances

With the United States growing more rapidly than other industrial countries, exports have grown less rapidly than imports, and our *current account deficit* has therefore risen over the years. In 1990 it was 1 percent of GDP. By 2000 it had increased to 4 percent. And in 2004 it was about 6 percent. At its most fundamental level, the current account deficit reflects the excess of investment opportunities in the United States over the level of savings in our economy. Reducing the budget deficit in the United States--which, as I said, is a very high priority--will help reduce the current account deficit by reducing the gap between investment and saving. But reducing the *growth deficit* between the United States and other countries is also essential. And this brings me to our G7 Agenda for Growth initiative.

The G7 Agenda for Growth

From the start of his Administration, President Bush called for close economic engagement with our allies, emphasizing candid discussions based on mutual respect and cooperation rather than antagonism. Our successful economic engagement with Japan is an example. From the first Camp David meeting between President Bush and Prime Minister Koizumi in June 2001 to my frequent discussions with Finance Minister Tanigaki, we have discussed the key issues such as restoring health to the Japanese banking system and maintaining a macroeconomic policy stance to support Japanese growth and end deflation.

With the G-7 Agenda for Growth we brought this approach to all G7 industrial countries. The goal, of course, is increased economic growth among the G7, especially those where growth is lagging. The Agenda for Growth focuses on structural reforms needed to increase flexibility, raise productivity, and bolster job creation. This initiative is proving very fruitful. It has permanently expanded the traditional focus of the G7 beyond monetary and fiscal policies to supply-side policies. During the U.S. chairmanship last year, we delved into key areas for reform each time we met – including tax reform, labor market reform, and health care reform. At our final meeting in 2004, we agreed to make supply-side, structural reform issues a regular focus of the G7 meetings. And indeed this has continued as planned under the UK chairmanship.

Beyond the Agenda for Growth

As the Agenda for Growth has taken hold within the G-7, we have sought to extend the pro-growth focus to other multilateral fora. For example, a group of finance and central bank officials that Treasury Under Secretary for International Affairs John Taylor chairs at the OECD has significantly shifted its emphasis to pro-growth supply-side policies and their impact on the current account. Last year the G20 endorsed its analogous "G20 Accord for Sustained Growth". And to help understand the divergence between U.S. and European productivity growth, the Treasury staff has been engaging with their counterparts at European Commission Presidency.

I believe that change is underway. Germany, for example, recently implemented labor market reforms that provide incentives for the unemployed to return to work. Italy passed a pension reform law in July, raising the retirement age. France has relaxed the 35-hour workweek restriction. The Japanese are working on privatizing mail delivery and its huge postal financial institutions

These are important achievements, but there is much more to do. Structural reform is difficult. Supply side policies take time to work. But as has been clearly demonstrated in Ireland, they work amazingly well. Last November I met in Warsaw with the Finance Ministers of Poland, Hungary, the Czech Republic, and Slovakia. I was greatly impressed with the speed and depth of their structural reforms, from lowering marginal tax rates to reducing barriers to investment. I am hopeful that these new members to the European Union will be a helpful force for change for the industrial countries, and our engagement with the EU will reflect that hope.

2. The Emerging Market Countries

As we all remember, the 1990s produced a series of damaging financial crises in emerging markets--from Mexico, to East Asia, to Russia, to Brazil. These crises rolled back hard-won economic gains, created profound social disruptions, and left many asking whether the international financial system was a source of instability rather than stability.

The most notable feature of emerging markets today is strong economic growth and the absence of financial crises. Economic growth in Latin America was 6 percent last year. In emerging market Asia it was 7-1/2 percent. In emerging market Europe it was 6-1/2 percent. In South Africa it was nearly 4 percent. Capital flows to emerging markets are again rising following the sudden stop after the Russia crisis in 1998.

Improved Policies and the Role of the United States

In my view these positive outcomes are primarily the result of better economic policies in emerging market countries themselves. Many countries have improved their fiscal policies and strengthened financial supervision. Many have adopted monetary policies that focus on price stability, and have moved from unsustainable fixed exchange rate pegs to flexible exchange rates, or have joined currency unions, or have adopted another country's currency. As a result emerging market inflation has been cut dramatically.

The United States has helped by assisting countries that are pursuing good policies. In fact, when the Bush Administration came into office, there was an urgent need for a comprehensive strategy to promote greater economic stability in emerging markets. This meant not only creating a policy environment that made financial crises less likely, but also setting out to ensure that international assistance, including from the International Monetary Fund (which I discuss later), was used to support countries with good policies, rather than provided in large amounts to countries with flawed policies. And we created new forms of U.S. engagement--such as the Group for Growth with Brazil and the Partnership for Prosperity with Mexico--to share experiences on how to tackle impediments to higher economic growth.

For example, when Brazil neared a full-blown financial crisis during its election in 2002, the United States supported a loan from the International Monetary Fund (IMF) to bolster the government's sound fiscal program, which was supported by the major candidates in the election. Then, when President Lula won the election and his government strengthened the fiscal program, risk spreads fell sharply. Brazil's economy grew more rapidly last year than it has in ten years.

At the same time, the Administration acted quickly to head off the spread of crises. For example, when Uruguay experienced a bank run sparked by its neighbor Argentina's crisis, the United States mobilized an assistance package that included a $1.5 billion five-day bridge loan from the Exchange Stabilization Fund to a loan from the IMF to support a plan to back dollar deposits in the banking system. The strategy enabled Uruguay to end the bank run, restore economic growth, and repay the loan in four days.

Financial support worked in Brazil and Uruguay because it was used to bolster good policies. Large amounts of international assistance--such as from the IMF--cannot buy success or avoid crises in countries with poor economic policies. Too often in the past large assistance packages simply underwrote flawed economic policies and artificially shielded investors from reckless risks until it was too late to avoid a crisis.

China, the Exchange Rate, and the G7

Reform of the currency exchange regime in China is one of the highest priorities for our international economic policy. While many large emerging market countries have moved to more flexible exchange regimes, China has maintained an exchange rate peg for over a decade. This impairs adjustment throughout the international financial system and prevents China from using its monetary policy to control inflation as other central banks in the world do.

Along with our G7 partners we have urged China to move to a flexible exchange rate. We take this issue very seriously and have devoted considerable time and attention - at all levels - to working with the Chinese to prepare them for a change. During the past year we have seen progress. A very important development was when Chinese officials met with the G7 Finance Ministers and Central Bank Governors for the first time, and this has continued this year. Engagement with China contributes to global economic stability because of the size of China's economy, and its rapid growth means that it is now an essential participant in the international financial system.

China has not only indicated that it will introduce more flexibility, it has taken the practical steps needed to do so. As members of the G7 have recognized, the time has now come for China to introduce flexibility into its exchange rate. The Chinese are now ready to adopt a more flexible exchange rate, they have sufficiently prepared their financial system to live in a world of greater flexibility and need to take action now.

Economic Freedom in the Broader Middle East and North Africa

Another historically significant new engagement on economic policy has been among the countries of the Broader Middle East, North Africa, and the G8. In the economic sphere this new engagement began in September 2003 at a meeting I chaired in Dubai; we have met four additional times since that time, most recently last weekend in Washington.

This engagement brings together the finance ministers from Morocco to Pakistan, including Turkey, Afghanistan, and Iraq. Our discussions are about their home-grown economic reforms and how the G8 can help. The engagement has already spanned several initiatives, including a new IFC small business facility for the region. By joining with the foreign ministers as we did in the Forum for the Future meeting in Morocco, we hope to exploit the synergy between economic freedom and political freedom that we are seeing in the region.

3. Supporting Poverty-Reduction and Economic Growth in Developing Countries

The Bush Administration's approach to developing countries is based on the principle that good economic policy in the countries is a prerequisite for economic growth and poverty reduction, and that we should work with countries to develop their policies. Official development assistance can be far more effective within such a good policy environment, and indeed it has frequently been wasted when such a policy environment is not in place.

Improving the overall investment climate is particularly important for promoting private sector development and job creation, and access to finance for small businesses is an important component of our development policy.

Based on this principle the Bush Administration launched several initiatives including our reform efforts in the World Bank (which I discuss below) and the Millennium Challenge Account, which will provide development assistance to countries that follow policies that lead to economic growth. The United States has nearly doubled development assistance since 2000. This increase -- which has raised our development assistance by about $10 billion annually -- represents roughly one-third of the increase in aid from all donor countries combined. U.S. annual assistance to sub-Saharan African countries alone has more than tripled since 2000, with over 30 sub-Saharan countries receiving increases of greater than 50 percent.

These new initiatives, combined with our existing activities, will further promote greater economic growth in developing countries. Given the truly astounding power of growth to reduce poverty, we remain fixated on promoting it. If sub-Saharan African economies expanded by 5 percent in 2005 and 2006, then nearly 30 million people would be lifted out of poverty. The Bush Administration will continue to work vigorously to achieve such ambitious results.

There have been important success stories where poor economies such as India and China have developed into fast growing emerging market countries, but many poor countries have failed to achieve sufficient growth on a sustained basis to lift their people out of poverty. For instance, in the 1990s sub-Saharan African economies grew by only about 2 percent annually, which is less than population growth, so per capita income declined.

Fortunately, during the last two years economic growth has picked up in many of the poorest countries. For example, in sub-Saharan Africa, growth is now estimated to have been about 4-1/2 percent in 2004. This increase clearly reflects the strong world economy overall, but it also is due to some improvements in economic policy especially greater inflation control in many countries. These higher rates of economic growth are raising per capita incomes and bringing tens of millions of people out of poverty in the poorest countries each year. But there are still billions in poverty and economic growth has to be increased further and be sustained if poverty is to be reduced significantly.

4. The International Financial System and Institutions

So far I have focused on the importance of economic policies undertaken by governments relating mainly to their own countries. Another important part of international policy relates to the international financial system and the international financial institutions. During the first term of the Bush Administration, important reforms were achieved at the IMF, the World Bank, and the other Multilateral Development Banks on which I serve as Governor. And we have made progress in the international financial services and tax areas. These changes are already being implemented and are factor in improved economic performance. And one of the key parts of U.S. foreign policy is our work on combating terrorist financing and supporting reconstruction efforts in Afghanistan, Iraq, and the Palestine Authority.

Reforms at the International Monetary Fund

These reforms set out to *clarify the limits on exceptional access* to IMF lending and to focus IMF programs and conditions on core macroeconomic areas of expertise. These reforms are now in place. Requests for exceptional access now face new procedures, including a higher burden of proof in the form of a special report that documents how IMF resources will support strong policies. The IMF's work--both with respect to its lending programs and surveillance--is more tightly focused and it now relies on more robust analytical tools.

A closely related achievement in the area of crisis prevention and resolution was the Administration's initiative to make the process of restructuring sovereign bonds more orderly through the use of *collective action clauses* (CACs) so that restructurings are less disruptive and more predictable. One year after the launch of this initiative, Mexico became the first country to include CACs in its New York-law governed bonds. Brazil, Korea, South Africa, and Turkey soon followed, as inclusion of CACs quickly became standard market practice.

Reforms at the World Bank and other Multilateral Development Banks (MDBs)

The MDBs serve a critical role in promoting global economic growth and stability, especially in countries and regions where poverty is most acute. From the outset, the Bush Administration has pursued an aggressive reform agenda in an effort to maximize the MDBs' effectiveness and achieve better results on the ground. These institutions were found by many to be lacking in: measurable results; institutional transparency and accountability; promotion of private sector-led growth; and lending policies that reflected debt sustainability problems in poor countries. As a result of recent reforms, considerable progress has been achieved in measuring results, increasing grants, focusing on private-sector led growth, fighting corruption, and improving transparency and accountability.

In 2001, President Bush called on the MDBs to provide 50 percent of their assistance to the poorest countries in the form of grants. Due to strong U.S. leadership in replenishment negotiations, IDA and the African Development Fund (AfDF) will provide approximately 45 percent of their assistance to the poorest countries in the form of grants. In addition, the Asian Development Fund (AsDF) agreed in 2004 to institute a 30 percent grants program for the poorest countries in Asia. Before President Bush's initiative, nearly all MDB assistance was provided as loans. These landmark achievements represent a crucial step toward ending the lend-and-forgive approach to multilateral assistance and ensuring long-term debt sustainability.

Because of its success in reforming the institutions to deliver assistance more effectively, the Bush Administration was able to justify a reversal of the trend in the 1990s of declining U.S. contributions to the MDBs. Displaying our strong commitment to these important institutions – based on their commitment to reform – during the Bush Administration the U.S. has delivered double-digit increases in funding for IDA, the AfDF and the AsDF, which provide consessional resources to the world's poorest countries.

Further Reforms at the IMF and World Bank

More also needs to be done to ensure that the IMF and World Bank are positioned to assist countries in taking on the economic challenges they face in the 21st century. The United States, in partnership with its G-7 partners and others, has called for a *Strategic Review* of the Bretton Woods institutions to identify the changes needed to make these organizations more responsive, relevant, and helpful to their members. The Bush Administration is committed to seeing this review through and working with the managements of the IMF and World Bank to implement the required reforms.

A bold debt proposal. The shift to greater use of grant financing will reduce unsustainable debt burdens over the long-term. However, debt will continue to act as a constraint on economic growth in the interim. To address this problem, the Bush Administration has put forth a bold debt proposal that would relieve the debt burdens of poor countries *without additional cost.* The proposal calls for immediate action to provide up to 100 percent relief on IDA and AfDF loans to the Heavily Indebted Poor Countries (HIPCs). These actions, combined with the new increases in grants going forward, will put these poor countries on a sustainable path.

A new non-borrowing program. We are also focusing on how the IMF's work in the poorest countries can be more effective. We have proposed a new non-borrowing program for countries that don't need IMF loans but still can benefit from their IMF's macroeconomic policy advice. Economic needs of the low-income countries are vast; we believe the IMF can play a constructive role in poor countries primarily through surveillance and policy advice and, when needed for balance of payments purposes, financial assistance. Last weekend, the G-7 Finance Ministers expressed their backing for the creation of a non-borrowing program.

These additional reforms will further the division of labor and exploit the comparative advantage of the IMF and the World Bank, with the IMF focusing on monetary, fiscal, exchange rate, and banking supervision issues, and the World Bank focusing on economic development.

International Trade, Financial Services, and Investment

Completion of the Doha Development Agenda is vital to spurring global economic growth, stability, and is an important part of U.S. foreign policy. As part of the Doha Agenda the United States has proposed the elimination of all global tariffs on consumer and industrial goods by 2015 and substantial cuts in farm tariffs and trade distorting subsidies. Trade liberalization on such a grand scale would deliver benefits of roughly $500 billion annually to the world's poor. This is more than double the size of current official development assistance flows to developing countries.

The Treasury has a particular responsibility in the financial services talks, which are an integral part of the broader Doha negotiation. We are working to draw greater attention to the services component of the Doha discussions and with other finance ministries on the financial services issues in particular.

Treasury is also active in the progress on free trade agreements (FTAs). The FTAs with Chile, Singapore and Australia entered into force in the past year, and we have concluded FTAs with Central America/Dominican Republic, Morocco, and Bahrain. In addition to liberalizing trade in goods and services, these FTAs provide protection for the free flow of capital, so that emerging markets can attract the funds they need to expand the productive potential of their economies. We plan to advance our negotiations on additional free trade agreements in Africa (Southern African Customs Union), Asia (Thailand), Latin America (Andean countries, Panama, Free Trade Area of the Americas), and the Middle East (United Arab Emirates, Oman).

Financial Regulatory Talks Between the United States, Japan, and the Europe

For the past three years, the United States and the European Commission have been discussing a range of financial regulatory issues. The agenda has included Europe's Financial Services Action Plan, the Sarbanes Oxley Act, the Basel II Capital Accord, and convergence of accounting standards. International issues arise because the United States and the European Union have different legal, cultural, and historical traditions. Actions by each may have unintended spillover effects for the other, which our discussions helped to manage. For similar reasons, we have also conducted annual meetings between Japanese and American financial regulators.

Progress on International Tax Treaties

Treasury has been very active pursuing tax treaties in the Bush Administration. This past year we fulfilled another long-standing goal with the conclusion of a new, modern tax treaty with Japan that entered into force on March 30, 2004. The new treaty provides for significantly reduced withholding rates on cross-border payments of dividends, interest and royalties as well as modernizing a number of other rules. The new treaty significantly reduced existing tax barriers to investment and trade in both directions, enhancing the global competitiveness of our businesses and creating new opportunities for international trade and investment.

The Global Fight Against Terrorist Financing

Since September 11, 2001 we have accomplished much in our global fight to disrupt the flow of funds that support terror – a critical component of the overall effort to keep America safe. Worldwide efforts have shut down channels terrorists and their sympathizers depended on to transfer funds, led to the capturing or killing of key terrorist facilitators and deterred donors from supporting al Qaida and other like-minded terrorist groups. We continue to work with our G7 and other international partners to coordinate these efforts. This past year Treasury was pleased to welcome Under Secretary Stuart Levey who oversees our new Office of Terrorism and Financial Intelligence, which is focused on safeguarding the financial system against illicit use and combating rogue nations, terrorist facilitators, money launderers, drug kingpins, and other national security threats.

Mr. Chairman, I think you can see we have accomplished much in international economic policy during the first term of the Bush Administration from reform of the international financial institutions, to a major increase in development assistance, to new forms of cooperation with our allies. We are pleased that the world economy is performing so well, and that global economic growth and stability have both increased so much. But as I have indicated, we have an ambitious agenda for the second term. I look forward to working with your committee and would be happy to answer any questions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 6, 2005
JS-2397

The Challenges Before Us: Defined Benefit Pension Plans and Social Security
Address by The Honorable Mark J Warshawsky
To the 2005 Meeting of Enrolled Actuaries
April 6, 2005

Good morning and thank you for the kind introduction. I am pleased to have this opportunity to address the 2005 Enrolled Actuaries meeting to discuss the Administration's pension reform proposal for single employer defined benefit plans. Although the Administration is also considering the problems in the multiemployer system, all my remarks today pertain only to single employer plans.

What, you might ask, would an economist contribute in an address to a meeting of actuaries? In part I appear as the spokesman for an important Administrative initiative. But I also have a long-standing interest and background in pensions and pension policy. Prior to joining the current Administration, I oversaw pension research for TIAA-CREF and was a Senior Economist on the staff of the Assistant Commissioner for Employee Plans and Exempt Organizations at the Internal Revenue Service responsible for a study of underfunded pension plans. I have also written a number of academic articles and books on pensions and annuities. Although my duties at the Treasury Department cover a wide range of topics, my interest in pensions has made my work on the Administration's defined benefit pension and Social Security reform proposals particularly satisfying.

REPORTS

- Assistant Secretary Mark Warshawsky's Speech to the 2005 Meeting of Enrolled Actuaries

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What, you might ask, would an economist contribute in an address to a meeting of actuaries? In part I appear as the spokesman for an important Administrative initiative. But I also have a long-standing interest and background in pensions and pension policy. Prior to joining the current Administration, I oversaw pension research for TIAA-CREF and was a Senior Economist on the staff of the Assistant Commissioner for Employee Plans and Exempt Organizations at the Internal Revenue Service responsible for a study of underfunded pension plans. I have also written a number of academic articles and books on pensions and annuities. Although my duties at the Treasury Department cover a wide range of topics, my interest in pensions has made my work on the Administration's defined benefit pension and Social Security reform proposals particularly satisfying.

Before I outline the basic structure of the Administration's pension proposal and discuss some modeling results of the impact that the proposal will have on the pension system, I'd like to say a few words about Social Security. As you are all aware, the Social Security system clearly is not financially viable and must be fixed. How to close the permanent financing gap raises difficult questions over how the net benefits of Social Security should be shared across generations. In this context, it is important to recognize that the large unfunded obligations in the system are primarily the consequence of the past system generosity to generations that are now either dead or retired. Of course, those early generations are beyond reform's reach, so the entitlement reforms needed to close the financing gap must fall entirely on later generations.

Viewing Social Security from the perspective of how it affects generations and individuals explains why it is imperative that Social Security be reformed now. Delaying reform only reduces the options for fairly distributing the benefits of Social Security across generations. Most people agree that it would not be fair to alter Social Security's promises to retirees and near retirees. The longer reform is delayed, the fewer generations that are left to participate in a reformed entitlement system so as to close Social Security's funding gap, and the more severe those reforms will be. Fairness to future generations requires that we act now.

Estimates made by the Social Security actuary nicely illustrate this point. According to those estimates, one policy that would close Social Security's permanent financing gap is to immediately raise the payroll tax rate by 3.5 percentage points. But if the tax increase were instead delayed until 2041 when the trust fund is depleted, numbers reported in the Trustee Report imply that the requisite tax increase would be 6.3 percentage points. Clearly, I do not advocate either of these policies. My point, once again, is that fairness to future generations requires that action be taken now.

In order to make Social Security fair to future generations, not only must reform occur now, it is essential that reform make Social Security permanently solvent. Permanent solvency means that our best estimates show the system needing no further reforms in the future. Anything short of permanent solvency amounts to a delay of reform that would be unfair to future generations.

Testing for permanent solvency requires that we look beyond 75 years. For example, the estimated 75-year Social Security financial imbalance suggests that raising the payroll tax rate by 1.92 percentage points, to 14.32 percent, would fix the system. But as many of you are aware, that is not true. If the payroll tax rate was raised in that manner, a large Trust Fund balance would be accumulated in the short-term that would peak in about 2060, and would then commence a steady decline to complete exhaustion at the end of the 75-year projection period. This type of reform would therefore not make the system permanently solvent. With each passing year, the Trustees would report an ever larger financial imbalance as the 75-year scoring window is moved forward to include years with ever larger gaps between expected system costs and income.

A reformed Social Security system that is truly permanently solvent must include personal retirement accounts (PRAs). PRAs allow individuals to save now to help fund their retirement incomes. In principle, that could be done with reforms that save tax revenues in the Social Security Trust Fund. But such "saving" would almost certainly be undone by political pressures to increase government spending and hence produce larger deficits outside of Social Security that would ultimately lead to crisis in the non-Social Security budget. There is no guarantee that the solution to any such fiscal crisis would not include a lowering of Social Security benefits. Hence, the only way to truly save for our retirement and give our children and grandchildren a fair deal is with personal accounts. Personal accounts serve as private and therefore effective "lock boxes". When pre-funding is done using a personal account, there is no pressure to increase government spending, because this pre-funding belongs to individuals and does not appear on the government balance sheet as budget surpluses.

Now on to my main topic, Defined Benefit Pension reform.

At the outset I want to address an issue that I know is of great importance to this group. I want to ensure to you that the Administration is committed to the future of the defined benefit system. I believe DB plans are valuable to many employees and employers. One of the motivations behind our proposal is to create a set of rules that will allow for a sustainable defined benefit system. I believe the Administration's proposal would revitalize the system by placing both the PBGC and individual pension plans on a sound financial footing.

I think that nearly all us who are interested in defined benefit plans recognize that the system is undergoing severe financial stress. Evidence of that stress is abundant. Underfunded plans have a collective $450 billion in unfunded liabilities with $100 billion of that total concentrated in plans with financially weak sponsors. Many of these sponsors, after enjoying a period of low or no contributions during the boom years of the 1990s, now face very substantial near term contribution burdens.

Claims on the pension insurance system have accelerated dramatically in recent years. After averaging $451 *million* annually between 1990 and 2001, average claims for the years 2002, 2003 and 2004 were $9.8 *billion*. Such unprecedented losses to the insurance fund resulted in a change in the single employer system's net position from a $7.7 billion surplus at the end of 2001 to a $23.3 billion deficit at the end of 2004. Such a deficit, if allowed to persist, threatens the pension benefit payments of more than 1 million participants of failed defined benefit plans taken over by PBGC.

Recent financial market performance exposed the fact that existing pension funding and insurance rules fail to provide adequate incentives for plans to maintain responsible funding levels. Pension rules need to be fundamentally reformed to provide such incentives. Rules should be sufficiently robust to encourage adequate plan funding of accrued liabilities under the widest possible range of financial market conditions, while also providing the tools plan sponsors need to assure themselves a smooth and predictable contribution pattern.

When pension plans default on their obligations participants typically suffer by losing benefits. For many retirees and near retirees these losses often come at a time when they are unable to make up the shortfall through other means. In all cases, this Administration is committed to ensuring that pension promises made are pension promises kept. That is why our reform proposal stress adequate and timely funding of accurately measured pension liabilities, real consequences of severe underfunding, improved disclosure, and ensuring the financial solvency of the PBGC.

Today I'll discuss some of the important features of the Administration proposal to reform the existing funding rules and insurance system in order to create proper funding incentives. I'll also provide a "sneak preview", if you will, of some PBGC simulation results that will provide a first look at how the proposed rule work in some stylized economic environments. As I'll note again later, these results are not predictions of what funding levels and claims are likely; they are simply simulations of how the proposal operates in some hypothetical economies.

Measurement

But before we discuss results, I'll describe the proposal in a bit of detail. Our plan ensures that both assets and liabilities are measured on a timely basis and that measurements reflect market values. That means marking assets to market and reducing smoothing in liability measurement to a minimum. Liabilities will be computed by discounting future benefit payments using an AA corporate bond yield curve. The yield curve matches future benefit payments to interest rates of bonds that mature when those payments become due. This is the most accurate method of measuring liabilities because it explicitly recognizes the time structure of benefit payments.

We also eliminate the confusing array of largely unrelated, special purpose, liability measures that have been added in ERISA over the years. Under the reform proposal there are two logically related liability measures that will be used for all funding and premium purposes. The first, called <u>ongoing liability</u> would measure benefits accrued under the plan and is appropriate for an ongoing plan with a financially health plan sponsor. Ongoing liability is computed using the yield curve, a specified mortality table, and reasonable assumptions about retirement rates and the take up rates on retirement subsidies. Ongoing liability – unlike current liability - will reflect expected lump sum take up rates.

The second measure, at-risk liability is designed to measure accrued benefits in a manner appropriate for a plan that is "at-risk" of termination because the plan sponsor is less financially healthy. At-risk is basically the same as ongoing with four critical assumption changes, reflecting behavioral changes that are observed when a plan approaches termination. At risk liability would assume that participants retire as early as possible and take advantage of any early retirement subsidy that might be available to them. At risk liability will also reflect costs associated with closing out a plan. These costs include a load of 4 percent of liabilities plus a $700 per participant charge.

Funding Targets

These liability measures are used as funding targets. These funding targets are meaningful and reflect the risk of plan termination Financially healthy sponsors will fund to ongoing liability and less-healthy sponsors will be required to fund to at-risk liability.

A sponsor is considered financially weak if the plan sponsor OR any significant member of the sponsor's controlled group has NO senior unsecured debt that is classified as investment grade by at least one of the nationally recognized rating agencies.

Because at-risk funding targets are likely to be higher than ongoing targets, we provide a five year phase-in period to the higher target for any plan that has a financially weak sponsor subsequent to enactment. The funding target during the phase in period will be a weighted average of the ongoing and at risk targets. The phase in period includes a look back provision for plans with sponsors that are classified as financially weak on the date of enactment. The phase in period will be reduced for each year a sponsor was classified as weak prior to the effective date of the new funding rules.

Funding

Under the proposal, sponsors that fall below minimum funding levels would be required to fund up towards their appropriate target in a timely manner. In general, if the market value of plan assets is less than the funding target for the year, the minimum required contribution for the year would be equal to the sum of the applicable normal cost for the year and the amortization payments for the shortfall plus any ongoing amortizations of prior year shortfalls. Amortization payments would be required in amounts that amortize the funding shortfall over a 7-year period. The initial amortization base is established as of the valuation date for the first plan year and is equal to the excess, if any, of the funding target over the market value of assets as of the valuation date. The shortfall is amortized in 7 annual level payments.

Here it is important to note that this is the same amortization regardless of the source of the funding deficiency. It is also worthwhile noting that this element of the plan is likely to provide immediate funding relief for many plan sponsors currently facing the prospect of Deficit Reduction Contributions with amortization periods as short as four years.

For each subsequent plan year, if the sum of the market value of assets and the present value of future amortization payments is less than the funding target, that shortfall is amortized over the following 7 years. If the sum of the market value of assets and the present value of future amortization payments exceeds the funding target, no new amortization base would be established for that year and the total amortization payments for the next year would be the same as in the prior year. When, on a valuation date, the market value of the plan's assets equals or exceeds the funding target, then the amortization charges would cease and all existing amortization bases would be eliminated.

Credit Balances

I'd like to say a few words about credit balances. Many of the critiques of the Administration proposal note that we will eliminate the use of credit balances as currently allowed. I am proud to tell you that is correct. Credit balances that allow underfunded plan are undesirable and dangerous because they create funding holidays as plans become increasing by underfunded and prolong the amount of time that such plans can remain below their funding targets, leaving participants at greater risk. One need only consider the case of Bethlehem Steel to see how significant an issue this is.

That said, it is important to understand that contributions above the minimum are accounted for in the Administration proposal. Plans that have made higher than minimum contributions in past years do not lose the value of such contributions. These contributions increase the value of plans assets relative to liabilities and, other things equal, reduce plan underfunding and decrease future amortization payments. In combination with the rest of the proposal, there is more than adequate incentive for plan sponsors to fund above the minimum.

Benefit Limitations

The reform proposal will include benefit limitations for seriously and severely underfunded plans. Benefit restrictions serve three critical purposes. First, they will limit liability growth as a plan becomes progressively underfunded relative to its funding target. It is important to arrest the growth of liabilities when plans are becoming dangerously underfunded in order to ensure that plan participants will collect benefit that they accrue. Under current law, sponsors of underfunded plans can continue to provide for additional accruals and, in many situations, even make benefit improvements. Plan sponsors in financial trouble have an incentive to provide generous pension benefits, rather than increase current wages, and employees may go along because of the PBGC guaranty. This increases the likely losses faced by participants and large claims to the PBGC. Hence, the second purpose of benefit restrictions is to guard against this type of moral hazard. Third, but certainly not least importantly, I believe benefit restrictions will serve as a very powerful incentive for plan sponsors to maintain well funded plans. As I describe the limitations, I am sure you will recognize that most of the plan sponsors you work for would be loathe to explain to their employees that, due to the severe underfunding of their pension plan, these limitations had been put in place.

Plans with financially weak sponsors that are funded at a level of between 60 and 80 percent of their targets will be prohibited from paying lump sums or increasing benefits. If funding falls below 60 percent of target liabilities accruals will also stop and there will be no preferential funding of executive compensations. Plans with healthy sponsors will be prohibited from increasing benefits or making lump sum payments if they are funded at less than 60 percent of their target. Underfunded plans with sponsors in bankruptcy will also be subject to benefit limits.

Increased Deductibility

As I noted above, our proposal asks more of plan sponsors than current law – we insist that plans reach and maintain a responsible level of plan funding. Along with these new responsibilities we provide enhanced tools to maintain adequately funded plans while maintaining a smooth pattern of contributions if they desire. One important tool is that the level of permissible deductible contributions will be raised. Under the Administration's proposal, plans will be able to build two separate funding cushions. The first is equal to 30 percent of ongoing liability and the second allows for prefunding of expected salary increases for final pay plans, and expected future plan amendments, based on the amendment experience of the last six years, for flat dollar plans. In addition, plans will always be able to deduct contributions that bring a plan's funding level up to at risk liability.

Higher limits for deductible contributions, along with existing authority to allocate plan assets and hedge investment and interest rate risk, will provide sponsors with the tools they need to smooth contributions over time. We believe that providing sponsors these tools will not only allow for more effective contribution smoothing than is accomplished using the mechanisms embodied in current law, but it will also allow sponsors to optimally balance contribution smoothing with other investment objectives.

We also think that under the new more flexible funding structure the actuary's role as plan advisor will be enhanced. Funding decisions under this system will require the use of sound judgment rather than being an exercise in following rules.

Premiums

The PBGC insurance premium structure also is in need of reform. Our proposal increases incentives for plan funding and provides the pension insurance system with adequate revenues to eventually restore it to solvency. The flat rate premium will be immediately increased from $19 to $30 per participant to reflect wage growth since 1991 when the $19 rate was set. In the future, the flat premium rate will be updated annually using the same index that is used to update PBGC's maximum guarantee limits. This provision will allow the price and level of insurance coverage to grow at the same rate in the future.

The proposal will also introduce risk based premiums. Risk-based premiums will be charges levied on unfunded target liabilities for all plans. Two key differences distinguish risk based premiums under the proposal from the variable rate premiums of current law. First, the liability on which underfunding is measured for premium purposes is the same liability measure used as a plan's funding target. Second, all plans with unfunded liabilities will pay risk-based premiums at the same rate. This feature of risk-based premiums should provide a much stronger incentive to maintain adequately funded plans.

Disclosure

The final element of the proposal is increasing pension funding disclosures to plan participants, investors and regulators. I don't have time here to discuss all of the changes in detail, but the intent is to provide participants in all plans with more current and accurate information on funding levels.

Results

Our colleagues at the PBGC have taken the basic structure of the proposed funding rules and simulated their effects on the single employer system under a range of assumptions about future economic and financial market activity. I'd like to share some of these results with you.

It is important to note that the results we will talk about today reflect only the funding rules. These results do not reflect the effects of some critical components of the proposal including the direct and incentive effects of benefit restrictions and the incentive effects of the proposed system of PBGC premiums. More broadly, the focus on minimum required contributions, while useful, fails to capture an essential feature of the proposal; we provide plan sponsors with both the tools and incentives to smooth contributions by funding above the minimum during good times. Projected minimum contributions do not reflect this behavior. I will discuss a stylized example of how a plan sponsor *might* use the additional flexibility provided in our proposal to maintain smooth contributions.

The simulations assume that the reform proposal is implemented fully in 2006. All slides that depict estimated future claims and contributions express those amounts not in dollar terms but as index numbers. We have taken this approach because we want to highlight the fact that these are not predictions but rather simulations designed to show the different outcomes generated by the proposal and current law. The base of the index is the estimated level of contributions or claims in 2005, as appropriate, under current law, assuming that liabilities are discounted using 105 percent of the 30 year Treasury bond rate.

While I'll just be running through a few key slides here, a more complete analysis is available at http://www.pbgc.gov/publications/white_papers/wp_040605.pdf

I'll begin by showing how the mechanics of the proposal work compared to current law. This is best demonstrated by holding all financial and economic variables fixed and simulating funding ratios, contributions, and claims under each set of funding rules. In this set of simulations, equities are assumed to have a nominal 9 percent annual return, the 30-year Treasury bond rate is 5 percent, inflation is 2.5 percent and wage and benefit growth rates are 4.2 percent.

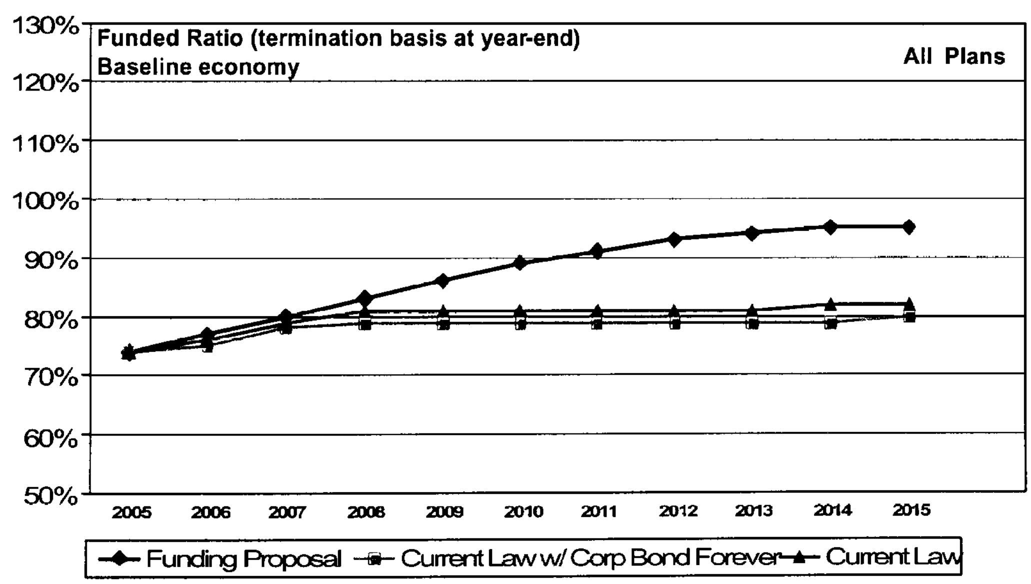
First we'll look at funding ratios relative to termination liability. One of the problems with current law is that sponsors are permitted to stop funding plans while there are significant unfunded accrued liabilities.

This is demonstrated in the graph [**Figure 1**] on the screen. Under current law, aggregate plan funding ratios reach a maximum of 82 percent of termination liability and remain there. This is only a modest improvement over the 77 percent funding ratio of 2003 even though in this scenario interest rates are constant and equity returns are constant at their long-run average value. Note that in this scenario the assumptions that interest rates are constant and equity prices are increasing steadily over time mean that plan funding levels reflect the operation of the funding rules rather than changes in asset or liability values. Such an outcome suggests that current law is ineffective in moving plan sponsors to adequate levels of funding. (Under current law using the corporate bond rate, funding reaches a peak of only 80 percent.)

By contrast under the Administration's funding proposal, aggregate funding improves steadily during the 2006 to 2012 period as plans fund to their new targets. Funding is significantly higher under the proposal than under current law by 2015 reaching a peak of 95 percent. All other things equal the proposal would appear to succeed in improving plan funding. Higher plan funding levels significantly increase the security of benefits for plan participants.

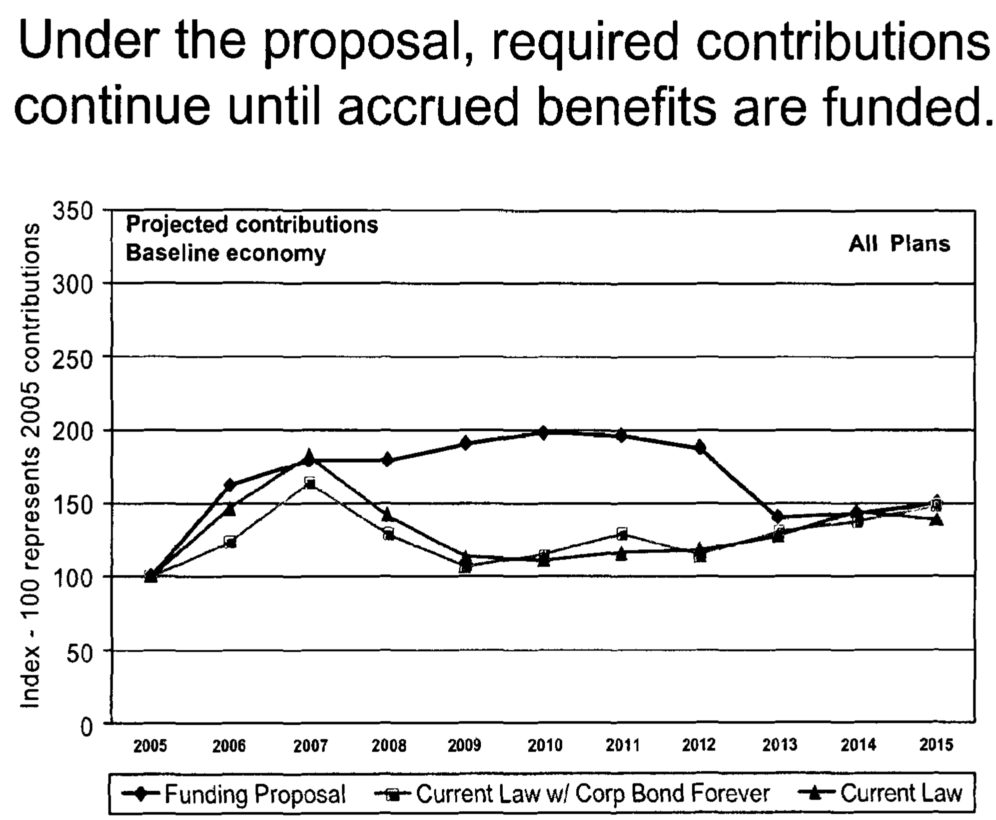
FIGURE 1

Current rules do not lead to better-funded plans.
The funding proposal improves funded ratios over time.



As you might expect, a set of funding rules that produces higher funding ratios in a steady state economy will require higher contributions. As my next slide [FIGURE 2] shows, during the first seven years of the proposal, 2006 to 2011, minimum contributions are higher under the proposal than under current law as plans fund to their new higher targets over a seven year amortization period. Thereafter contributions under current law and the funding proposal converge and by the end of the forecast period in 2015 are the same.

FIGURE 2

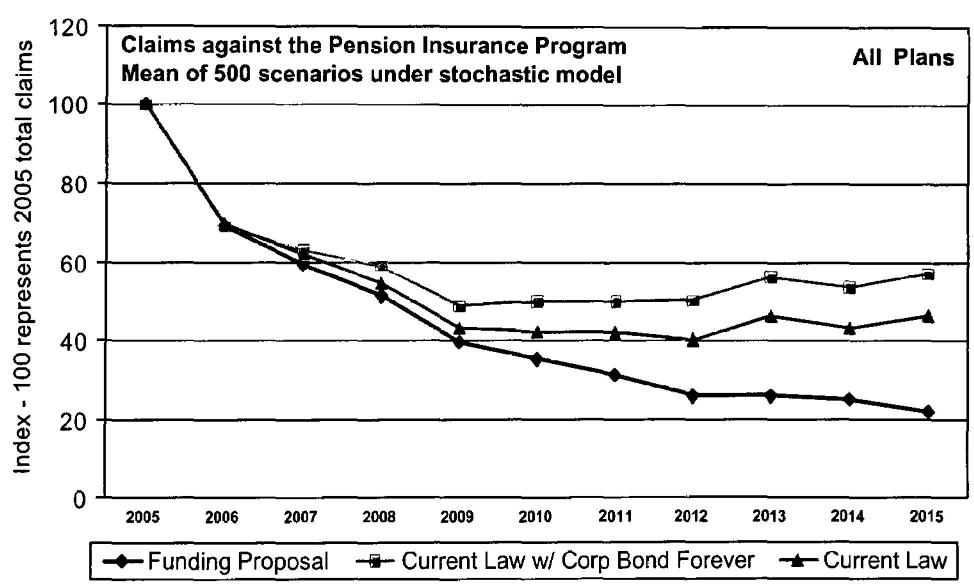


The critical measure of the effectiveness of a plan funding proposal is its effect on claims. Claims projections under the funding proposal are significantly lower than under current law, because the proposal's new funding rules require plans to be significantly better funded The next slide [**FIGURE 3**] shows - under the proposal and under current law - the mean claims against the pension insurance program from the 500 randomly chosen economic scenarios. Claims represent the amount of underfunding in terminated plans that would be guaranteed by the PBGC. (Of course, as explained above, participants also often suffer major losses in their pension benefits upon termination due to statutory limits on PBGC's guaranty.)

It is important to focus on the relative differences between the scenarios and not the values shown under each scenario. As noted above, the amounts shown represent the mean result of 500 economic scenarios. It is not intended to forecast what claims will actually be. One large distress termination could change the numbers significantly. However, the relationship among the lines would not change.

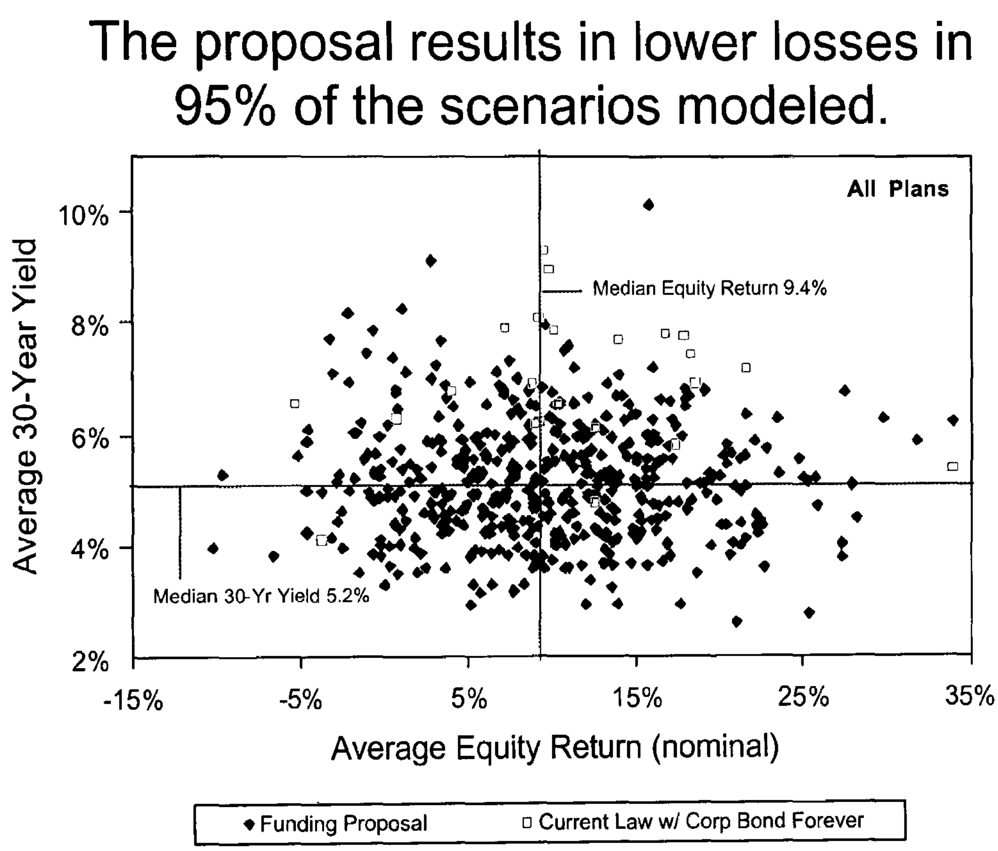
FIGURE 3

Better funded plans reduce losses to participants and burden on premium payers.



The next slide [**FIGURE 4**] provides a different and fuller picture of how the funding proposal performs against current law in reducing claims. The graph shows instances of lower claims under current law (the pink squares) and under the funding proposal (blue diamonds) plotted on average 30-year bond yields and the average equity return in the stochastic simulations. The funding proposal resulted in lower claims in 95 percent of the simulations. The few scenarios in which the proposal results in higher claims were almost all scenarios characterized by rising interest rates, as the current low interest rate 4-year smoothing artificially increases contributions.

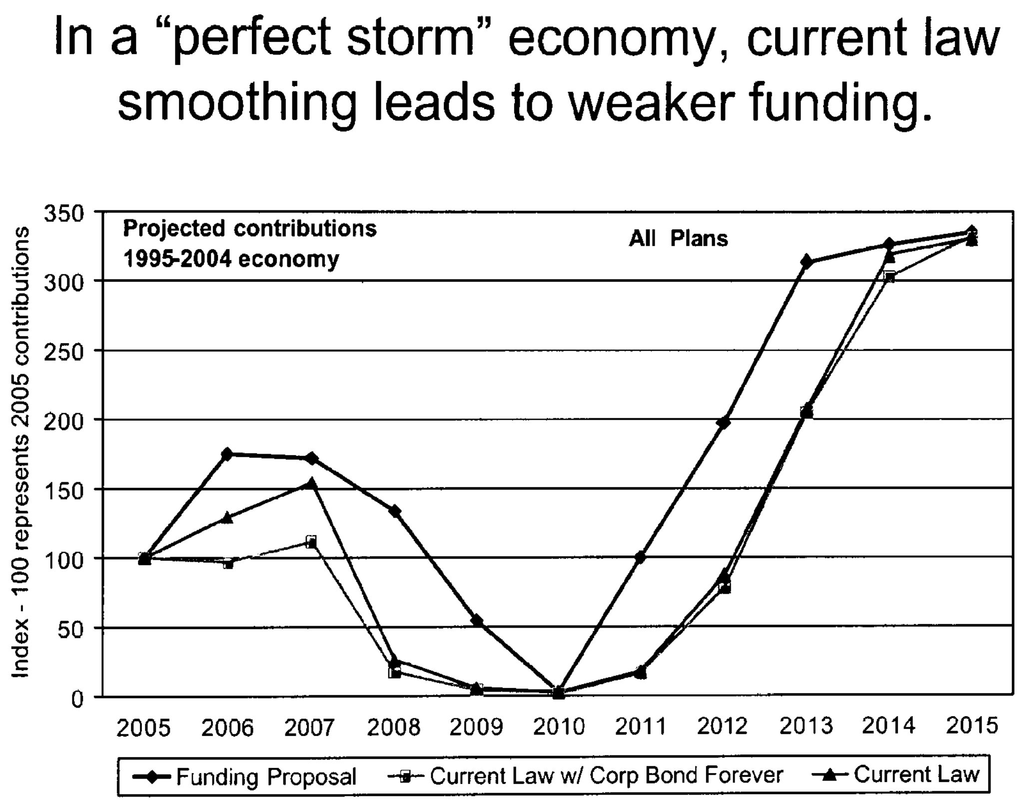
FIGURE 4



Finally, I want to address the issue of contribution volatility. To see how the proposal would have operated in the recent past, we will also look at the proposal's performance during in the economic environment of the most recent 10 year period 1995 to 2004 – a good choice for discussing volatility! Current funding numbers were used as a starting point to estimate funding ratios, contributions and claims.

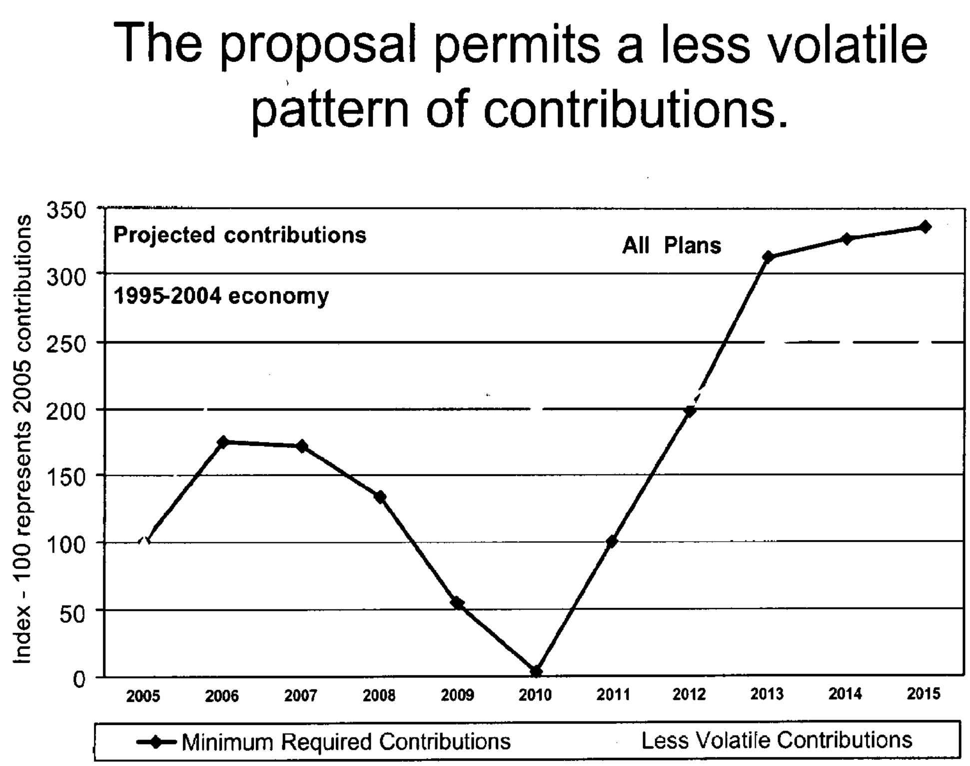
This slide [**FIGURE 5**] shows that Contributions are volatile under both current law and the funding proposal reflecting significant changes in interest rates and equity market values over the period; volatility, however, is actually lower under the funding proposal than under current law. That said, no one would want to experience this type of contribution volatility on a regular basis.

FIGURE 5



One feature of the proposal that will enable sponsors to control the type of funding volatility that occurs in the environments like that of the 1995 to 2004 period is the ability to make higher tax deductible contributions. In the next slide, [**FIGURE 6**] is a stylized example of how this new ability might be used by a sponsor to smooth contributions over this period. A smoothing contributor is assumed to contribute 25% above the required amount in 2006. In each subsequent year, contributions are assumed to be the greater of 98% of the prior year's contribution or the minimum required amount. The graph depicts the smoothed contribution path and compares it to the path under the proposal in which the sponsor makes only the minimum required contribution each year. This is a clear demonstration that using the features of the proposal, plan sponsors, guided by the wise counsel of the consulting actuary, can manage the volatility of their required contributions.

FIGURE 6



Conclusion

The results of these simulations suggest that the Administration's single employer defined benefit funding proposal will accomplish its primary goals of increasing the retirement security of defined benefit participants and decreasing losses to the pension insurance fund. Stochastic modeling indicates that benefit losses and claims are likely to be lower under the proposal than current law under a wide range of economic environments. We are proud of this proposal and feel that its enactment will improve and help maintain the defined benefit system.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 20, 2005
js-2398

Statement following meeting of Secretary Snow and EU Commissioner McCreevy in New York

U.S. Treasury Secretary John Snow and EU Commissioner for Internal Market, Charles McCreevy, met today to discuss issues facing the U.S. and EU in the areas of capital markets and financial regulation. Secretary Snow commended the EU for its vision of creating an integrated European capital market, which will contribute to a stronger global economy, and urged that Europe undertake strong efforts to implement the measures it has already adopted to create a liberal and open single financial market. He pledged that the Administration will continue its close cooperation with Europe through the US-EU Financial Market and Regulatory Dialogue in addressing issues of mutual concern with the aim of building a strong Transatlantic financial market anchored in the global system.

Commissioner McCreevy thanked Secretary Snow for Treasury's leadership of the dialogue and expressed satisfaction with the spirit of cooperation that has been forged. He committed to continue to discuss financial issues with the United States in the informal and cooperative manner that is the basis of the dialogue and has achieved important successes to date.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 20, 2005
JS-2399

The Honorable John W. Snow
Prepared Remarks to
The Bond Market Association
New York, NY

Good afternoon. It's great to be here in New York, and I appreciate the opportunity to speak with you today. We share important concerns, including the one at the top of the President's agenda: the long-range fiscal health of the nation's Social Security system, and the implications of both reform and of inaction.

My trip to New York is an important stop on the Administration's "60 Stops in 60 Days" tour on Social Security. This is week seven of that tour, and Administration officials like me – not to mention the President and Vice President – have made over 130 stops in 39 states so far. We're dedicated to achieving the President's vision for a national dialogue on Social Security, and I think we've been very successful. There really is a terrific, vibrant national dialogue going on. From Wall Street to Main Street, from lunch counters to family dinner tables to college dining halls... this conversation is taking place and that means we're making progress on saving and strengthening the system for all generations.

I know that reforming Social Security is an important topic for the members of this association and for the broader financial industry here in New York. You are obviously aware of the problems that the Social Security program faces. You understand what an enormous impact Social Security can have on our economy overall, and I know that you are interested in seeing the system successfully reformed in a way that protects beneficiaries as well as our economy – for the near term as well as for long term.

You are sharply aware of the fact that if those of us in the government don't pursue and enact meaningful changes now, the Social Security system would eventually need to be propped up with massive tax increases, which would send terrible shockwaves through our economy.

The American economy is the most dynamic and resilient in the world, but we cannot take that for granted, and this is something uniquely understood by financial leaders like you, who watch and participate in our markets every day. I have a message for you from our President: he understands that the government must plan for the future and deal with looming financial threats when we see them... and that's exactly what he is doing.

The President doesn't believe in ignoring the reality. He doesn't think it would be wise to turn a blind eye to the reports of the non-partisan Social Security actuaries, which tell us that the program faces a long-term deficit of $11 trillion. The President doesn't believe in costly procrastination – in this case to the tune of $700 billion every year that we wait to act.

The President is too intellectually honest to ignore the irrefutable facts, the undeniable fact that the Social Security system is on an unsustainable path. The demographics, the arithmetic, cannot be denied: Cash flows peak in 2008 and turn negative in 2017, and the trust fund itself will be exhausted in 2041. People are living longer and having fewer children, so there are fewer workers to support retirees. We had 16 workers paying into a system for every one beneficiary in 1950, and today we only have about three workers for every beneficiary. That ratio will drop to two-to-one by the time today's young workers retire.

When those young workers retire, in 2041, the system will be exhausted, bankrupt. Today's 30-year-old can expect a nearly 30 percent benefit cut from the current system when he/she reaches retirement age. Without action, our children and grandchildren will be faced with huge benefit cuts or massive tax increases.

The President doesn't want that future for America's younger workers. His leadership on Social Security reform displays his great courage as well as his dedication to doing what is right for the American people, for generations to come.

For the current generation of retirees, and near retirees – those who are 55 or older today – there will, of course, be no change. Those Americans still have an interest, a stake in the issue – but more because they care about the financial future of their children and grandchildren and want them to have a Social Security benefit they can count on when they retire.

I appreciate the support of this organization for the creation of personal retirement accounts for younger generations of workers. The President believes that it is a critical part of any Social Security reform that younger workers are given the opportunity to build a nest egg and benefit from sound long-term investment in the free market system. The power of compound interest is a mighty one; including personal retirement accounts in Social Security reform will mean opening a door to that force for people who would not have had the opportunity otherwise. This is an exciting and empowering proposition, and best of all we know that it can be done without disrupting the system of benefits for their parents and other generations of retired beneficiaries.

Social Security has been patched up in the past. We've raised taxes to take us through a few more generations of retirees. But the patches don't last because our demographics are working increasingly against us. We need lasting, meaningful reform. Part of lasting reform ought to be this option, for younger workers, to build a nest egg and I'm excited to be talking with this group about how to make that opportunity a reality in a fiscally responsible way that will not unsettle our financial markets. The President believes that a gradual approach to the establishment of personal retirement accounts – phasing in account participation and slowly phasing up the amount of allowable contributions – is the way to achieve those goals.

While Social Security reform addresses critical long-term deficits, I also want to share with you the action that the Administration is taking on the short-term budget deficit. A combination of spending restraint and economic growth – which increases Treasury receipts – is well underway and achieving results. We expect the 2005 deficit to be 3.5 percent of GDP; this is substantially lower than the 4.5 - 6 percent experienced at times in the 1980s and 1990s. The deficit is still but still too large, but with tight controls on discretionary spending and increased revenue stemming from the expanding economy, we expect to cut the deficit in half to well under 2% of GDP by 2009.

Ongoing budget deficit reduction must be accompanied by a recognition of, and plan for, the long-term unfunded liability that is the reality of the Social Security system's current structure. Insisting on the first while ignoring the second would be hypocritical and irresponsible. Dealing with both, head-on, is the fiscally responsible thing to do, and the President is fully dedicated to both.

It has been a pleasure to spend time with you, talking about an issue that is so important to all Americans. I am looking forward to seeing a bi-partisan bill in Congress that will bring us to the next stage of the Social Security reform movement. Any effort to improve something that impacts so many Americans must be bi-partisan, and I think we will see legislation that will save Social Security and strengthen it so that it offers a better deal to younger generations.

I look forward to continuing this dialogue with you as we move forward on this historic reform effort.

Thank you.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 21, 2005
JS-2400

Testimony of Secretary John W. Snow before the House Appropriations Subcommittee on the Departments of Transportation, Treasury, Housing and Urban Development, the Judiciary, District of Columbia, and Independent Agencies

Chairman Knollenberg, Mr. Olver, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the President's fiscal year 2006 budget for the Department of the Treasury.

The Department's budget reflects the President's top priorities for fiscal year 2006: fighting the financial war on terror while ensuring America's economic strength, and demonstrating the fiscal responsibility necessary to reduce the deficit. The fiscal year 2006 request of $11.6 billion also supports Treasury's longer term core strategic missions: promoting national prosperity through economic growth and job creation; maintaining public trust and confidence in our economic and financial systems; and ensuring the Treasury organization has the workforce, technology, and business practices to meet the nation's needs effectively and efficiently. This budget request focuses on the President's belief that the budget be fair while holding the government accountable. It adheres to the principle that "taxpayer dollars must be spent wisely, or not at all."

Mr. Chairman, we provided the Committee with a detailed breakdown and justification for President's fiscal year 2006 budget request for Treasury. I would like to take the opportunity today to point out some highlights of our request and then I'd be happy to take any questions you may have.

STRENGTHEN NATIONAL SECURITY

Treasury's budget reinforces the President's commitment to combating terrorist financing and safeguarding the U.S. financial system. Since September 11th, we have leveraged the relationships, resources, and expertise that we have acquired over the past several years in combating money laundering to address terrorist financing and protecting our financial systems. Our efforts in both attacking terrorist financing and protecting the financial system are complementary and are effecting the changes required to protect the integrity of our financial systems by identifying, disrupting and dismantling sources, flows, and uses of tainted capital within those systems. To support these efforts, the President requests $351.3 million for fiscal year 2006.

The Office of Terrorism and Financial Intelligence (TFI) leads Treasury's efforts to sever the lines of financial support to international terrorists and serves as a critical component of the Administration's overall effort to keep America safe from terrorist plots. The establishment of TFI unifies leadership for the functions of the Office of Intelligence Analysis (OIA), the Office of Terrorist Financing and Financial Crimes (TFFC), the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), and the Treasury Executive Office for Asset Forfeiture (TEOAF). The objectives of unifying this leadership are better coordination of Treasury's array of economic tools against terrorist and national security threats. To safeguard financial systems both at home and abroad, TFI draws upon a range of capabilities that cut across various categories, including financial sanctions, financial regulation and supervision, international initiatives, private sector outreach, and law enforcement support. TFI consolidates the policy, enforcement, regulatory, international, and analytical functions of the Treasury and adds to them critical intelligence components. OIA provides focused and operable intelligence in support of the Department's mission and policies. TFI's enforcement responsibilities are executed by the TFFC, OFAC, and FinCEN. Finally, TFI provides policy guidance for the IRS-Criminal Investigation Division (IRS-CI) in their anti-money laundering, terrorist financing, and financial crimes cases.

Since September 2001, the <<United States>> and its allies have designated 399 terrorist related entities and frozen over $147 million in terrorist assets. TFI has designated and frozen the assets of prominent terrorist financiers and organizations, including Adel Batterjee, a Saudi financier of al Qaida, and the Islamic African Relief Agency, a corrupt global charity that supported Usama bin Laden and HAMAS. Thanks to collaborative efforts by TFI and other agencies, the U.S. has facilitated the finding and freezing of nearly $6 billion in Iraqi assets outside of Iraq, the return of over $2.7 billion of those funds, and the recovery of more than $1 billion in cash inside Iraq.

Treasury's fiscal year 2006 request includes increases for resources to enhance Treasury's analytical capability so that senior officials have access to actionable financial intelligence. The request also supports TFI creating a 21st century information technology infrastructure to assist in the global fight against terror.

The Financial Crimes Enforcement Network has a major role in supporting TFI's enforcement responsibilities. The President's request includes $73.6 million for FinCEN to support its mission to safeguard the financial system from abuses of financial crime, including terrorist financing, money laundering and other illicit activity. This increase will provide FinCEN with the funding needed to enhance its outreach efforts to financial institutions newly covered by Bank Secrecy Act regulations and strengthen examination and enforcement activities; strengthen analytical support services; and expand FinCEN's support to other international financial intelligence units to facilitate information exchange.

The IRS-CI also plays a key role in investigating financial crimes. The request supports the unique skills and expertise of IRS-CI agents in investigating tax fraud and financial crimes not only to support tax compliance, but also benefit the war on terror and our efforts to root out financial crimes. These agents apply their training, skills, and expertise to support the national effort to combat terrorism and participate in the Joint Terrorism Task Force and other similar interagency efforts focused on disrupting and dismantling terrorist financing.

In addition, the Office of Critical Infrastructure Protection and Compliance Policy leads our efforts to safeguard the financial infrastructure. This Office works closely with other federal agencies and the private sector to safeguard our infrastructure. That is essential, given that the majority of the critical financial infrastructure of the United States is owned and operated by the private sector.

Finally, an essential aspect of ensuring our national security is to secure fragile states and foster sustainable development in the world's poorest nations. The Office of International Affairs uses bilateral diplomacy and its role as steward of the international financial institutions, including the World Bank and International Monetary Fund--to create the economic growth that will reduce conflict and the conditions that favor terrorism in the developing world.

ENSURE FINANCIAL SECURITY

Treasury's strategic goal to manage the U.S. Government's finances effectively is the largest part of the President's fiscal year 2006 request for the Department. The budget request of $11 billion -- the majority of which is for the Internal Revenue Service -- underscores our commitment to provide quality service to taxpayers and enforce America's tax laws in a balanced manner. The request includes a 7.8 percent increase in enforcement funding over fiscal year 2005. The increase will provide additional resources to examine more tax returns, collect past due taxes and investigate cases of tax evasion.

It is important that these enforcement investments be fully funded, therefore the Administration is proposing to fund them as contingent appropriations. The Administration proposes to employ a budget enforcement mechanism that allows for an adjustment by the Budget Committees to the section 302(a) allocation to the Appropriations Committees found in the concurrent resolution on the budget. In addition, the Administration will also seek to establish statutory spending limits, as defined by section 251 of the Balanced Budget and Emergency Deficit Control Act of 1985, and to adjust them for this purpose. To ensure full funding of the program and inflationary cost increases, either of these adjustments would only be permissible if the Congress funded the base level for IRS enforcement at $6.4 billion and restricted the use of the funds. The maximum allowable adjustment to the 302(a) allocation and/or the statutory spending limit would be $446 million for fiscal year 2006, bringing the total enforcement level in the IRS to $6.9 billion.

The proposed fiscal year 2006 budget makes a strong commitment to a sound system of tax administration. The IRS collects $2 trillion annually; however, billions continue to go uncollected every year. The increase in enforcement funding will be used to bolster audit coverage of corporations and high-income individuals who try to evade taxes as well as to expand collection and criminal investigation efforts. These investments will pay for themselves several times over.

The President's request also provides $199 million to continue efforts to modernize the tax system through investments in IRS' Business Systems Modernization (BSM). The modernization program is providing real business benefits to taxpayers and IRS employees by delivering several modernized systems. For example, the Service implemented the Integrated Financial System that replaces its administrative accounting system. BSM funding allowed IRS to fully deploy online e-Services functionality for tax practitioners and other third parties, such as banks and brokerage firms allowing improved and faster interactions for transactions such as the application for e-filing, requests for Preparer Tax Information Number and Secure Electronic Return Originator applications, among many other products. The IRS also deployed Modernized e-File, which provides e-filing for the first time to large corporations and tax-exempt organizations. Replacing the outdated legacy system, the Customer Account Data Engine, which began processing the simplest 1040 EZ returns in July of last year, is a modern database that will eventually house tax information for more than 200 million tax returns per year.

The IRS also administers a refundable tax credit for the cost of health insurance for both qualified individual and family members. The request provides $20.2 million to continue implementation and operation of the Health Insurance Tax Credit Program. The annual cost of this program is reduced by over $15 million due to IRS' active program oversight and cost-cutting initiatives.

The Alcohol and Tobacco Tax and Trade Bureau (TTB) is responsible for the regulation of the alcohol and tobacco industries, and the collection of $14.7 billion annually in alcohol, tobacco, firearms, and ammunition excise taxes at a cost of $1 for every $368 collected. Our fiscal year 2006 request includes $91.1 million for TTB. The budget proposes to establish user fees to cover a portion of the costs of TTB's regulatory functions under its Protect the Public line-of-business.

The budget also includes a $236.2 million request for the Financial Management Service (FMS), which administers the government's payments and collections systems. In FY 2004, FMS issued more than 940 million non-Defense payments, 705 million electronic payments and 235 million paper checks, FMS annually issues more than 940 million non-Defense payments valued at $1.5 trillion. The Budget provides funding for FMS' electronic initiatives, such as: Pay.gov, which is a Government-wide web portal to collect non-tax revenue electronically; Paper Check Conversion, which converts checks into electronic debits thereby moving funds more quickly; and Stored Value Cards, which directly support military operations overseas. The fiscal year 2006 request also includes legislative proposals to improve and enhance opportunities to collect delinquent debt through FMS' debt collection program.

The Bureau of the Public Debt (BPD) continues its management and improvement of federal borrowing and debt accounting processes. The budget requests $179.9 million in direct appropriations for BPD which includes $3 million in user fees. The funding will allow BPD to continue improving the efficiency of the securities services to customers by expanding TreasuryDirect, an investment system that will enable Treasury customers to manage their investment accounts online.

The functions of the United States Mint and the Bureau of Engraving and Printing (BEP) are vital to the health of our nation's economy. These two agencies fulfill the Treasury Department's responsibility of meeting global demand for the world's most accepted coins and currency. The United States Mint also continues to manufacture and market popular numismatic products, while BEP also continues to develop new designs of next generation currency to guard against counterfeiting.

PROMOTE ECONOMIC OPPORTUNITY

The Treasury Department works to ensure that U.S. and world economies perform at full economic potential. To reach this potential, the economy must increase its rate of growth and create new, high quality jobs for all Americans. The legal and regulatory framework must also support this growth by providing an environment where businesses and individuals can grow and prosper without the burdens and costs of unnecessary rules and regulations.

Our budget requests $1.6 billion to support these strategic goals. The request includes funds for policy offices that guide domestic economic development, tax programs, financial institutions and other fiscal matters. These policies are essential as Treasury works to simplify the U.S. tax code and create a legal and regulatory framework that allows the nation's businesses to thrive.

Treasury's international programs and three Treasury bureaus, the Community Development Financial Institutions Fund, the Office of the Comptroller of Currency and the Office of Thrift Supervision play diverse roles in fostering economic growth and prosperity. From serving as the President's principal economic advisor to maintaining the health of the national banking and thrift system, the Treasury has a significant influence on creating the conditions for a robust economy. Through the Office of International Affairs, the Treasury also pursues diplomacy to create the conditions for global growth, which creates economic opportunity at home and overseas, by a range of actions, including the reduction of undue barriers to trade and investment and the establishment of stability in the international financial system.

Treasury's international assistance programs request of $1.5 billion for fiscal year 2006 is part of the Foreign Operations, Export Financing, and Related Program Appropriations Act. These programs include multilateral development banks (MDBs), debt reduction, and technical assistance -- all critical instruments to promote the Administration's international economic agenda. MDBs promote global economic growth and poverty reduction, and help create stronger markets for U.S. goods and services. Debt reduction helps poor countries move to a sustainable level of debt and remove debt overhang that inhibits growth. Our technical assistance programs help countries institute the sound budget and financial systems needed for economic growth.

MANAGE FOR RESULTS

The President requests $211.8 million to protect the integrity and effectively manage the resources of the Department of Treasury, and ensure that it remains a world class organization. Included in this request is $16.7 million to fund the Department's Office of Inspector General (OIG) and augment audit and investigative capabilities.

This portion of the budget also includes $133.3 million for the Inspector General for Tax Administration (TIGTA) and its efforts to oversee the nation's tax administration. TIGTA continues to play a significant role in providing independent oversight, which promotes efficiency and integrity in the IRS' ability to collect $2 trillion annually. TIGTA aggressively combats any identified attempts to disrupt and/or interfere with tax administration. The nation's voluntary tax compliance system is supported and protected by TIGTA agents who participate in the Joint Terrorism Task Force and proactively seek to identify individuals or groups who pose a threat to effective tax administration. Critical information is shared with the IRS and allows the leaders of the IRS to make effective business decisions, which promote efficient tax administration and support IRS employee safety.

The proposed budget request includes $7.9 million in new funding to provide for an improved technology infrastructure, essential for keeping pace with the Department's needs to enhance productivity, improve communication, interact effectively with the world-wide financial community, and meet other management needs. Funding will be used to improve the Department's information technology infrastructure to ensure the effectiveness of the Department in managing federal finances and combating financial crimes and terrorist financing. The request also ensures that the Department will continue its major facilities projects and services for the Main Treasury and Treasury Annex buildings to ensure the safety and health of occupants and perform structural repairs and improvements. Additional funds will allow Treasury to complete the project during fiscal year 2006 and reoccupy the restored office space.

THE PRESIDENT'S MANAGEMENT AGENDA

Treasury has focused its management initiatives around the goals of the President's Management Agenda (PMA). Under guidance from the PMA, the Treasury has grasped tangible results in managing the nation's finances, taking advantage of new opportunities and opposing threats. The Department is committed to defining desired results for each area and managing to achieve them, at acceptable cost levels.

In fiscal year 2004, Treasury achieved significant milestones in implementing the President's Management Agenda, improving three of our five status scores for the PMA over the prior year.

Treasury managed for results as we implemented a new performance appraisal system for our Senior Executive Service that links managers' performance assessments to accomplishing the Department's top priorities. We are also focusing on recruiting and retaining a world-class workforce, and have started implementing a new Human Capital Strategic Plan. This plan is the Department's roadmap for molding a workforce of engaged, highly competent, and business-aligned employees.

The Department is making good progress on using competition to improve efficiency. This past year, we completed five public-private competitions, and as a result, expect savings of $200 million over the next five years. Our efficiency initiatives have received national recognition, winning the President's Quality Award for Management Innovation at the IRS for our Area Distribution Center competition.

Treasury continues to be a leader in making financial information available in a timely manner through a three-day close of its books at the end of each month, and for the fifth consecutive year we received a clean audit opinion. The Department continues to work at securing our information systems. Our systems are more secure now than at any other time, with 86 percent certified and accredited as secure at the end of 2004.

CONCLUSION

Mr. Chairman, I look forward to working with you, members of the Committee, and your staff to maximize Treasury's resources in the best interest of the American people and our country as we move into fiscal year 2006. We have hard work ahead of us and I am hopeful that together we can work to make the Treasury a model for management and service to the American people, and continue to generate economic growth, increase the number of jobs for our citizens, and keep our financial systems strong and secure.

Thank you again for the opportunity to present the Treasury Department's budget today. I would be pleased to answer your questions.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 21, 2005
JS-2401

Treasury Wields PATRIOT Act Powers
to Isolate Two Latvian Banks
Financial Institutions Identified as
"Primary Money Laundering Concerns

The U.S. Department of the Treasury today utilized *USA PATRIOT Act* powers to designate two Latvian financial institutions as "primary money laundering concerns." Multibanka and VEF Bank were named pursuant to Section 311 of the *Act* for money laundering activities and financial abuse by account holders and owners.

"The Treasury has judiciously and strategically utilized the power of Section 311 to isolate rogue actors that present money laundering concerns and risks to the U.S. financial sector," said Treasury Secretary John W. Snow. "Our use of this authority also alerts our global counterparts of specific concerns about real threats to the integrity of the international financial system."

In conjunction with this designation, Treasury's Financial Crimes Enforcement Network (FinCEN) issued proposed rules that when made final will prohibit U.S. financial institutions from establishing, maintaining, administering or managing any correspondent account in the United States for or on behalf of these two banks.

"These two Latvian banks represent a danger to the international community because they facilitate the placement and movement of dirty money in the global financial system," said Daniel Glaser, the Treasury's Deputy Assistant Secretary for Terrorist Financing and Financial Crimes. "We will continue to work closely with the Latvian government to crack down on crimes in their financial sector."

Multibanka

Headquartered in Riga, Multibanka is the oldest commercial bank in Latvia and is among the smaller of Latvia's 23 banks. Multibanka has four foreign offices (Russia, Ukraine and Belarus), five domestic branches and one leasing subsidiary called Multilizings. The Notice of Proposed Rulemaking issued today identifies several reasons for the designation of Multibanka as a primary money laundering concern:

- Multibanka offers confidential banking services and numbered accounts for non-Latvian customers. Reports substantiate that a significant portion of its business involves wiring money out of the country on behalf of its accountholders.
- Information available to the U.S. Government shows Multibanka has been used by Russian and other shell companies to facilitate financial crime by allowing criminals to disguise illegal proceeds in countries known for lax enforcement of anti-money laundering laws.
- According to information available to the U.S. Government, certain criminals use accounts at Multibanka to facilitate financial fraud schemes. Specifically, an individual involved in financial fraud reported carrying out large sum transactions through his account at Multibanka. In addition, an individual arrested in 2004 for his involvement in an access device fraud ring used an account at Multibanka to launder proceeds of his criminal activities.

VEF Bank

Headquartered in Riga, VEF is one of the smallest of Latvia's 23 banks. It has one subsidiary, Veiksmes līzings, which offers financial leasing and factoring services. In addition to its headquarters in Riga, VEF has one branch in Riga, and one representative office in the Czech Republic. The Notice of Proposed Rulemaking issued today identifies several reasons for the designation of VEF Bank as a primary money laundering concern:

- VEF Bank lacks adequate controls and procedures to detect and combat money laundering. These deficiencies, coupled with the bank's dealings with foreign shell companies and provision of confidential banking services, make VEF vulnerable to money laundering and other financial crimes.
- VEF Bank offers confidential banking services for non-Latvian customers. Less than 20 percent of these deposits are from individuals or companies located in Latvia, an indicator that a bank may be used to launder money.

Title III of the *USA PATRIOT Act* amends the anti-money laundering provisions of the *Bank Secrecy Act* (BSA) to promote the prevention, detection and prosecution of international money laundering and the financing of terrorism. Section 311 authorizes the Secretary of the Treasury – in consultation with the Departments of Justice and State and appropriate Federal financial regulators – to designate a foreign jurisdiction, institution, class of transactions or type of account to be of "primary money laundering concern" and to require U.S. financial institutions to take certain "special measures" against the designee.

These special measures range from enhanced recordkeeping or reporting obligations to a requirement to terminate correspondent banking relationships with the designated entity. The measures are meant to provide Treasury with a range of options to most effectively target specific money laundering and terrorist financing.

The Treasury Department has previously identified the following financial institutions as "primary money laundering concerns," pursuant to Section 311:

- The First Merchant Bank of the "Turkish Republic of Northern Cyprus" ("TRNC") and Infobank of Belarus in August 2004;
- The Commercial Bank of Syria and its subsidiary Syrian Lebanese Commercial Bank in May 2004; and
- Myanmar Mayflower Bank and Asia Wealth Bank in November 2003.

The Bush Administration has also taken action, pursuant to Section 311, against the foreign jurisdictions of Burma, Nauru and the Ukraine. The designation of the Ukraine was lifted after Ukrainian authorities took subsequent and aggressive steps to address the concerns and risks identified in the 311 action.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 21, 2005
JS-2402

U.S. and Bulgaria to Negotiate Income Tax Treaty

WASHINGTON, DC -- The United States and Bulgaria announced today that they plan to begin negotiation of a bilateral income tax treaty. The first round of negotiations are expected to take place in the autumn of 2005. The treaty would be the first tax treaty between the two countries.

The Treasury Department invites written comments from the public regarding the upcoming negotiations. Comments should be sent to Patricia Brown, Acting International Tax Counsel, Room 5064C Main Treasury Building, 1500 Pennsylvania Avenue, NW, Washington, DC 20220.

Comments also may be sent by fax to (202) 622-1772, or by e-mail to Patricia.A.Brown@do.treas.gov.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 21, 2005
JS-2403

Statement by Secretary of the Treasury John Snow

I am pleased that the House has passed energy legislation that will provide the reliable supplies of energy we need for a growing economy. A dependable energy supply will reduce our reliance on foreign oil and spur economic growth. One of the best things we can do for our economy is to get an energy bill enacted.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 22, 2005
JS-2404

Treasury Officials to Join Bankers in Schools Across the Country for 9th Annual Teach Children to Save Day

Treasury is teaming up with the American Bankers Association Education Foundation next week for the ninth annual Teach Children to Save Day. More than 20 Treasury officials will join local bankers across the country on April 26 to visit primary, elementary, middle and high schools to teach students the importance of saving.

"Teach Children to Save Day is an opportunity for us to highlight what teachers, parents, community leaders and so many other dedicated groups and individuals are hard at work on all year long – providing today's children with the knowledge they need to make sound financial decisions throughout their lifetimes," said Treasury Secretary John W. Snow. "Knowing the facts has a way of opening doors, and when it comes to a secure economic future, we want to make sure that the doors of opportunity are wide open for America's youth."

Secretary Snow and Treasurer Anna Escobedo Cabral will join ABA Chairman Elizabeth A. Duke to kick off the nationwide efforts with fifth-graders from Seaton Elementary at Treasury's Bureau of Engraving and Printing (located at 14th and C Streets, S.W. in Washington, DC) at 1:30 p.m. EDT on April 26. All attending press must call (202) 874-2778 by 3 p.m. April 25, with name, media organization, and phone number for security clearance. Media should use the 14th and C Streets S.W. (tour) entrance. Media will be asked to show press credentials.

Across the country, a total of 23 Treasury officials will be joining bankers in classrooms to teach lessons including games and activities that illustrate the value of saving, budgeting and the power of interest. For more information on National Teach Children to Save Day, please visit www.aba.com and click on "Consumer Connection."

Media interested in covering the following events should contact Treasury's Public Affairs Office at (202) 622-2960 or Laura Fisher with the ABA at (202) 663-5466. The following events scheduled for Tuesday, April 26, are open to the press:

Bobbie Gray, Office of Financial Education

- Glenn Dale Elementary School
  6700 Glenn Dale Road
  Glenn Dale, MD
  8:30 a.m. EDT

Luke Bernstein, Office of Financial Education

- Valley Elementary School
  100 Rock Glen Rd
  Sugarloaf, PA
  9:20 a.m. AND 10:05 a.m. EDT

Bobby Pittman, Deputy Assistant Secretary for International Development Finance and Debt

- Fulton Elementary School
  11600 Scaggsville Road

Fulton, MD
9:30 a.m. EDT

Ed Christovich, Office of Financial Education

- St. Peters Interparish School
  422 Third Street, S.E.
  Washington, DC
  9:30 a.m. EDT

Jean Card, Senior Writer

- Kipp DC KEY Academy (Knowledge Empowers You)
  770 M Street, S.E.
  Washington, DC
  10:00 a.m. EDT

Madelyn Simmons Marchessault, United States Mint
Robert Robidoux, Philadelphia Mint Plant Manager

- 151 North Independence Mall East
  Philadelphia, PA
  10:00 a.m. EDT

Don Hammond, Acting Under Secretary for Domestic Finance

- Key School
  5001 Dana Place, N.W.
  Washington, DC
  10:00 a.m. EDT

Paul Curry, Executive Secretary

- Just Elementary
  1315 Spruce Street
  Tampa, FL
  10:30 a.m. EDT
- Bauder Elementary
  12755 86th Ave
  Seminole, FL
  2:00 p.m. EDT

Robert Carroll, Deputy Assistant Secretary for Tax Analysis

- Maury Elementary
  600 Russell Road
  Alexandria, VA
  10:30 a.m. EDT

Dan Iannicola, Deputy Assistant Secretary for Financial Education

- Indian Land High School
  8361 Charlotte Highway
  Fort Mill, SC
  12:00 p.m. EDT

Sandra Pedroarias, Office of Financial Education

- Buzz Aldrin Elementary
  11375 Center Harbor Road
  Reston, VA
  1:00 p.m. EDT

Greg Zerzan, Acting Assistant Secretary for Financial Institutions

- Mt. Elden Middle School
  3223 North Fourth Street
  Flagstaff, AZ
  8:45 a.m. MDT

D.J. Vogt, Office of Legislative Affairs

- Henderson Elementary
  2820 Henderson Drive
  Cheyenne, WY
  9:00 a.m. MDT

Roger Kodat, Deputy Assistant Secretary for Government Financial Policy

- Cheyenne-Eagle Butte High School
  Cheyenne River Sioux Tribal Reservation
  Eagle Butte, SD
  10:25 a.m. AND 12 p.m. MDT
- Tiospaye Topa School
  Cheyenne River Sioux Tribal Reservation
  La Plante, SD
  1:30 p.m. AND 2:30 p.m. MDT

Kimberly Reed, Senior Advisor to the Secretary

- Rossiter Elementary School
  1497 Sierra Road East
  Helena, MT
  10:30 a.m. AND 2 p.m. MDT

Troy Stang, Community Development Financial Institutions Fund

- Sunrise Elementary
  14603 East 24th Avenue
  Spokane, WA
  10:45 a.m. PDT

Jesse Villarreal, Office of Domestic Finance

- Parrish Middle School
  802 Capitol Street N.E.
  Salem, OR
  11:15 a.m. PDT

D. Scott Parsons, Deputy Assistant Secretary for Critical Infrastructure Protection

- Mabel Hoggard Elementary
  950 N. Tonopah Drive
  Las Vegas, Nevada
  12:00 p.m. PDT

Mike Garcia, Office of Domestic Finance

- Cordoba Lane Elementary
  2460 Cordoba Lane
  Rancho Cordoba, CA
  1:00 p.m. PDT

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 22, 2005
js-2405

Secretary Snow to Join Treasurer to Unveil Currency Signed by Cabral

Treasury Secretary John W. Snow will join Treasurer Anna Escobedo Cabral next week at the Bureau of Engraving and Printing (BEP) for the unveiling of the first paper currency with the new Treasurer's signature. The Secretary and Treasurer will witness the final stages of the printing process of the first notes with Treasurer Cabral's signature at 1:30 p.m. on April 26 at the BEP's printing facilities located at 14th and C Streets S.W. in Washington, D.C.

"Having my signature on the U.S. currency is a tremendous honor; sharing that honor with Anna Cabral is priceless. Like the bills that her signature will grace, Anna is a representation of that which makes America great. She is an enormously accomplished woman and one of the finest leaders we have in government today. I'm thrilled to see her signature on the currency, and I know the President is delighted to have her serving in his Administration. She is an invaluable asset to the Treasury and to her country," said Secretary Snow.

Immediately following the unveiling of the new notes, the Secretary and Treasurer will kick off Treasury's participation in a nationwide effort to teach children the importance of saving. Partnering with the American Bankers Association Education Foundation, more than 20 Treasury officials will join local bankers in classrooms across the country for the ninth annual Teach Children to Save Day on April 26. Secretary Snow and Treasurer Cabral will highlight these efforts by speaking to a group of fifth-graders from Seaton Elementary in Washington, D.C. at the BEP about the importance of financial education. For more information on this event, go to: http://www.treasury.gov/press/releases/js2404.htm.

The currency unveiling will be pool coverage only.

All media are welcome to cover the financial education lesson at the BEP. Press wishing to attend this portion of the event must call (202) 874-2778 by 3 p.m. EST, Monday, April 25 with name, media organization, and phone number for security clearance.

The signatures of Secretary Snow and Treasurer Cabral were transferred by the BEP's engravers to steel plates, which will be used to print all new U.S. paper currency. Since the introduction of the smaller-size notes in 1929, the signatures of 24 Treasury Secretaries and 16 Treasurers – including Secretary Snow and Treasurer Cabral – have appeared on U.S. paper currency.

The new $1 Series 2003 A Snow-Cabral notes are expected to be sent to the Federal Reserve by the end of April for distribution as needed.

Each business day, the BEP produces roughly 38 million notes with a face value of approximately $696 million. An estimated $719 billion in U.S. paper currency is currently in circulation worldwide.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

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April 26, 2005
js-2406

Treasury Designates Viktor Bout's International Arms Trafficking Network

The U.S. Department of the Treasury today identified 30 companies and four individuals linked to Viktor Bout, an international arms dealer and war profiteer. Today's action took place pursuant to Executive Order 13348, which targets family members and associates of former Liberian President Charles Ghankay Taylor. Bout himself was designated under the same authority in July 2004 because of his association with Taylor.

"Our targeted sanctions are exposing and isolating the core elements of the Bout financial empire and illicit arms pipeline," said Juan Zarate, the Treasury's Assistant Secretary for Terrorist Financing and Financial Crimes. "The Treasury remains committed to fulfilling our international obligations to sanction the former Charles Taylor regime by taking aggressive action against Bout front companies and agents."

The U.S. is submitting the 30 companies and four individuals to a Sanctions Committee established by United Nations Security Council Resolution 1521, which will consider adding them to the consolidated list of individuals and entities tied to Taylor.

This designation is the result of close coordination with the Departments of Justice and State, federal law enforcement agencies and UN officials.

"Today's announcement is an excellent example of how the Treasury's Office of Terrorism and Financial Intelligence (TFI) works hand-in-hand with our counterparts in the U.S. Government to maximize the effectiveness of our financial tools, in this case, OFAC's designation authority, to isolate rogue actors," said Stuart Levey, the Treasury's Under Secretary for TFI.

Bout runs a network of air cargo companies that are based in various countries in the Middle East, Africa, Eastern Europe and the United States. Additionally, Bout controls what is reputed to be the largest private fleet of Soviet-era cargo aircraft in the world.

Shortly after the breakup of the Soviet Union, Bout, a former Soviet air force officer with a gift for languages, was able to acquire surplus or obsolete airplanes which he used to deliver arms and ammunition from old Soviet stockpiles. The high profits he garnered supplying military equipment to rebel groups and sanctioned regimes allowed him to expand his business. Notably, information available to the U.S. Government shows that Bout profited $50 million from supplying the Taliban with military equipment when they ruled Afghanistan.

Today, Bout has the capacity to transport tanks, helicopters and weapons by the tons to virtually any point in the world. The arms he has sold or brokered has helped fuel conflicts and support UN sanctioned regimes in Afghanistan, Angola, the Democratic Republic of Congo, Liberia, Rwanda, Sierra Leone and Sudan.

The firms designated today include Bout's flagship entity, *Air Cess*. This company first appeared in Belgium in 1996 although it was registered in Monrovia, Liberia with Bout as its head. Other key major firms in the network include *Centrafrican Airlines, San Air General Trading, Air Bas, CET Aviation, Irbis, Transavia Travel,* and *Santa Cruz Imperial*. San Air and Centrafrican played a key role in supplying arms to Charles Taylor's regime in Liberia and the Sierra Leone rebel group, the Revolutionary United Front (RUF). In exchange for these supplies, Bout received payment from the Liberia's international ship registry as well as diamonds and other valuable commodities acquired illegally by Taylor's associates and the RUF.

Individuals named today include Bout's older brother Sergei, two senior Bout managers – Serguei Denissenko and Valeriy Naydo – and Bout's U.S.-based chief financial officer, Richard Chichakli.

Today's action prohibits any transactions between U.S. persons and the designated entities and also freezes any assets of the designated persons that are within U.S. jurisdiction.

The 34 new names bring the total number of individuals and entities designated under E.O. 13348 thus far to 62. For a complete list of entities designated today, please visit: http://www.treas.gov/offices/enforcement/ofac/actions/20050426.shtml.

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REPORTS

- Please find attached a diagram of the entities designated today.

LIBERIA/CHARLES TAYLOR E.O.

VIKTOR BOUT BUSINESS EMPIRE

April 2005

U.S. Department of Treasury
Office of Foreign Assets Control

VIKTOR BOUT
DOB: 13 JANUARY 1967
Currently resides in Russia
(designated 23 July 2004)

AIR CARGO COMPANIES

- **AIR CESS** — Malabo, Equatorial Guinea; Sharjah, U.A.E.; Islamabad, Pakistan; Entebbe, Uganda
- **AIRBAS TRANSPORTATION** — Sharjah, UAE; Richardson, Texas, USA
- **CENTRAFRICAN AIRLINES** — Bangui, Central African Republic; Sharjah, UAE; Ajman, UAE; Ras al Khaimah, UAE; Kigali, Rwanda
- **SAN AIR GENERAL TRADING** — Ajman, UAE; Richardson, Texas, USA
- **SANTA CRUZ IMPERIAL** — Dubai, UAE; Sharjah, UAE
- **TRANSAVIA NETWORK** — Sharjah, UAE; Ajman UAE; Ostende, Belgium
- **ABIDJAN FREIGHT** — Abidjan, Ivory Coast
- **AIR ZORY** — Sofia, Bulgaria; Nicosia, Cyprus
- **BUKAVU AVIATION TRANSPORT** — Democratic Republic of Congo
- **BUSINESS AIR SERVICES** — Democratic Republic of Congo
- **GAMBIA NEW MILLENIUM AIR COMPANY** — Banjul, Gambia
- **IRBIS AIR COMPANY** — Almaty, Khazahkstan
- **MOLDTRANSAVIA SRL** — Chisinau, Moldova
- **ODESSA AIR** — Entebbe, Uganda

MANAGERS/ASSOCIATES

- **SERGEI ANATOLYIEVICH BOUT** — Sharjah, UAE; Sofia, Bulgaria; Moscow, Russia; DOB: 27 August 1961
- **RICHARD A. CHICHAKLI** — Richardson, TX, USA; DOB: 29 March 1959

- **SERGUEI DENISSENKO** — Ajman, UAE; Richardson, TX, USA; DOB: 1961
- **VALERIY NAYDO** — Ajman, UAE; DOB: 10 August 1957

HOLDING/SHELL COMPANIES

- **ATC LTD.** — Gibraltar
- **CET AVIATION ENTERPRISE** — Ajman, UAE; Equatorial Guinea
- **NORDIC, LTD.** — Sofia, Bulgaria
- **ROCKMAN LTD.** — Sofia, Bulgaria
- **SOUTHBOUND LTD.** — Gibraltar
- **VIAL COMPANY** — Delaware, USA
- **WESTBOUND LTD.** — Gibraltar

CHICHAKLI-CONTROLLED FIRMS*

- CENTRAL AFRICA DEVELOPMENT FUND
- CHICHAKLI & ASSOCIATES PLLC
- CONTINUE PROFESSIONAL EDUCATION INC.
- DAYTONA POOLS, INC.
- DHH ENTERPRISE, INC.
- IB OF AMERICA HOLDINGS, INC
- ORIENT STAR CORPORATION
- RICHARD A. CHICHAKLI, P.C.
- TRANS AVIATION GLOBAL GROUP INC.

*ALL SHARE THE SAME ADDRESS IN RICHARDSON, TEXAS, USA EXCEPT FOR DAYTONA POOLS

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 26, 2005
js-2407

Testimony of Secretary John W. Snow
before the
Senate Appropriations Subcommittee on Transportation, Treasury, the Judiciary,
Housing and Urban Development, and Related Agencies

Chairman Bond, Senator Murray, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the President's fiscal year 2006 budget for the Department of the Treasury.

The Department's budget reflects the President's top priorities for fiscal year 2006: fighting the financial war on terror while ensuring America's economic strength, and demonstrating the fiscal responsibility necessary to reduce the deficit. The fiscal year 2006 request of $11.6 billion also supports Treasury's longer term core strategic missions: promoting national prosperity through economic growth and job creation; maintaining public trust and confidence in our economic and financial systems; and ensuring the Treasury organization has the workforce, technology, and business practices to meet the nation's needs effectively and efficiently. This budget request focuses on the President's belief that the budget be fair while holding the government accountable. It adheres to the principle that "taxpayer dollars must be spent wisely, or not at all."

Mr. Chairman, we provided the Committee with a detailed breakdown and justification for President's fiscal year 2006 budget request for Treasury. I would like to take the opportunity today to point out some highlights of our request and then I'd be happy to take any questions you may have.

STRENGTHEN NATIONAL SECURITY

Treasury's budget reinforces the President's commitment to combating terrorist financing and safeguarding the U.S. financial system. Since September 11th, we have leveraged the relationships, resources, and expertise that we have acquired over the past several years in combating money laundering to address terrorist financing and protecting our financial systems. Our efforts in both attacking terrorist financing and protecting the financial system are complementary and are effecting the changes required to protect the integrity of our financial systems by identifying, disrupting and dismantling sources, flows, and uses of tainted capital within those systems. To support these efforts, the President requests $351.3 million for fiscal year 2006.

The Office of Terrorism and Financial Intelligence (TFI) leads Treasury's efforts to sever the lines of financial support to international terrorists and serves as a critical component of the Administration's overall effort to keep America safe from terrorist plots. The establishment of TFI unifies leadership for the functions of the Office of

Intelligence Analysis (OIA), the Office of Terrorist Financing and Financial Crimes (TFFC), the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), and the Treasury Executive Office for Asset Forfeiture (TEOAF). The objectives of unifying this leadership are better coordination of Treasury's array of economic tools against terrorist and national security threats. To safeguard financial systems both at home and abroad, TFI draws upon a range of capabilities that cut across various categories, including financial sanctions, financial regulation and supervision, international initiatives, private sector outreach, and law enforcement support. TFI consolidates the policy, enforcement, regulatory, international, and analytical functions of the Treasury and adds to them critical intelligence components. OIA provides focused and operable intelligence in support of the Department's mission and policies. TFI's enforcement responsibilities are executed by the TFFC, OFAC, and FinCEN. Finally, TFI provides policy guidance for the IRS-Criminal Investigation Division (IRS-CI) in their anti-money laundering, terrorist financing, and financial crimes cases.

Since September 2001, the <<United States>> and its allies have designated 399 terrorist related entities and frozen over $147 million in terrorist assets. TFI has designated and frozen the assets of prominent terrorist financiers and organizations, including Adel Batterjee, a Saudi financier of al Qaida, and the Islamic African Relief Agency, a corrupt global charity that supported Usama bin Laden and HAMAS. Thanks to collaborative efforts by TFI and other agencies, the U.S. has facilitated the finding and freezing of nearly $6 billion in Iraqi assets outside of Iraq, the return of over $2.7 billion of those funds, and the recovery of more than $1 billion in cash inside Iraq.

Treasury's fiscal year 2006 request includes increases for resources to enhance Treasury's analytical capability so that senior officials have access to actionable financial intelligence. The request also supports TFI creating a 21st century information technology infrastructure to assist in the global fight against terror.

The Financial Crimes Enforcement Network has a major role in supporting TFI's enforcement responsibilities. The President's request includes $73.6 million for FinCEN to support its mission to safeguard the financial system from abuses of financial crime, including terrorist financing, money laundering and other illicit activity. This increase will provide FinCEN with the funding needed to enhance its outreach efforts to financial institutions newly covered by Bank Secrecy Act regulations and strengthen examination and enforcement activities; strengthen analytical support services; and expand FinCEN's support to other international financial intelligence units to facilitate information exchange.

The IRS-CI also plays a key role in investigating financial crimes. The request supports the unique skills and expertise of IRS-CI agents in investigating tax fraud and financial crimes not only to support tax compliance, but also benefit the war on terror and our efforts to root out financial crimes. These agents apply their training, skills, and expertise to support the national effort to combat terrorism and participate in the Joint Terrorism Task Force and other similar interagency efforts focused on disrupting and dismantling terrorist financing.

In addition, the Office of Critical Infrastructure Protection and Compliance Policy leads our efforts to safeguard the financial infrastructure. This Office works closely with other federal agencies and the private sector to safeguard our infrastructure. That is essential, given that the majority of the critical financial infrastructure of the United States is owned and operated by the private sector.

Finally, an essential aspect of ensuring our national security is to secure fragile states and foster sustainable development in the world's poorest nations. The Office of International Affairs uses bilateral diplomacy and its role as steward of the international financial institutions, including the World Bank and International Monetary Fund--to create the economic growth that will reduce conflict and the conditions that favor terrorism in the developing world.

ENSURE FINANCIAL SECURITY

Treasury's strategic goal to manage the U.S. Government's finances effectively is the largest part of the President's fiscal year 2006 request for the Department. The budget request of $11 billion -- the majority of which is for the Internal Revenue Service -- underscores our commitment to provide quality service to taxpayers and enforce America's tax laws in a balanced manner. The request includes a 7.8 percent increase in enforcement funding over fiscal year 2005. The increase will provide additional resources to examine more tax returns, collect past due taxes and investigate cases of tax evasion.

It is important that these enforcement investments be fully funded, therefore the Administration proposes to employ a budget enforcement mechanism used commonly in the 1990's for spending items that contribute to increased revenues or reductions in improper payments. Under the proposal, an adjustment for IRS enforcement would be made by the Budget Committees to the section 302(a) allocation to the Appropriations Committees found in the concurrent resolution on the budget. In addition, the Administration will also seek to establish statutory spending limits, as defined by section 251 of the Balanced Budget and Emergency Deficit Control Act of 1985, and to adjust them for this purpose. To ensure full funding of the program and inflationary cost increases, either of these adjustments would only be permissible if the Congress funded the base level for IRS enforcement at $6.4 billion and restricted the use of the funds. The maximum allowable adjustment to the 302(a) allocation and/or the statutory spending limit would be $446 million for fiscal year 2006, bringing the total enforcement level in the IRS to $6.9 billion. This entire amount is included in the overall discretionary spending total sought by the Administration and is fully accounted for in the budget.

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The President's request also provides $199 million to continue efforts to modernize the tax system through investments in IRS' Business Systems Modernization (BSM). The modernization program is providing real business benefits to taxpayers and IRS employees by delivering several modernized systems. For example, the Service implemented the Integrated Financial System that replaces its administrative accounting system. BSM funding allowed IRS to fully deploy online e-Services functionality for tax practitioners and other third parties, such as banks and brokerage firms allowing improved and faster interactions for transactions such as the application for e-filing, requests for Preparer Tax Information Number and Secure Electronic Return Originator applications, among many other products. The IRS also deployed Modernized e-File, which provides e-filing for the first time to large corporations and tax-exempt organizations. Replacing the outdated legacy system, the Customer Account Data Engine, which began processing the simplest 1040 EZ returns in July of last year, is a modern database that will eventually house tax information for more than 200 million tax returns per year.

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The Alcohol and Tobacco Tax and Trade Bureau (TTB) is responsible for the regulation of the alcohol and tobacco industries, and the collection of $14.7 billion annually in alcohol, tobacco, firearms, and ammunition excise taxes at a cost of $1 for every $368 collected. Our fiscal year 2006 request includes $91.1 million for TTB. The budget proposes to establish user fees to cover a portion of the costs of TTB's regulatory functions under its Protect the Public line-of-business.

The budget also includes a $236.2 million request for the Financial Management Service (FMS), which administers the government's payments and collections systems. In FY 2004, FMS issued more than 940 million non-Defense payments, 705 million electronic payments and 235 million paper checks, FMS annually issues more than 940 million non-Defense payments valued at $1.5 trillion. The Budget provides funding for FMS' electronic initiatives, such as: Pay.gov, which is a Government-wide web portal to collect non-tax revenue electronically; Paper Check Conversion, which converts checks into electronic debits thereby moving funds more quickly; and Stored Value Cards, which directly support military operations overseas. The fiscal year 2006 request also includes legislative proposals to improve and enhance opportunities to collect delinquent debt through FMS' debt collection program.

The Bureau of the Public Debt (BPD) continues its management and improvement of federal borrowing and debt accounting processes. The budget requests $179.9 million in direct appropriations for BPD which includes $3 million in user fees. The funding will allow BPD to continue improving the efficiency of the securities services to customers by expanding TreasuryDirect, an investment system that will enable Treasury customers to manage their investment accounts online.

The functions of the United States Mint and the Bureau of Engraving and Printing (BEP) are vital to the health of our nation's economy. These two agencies fulfill the Treasury Department's responsibility of meeting global demand for the world's most accepted coins and currency. The United States Mint also continues to manufacture and market popular numismatic products, while BEP also continues to develop new designs of next generation currency to guard against counterfeiting.

PROMOTE ECONOMIC OPPORTUNITY

The Treasury Department works to ensure that U.S. and world economies perform at full economic potential. To reach this potential, the economy must increase its rate of growth and create new, high quality jobs for all Americans. The legal and regulatory framework must also support this growth by providing an environment where businesses and individuals can grow and prosper without the burdens and costs of unnecessary rules and regulations.

Our budget requests $1.6 billion to support these strategic goals. The request includes funds for policy offices that guide domestic economic development, tax programs, financial institutions and other fiscal matters. These policies are essential as Treasury works to simplify the U.S. tax code and create a legal and regulatory framework that allows the nation's businesses to thrive.

Treasury's international programs and three Treasury bureaus, the Community Development Financial Institutions Fund, the Office of the Comptroller of Currency and the Office of Thrift Supervision play diverse roles in fostering economic growth and prosperity. From serving as the President's principal economic advisor to maintaining the health of the national banking and thrift system, the Treasury has a significant influence on creating the conditions for a robust economy. Through the Office of International Affairs, the Treasury also pursues diplomacy to create the conditions for global growth, which creates economic opportunity at home and overseas, by a range of actions, including the reduction of undue barriers to trade and investment and the establishment of stability in the international financial system.

Treasury's international assistance programs request of $1.5 billion for fiscal year 2006 is part of the Foreign Operations, Export Financing, and Related Program Appropriations Act. These programs include multilateral development banks (MDBs), debt reduction, and technical assistance -- all critical instruments to promote the Administration's international economic agenda. MDBs promote global economic growth and poverty reduction, and help create stronger markets for U.S. goods and services. Debt reduction helps poor countries move to a sustainable level of debt and remove debt overhang that inhibits growth. Our technical assistance programs help countries institute the sound budget and financial systems needed for economic growth.

MANAGE FOR RESULTS

The President requests $211.8 million to protect the integrity and effectively manage the resources of the Department of Treasury, and ensure that it remains a world class organization. Included in this request is $16.7 million to fund the Department's Office of Inspector General (OIG) and augment audit and investigative capabilities.

This portion of the budget also includes $133.3 million for the Inspector General for Tax Administration (TIGTA) and its efforts to oversee the nation's tax administration. TIGTA continues to play a significant role in providing independent oversight, which promotes efficiency and integrity in the IRS' ability to collect $2 trillion annually. TIGTA aggressively combats any identified attempts to disrupt and/or interfere with tax administration. The nation's voluntary tax compliance system is supported and protected by TIGTA agents who participate in the Joint Terrorism Task Force and proactively seek to identify individuals or groups who pose a threat to effective tax administration. Critical information is shared with the IRS and allows the leaders of the IRS to make effective business decisions, which promote efficient tax administration and support IRS employee safety.

The proposed budget request includes $7.9 million in new funding to provide for an improved technology infrastructure, essential for keeping pace with the Department's needs to enhance productivity, improve communication, interact effectively with the world-wide financial community, and meet other management needs. Funding will be used to improve the Department's information technology infrastructure to ensure the effectiveness of the Department in managing federal finances and combating financial crimes and terrorist financing. The request also ensures that the Department will continue its major facilities projects and services for the Main Treasury and Treasury Annex buildings to ensure the safety and health of occupants and perform structural repairs and improvements. Additional funds will allow Treasury to complete the project during fiscal year 2006 and reoccupy the restored office space.

THE PRESIDENT'S MANAGEMENT AGENDA

Treasury has focused its management initiatives around the goals of the President's Management Agenda (PMA). Under guidance from the PMA, the Treasury has grasped tangible results in managing the nation's finances, taking advantage of new opportunities and opposing threats. The Department is committed to defining desired results for each area and managing to achieve them, at acceptable cost levels.

In fiscal year 2004, Treasury achieved significant milestones in implementing the President's Management Agenda, improving three of our five status scores for the PMA over the prior year.

Treasury managed for results as we implemented a new performance appraisal system for our Senior Executive Service that links managers' performance assessments to accomplishing the Department's top priorities. We are also focusing on recruiting and retaining a world-class workforce, and have started implementing a new Human Capital Strategic Plan. This plan is the Department's roadmap for molding a workforce of engaged, highly competent, and business-aligned employees.

The Department is making good progress on using competition to improve efficiency. This past year, we completed five public-private competitions, and as a result, expect savings of $200 million over the next five years. Our efficiency initiatives have received national recognition, winning the President's Quality Award for Management Innovation at the IRS for our Area Distribution Center competition.

Treasury continues to be a leader in making financial information available in a timely manner through a three-day close of its books at the end of each month, and for the fifth consecutive year we received a clean audit opinion. The Department continues to work at securing our information systems. Our systems are more secure now than at any other time, with 86 percent certified and accredited as secure at the end of 2004.

CONCLUSION

Mr. Chairman, I look forward to working with you, members of the Committee, and your staff to maximize Treasury's resources in the best interest of the American people and our country as we move into fiscal year 2006. We have hard work ahead of us and I am hopeful that together we can work to make the Treasury a model for management and service to the American people, and continue to generate economic growth, increase the number of jobs for our citizens, and keep our financial systems strong and secure.

Thank you again for the opportunity to present the Treasury Department's budget today. I would be pleased to answer your questions.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 26, 2005
js-2408

Testimony of Secretary John W. Snow before the Senate Appropriations Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies

Chairman Bond, Senator Murray, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the President's fiscal year 2006 budget for the Department of the Treasury.

The Department's budget reflects the President's top priorities for fiscal year 2006: fighting the financial war on terror while ensuring America's economic strength, and demonstrating the fiscal responsibility necessary to reduce the deficit. The fiscal year 2006 request of $11.6 billion also supports Treasury's longer term core strategic missions: promoting national prosperity through economic growth and job creation; maintaining public trust and confidence in our economic and financial systems; and ensuring the Treasury organization has the workforce, technology, and business practices to meet the nation's needs effectively and efficiently. This budget request focuses on the President's belief that the budget be fair while holding the government accountable. It adheres to the principle that "taxpayer dollars must be spent wisely, or not at all."

Mr. Chairman, we provided the Committee with a detailed breakdown and justification for President's fiscal year 2006 budget request for Treasury. I would like to take the opportunity today to point out some highlights of our request and then I'd be happy to take any questions you may have.

STRENGTHEN NATIONAL SECURITY

Treasury's budget reinforces the President's commitment to combating terrorist financing and safeguarding the U.S. financial system. Since September 11th, we have leveraged the relationships, resources, and expertise that we have acquired over the past several years in combating money laundering to address terrorist financing and protecting our financial systems. Our efforts in both attacking terrorist financing and protecting the financial system are complementary and are effecting the changes required to protect the integrity of our financial systems by identifying, disrupting and dismantling sources, flows, and uses of tainted capital within those systems. To support these efforts, the President requests $351.3 million for fiscal year 2006.

The Office of Terrorism and Financial Intelligence (TFI) leads Treasury's efforts to sever the lines of financial support to international terrorists and serves as a critical component of the Administration's overall effort to keep America safe from terrorist plots. The establishment of TFI unifies leadership for the functions of the Office of Intelligence Analysis (OIA), the Office of Terrorist Financing and Financial Crimes (TFFC), the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control (OFAC), and the Treasury Executive Office for Asset Forfeiture (TEOAF). The objectives of unifying this leadership are better coordination of Treasury's array of economic tools against terrorist and national security threats. To safeguard financial systems both at home and abroad, TFI draws upon a range of capabilities that cut across various categories, including financial sanctions, financial regulation and supervision, international initiatives, private sector outreach, and law enforcement support. TFI consolidates the policy, enforcement, regulatory, international, and analytical functions of the Treasury and adds to them critical intelligence components. OIA provides focused and operable intelligence in support of the Department's mission and policies. TFI's enforcement responsibilities are executed by the TFFC, OFAC, and FinCEN. Finally, TFI provides policy guidance for the IRS-Criminal Investigation Division (IRS-CI) in their anti-money laundering, terrorist financing, and financial crimes cases.

Since September 2001, the <<United States>> and its allies have designated 399 terrorist related entities and frozen over $147 million in terrorist assets. TFI has designated and frozen the assets of prominent terrorist financiers and organizations, including Adel Batterjee, a Saudi financier of al Qaida, and the Islamic African Relief Agency, a corrupt global charity that supported Usama bin Laden and HAMAS. Thanks to collaborative efforts by TFI and other agencies, the U.S. has facilitated the finding and freezing of nearly $6 billion in Iraqi assets outside of Iraq, the return of over $2.7 billion of those funds, and the recovery of more than $1 billion in cash inside Iraq.

Treasury's fiscal year 2006 request includes increases for resources to enhance Treasury's analytical capability so that senior officials have access to actionable financial intelligence. The request also supports TFI creating a 21st century information technology infrastructure to assist in the global fight against terror.

The Financial Crimes Enforcement Network has a major role in supporting TFI's enforcement responsibilities. The President's request includes $73.6 million for FinCEN to support its mission to safeguard the financial system from abuses of financial crime, including terrorist financing, money laundering and other illicit activity. This increase will provide FinCEN with the funding needed to enhance its outreach efforts to financial institutions newly covered by Bank Secrecy Act regulations and strengthen examination and enforcement activities; strengthen analytical support services; and expand FinCEN's support to other international financial intelligence units to facilitate information exchange.

The IRS-CI also plays a key role in investigating financial crimes. The request supports the unique skills and expertise of IRS-CI agents in investigating tax fraud and financial crimes not only to support tax compliance, but also benefit the war on terror and our efforts to root out financial crimes. These agents apply their training, skills, and expertise to support the national effort to combat terrorism and participate in the Joint Terrorism Task Force and other similar interagency efforts focused on disrupting and dismantling terrorist financing.

In addition, the Office of Critical Infrastructure Protection and Compliance Policy leads our efforts to safeguard the financial infrastructure. This Office works closely with other federal agencies and the private sector to safeguard our infrastructure. That is essential, given that the majority of the critical financial infrastructure of the United States is owned and operated by the private sector.

Finally, an essential aspect of ensuring our national security is to secure fragile states and foster sustainable development in the world's poorest nations. The Office of International Affairs uses bilateral diplomacy and its role as steward of the international financial institutions, including the World Bank and International Monetary Fund--to create the economic growth that will reduce conflict and the conditions that favor terrorism in the developing world.

ENSURE FINANCIAL SECURITY

Treasury's strategic goal to manage the U.S. Government's finances effectively is the largest part of the President's fiscal year 2006 request for the Department. The budget request of $11 billion -- the majority of which is for the Internal Revenue Service -- underscores our commitment to provide quality service to taxpayers and enforce America's tax laws in a balanced manner. The request includes a 7.8 percent increase in enforcement funding over fiscal year 2005. The increase will provide additional resources to examine more tax returns, collect past due taxes and investigate cases of tax evasion.

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The proposed fiscal year 2006 budget makes a strong commitment to a sound system of tax administration. The IRS collects $2 trillion annually; however, billions continue to go uncollected every year. The increase in enforcement funding will be used to bolster audit coverage of corporations and high-income individuals who try to evade taxes as well as to expand collection and criminal investigation efforts. These investments will pay for themselves several times over.

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CONCLUSION

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Thank you again for the opportunity to present the Treasury Department's budget today. I would be pleased to answer your questions.

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FROM THE OFFICE OF PUBLIC AFFAIRS

April 26, 2005
2005-4-26-10-46-46-25031

U.S. International Reserve Position

The Treasury Department today released U.S. reserve assets data for the latest week. As indicated in this table, U.S. reserve assets totaled $79,577 million as of the end of that week, compared to $78,711 million as of the end of the prior week.

I. Official U.S. Reserve Assets *(in US millions)*

	April 15, 2005			April 22, 2005		
TOTAL		**78,711**			**79,577**	
1. Foreign Currency Reserves [1]	**Euro**	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
a. Securities	11,914	14,612	26,526	12,056	14,861	26,917
Of which, issuer headquartered in the U.S.			0			0
b. Total deposits with:						
b.i. Other central banks and BIS	11,657	2,937	14,594	11,788	2,987	14,775
b.ii. Banks headquartered in the U.S.			0			0
b.ii. Of which, banks located abroad			0			0
b.iii. Banks headquartered outside the U.S.			0			0
b.iii. Of which, banks located in the U.S.			0			0
2. IMF Reserve Position [2]			15,045			15,212
3. Special Drawing Rights (SDRs) [2]			11,504			11,632
4. Gold Stock [3]			11,041			11,041
5. Other Reserve Assets			0			0

II. Predetermined Short-Term Drains on Foreign Currency Assets

	April 15, 2005			April 22, 2005		
	Euro	**Yen**	**TOTAL**	**Euro**	**Yen**	**TOTAL**
1. Foreign currency loans and securities			0			0
2. Aggregate short and long positions in forwards and futures in foreign currencies vis-à-vis the U.S. dollar:						
2.a. Short positions			0			0
2.b. Long positions			0			0
3. Other			0			0

III. Contingent Short-Term Net Drains on Foreign Currency Assets

	April 15, 2005			April 22, 2005		
	Euro	Yen	TOTAL	Euro	Yen	TOTAL
1. Contingent liabilities in foreign currency			0			0
1.a. Collateral guarantees on debt due within 1 year						
1.b. Other contingent liabilities						
2. Foreign currency securities with embedded options			0			0
3. Undrawn, unconditional credit lines			0			0
3.a. With other central banks						
3.b. With banks and other financial institutions						
Headquartered in the U.S.						
3.c. With banks and other financial institutions						
Headquartered outside the U.S.						
4. Aggregate short and long positions of options in foreign						
Currencies vis-à-vis the U.S. dollar			0			0
4.a. Short positions						
4.a.1. Bought puts						
4.a.2. Written calls						
4.b. Long positions						
4.b.1. Bought calls						
4.b.2. Written puts						

Notes:

1/ Includes holdings of the Treasury's Exchange Stabilization Fund (ESF) and the Federal Reserve's System Open Market Account (SOMA), valued at current market exchange rates. Foreign currency holdings listed as securities reflect marked-to-market values, and deposits reflect carrying values. Foreign Currency Reserves for the latest week may be subject to revision. Foreign Currency Reserves for the prior week are final.

2/ The items, "2. IMF Reserve Position" and "3. Special Drawing Rights (SDRs)," are based on data provided by the IMF and are valued in dollar terms at the official SDR/dollar exchange rate for the reporting date. The entries for the latest week reflect any necessary adjustments, including revaluation, by the U.S. Treasury to IMF data for the prior month end.

3/ Gold stock is valued monthly at $42.2222 per fine troy ounce.

PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 26, 2005
JS-2409

MEDIA ADVISORY: A/S Zarate and Rep. Royce Discuss Treasury's Designation of Viktor Bout's International Arms Trafficking Network

****NOTE TIME CHANGE****

Treasury Assistant Secretary Juan Zarate and Congressman Ed Royce (CA-40) will hold a pen-and-pad briefing to discuss the Treasury's designation of Viktor Bout's financial network (http://www.treasury.gov/press/releases/js2406.htm). Bout is a notorious international arms dealer and war profiteer.

WHO:
Juan C. Zarate, *Assistant Secretary*
Terrorist Financing and Financial Crimes
U.S. Department of the Treasury

Rep. Ed Royce, *Vice Chairman* Africa, Global Human Rights and International Operations Subcommittee Committee on International Relations U.S. House of Representatives

WHAT:
Pen-and-pad briefing

WHEN:
Wednesday, April 27, 2005
11:45 am EST

WHERE:
Department of the Treasury, Media Room 4121

Media without Treasury press credentials (including media with White House credentials) planning to attend should contact Frances Anderson in Treasury's Office of Public Affairs at (202) 528-9086 or Frances.Anderson@do.treas.gov. Please be prepared to provide her with the following information: full name, social security number and date of birth ***by 9:00 am on 4/27/05.***

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 26, 2005
js-2410

Treasury Secretary and U.S. Treasurer Join ABA to Kick Off 9th Annual "Teach Children to Save Day

The Treasury Department today teamed up with the American Bankers Association (ABA) Education Foundation for the 9th Annual "Teach Children to Save Day." Treasury officials joined local bankers across the country to visit primary, elementary, middle and high schools to teach students the importance of saving.

Secretary John W. Snow and U.S. Treasurer Anna Escobedo Cabral joined ABA Chairman Elizabeth A. Duke to kick off the nationwide efforts with fifth-graders from Washington D.C.'s Seaton Elementary at Treasury's Bureau of Engraving and Printing (BEP). Across the country, a total of 23 Treasury officials joined bankers in classrooms from Spokane, Washington to Tampa, Florida to teach lessons that illustrate the value of saving, budgeting and the power of interest.

In addition to the financial education lesson, Secretary Snow and Treasurer Cabral witnessed the printing of the first paper currency with the new Treasurer's signature today at the BEP.

"I am grateful for the opportunity to serve as Treasurer and honored to have my name on the U.S. currency, along with that of Secretary Snow, a truly gifted and committed leader," said Treasurer Cabral. "I am also pleased to have been able to share today with students from Seaton Elementary. They remind us how important it is to teach children how to use their money to create opportunity and prosperity. It is crucial that we provide them the knowledge and resources they'll need to make educated decisions about their finances. I commend everyone that joined us across the country for Teach Children to Save Day, as well as the teachers, parents and community leaders who are hard at work to provide financial education all year long."

The ABA Education Foundation was founded in 1925 to support the banking industry's efforts to teach personal finance skills in schools and communities. Its programs help children, teenagers and adults develop the skills they need to budget, save, and manage credit. Since the ABA Education Foundation began "Teach Children to Save Day" in 1997, more than 18,300 bankers have reached out to nearly 1.2 million students. This year, 4,100 bankers from across the country taught money skills to an estimated 180,000 students. For more information on "Teach Children to Save Day," please visit http://www.aba.com and click on "Consumer Connection."

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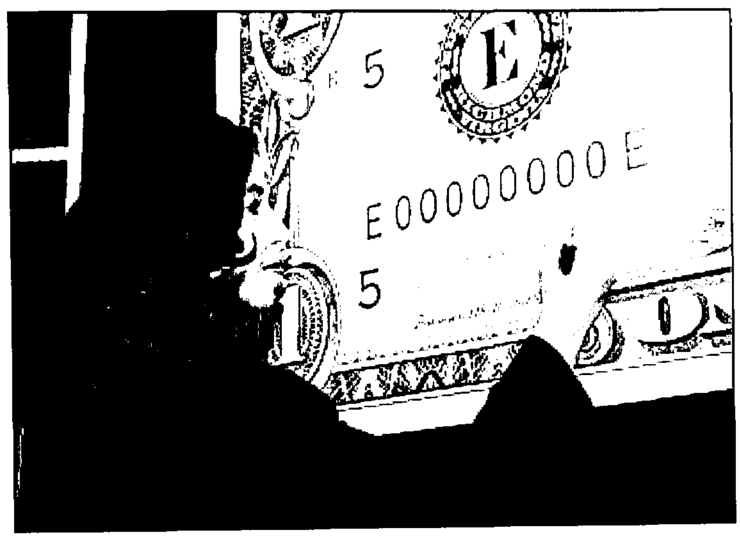
PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 27, 2005
2005-4-27-18-13-3-5586

Treasurer Cabral Unveil "Snow-Cabral" Paper Currency



Secretary John Snow and U.S. Treasurer Anna Escobedo Cabral unveiled the first $1 notes with the new Treasurer's signature on Tuesday, April 26 at the Treasury's Bureau of Engraving and Printing in Washington, DC. "Having my signature on the U.S. currency is a tremendous honor; sharing that honor with Anna Cabral is priceless," said Secretary Snow.

All media queries should be directed to
The Press Office at (202) 622-2960.
Only call this number if you are a member of the media.

High Resolution Image

PRESS ROOM

April 28, 2005
js-2411

Treasury's Deputy Assistant Secretary Iannicola Encourages Financial Education Efforts in Native Communities

Treasury's Deputy Assistant Secretary for Financial Education Dan Iannicola, Jr. today discussed the importance of financial education at a policy briefing sponsored by the Native Financial Education Coalition in Washington, D.C. The meeting attendees included Congressional staff, federal agency personnel, tribal leaders and other policymakers.

Iannicola told the participants that spreading financial education in Native communities should be a high priority. "Native communities often deal with unique challenges, both in the reservation and off-reservation contexts," said Iannicola. "Financial education can help people overcome these challenges and achieve a secure financial future."

The Native Financial Education Coalition (NFEC) is a group of local, regional and national organizations and government agencies working together to promote financial education in Native communities. Started by the Treasury Department in 2000, the now independent Native Financial Education Coalition seeks to exchange information, forge partnerships, identify and develop strategies for outreach and training, as well as identify gaps in information about financial education needs. NFEC has trained nearly 800 instructors to teach financial education courses in Native communities using the Building Native Communities: Financial Skills for Families curriculum.

The Department of the Treasury is a leader in promoting financial education. Treasury established the Office of Financial Education in May of 2002. The Office works to promote access to the financial education tools that can help all Americans make wiser choices in all areas of personal financial management, with a special emphasis on saving, credit management, home ownership and retirement planning. The Office also coordinates the efforts of the Financial Literacy and Education Commission, a group chaired by the Secretary of Treasury and composed of representatives from 20 federal departments, agencies and commissions, which works to improve financial literacy and education for people throughout the United States. For more information about the Office of Financial Education visit: http://www.treas.gov/financialeducation.

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PRESS ROOM

FROM THE OFFICE OF PUBLIC AFFAIRS

April 29, 2005
JS-2412

Preliminary Annual Report on Foreign Holdings Of U.S. Securities At End-June 2004

Preliminary data from an annual survey of foreign portfolio holdings of U.S. securities at end-June 2004 are released today and posted on the U.S. Treasury web site at (http://www.treas.gov/tic/fpis.html). Final survey results, which will include additional detail as well as revisions to the preliminary data, will be reported by June 30, 2005.

The survey was undertaken jointly by the U.S. Treasury, the Federal Reserve Bank of New York, and the Board of Governors of the Federal Reserve System. The most recent survey was for end-June 2003. Future surveys are scheduled to be carried out annually, and the next survey will be for end-June 2005.

A complementary survey measuring U.S. portfolio holdings of foreign securities will also be carried out annually. Data from the most recent such survey, which reports on securities held at year-end 2004, are currently being processed. Preliminary results are expected to be reported by September 30, 2005.

Overall Preliminary Results

The survey measured foreign holdings as of June 30, 2004, of $6,006 billion, with $1,904 billion held in U.S. equities, $3,515 billion in U.S. long-term debt securities (securities with an original term-to-maturity in excess of one year), and $588 billion in U.S. short-term debt securities. The previous such survey, conducted as of June 30, 2003, measured foreign holdings of $4,979 billion, with $1,564 billion in U.S. equities, $2,939 billion in U.S. long-term debt securities, and $475 billion in short-term U.S. debt securities (see Table 1).

Table 1. Foreign holdings of U.S. securities, by type of security, as of survey dates
(Billions of dollars, except as noted)

Type of Security	June 30, 2003	June 30, 2004
Long-term Securities	4,503	5,418
Equity	1,564	1,904
Long-term Debt	2,939	3,515
Short-term Debt Securities	475	588
Total	4,979	6,006

Foreign Portfolio Investment in the U.S. by Economy

Table 2. Foreign holdings of U.S. securities, by economy and type of security, for the economies having major portfolio investment in the U.S., as of June 30, 2004
(Billions of dollars)

		Total	Equities	Long-term	Short-term
1	Japan	1,019	162	736	121
2	United Kingdom	488	250	221	16
3	Luxembourg	392	130	230	31
4	Cayman Islands	375	115	230	31
5	China , Mainland	341	3	320	18
6	Belgium	308	18	285	5
7	Canada	291	210	67	15
8	Netherlands	203	127	70	6
9	Switzerland	199	120	68	11
10	Germany	190	76	107	8
11	Bermuda	180	52	113	15
12	Ireland	164	52	66	46
13	Taiwan	124	9	113	2
14	Middle East Oil-exporters /1	121	69	34	18
15	Singapore	120	72	42	6
16	France	117	62	41	15
17	South Korea	90	1	81	8
18	Hong Kong	89	22	43	23
19	Australia	74	47	21	6
20	Sweden	73	46	26	1
21	British Virgin Islands	65	36	27	3
22	Mexico	65	9	30	25
23	Norway	59	29	29	2
24	Italy	58	35	20	3
25	Russia	48	0	8	48
	Country Unknown	224	3	218	3
	Rest of world	528	151	269	109
	Total	6,006	1,904	3,515	588

/1 Bahrain , Iran , Iraq , Kuwait , Oman , Qatar , Saudi Arabia , and the United Arab Emirates .

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