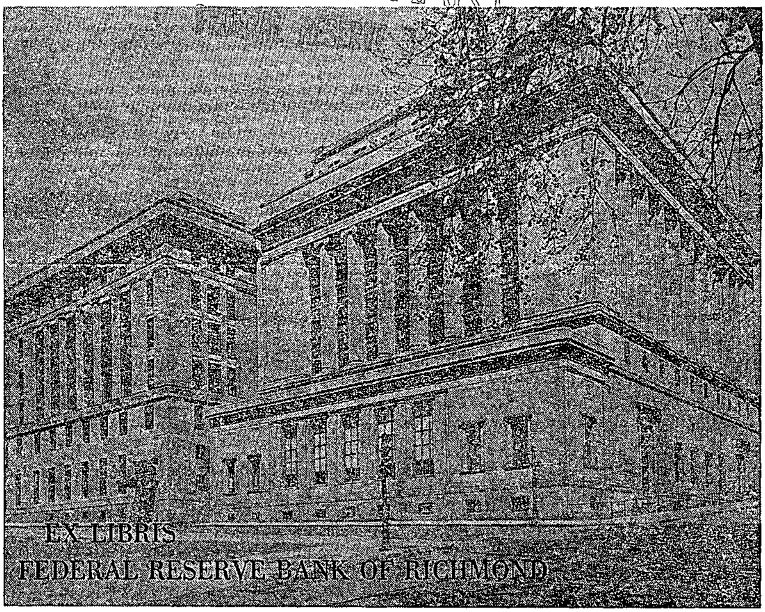
ANNUAL REPORT

f the Secretary of the Treasury
on the State of the Finances

**FOR THE FISCAL YEAR ENDED JUNE 30, 1976
AND TRANSITION QUARTER**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ANNUAL REPORT

of the Secretary of the Treasury
on the State of the Finances

THE DEPARTMENT OF THE TREASURY 1789

**FOR THE FISCAL YEAR ENDED JUNE 30, 1976
AND TRANSITION QUARTER**

DEPARTMENT OF THE TREASURY

DOCUMENT NO. 3270

Secretary

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THE SECRETARY OF THE TREASURY
WASHINGTON

January 6, 1977

Dear Sirs:

I have the honor to transmit to you a report on the state of the finances of the United States Government for the combined fiscal year ended June 30, 1976, and transition quarter ended September 30, 1976. This submission is in accordance with 31 U.S.C. 1027.

Sincerely yours,

William E. Simon

President of the Senate

Speaker of the House of Representatives

The statistical tables to this Annual Report will be published in a separate STATISTICAL APPENDIX.

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STATISTICAL APPENDIX

The tables to this Annual Report will be published in the separate Statistical Appendix.

NOTE.—Details of figures may not add to totals because of rounding.

Secretaries, Deputy Secretaries, Under Secretaries, General Counsels, Assistant Secretaries, Deputy Under Secretaries, and Treasurers of the United States serving in the Department of the Treasury from January 21, 1973, through September 30, 1976[1]

Term of service		Officials
From	To	
		Secretaries of the Treasury:
June 12, 1972	May 8, 1974	George P. Shultz, New York.
May 8, 1974	....	William E. Simon, New Jersey.
		Deputy Secretaries:
Jan. 22, 1973	May 8, 1974	William E. Simon, New Jersey.
July 31, 1974	Feb. 13, 1976	Stephen S. Gardner, Pennsylvania.
Mar. 3, 1976	....	George H. Dixon, Minnesota.
		Under Secretaries for Monetary Affairs:
Jan. 27, 1969	July 8, 1974	Paul A. Volcker, New Jersey.
July 9, 1974	June 30, 1975	Jack F. Bennett, Connecticut.
Aug. 5, 1975	....	Edwin H. Yeo III, Pennsylvania.
		Under Secretaries (Counselors):[2]
June 12, 1972	Mar. 17, 1973	Edwin S. Cohen, Virginia.
Mar. 15, 1974	July 8, 1974	Jack F. Bennett, Connecticut.
July 9, 1974	Oct. 28, 1975	Edward C. Schmults, New York.
Apr. 14, 1976	....	Jerry Thomas, Florida.
		General Counsels:
July 1, 1970	June 1, 1973	Samuel R. Pierce, Jr., New York.
June 2, 1973	July 8, 1974	Edward C. Schmults, New York.
Aug. 1, 1974	....	Richard R. Albrecht, Washington.
		Assistant Secretaries:
Apr. 1, 1969	Jan. 21, 1973	Eugene T. Rossides, New York.
Dec. 12, 1971	July 17, 1975	Edgar R. Fiedler, New York.
Apr. 11, 1972	....	Warren F. Brecht, Connecticut.
June 12, 1972	July 1, 1974	John M. Hennessy, Massachusetts.
Aug. 18, 1972	Sept. 2, 1975	Frederic W. Hickman, Illinois.
Jan. 22, 1973	Feb. 1, 1974	Edward L. Morgan, Arizona.
May 8, 1974	Sept. 14, 1976	David R. Macdonald, Illinois.
May 28, 1974	Sept. 1, 1975	Frederick L. Webber, Virginia.[3]
June 24, 1974	....	Gerald L. Parsky, Washington, D.C.[3]
Aug. 1, 1974	Nov. 15, 1975	Charles A. Cooper, Florida.
July 17, 1975	....	Sidney L. Jones, Michigan.
Sept. 3, 1975	....	Charles M. Walker, California.
Nov. 6, 1975	....	Harold F. Eberle, Jr., California.[3]
Apr. 14, 1976	....	Robert A. Gerard, Washington, D.C.
		Deputy Under Secretaries:
Aug. 18, 1972	Mar. 14, 1974	Jack F. Bennett, Connecticut.
Aug. 22, 1972	July 4, 1973	James E. Smith, Virginia.
Aug. 3, 1973	Apr. 13, 1974	William L. Gifford, New York.
		Fiscal Assistant Secretaries:
June 15, 1962	July 28, 1975	John K. Carlock, Arizona.
July 29, 1975	....	David Mosso, Virginia.
		Treasurers of the United States:[4]
Dec. 17, 1971	Feb. 14, 1974	Romana Acosta Banuelos, California.
June 21, 1974	....	Francine I. Neff, New Mexico.

[1]For officials from Sept. 11, 1789, to Jan. 20, 1973, see exhibit 81, 1973 Annual Report.
[2]Act of May 18, 1972, which established the Deputy Secretary position, permitted the Under Secretary position to be used as a counselor to the Secretary and so designated by the President as desired.
[3]Act of May 18, 1972, provided for two Deputy Under Secretaries, to be designated Assistant Secretaries by the President as desired.
[4]Treasury Department Order 229, Jan. 14, 1974, raised the position of Treasurer of the United States from the operating level of the Department to the Office of the Secretary.

PRINCIPAL ADMINISTRATIVE AND STAFF OFFICERS OF THE DEPARTMENT OF THE TREASURY AS OF SEPTEMBER 30, 1976

Secretary of the Treasury	William E. Simon
Deputy Secretary of the Treasury	George H. Dixon
Under Secretary for Monetary Affairs	Edwin H. Yeo III
Under Secretary	Jerry Thomas
General Counsel	Richard R. Albrecht
Office, Secretary of the Treasury:	
Adviser to the Secretary (Counsellor to the Chairman, Economic Policy Board)	(Vacancy)
Executive Assistant to the Secretary	John C. Gartland
Director, Executive Secretariat	Ann M. Morgan
Confidential Assistant to the Secretary	Barbara A. Jensen
Senior Consultant	John Lintner
Office, Deputy Secretary of the Treasury:	
Executive Assistant to the Deputy Secretary	Thomas J. McDowell
Office, Under Secretary for Monetary Affairs:	
Assistant Secretary (International Affairs)	Gerald L. Parsky
Deputy Assistant Secretary for Trade and Raw Materials Policy	J. Robert Vastine
Deputy Assistant Secretary for Investment and Energy Policy	John M. Niehuss
Deputy Assistant Secretary for International Monetary Affairs	F. Lisle Widman
Deputy Assistant Secretary for Developing Nations	Richard D. Erb
Deputy Assistant Secretary for Research and Planning	Roger E. Shields
Deputy to the Assistant Secretary for Saudi Arabian Affairs	Lewis W. Bowden
Deputy to the Assistant Secretary and Secretary of IMG (International Monetary Group)	George H. Willis
Inspector General	Weir M. Brown
Assistant Secretary (Capital Markets and Debt Management)	Robert A. Gerard
Deputy Assistant Secretary (Capital Markets Policy)	(Vacancy)
Director, Office of Securities Markets Policy	A. Gary Klesch
Director, Office of Municipal Finance	Robert A. Ladig (acting)
Director, Office of Capital Markets Legislation	Basil N. Petrou
Deputy Assistant Secretary (Debt Financing)	(Vacancy)
Director, Office of Market Analysis and Agency Finance	Roland H. Cook
Director, Office of Government Financing	Francis X. Cavanaugh
Senior Adviser (Debt Research)	Edward P. Snyder
Special Assistant to the Secretary (Debt Management)	John J. Niehenke
Deputy to the Assistant Secretary for New York Finance	Mark D. Coler
Assistant Secretary (Economic Policy)	Sidney L. Jones
Deputy to the Assistant Secretary	George G. Kaufman
Director, Office of Financial Analysis	John H. Auten
Fiscal Assistant Secretary	David Mosso
Deputy Fiscal Assistant Secretary	Paul H. Taylor
Assistant Fiscal Assistant Secretary (Banking)	John A. Kilcoyne
Assistant Fiscal Assistant Secretary (Financing)	Philip J. Fitzpatrick
Assistant Fiscal Assistant Secretary	Lester W. Plumly
Treasurer of the United States	Francine I. Neff
Department Bicentennial Coordinator	Abby L. Gilbert (acting)

Special Assistant to the Secretary (National Security)	William N. Morell
Deputy Special Assistant to the Secretary	Gerald W. Nensel
Office, Under Secretary:	
Special Assistant to the Under Secretary	Joseph J. Adams
Special Assistant to the Under Secretary for Revenue Sharing and Intergovernmental Relations	Kent A. Peterson
Assistant Secretary (Administration)	Warren F. Brecht
Deputy Assistant Secretary for Administration and Director, Office of Management and Organization	J. Elton Greenlee
Director, Office of Administrative Programs	Robert R. Fredlund
Director, Office of Audit	Wilbur R. DeZerne
Director, Office of Budget and Finance	Arthur D. Kallen
Director, Office of Personnel	Morris A. Simms, Jr.
Director, Office of Computer Science	Francis A. McDonough
Director, Office of Equal Opportunity Program	David A. Sawyer
Assistant Secretary (Legislative Affairs)	Harold F. Eberle, Jr.
Deputy Assistant Secretary (Legislative Affairs)	John H. Harper
Special Assistant to Assistant Secretary	John E. Hunnicutt
Assistant Secretary (Enforcement, Operations, and Tariff Affairs)	(Vacancy)
Deputy Assistant Secretary (Operations)	James B. Clawson
Director, Office of Operations	William F. Hausman
Director, Foreign Assets Control	Stanley L. Sommerfield (acting)
Deputy Assistant Secretary (Enforcement)	James J. Featherstone
Director, Office of Law Enforcement	William B. Butler
Chief, Interpol (National Central Bureau)	Louis B. Sims
Deputy Assistant Secretary (Tariff Affairs)	Peter O. Suchman
Director, Office of Tariff Affairs	Richard B. Self (acting)
Special Assistant to the Secretary (Public Affairs)	(Vacancy)
Deputy Special Assistant to the Secretary	John O. Mongoven
Assistant to the Secretary and Director, Office of Revenue Sharing	Jeanna D. Tully
Office, General Counsel:	
Deputy General Counsel	Henry C. Stockell, Jr.
Assistant General Counsel and Chief Counsel, Internal Revenue Service	Meade Whitaker
Assistant General Counsel	Wolf Haber
Assistant General Counsel	Russell L. Munk
Assistant General Counsel	Hugo A. Ranta
Counselor to the General Counsel	Forest D. Montgomery
Director of Practice	Leslie S. Shapiro
Assistant Secretary (Tax Policy)	Charles M. Walker
Deputy Assistant Secretary for Tax Legislation	William M. Goldstein
Deputy Assistant Secretary for Tax Analysis	David F. Bradford
Associate Director, Office of Tax Analysis	Harvey Galper
Tax Legislative Counsel	(Vacancy)
International Tax Counsel	David S. Foster
Director, Office of Industrial Economics	Karl Ruhe

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

Director	Rex D. Davis
Deputy Director	John G. Krogman
Assistant Director (Administration)	William J. Rhodes
Assistant Director (Criminal Enforcement)	Michael La Perch, Jr. (acting)
Assistant Director (Inspection)	Jarvis L. Brewer
Assistant Director (Regulatory Enforcement)	Stephen E. Higgins
Assistant Director (Technical and Scientific Services)	A. Atley Peterson (acting)
Chief Counsel	Marvin J. Dessler

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Comptroller of the Currency (acting)	Robert Bloom
First Deputy Comptroller	Robert Bloom
First Deputy Comptroller (Operations)	H. Joe Selby
Deputy Comptroller (Operations Review)	Thomas G. DeShazo
Deputy Comptroller (Special Surveillance)	Robert A. Mullin
Deputy Comptroller (Washington Operations)	Richard D. Chotard
Deputy Comptroller (Operations Planning)	W.A. Howland, Jr.
Deputy Comptroller (Banking Operations)	Charles B. Hall
Deputy Comptroller (Economics)	David C. Motter
Deputy Comptroller (Strategic Studies)	David H. Jones
Deputy Comptroller (Trust Operations)	Dean E. Miller
Deputy Comptroller (FDIC Affairs)	Joseph M. Ream
Chief Counsel	C. Westbrook Murphy
Deputy Chief Counsel	John E. Shockey
Associate Deputy Comptroller (International Operations)	Robert R. Bench
Associate Deputy Comptroller (Special Projects)	Paul Homan
Associate Deputy Comptroller (Electronic Funds Transfer Systems)	Thomas W. Taylor
Associate Deputy Comptroller (Bank Organization and Structure)	Gail W. Pohn
Special Assistant to the Comptroller	James T. Keefe
Special Assistant to the Comptroller (Congressional Affairs)	Donald A. Melbye
Special Assistant to the Comptroller	Robert A. Baer
EEO Officer	Thomas G. DeShazo
Consumer Affairs (Director)	Thomas W. Taylor
Director, Public Affairs	William B. Foster
Director, Communications	Caryl Austrian

BUREAU OF ENGRAVING AND PRINTING

Director	James A. Conlon
Deputy Director	Kenneth A. DeHart
Assistant Director (Administration)	Seymour Berry
Assistant Director (Operations)	Everett J. Prescott
Assistant Director (Research and Engineering)	Richard C. Sennett

FEDERAL LAW ENFORCEMENT TRAINING CENTER

Director	Arthur F. Brandstatter
Deputy Director	(Vacancy)
Associate Director for Training	Alvin C. Turner (acting)
Assistant Director (Criminal Investigator Training Division)	William H. McClarin
Assistant Director (Police Training Division)	Peter W. Phillips (acting)
Associate Director for Administration	David W. McKinley
Assistant Director (Special Training Division)	Robert T. Lacey
Assistant Director (Washington Liaison Office)	John C. Dooher

BUREAU OF GOVERNMENT FINANCIAL OPERATIONS

Commissioner	Dario A. Pagliai
Deputy Commissioner	Gerald Murphy
Assistant Commissioner, Administration	George L. McConville
Assistant Commissioner, Banking and Cash Management	Lloyd L. Morgan
Assistant Commissioner, Comptroller	Steve L. Comings
Assistant Commissioner, Disbursements and Claims	Michael D. Serlin
Assistant Commissioner, Government-wide Accounting	John O. Turner

INTERNAL REVENUE SERVICE

Commissioner	Donald C. Alexander
Deputy Commissioner	William E. Williams
Assistant Commissioner (Accounts, Collection and Taxpayer Service)	James I. Owens (acting)
Assistant Commissioner (Administration)	Joseph T. Davis

Assistant Commissioner (Compliance)	Singleton B. Wolfe
Assistant Commissioner (Employee Plans and Exempt Organizations)	Alvin D. Lurie
Assistant Commissioner (Inspection)	Warren A. Bates
Assistant Commissioner (Planning and Research)	Anita F. Alpern
Assistant Commissioner (Technical)	John L. Withers
Chief Counsel	Meade Whitaker

BUREAU OF THE MINT

Director	Mary T. Brooks
Deputy Director	Frank H. MacDonald
Assistant Director for Administration	Chadwick B. Pierce
Assistant Director for Management Planning	Arnold Bresnick
Assistant Director for Marketing and Statistical Services	Francis B. Frere
Assistant Director for Production	George G. Ambrose
Assistant Director for Technology	Alan J. Goldman

BUREAU OF THE PUBLIC DEBT

Commissioner	H.J. Hintgen
Deputy Commissioner	William M. Gregg
Assistant Commissioner (Washington)	Kenneth W. Rath
Assistant Commissioner (Field)	Martin French
Chief Counsel	Calvin Ninomiya

UNITED STATES CUSTOMS SERVICE

Commissioner of Customs	Vernon D. Acree
Deputy Commissioner of Customs	G.R. Dickerson
Assistant Commissioner (Operations)	Roland Raymond
Assistant Commissioner (Regulations and Rulings)	Leonard Lehman
Assistant Commissioner (Administration)	John A. Hurley
Assistant Commissioner (Investigations)	George C. Corcoran, Jr.
Assistant Commissioner (Internal Affairs)	William A. Magee, Jr.
Assistant Commissioner (Enforcement Support)	Alfred R. DeAngelus
Chief Counsel	Theodore W. Allis

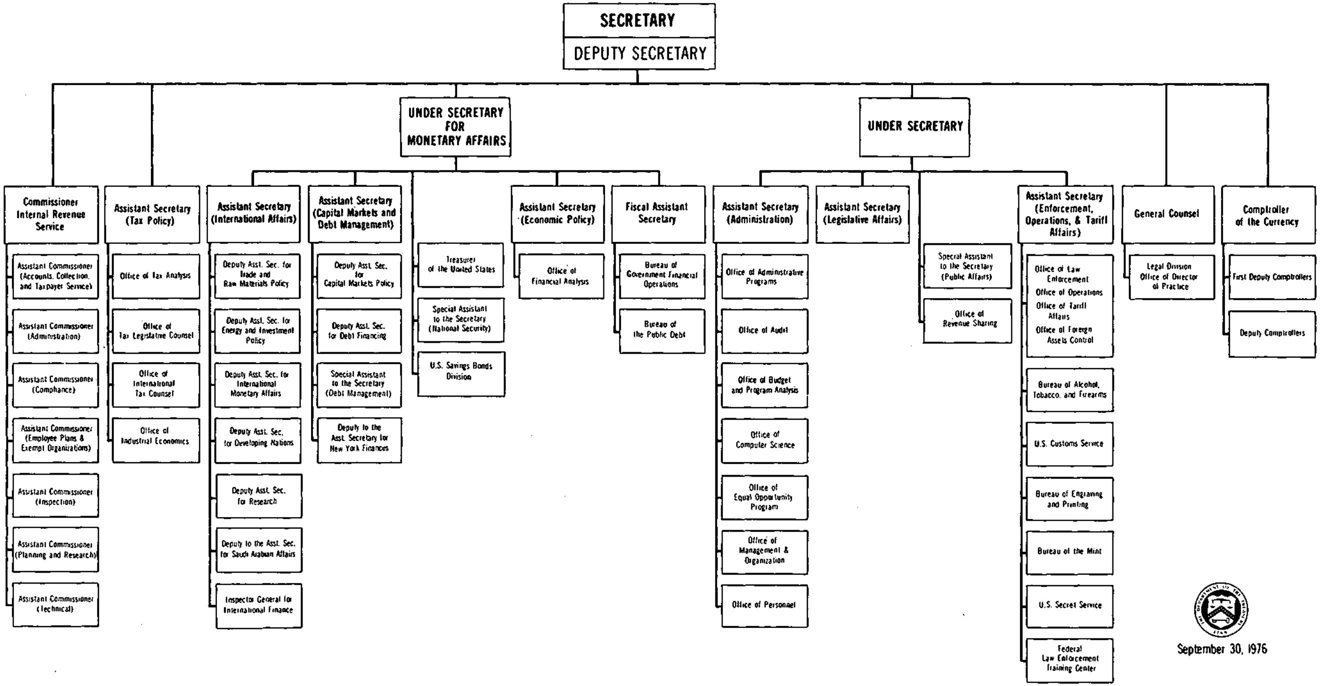
UNITED STATES SAVINGS BONDS DIVISION

National Director	Francine I. Neff
Deputy National Director	Jesse L. Adams, Jr.
Director of Sales	Walter R. Niles
Director of Advertising and Promotion	Louis F. Perrinello

UNITED STATES SECRET SERVICE

Director	H. Stuart Knight
Deputy Director	Lilburn E. Boggs
Assistant Director (Protective Intelligence)	James T. Burke
Assistant Director (Investigations)	Burrill A. Peterson
Assistant Director (Protective Forces)	Thomas J. Kelley
Assistant Director (Inspection)	Myron I. Weinstein
Assistant Director (Administration)	Francis A. Long

ORGANIZATION OF THE DEPARTMENT OF THE TREASURY



September 30, 1976

INTRODUCTION

This statement reviews some of the major domestic and international developments which affected areas of Treasury interest and responsibility during fiscal 1976 and the transition quarter. Detailed information on the operating and administrative activities of the Department of the Treasury is provided in the main text of the report and supporting exhibits. Further information is contained in a separate Statistical Appendix.

DOMESTIC DEVELOPMENTS

The Domestic Economic Recovery

The U.S. domestic economic situation improved substantially. At the beginning of fiscal 1976 an economic recovery was just getting underway after the severe recession downturn. The economy bottomed out early in 1975 and once again began to expand. During the ensuing 18 months of economic expansion which includes the period under review, real GNP rose at a 6 1/4-percent annual rate. In the first 12 months of the expansion, real output rose at over a 7 1/4-percent annual rate before slowing to a 4 1/4-percent rate of advance in the next 6 months. This was an impressive turnaround when compared with the negative growth registered during the severe recession of 1974 and early 1975—the deepest recession since the 1930's. While recovery is far from complete, the U.S. economy is back on a path of economic expansion and making good progress.

Significant improvements also occurred in U.S. employment conditions although the unemployment rate remained disturbingly high. Civilian employment rose by 3 1/2 million persons—a strong recovery by past cyclical standards. The labor force also rose by about 3 million persons and the number of persons unemployed was reduced only slightly from over 8 million to the 7 1/2 million level. The total unemployment rate during the transition quarter was 7.8 percent, down from a peak quarterly rate of 8.7 percent at the end of fiscal 1975.

Specific structural employment problems persist in the forms of very high rates of unemployment among minority groups, certain geographical pockets of high unemployment, and serious difficulties in particular industries. Various government programs continue to try to alleviate these specific unemployment problems. In round numbers, recent annual expenditure levels have been close to $20 billion in unemployment assistance, about $2.5 billion in public employment programs, and another $6 billion or so in manpower training programs. These are substantial levels of expenditure, but even higher levels of Federal expenditures in these and other areas have been urged by some in order to reduce the rate of unemployment. In general, the current administration has believed that a sustainable economic expansion would do more to reduce unemployment than anything else and that excessive government stimulus would only create additional problems.

Personal consumption has been a major source of strength in the recovery and it will necessarily continue to be an important element. Personal consumption increased at about a 10 1/2-percent annual rate leading to a renewal of economic activity throughout the economy. With price inflation removed, the real growth of personal consumption was 5 percent. During the latter months of fiscal 1976, gains in real consumption slowed down and a minor inventory reaction resulted, particularly for some nondurable industries. Consumers remained cautious during the transition quarter and spending was proceeding about in line with fairly modest income gains. After correction for inflation, retail sales had been virtually flat during the latter months of fiscal 1976 and the transition quarter. Continuation of this sluggishness for much longer would raise questions as to the strength of the economic expansion. Evidence of strengthening began to emerge at the turn of the transition quarter and the early months of the new fiscal year.

A crucial element in the current economic outlook is an expected acceleration of capital investment. Spending for capital equipment bottomed out early in fiscal 1976 and modest improvement had been registered by the end of the transition quarter with larger increases expected in 1977. Improving corporate profits, the prospect of emerging capacity constraints in some industries, and the overall improvement in business demand are basic reasons for expecting increased capital spending.

Business spending for inventories swung from massive liquidation during the last half of fiscal 1975 to accumulation during the 15-month period under review. This contributed to very rapid growth in GNP. By the close of the transition quarter, the rate of increase in inventory was leveling off and apparently contained a certain amount of involuntary accumulation. However, the bulk of inventory investment was still voluntary and appeared to be justified by the fundamentals of the economic situation. Nonetheless, sluggishness in retail sales was beginning to cause some concern by the end of the transition quarter and inventory-sales ratios, while low by historical standards, were rising.

The other major investment sector—housing—has been slow to regain satisfactory levels of operation although a cyclical recovery is now apparently underway. Total private housing starts were averaging about a 1 1/4 million-unit annual rate in the early months of fiscal 1976 and moved up to about a 1 1/2 million rate by the fiscal yearend. A sharp monthly increase to a 1.8 million rate occurred at the close of the transition quarter, but the significance of such monthly changes is difficult to judge.

In any event, residential construction activity is expected to continue to show gradual improvement. A large and continuing flow of savings into thrift institutions provides mortgage financing, and new building permits also point to increased activity.

On balance, the economic expansion was proceeding fairly satisfactorily as the transition quarter came to a close. Real growth had slowed to the 4-percent range but a similar slowing had occurred in the second year of previous postwar expansions. In the present case, it seemed to reflect the cessation of rapid rebuilding of inventories rather than any serious imbalances or lack of forward momentum in the economy. However, there was room for difference of opinion as to whether or not a satisfactory pace of expansion would continue spontaneously, or whether some moderate increase in economic stimulus might be required.

Slower Rates of Inflation

One of the more encouraging features of the economic expansion was the progress made in controlling inflation. While real output increased rapidly, the double-digit inflation that crested in 1974 steadily moderated. Consumer prices rose at slightly less than a 6-percent annual rate in contrast to a gain of 9.3 percent in fiscal 1975. Wholesale prices rose 5.0 percent in contrast to an 11.6-percent rise in fiscal 1975. Some of the improvement was due to special factors in the food and fuel area, and it was disturbing that the wholesale prices of industrial commodities rose at a 6.5-percent annual rate during the 15-month period, particularly since even somewhat higher annual rates of increase were being registered by the end of the period. On balance, however, considerable improvement had occurred in the inflation area.

The improvement was reflected in a better balance between wage costs and productivity increases. Output per man-hour in the private business sector rose at a 4.1-percent annual rate, well above the meager 1.7-percent rise during fiscal 1975. Compensation per man-hour, on the other hand, rose less rapidly, at a 7.8-percent annual rate in contrast to a 10.6-percent rate in fiscal 1975. As a result, cost-push pressures eased substantially. Labor costs per unit of output, which had risen at an 8.7-percent annual rate during fiscal 1975, increased at a 3.5-percent annual rate during fiscal 1976 and the transition quarter.

After sorting through the detailed statistics, it appears that three things could be said about the inflation problem. First, considerable progress has been made in moderating inflation pressures, and the economic recovery that has occurred is directly related to the improvement. Second, despite this progress, the current 5- to 6-percent rate of inflation is still far too high and will continue to distort the economy and its financial markets until the rate of inflation can be returned to the 2- to 3-percent range. Third, and more broadly, inflation remains the greatest single threat to both the sustainability of the current economic expansion and the longer term stability of the U.S. economy.

The Budget and Fiscal Developments

Recent budgetary experience has been dominated by two major developments: The strong upward momentum of Federal spending and large budget deficits because of economic recession. In fiscal 1966, Federal outlays totaled some $135 billion. By fiscal 1974 spending had increased to $268 billion. After this doubling in a period of 8 years, Federal spending then jumped 36 percent in just 2 fiscal years—1974 to 1976. While some of this sharp increase in the last 2 fiscal years was recession induced, expenditure increases were spread widely throughout all the major categories. The rapid momentum of rising Federal spending has increasingly restricted rational economic choice because the bulk of the Federal budget, an estimated 75 percent, is considered to be uncontrollable in the technical budgetary sense of the term.

For fiscal 1976 the President initially proposed budget outlays of $349.4 billion. In January 1976 this estimate was raised to $373.5 billion. Continued efforts were made by the administration during fiscal 1976 to hold down the growth of Federal spending including the frequent use of the Presidential veto power. These efforts and other developments held the fiscal 1976 outlay figure to $365.6 billion—about $8 billion below the January estimate. Spending in the transition quarter totaled $94.5 billion. This was $3.5 billion below the January estimate and $7.6 below a mid-session review estimate prepared in July 1976. An assumed shift in spending into the transition quarter did not occur.

Receipts were held down by the recession, and large budget deficits resulted. Final budget results show a $65.6 billion deficit in 1976 and a $12.7 billion deficit in the transition quarter. Future budgetary prospects were clouded by the forward momentum of Federal spending, but the recovery of the economy was contributing to strong growth in receipts.

Taxation Developments

Tax policy developments reflected the urgent need for both substantial income tax reduction coupled with spending control and comprehensive tax reform to promote efficiency and equity and to provide tax simplification.

Temporary tax cuts had been enacted in March 1975 in the Tax Reduction Act of 1975 and would have expired at the end of calendar 1975. The President proposed in October 1975 a permanent $28 billion income tax cut for fiscal 1977 tied to equivalent Federal spending cuts. The program included $20.7 billion in personal income tax reductions concentrated at low- and middle-income levels and $7 billion of business tax cuts to encourage investment in productive facilities. But Congress passed a temporary tax cut in December 1975 of $8.4 billion to expire in

6 months. The President vetoed the bill because in his view it was inadequate and provided no spending limitation. Congress sustained the veto. A short-term compromise was immediately enacted in the Revenue Adjustment Act of 1975 which provided temporary tax reduction and a spending limitation commitment. The act extended with some modification the 1975 tax cuts and withholding rates for the first 6 months of 1976. In his 1976 state of the Union address, the President renewed his request for a permanent income tax cut. His fiscal 1977 budget assumed congressional approval of his tax cut recommendation of $28.1 billion coupled with $0.8 billion of reduced revenue from other income tax proposals, $3.3 billion of increased revenues from a proposed social security tax rate increase, and $2.1 billion of increased revenues from proposed higher unemployment taxes. The net effect on fiscal 1977 receipts of all tax changes in the budget was estimated to be a net reduction of $23.4 billion.

Three short-term tax cut extensions were enacted after mid-1976 as Congress continued to debate the omnibus tax reduction and reform bill, H.R. 10612. Finally, a $16.8 billion tax cut extension for fiscal 1977 was enacted in the Tax Reform Act of 1976.

The administration continued to recommend and urge enactment of numerous tax reform proposals in fiscal 1976. Proposals were directed at substantially reducing the number of individuals with high economic incomes who pay little or no tax, encouraging economic growth through more capital formation, encouraging job creation, making estate and gift taxation more equitable, and helping State and local governments borrow needed funds. Comprehensive tax reform resulting in a net revenue gain of $1.5 billion in fiscal 1977 was enacted in the Tax Reform Act of 1976 encompassing many of the administration's recommendations with congressional modifications.

Overall, the impact on fiscal 1977 budget receipts of tax cut extensions and reform measures in the 1976 Tax Reform Act was reduced revenues of $15.3 billion.

Domestic Finances

The financial markets during the 15 months absorbed record amounts of funds at generally declining interest rates. Occasional tightening actions by the Federal Reserve in response to flareups in the rates of growth of the monetary aggregates were followed by periods of more ready credit accommodation during which interest rates fell to successively lower levels. By late September 1976, money market rates were fluctuating around 5 1/4 percent, about 3/8 percent below the level of June 1975. In the bond markets, the decline in yields on Treasurys was somewhat less than 3/8 percent, while the decline in yields on corporates and municipals was considerably greater—nearly 1 percentage point. Nonetheless, by historical standards, these rates were still very high.

The large volume of financing was marked by divergent trends. Strengthened demands for long-term funds, not only on the part of the Treasury but also for corporate securities and mortgages, were moderated by continuing weak demand for short-term credit, especially on the part of the business sector.

Nonfinancial corporations continued the restructuring of their balance sheets and improved their liquidity through the funding of short-term debt. Bank loans to nonfinancial corporations declined by about $9 billion, and although other types of corporate short-term nonfinancial borrowings (notably, commercial paper and finance company loans to business) expanded modestly, nonfinancial corporations reduced their short-term borrowings significantly. At the same time, there were $39.5 billion in net new issues of corporate and foreign bonds—only slightly below the record rate reached in fiscal 1975—and net new stock issues expanded to $21 billion.

During fiscal 1976, the reduction in business borrowings from commercial banks, coupled with the slow pace of other bank lending, enabled the commercial banks to place substantial funds in Treasury securities. Although the pace of expansion of total bank credit, at about 4 1/2 percent for the fiscal year, was relatively slow, commercial bank net purchases of Treasury securities accounted for about 32 percent of the net volume of Treasury securities issued to the public.

In all, Treasury securities in the hands of the public (that is, excluding holdings by trust funds, other Government accounts, and the Federal Reserve) increased by $73 billion during fiscal 1976. These net issues served to help finance off-budget agency borrowing for Federal credit programs as well as the Treasury deficit. The Federal Financing Bank accounted for the bulk of such financing, increasing its loans by $9.1 billion.

Not only commercial banks but also nonfinancial corporations, savings institutions, and State and local governments, in the course of rebuilding their liquidity positions, added unusually large amounts to their holdings of Treasury securities, absorbing in combination about 44 percent of the net issues to the public. Some Treasury issues attracted widespread purchases by individuals, bringing net purchases by individuals to about 18 percent of the total. Net purchases of Treasury securities by foreign investors were relatively small.

The Treasury tailored its security offerings to meet investor preferences and also with a view toward lengthening the average maturity of the marketable debt. Notes and bonds totaling $44.3 billion comprised 55 percent of the net offerings other than special issues to Government accounts. In May, the first offering was made of a 10-year note under newly granted authority. In addition, savings bonds increased by $4.2 billion. Although the percentage of debt issued to the public in the form of Treasury bills was considerably lower than in other recent years, the required huge financing operation resulted in a net increase in Treasury bills outstanding of $32.6 billion.

The municipal bond market was able to absorb a record volume of bond issues in fiscal 1976, despite a degree of temporary unsettlement precipitated in part by the New York City crisis. Municipal bond yields, as measured by the Bond Buyer index, reached a peak of 7.67 percent in October 1975 but had receded to about 6 3/4 percent by mid-1976. During the transition quarter, municipal bond offerings remained strong, but yields continued to decline in line with market trends, reaching 6 1/2 percent in late September 1976.

The pattern of financing in fiscal 1976 was carried over into the transition quarter. Short-term credit demands rose at a moderately faster pace even though bank loans to business continued to decline. A curtailment in corporate security offerings was about offset by stronger mortgage demands. While Treasury's net borrowings from the public subsided noticeably from the fiscal 1976 rate, the overall volume of financing consummated during the transition quarter was at a record rate.

The placement of these heavy financing demands during the 15 months was facilitated by the surge of funds to savings institutions. Notwithstanding some hesitation early in fiscal 1976, new records were set for inflow of funds to savings and loan associations, mutual savings banks, credit unions, insurance companies, and corporate and State and local government pension funds, which altogether totaled $143 billion. In addition, nonfinancial businesses put some of the proceeds of their security offerings and of their heavy internal flows into credit market instruments. Foreign investors also supplied some $15 billion in funds to the credit markets, a rate somewhat below that of several recent years and considerably below the $21 billion in fiscal 1971. Although the provision of funds by the banking system remained on the low side ($42 billion), the heavier inflow of funds to savings institutions was sufficient to provide a ready market for the enlarged demands for credit without much growth in purchases by individuals.

INTERNATIONAL DEVELOPMENTS

The world economy underwent substantial changes during the period under review. At the beginning of July 1975, only the U.S. and Japanese economies had begun to pull out of their respective recessions. For the industrial economies as a whole, negative real growth of some 4 percent had been experienced in the preceding half year but during the last half of 1975 recovery spread as confidence was rebuilt—in large part due to the strength of the U.S. performance. By the end of the first half of 1976 the major economies were growing at annual rates in excess of 7 percent while the industrial world in total expanded in real terms around 6 percent.

As often happens during periods of expansion, "pauses" in the recovery process follow high and unsustainable rates of growth. The late summer months reflected such periods of pause in most of the major economies, but by the end of September some indications of renewed progress on the growth front were appearing.

Economic recovery was reflected in a resumption in the growth in both the nominal and real value of world exports and imports, which turned upward again in the first and second quarters of 1976, after allowance for seasonal factors. Trade volumes rose an estimated 13–14 percent after experiencing declines in the half year leading into the fiscal year.

Equally significant to progress in the recovery of real growth was the reduction in worldwide inflation rates that took place in the 15-month period. The global annual rate of inflation, which had already receded from the peak level reached in November 1974, showed some further improvement. By May 1976, however, it was still extremely high at 11 percent, as measured by the IMF calculation of 12 months' changes in consumer prices.

Industrial countries as a group brought down the 12 months' increase in consumer prices from over 11 percent in the second quarter of 1975, to about 7 percent in August 1976, though in individual countries there were wide differences, ranging from 1 1/2 percent in Switzerland to 17 percent in Italy. The U.S. figure was 5.6 percent in August.

Progress was also made in slowing down price advances in the oil-exporting countries, and in Australia and South Africa. Slow progress was made in less industrialized European countries where the rate of price advance averaged 16 percent in June 1976, and inflation actually became worse in the oil-importing developing countries as a group, rising to 33 percent in July 1976 (74 percent in the Western Hemisphere in that month). Although these latter high average rates of inflation were influenced by hyperinflation in a few countries, there were also mixed results among countries with less extreme rates of price increases.

Economic recovery also was accompanied by some important shifts in the pattern of world payments. After allowing for official transfers in the form of grants, there remained in calendar 1976 about $41 billion of the current account surpluses of the oil-exporting group which had to be reflected in the corresponding current deficits of other countries and financed (as compared with about $40 billion in calendar 1975). However, it is estimated that OECD (Organization for Economic Cooperation and Development) countries will account for about $23 billion in 1976, as against about $6 billion in 1975, and that the net current deficits for the rest of the world, including the state trading countries, will accordingly be reduced to about $18 billion, as against about $34 billion in 1975. Among individual countries, the current account positions of the United States, France, Italy, and the Nordic group appear to have softened, while those of Japan, Benelux, and Switzerland were expected to harden, between the 2 years.

Financing of the unusually large current account deficits resulting from the oil price increase has meant that foreign debts to private international lenders have been increasing much more rapidly than in the years before 1974. Consequently, a number of countries are seeking to reduce their rates of borrowing by restraining domestic demand, curbing inflation, and strengthening their current account positions. In doing so, they presumably shift part of their deficits to other oil importers which continue to attract private capital, given that the OPEC (Organization of Petroleum Exporting Countries) surplus which must be offset is essentially set by governments of producer countries rather than by economic factors.

The current impact of these large payments imbalances on the world economy and the global financial system to some extent has become less severe as the value of world trade has increased, but each year of large OPEC surpluses adds to their cumulative effect. In 1974, the ratio to world imports (cost, insurance, and freight) of the gross current account imbalances appears to have been in the range of about 10 percent, as against less than 4 percent in 1973, because of the increase in oil prices. In 1975, this ratio fell to about 7 1/2 percent and in 1976 might be in the neighborhood of 6 percent, which is still well above the 1973 figure.

International Monetary Developments

Negotiations on reform of the international monetary system succeeded in reaching agreement on future provisions in the IMF Articles of Agreement relating to exchange arrangements, and on measures to further move gold from the center of the monetary system. The first major revision of the Articles of Agreement of the International Monetary Fund since its inception in 1945 was completed by the Governors of the Fund, with the Secretary acting for the United States. It was then transmitted to member governments for their formal approval. The revised Articles were accompanied by a proposed increase in IMF quotas of about one-third, to SDR 39 billion (about $45 billion), after the Interim Committee of the Board of Governors (in which the United States is represented by the Secretary of the Treasury) resolved the difficult questions of allocating new quotas among individual countries. This involved a doubling of the quota shares of the oil-producing countries and a corresponding reduction of the shares of the developed countries, leaving the oil-importing developing countries with an unchanged share of the quotas in the Fund. The U.S. share in quotas was reduced, but changes in certain requisite qualified majorities mean that future proposals to amend the Articles, or to increase quotas, cannot become effective without U.S. approval.

The amended IMF Articles will give countries latitude to apply exchange arrangements of their choosing. However, this freedom of national choice as to exchange regimes will be subject to general obligations applicable to all countries to pursue policies that are necessary to achieve underlying economic stability, which is recognized to be a prerequisite for exchange stability. Member countries also undertake, under the amended Articles, to avoid manipulation of the exchange rate or, more generally, of the international monetary system in order to prevent the effective adjustment of payments imbalances or to gain unfair advantage over other members. The Fund is given responsibility for overseeing the international monetary system in order to ensure its effective operation. Moreover, the Fund is directed to exercise "firm surveillance" over the exchange rate policies of members, and to adopt specific principles for the guidance of all members with respect to these policies.

The principal features of the understandings reached on gold were: (1) The official price of gold in the IMF Articles will be eliminated, with the special drawing right (SDR) taking the place of gold as the unit of account for the IMF; (2) all requirements to use gold in transactions with the IMF will be eliminated, and the IMF will be prohibited from accepting gold in any transaction unless there is an 85-percent majority vote to the contrary; (3) one-sixth of the Fund's gold (25 million ounces) will be sold over a 4-year period, with the excess of sales receipts over the present official gold price being channeled to a trust fund for the benefit of developing countries; also, one-sixth of the Fund's gold will be restituted (i.e., sold to members in proportion to their quotas in the IMF in exchange for currency at the present official gold price) over the same 4-year period.

Supplementing this agreement, the members of the Group of Ten industrial countries undertook to observe certain transitional arrangements with respect to their treatment of gold. They agreed not to peg the price of gold or to increase the aggregate quantity of gold held by the Fund and the monetary authorities of the Group of Ten, and to respect any further conditions that were agreed upon by their central banks at regular meetings. These arrangements will be reviewed in 2 years.

The major decisions on all these matters were reached through an intensive series of informal and formal international negotiations during the year in which the Secretary of the Treasury and the Under Secretary for Monetary Affairs took leading roles. Basic understandings on exchange rate arrangements under the amended IMF Articles were reached in bilateral discussions with the Government of France and endorsed by the heads of state participating in the summit meetings in Rambouillet in November 1975. These understandings formed the basis for agreement by the IMF Interim Committee in Jamaica in January 1976. Agreements on gold and the distribution of quotas were reached at the meeting of the Interim Committee in August 1975, in Washington.

Legislation authorizing U.S. acceptance of the proposed amendments to the Articles of Agreement of the Fund and consent to the proposed increase in the U.S. quota in the IMF was approved by the Congress and signed by the President in October 1976. The amendment of the Fund's Articles of Agreement and the proposed increase in IMF quotas will become effective, however, only after acceptance of the amendments by 60 percent of the member countries having 80 percent of the voting power.

During 1975–76, access to Fund resources was liberalized in several ways. Each regular credit tranche was temporarily enlarged by 45 percent, effective during the interim period preceding the coming into effect of the proposed amendment to the IMF Articles. The IMF's compensatory financing facility was substantially liberalized in December 1975. And, as noted above, a trust fund has been established (separate from the IMF but managed by it as trustee) for the benefit of developing countries.

The special IMF oil facility, under which the Fund borrowed about $8.2 billion for lending to countries in need in 1974–76, was terminated in the spring of 1976. This action was related to the realization that, while deficit countries had been given a breathing space by this facility, to meet the initial impact of higher oil prices, the Fund should now return to its normal policies of fostering payments adjustment while providing assistance through its regular procedures, thus helping countries to adjust their deficits and avoid excessive borrowing to finance payments deficits that would otherwise continue to pile up too much foreign debt.

The net use of Fund credit rose from about SDR 5 billion ($6.2 billion) at the end of June 1975 to SDR 12 billion ($13.9 billion) at the end of August 1976.

National Economic Policies and the Renewed Threat of Inflation

As the world recovery gained momentum in the summer of 1976, it became clear that inflationary pressures were reviving quickly even though unemployment in industrial countries was receding slowly. The Secretary of the Treasury joined with other Finance Ministers and monetary authorities in endorsing a strategy for sustainable economic expansion, pointing to the need for caution in the pursuit of expansionary policies. Such new spending might produce a renewed round of excessive inflation and a resulting loss of confidence of businessmen and consumers, thus failing to achieve the desired lasting expansion. This theme was strongly supported by the Secretary both in Paris at the OECD Ministerial meeting in June 1976 and by President Ford at the Puerto Rico summit meeting in June 1976. It received wide acceptance at the annual meeting of the IMF and World Bank in Manila in October 1976.

Exchange Rate Relationships and World Reserves

During this recovery period the currencies of the advanced countries continued to be permitted to move against the dollar, either individually, or jointly, as through the European common margins agreement (the "snake"). The latter required intervention, often on a substantial scale, to maintain the basically fixed rates among the participating countries. Also, a number of countries borrowed abroad on official account or with official guarantees. In these countries, part of the dollar exchange available to the market was provided by feeding these governmental receipts into the market. Increasingly, however, countries began to carry out the broad objective under the Rambouillet and Jamaica agreements, allowing exchange rates to reflect underlying conditions in the national economies rather than intervening officially to resist market forces tending to produce changes in the exchange rates.

In 1975–76, the Canadian dollar, the German mark, the Swiss franc, and the Japanese yen tended to appreciate in dollar terms while several currencies, including the French franc, the pound sterling, and the Italian lira, decreased in dollar value, reflecting relatively high rates of inflation and large payments deficits. The dollar value of the SDR depreciated from $1.236 at the end of June 1975 to $1.146 at the end of June 1976. At the end of the transition quarter the dollar value of the SDR stood at $1.154.

Gross official reserves of all reporting countries rose from SDR 186 billion in June 1975 to SDR 207 billion ($237 billion) in June 1976, for an annual rate of increase of 11 percent. About one-third of this accrued to the oil-exporting countries, and the remainder was divided among the industrial countries and the developing countries. Thus, less than a fifth of the current surplus of the oil-exporting countries was financed by reported reserve accumulation in these countries as a group, a much smaller portion than in 1974–75.

International Trade and Raw Materials Policies

As trade and raw materials policies have grown in international importance in recent years, Treasury's role in both national and international policy formulation has become progressively more active. The need for coordinated domestic and international policy goals has produced an increasing emphasis on trade and raw material policy formulation. U.S. positions on a more open and market-oriented world trading order were important elements in the Rambouillet and San Juan economic summit meetings. The United States actively participated in negotiations leading to a consensus among major trading nations to avoid artificial stimulus of exports through use of official export credits. As a member of the interagency Task Force on the Law of the Sea, the Department proposed a weighted voting system for the International Seabed Authority and helped develop a financing program for the operating arm of the Authority.

The East-West Foreign Trade Board, chaired by the Secretary of the Treasury, continued to monitor trade with the nonmarket economies to ensure that it remained consistent with U.S. national interests. The Board has kept a close watch on Soviet grain purchases and the negotiation of the U.S.-U.S.S.R. Long-term Grain Sales Agreement. In addition, Secretary Simon visited Poland, Yugoslavia, and Romania in June 1976 to explore ways of strengthening economic, trade, and financial relations with those states.

The Treasury played an active role in formulation of U.S. commodity policies, providing staff support and policy input to the Commodities Policy Coordinating Committee, which it cochairs with the State Department, and participating in the interagency Commodities Policy Task Force.

The multilateral trade negotiations (MTN) underway in Geneva are the principal means for pursuing the U.S. goal of a more free and open market-oriented system. Positions adopted by the United States in the MTN with respect to tariffs, subsidies and countervailing duties, safeguards, customs matters, and special treatment for developing countries have benefited from active Treasury participation. The Department also helped in preparation of the U.S. generalized system of preferences for developing countries' exports.

North-South Relations

The UNCTAD IV meeting in Nairobi was of symbolic importance in the North-South dialog. The United States made a series of concrete proposals in Nairobi and agreed to participate over the next 2 years in a series of undertakings to come to grips with key economic issues such as commodity policy, trade, debt, transfer of technology, and special measures to assist the poorest nations. While political considerations sometimes overrode substance at the conference, confrontation was avoided and agreement was reached on a work program which should allow developed and developing nations to bring technical expertise to bear on critical economic issues.

International Investment

During 1975 and 1976, the United States continued its efforts to maintain a free and open climate for international investment. As a result of U.S. initiatives, and with active participation by the Treasury, the member governments of the OECD adopted, in June of 1976, a declaration on international investment and multinational enterprises with the objective of promoting a stable and open environment for international investment. In addition and again at a U.S. initiative, the OECD began discussions aimed at removal of existing impediments to the flow of international portfolio capital. During 1976, the U.N. Commission on Transnational Corporations undertook a comprehensive program designed to lead to the formulation of a U.N.-wide code of conduct for multinational enterprises.

In March of 1976 President Ford established a Cabinet-level Task Force on Questionable Corporate Payments Abroad to review the problem of bribery. As a result of the task force work, in June 1976 the President announced that he intended to propose legislation to the Congress requiring reporting and disclosure of certain payments by U.S. businesses to foreign government officials. In addition, the United States proposed to the United Nations in August 1976 that action be taken toward a comprehensive international agreement to curb corrupt practices in international commerce. As a result, an intergovernmental working group of the Economic and Social Council charged with developing an international agreement on illicit payments, is expected to report to the Council in the summer of 1977.

In the spring of 1976, the Treasury completed its benchmark survey of foreign portfolio investment in the United States, as a part of an overall administration survey of foreign investment in the United States, required by the Foreign Investment Study Act of 1974. Also, Congress passed legislation in September 1976 to create the necessary legal authority to maintain a regular information collection program with respect to foreign investment in the United States and U.S. investment abroad.

The Committee on Foreign Investment in the United States, an interagency group chaired by Treasury officials, was established by President Ford in the spring of 1975 to coordinate overall policy towards inward investment. It considered certain proposed investments by foreign governments in the United States—including an investment by Romania in the Island Creek Coal Co. and a proposed Iranian investment in Occidental Petroleum.

International Energy Developments

The most significant international energy developments have been the increasing solidarity and cooperation among consuming nations, the initiation of a producer/consumer dialog on energy matters in the Energy Commission of the Conference on International Economic Cooperation (CIEC), and the continued dominance by OPEC of the world oil market.

As a result of the 1973 oil embargo, 19 industrialized oil-consuming countries established the International Energy Agency (IEA) to help coordinate their international energy policies. The IEA has succeeded in (1) developing an international oil allocation system to ensure adequate distribution of oil supplies among member countries in the event of another embargo, and (2) adopting a long-term cooperative program to promote increased energy production in member countries.

The CIEC was formally inaugurated by a Ministerial meeting in December 1975. It was agreed that discussion of international economic issues would take place among delegates from 19 countries representing the OPEC and nonoil developing countries and 8 representatives of the developed nations beginning in February of 1976 with the objective of meeting periodically leading up to a Ministerial conference scheduled for December 1976.

Discussion of energy issues in CIEC concentrated on the effects of higher oil prices on world economic progress and the problems of effecting a smooth transition from a world economy based on hydrocarbon energy sources to one based increasingly on alternative energy sources. This commission is the only international forum where oil producers and oil-consuming nations are engaged in a dialog on important energy issues, and its deliberations are breaking new ground in international economic relations.

Developing Nations Finance

The Secretary has frequently expressed the U.S. philosophy surrounding our contribution to the financing of developing-country needs: Development assistance should be thought of not as an international welfare program to redistribute the world's wealth but as an important element of an international investment program to increase the rate of economic growth in developing nations and to provide higher living standards for the people of every nation.

The United States provides financial assistance to developing nations both through multilateral channels such as the World Bank group, the regional development banks, and the IMF, and through bilateral channels such as the Agency for International Development and Public Law 480.

Multilateral assistance has been accelerated: Congress appropriated $745.5 million for U.S. contributions to the international development banks for fiscal 1977, compared with $695.6 million for fiscal 1976. The World Bank group committed $6.9 billion for development projects in fiscal 1976, an increase of 13 percent over 1975. Commitment levels of the Inter-American Development Bank (IDB) rose to $1.2 billion, a 16-percent increase, and those of the Asian Development Bank increased to $880 million, a sizable increment. These increases in the commitments of the international financial institutions can be expected to continue in the near future.

Repeatedly, the Secretary has stressed the importance of sound financial policies for the development banks. A step in this direction was taken when the World Bank adopted a lending rate formula which covers the cost of funds to the Bank plus its operating costs. Similarly, the IDB adopted an automatic lending rate formula, and one is under consideration as well in the Asian Development Bank. These actions will enable the development banks to continue to have access to capital markets at favorable interest rate terms. Thus, the banks will be better able to finance their expanded levels of development lending.

In addition to long-term development financing needs, developing nations have requirements for short-term balance of payments financing. Large current account deficits have been encountered by non-oil-exporting developing countries in recent years due to the twin shocks, in 1974 and 1975, of higher oil prices and recession in the industrialized countries. The international community has responded to the situation in various ways. With a doubling of net official flows, and an even larger increase in private flows, the current account deficits of developing countries have been financed, providing these countries time to undertake necessary economic adjustments.

In the bilateral sphere, the United States has pursued a number of programs for financing developing-country needs. The Agency for International Development committed $2.3 billion in loans and grants and supporting assistance in fiscal 1976, $200 million less than in 1975. Under Public Law 480, during fiscal 1976 and the transition quarter, Title I sales agreements for $914 million were signed, while Title II donations totaled $247 million. Programs of the Overseas Private Investment Corporation and the Council on International Economic Policy contributed to the security of private investment flows to developing countries.

The growing foreign indebtedness of developing countries is a matter of particular concern to the Treasury. On January 30, 1976, the Secretary submitted to Congress the administration's second annual report on the external debt of developing countries. The vast majority of loans by the United States to developing countries are repaid on schedule. However, some countries have fallen into arrears on their repayments to the United States, and the Treasury has taken vigorous action to encourage these countries to become current on their payments.

Although the Treasury does not believe that generalized debt rescheduling should be employed as a form of foreign assistance, it recognizes that in a few exceptional cases the official debts of a developing country must be rescheduled for the economy of that country to remain viable. The United States signed rescheduling agreements in March 1976 with Pakistan and with Bangladesh. In June 1976, the United States entered into a multilateral understanding with other creditor countries pursuant to which each country agreed to enter into a bilateral agreement with Zaire to reschedule certain outstanding indebtedness of Zaire.

Finally, to strengthen U.S. economic and financial relationships with the countries of the Middle East, the Secretary visited Saudi Arabia, Egypt, Israel, Syria, and the United Arab Emirates. The Secretary also traveled to three Latin American nations—Chile, Brazil, and Mexico. The visit to Brazil settled several bilateral trade disputes, and in Chile the Secretary warned officials that U.S. support for their economic programs depends on the Chilean Government's commitment to the protection of human rights.

Financial Support Fund

The Secretary testified before both House and Senate committees advocating approval of the Support Fund of approximately $24 billion negotiated in April 1975 as a temporary safety net, or insurance mechanism, to strengthen international cooperation in the energy and economic policies of participating OECD members. It would be used to supplement other sources of financing if it developed that these countries could not obtain elsewhere on reasonable terms the financing they need to avoid introducing restrictive trade policies, capital controls, or unduly severe deflation. The Agreement establishing the Support Fund had been ratified by 15 OECD member countries, including Germany and Japan, by the end of fiscal 1976 and 3 other countries have completed domestic procedures prerequisite to ratification. The Congress did not act on the bill before adjournment, however.

CONCLUSION

The U.S. domestic economic situation improved substantially during fiscal 1976 and the transition quarter. Strong gains in production, employment, and real income were achieved during this period of cyclical recovery although the unemployment rate remained disturbingly high. Real growth had fallen slightly below a 4-percent annual rate by the end of the period, but this seemed to reflect the cessation of rapid rebuilding of inventories rather than any serious imbalances or lack of forward momentum in the economy.

One of the more encouraging features of the economic expansion was the progress made in controlling inflation. While real output increased rapidly, the double-digit inflation that crested in 1974 moderated to the 5- to 6-percent range. However, this rate was still far too high and inflation remained the greatest single threat to both the sustainability of the current economic expansion and the longer term stability of the U.S. economy.

In other industrial countries, a period of rapid real growth in fiscal 1976 was succeeded by a pause in the past few months. World trade expanded vigorously after declining during the recession. Some further progress was made in reducing excessive rates of inflation in some industrial countries, but in the rest of the world abnormally high rates persisted. In calendar 1976, OECD countries anticipated current payments deficits totaling about $23 billion, while the oil-importing developing countries and the state trading countries together may record about $18 billion in deficits. A current account surplus of about $41 billion for the group of oil-exporting countries was anticipated.

Negotiations on reform of the international monetary system, which began in 1972, were completed, resulting in the first major revision of the Articles of Agreement of the International Monetary Fund since its inception in 1945. The United States adhered to the revised Articles and agreed to an increase in the resources of the IMF of about one-third, to a total of $45 billion.

The U.S. emphasis on moderate but sustainable economic progress, and on the avoidance of overstimulatory policies that could re-ignite inflation, received wide international acceptance. Exploratory discussions on a wide front were also undertaken in the fields of energy, commodity policies, international investment, and other matters of concern to developing countries. The United States maintained the basic posture that commodity problems and international debt resettlement problems should be examined on a case-by-case basis.

The United States continued to provide financial assistance to developing nations through both multilateral and bilateral channels, based on the philosophy that development assistance should be considered as an important element of an international investment program to increase the rate of economic growth and provide higher living standards for the people of every nation, and not as an international welfare program to redistribute the world's wealth.

REVIEW OF TREASURY OPERATIONS

FINANCIAL OPERATIONS

Summary

On the unified budget basis the deficit for fiscal 1976 was $65.6 billion and $12.7 for the transition quarter. Net receipts for fiscal 1976 amounted to $300.0 billion ($19.0 billion over fiscal 1975), and outlays totaled $365.6 billion ($41.0 billion over 1975). Transition quarter receipts and outlays were $81.8 and $94.5, respectively.

Fiscal 1976 borrowing from the public amounted to $82.8 billion as a result of (1) the $65.6 billion deficit, (2) a $7.8 billion increase in cash and monetary assets, and (3) a $9.4 billion decrease in other means of financing. During the transition quarter borrowing from the public totaled $18.0 billion resulting from (1) the $12.7 billion deficit, (2) a $2.9 billion increase in cash and monetary assets, and (3) a $2.4 billion decrease in other means of financing.

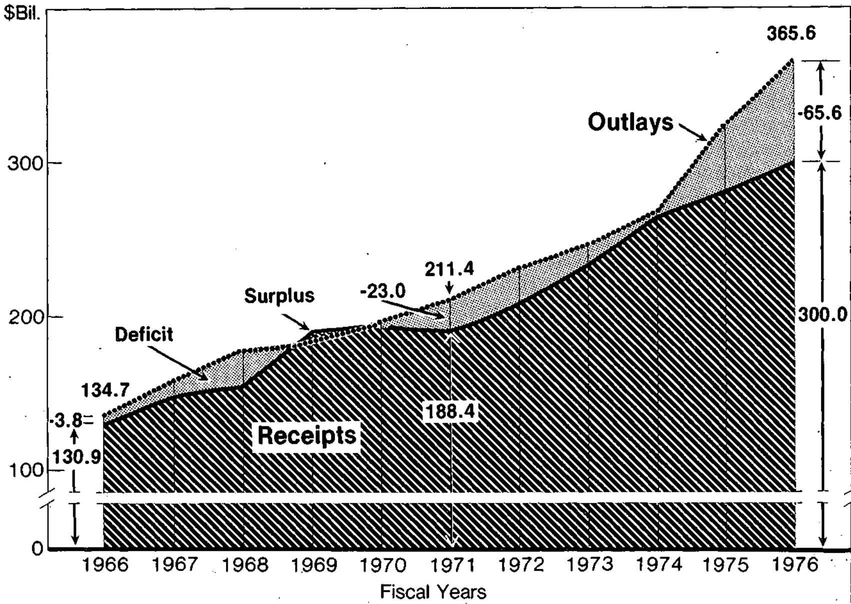
As of June 30, 1976, Federal securities outstanding totaled $631.3 billion, comprised of $620.4 billion in public debt securities and $10.9 billion in agency securities. Of the $631.3 billion, $479.7 billion represented borrowing from the public. Federal securities outstanding as of September 30, 1976, were $645.7 billion, which included $634.7 billion in public debt securities and $11.0 billion in agency securities. Of the $645.7 billion, $497.7 billion represented borrowing from the public.

The Government's fiscal operations in fiscal years 1975 and 1976 and the transition quarter are summarized as follows:

[In billions of dollars]

	1975	1976	T.Q.
Budget receipts and outlays:			
Receipts	281.0	300.0	81.8
Outlays	324.6	365.6	94.5
Budget deficit (−)	−43.6	−65.6	−12.7
Means of financing:			
Borrowing from the public	50.9	82.8	18.0
Increase in cash and other monetary assets (−)	−.3	−7.8	−2.9
Other means:			
Increment on gold and seigniorage	.6	.7	.1
Outlays of off-budget Federal agencies	−9.5	−8.0	−2.0
Other	2.0	−2.1	−.5
Total budget financing	43.6	65.6	12.7

THE BUDGET



Receipts

Total budget receipts amounted to $300.0 billion in fiscal 1976 and $81.8 billion in the transition quarter. A comparison of net budget receipts by major source for fiscal years 1975 and 1976 is shown below, along with the transition quarter receipts.

[In millions of dollars]

Source	1975	1976	T.Q.
Individual income taxes	122,386	131,603	38,801
Corporation income taxes	40,621	41,409	8,460
Employment taxes and contributions	75,204	79,909	21,803
Unemployment insurance	6,771	8,054	2,698
Contributions for other insurance and retirement	4,466	4,752	1,259
Excise taxes	16,551	16,963	4,473
Estate and gift taxes	4,611	5,216	1,455
Customs duties	3,676	4,074	1,212
Miscellaneous receipts	6,711	8,026	1,612
Total budget receipts	280,997	300,005	81,773

Projected estimates of receipts to future years, required of the Secretary of the Treasury, are shown and explained in the President's budget.

Individual income taxes.—Individual income taxes reached $131.6 billion in fiscal 1976, an increase of $9.2 billion over fiscal 1975. The Tax Reduction Act of 1975 and the Revenue Adjustment Act of 1975 together reduced individual tax payments by $9.4 billion in fiscal 1975, by $13.2 billion in fiscal 1976, and by $0.5 billion in the transition quarter.

Extension of the individual tax cuts, codified in Public Law 94–455, reduced the transition quarter receipts by an additional $2.5 billion.

Corporation income taxes.—Corporation income taxes increased by $0.8 billion over fiscal 1975 to reach $41.4 billion in fiscal 1976. Legislation enacted during 1975 reduced corporate tax payments by $0.8 billion in fiscal 1975, by $2.6 billion in fiscal 1976, and by $0.2 billion in the transition quarter. Extension of the corporate tax cuts, codified in Public Law 94–455, further reduced transition quarter payments by $0.3 billion.

Employment taxes and contributions.—Receipts from this source totaled $79.9 billion in fiscal 1976. The increase in the social security taxable earnings base from $13,200 to $14,100, effective January 1, 1975, contributed $1.6 billion of the $4.7 billion increase from 1975 to 1976.

Unemployment insurance.—Unemployment insurance receipts increased by 19 percent in fiscal 1976 to $8.1 billion. State tax deposits at the Treasury, the largest component in this category, increased by $1.1 billion (or 21 percent), reflecting increased State financing of past unemployment benefits.

Contributions for other insurance and retirement.—Receipts in this category increased by $0.3 billion to a total of $4.8 billion in fiscal 1976 and $1.3 billion in the transition quarter.

Excise taxes.—Receipts of excise taxes in fiscal 1976 were $17.0 billion, an increase of $0.4 billion over fiscal 1975, and totaled $4.5 billion in the transition quarter. Fiscal 1976 and the transition quarter figures reflect the phasing out of the telephone excise tax.

Estate and gift taxes.—The fiscal 1976 increase of $0.6 billion in this category reflects in part the recovery in the level of stock prices.

Customs duties.—Customs duties increased by $0.4 billion, reaching $4.1 billion in fiscal 1976.

Miscellaneous receipts.—These receipts totaled $8.0 billion in fiscal 1976, an increase of $1.3 billion over fiscal 1975. Deposits of earnings by the Federal Reserve System declined by $0.3 billion. This was more than offset by the inclusion of an additional $1.4 billion of oil import fees (the constitutionality of which were upheld by the Supreme Court on June 17, 1976). In addition, the totals for fiscal 1976 and the transition quarter exclude, while fiscal 1975 includes, Government Receipt Clearing Account F3875, which was reclassified effective with the September 1975 publication of the Monthly Treasury Statement.

Outlays

Total outlays in fiscal 1976 were $365.6 billion (compared with $324.6 billion for 1975). Transition quarter outlays amounted to $94.5 billion. Outlays by major agency for fiscal years 1975 and 1976 and the transition quarter are presented in the following table. For details see the Statistical Appendix.

[In millions of dollars]

	1975	1976	T.Q.
Funds appropriated to the President	3,572	3,525	1,221
Agriculture Department	9,725	12,796	3,850
Defense Department	87,471	90,160	22,509
Health, Education, and Welfare Department	112,411	128,785	34,341
Housing and Urban Development Department	7,488	7,079	1,397
Labor Department	17,649	25,742	5,905
Transportation Department	9,247	11,936	3,003
Treasury Department	41,177	44,335	9,699
Energy Research and Development Administration[1]	3,198	3,759	1,051
National Aeronautics and Space Administration	3,267	3,670	953
Veterans Administration	16,575	18,415	3,957
Other	26,920	30,112	9,153
Undistributed intrabudgetary transactions	-14,098	-14,704	-2,567
Total outlays	324,601	365,610	94,473

[1] Effective Jan. 19, 1975, the functions of the Atomic Energy Commission were transferred to the Energy Research and Development Administration.

Cash and monetary assets

On June 30, 1976, cash and monetary assets amounted to $23.7 billion. The balance consisted of U.S. Treasury operating cash of $14.8 billion ($7.2 billion more than June 30, 1975); $1.6 billion held in special drawing rights ($0.3 billion less than fiscal 1975); a net $3.2 billion with the International Monetary Fund ($1.0 billion more than 1975); and $4.0 billion of other cash and monetary assets ($0.2 billion less than 1975).

Cash and monetary assets totaled $26.6 billion on September 30, 1976. This amount was comprised of U.S. Treasury operating cash of $17.4 billion; $1.6 billion in special drawing rights; a net $4.0 billion with the International Monetary Fund; and $3.6 billion of other cash and monetary assets.

For a discussion of the assets and liabilities in the Treasury's account, see page 170. Transactions affecting the account in fiscal 1976 and in the transition quarter are shown separately in the following tables:

Transactions affecting the account of the U.S. Treasury, fiscal 1976

[In millions of dollars]

Operating balance June 30, 1975			7,589
Excess of deposits or withdrawals (-), budget, trust, and other accounts:			
Deposits		347,455	
Withdrawals (-)		409,384	-61,929
Excess of deposits or withdrawals (-), public debt accounts:			
Increase in gross public debt		87,244	
Deduct:			
Net discounts on new issues	9,899		
Interest increment on savings and retirement plan securities	3,526		
Net public debt transactions included in budget, trust, and other Goverment accounts	4,642		
Net deductions		18,067	69,177
Operating balance June 30, 1976			14,835

Transactions affecting the account of the U.S. Treasury, transition quarter

[In millions of dollars]

Operating balance June 30, 1976			[1] 14,828
Excess of deposits or withdrawals (–), budget, trust, and other accounts:			
Deposits		89,807	
Withdrawals (–)		101,996	–12,189
Excess of deposits or withdrawals (–), public debt accounts:			
Increase in gross public debt		14,269	
Adjustments to gross public debt:			
Net discounts on new issues	–2,317		
Interest increment on savings and retirement plan securities	–909		
Net public debt transactions included in budget, trust, and other Government accounts	3,729		
Net adjustments (+)		503	14,773
Operating balance Sept. 30, 1976			17,414

[1] Effective July 1, 1976, "other demand deposits" are excluded from the operating balance.

Corporations and other business-type activities of the Federal Government

The business-type programs which Government corporations and agencies administer are financed by various means: Appropriations (made available directly or in exchange for capital stock), borrowings from either the U.S. Treasury or the public, or by revenues derived from their own operations. Various agencies have been borrowing from the Federal Financing Bank, which began operations in May 1974. The bank is authorized to purchase and sell securities issued, sold, or guaranteed by Federal agencies.

Corporations or agencies having legislative authority to borrow from the Treasury issue their formal securities to the Secretary of the Treasury. Amounts so borrowed and outstanding are reported as liabilities in the periodic financial statements of the Government corporations and agencies. In fiscal 1976, borrowings from the Treasury, exclusive of refinancing transactions, totaled $26.6 billion, repayments were $18.2 billion, and outstanding loans on June 30, 1976, totaled $53.1 billion. During the transition quarter, borrowings from the Treasury, exclusive of refinancing transactions, totaled $26.6 billion, repayments were $22.3 billion, and outstanding loans on September 30, 1976, totaled $57.4 billion.

Those agencies having legislative authority to borrow from the public must either consult with the Secretary of the Treasury regarding the proposed offering, or have the terms of the securities to be offered approved by the Secretary.

The Federal Financing Bank makes funds available in accordance with program requirements to agencies having authority to borrow from the bank. Interest rates shall not be less than rates determined by the Secretary of the Treasury taking into consideration current average yields on outstanding Government or bank securities of comparable maturity. The bank may charge fees to provide for expenses and reserves. During fiscal 1976 and the transition quarter, all funds loaned by the bank have been borrowed from the Treasury.

During fiscal 1976, Congress granted new authority to borrow from the Treasury in the total amount of $11.3 billion, adjustments reduced borrowing authority by $6.8 billion, a net increase of $4.5 billion. During the transition quarter, Congress granted new authority to borrow from the Treasury in the total amount of $10.8 billion, adjustments increased borrowing authority by $1.1 billion, making a total increase of $11.9 billion. The status of borrowings and borrowing authority and the amount of corporation and agency securities outstanding as of June 30, 1976, and as of September 30, 1976, are shown in the Statistical Appendix.

Unless otherwise specifically fixed by law, the Treasury determines interest rates on its loans to agencies by considering the Government's cost for its borrowings in the current market, as reflected by prevailing market yields on Government securities which have maturities comparable with the Treasury loans to the agencies. A description of the Federal agency securities held by the Treasury on June 30, 1976, and on September 30, 1976, is shown in the Statistical Appendix.

During fiscal 1976 and during the transition quarter, the Treasury received $2.4 billion and $0.9 billion, respectively, from agencies which consisted of dividends, interest, and similar payments. (See the Statistical Appendix.)

As required by Department Circular No. 966, Revised, semiannual statements of financial condition, and income and retained earnings are submitted to the Treasury by Government corporations and business-type agencies (all other activities report on an annual basis). Quarterly statements showing direct and guaranteed loans, and annual statements of commitments and contingencies are also submitted. These statements serve as the basis for the combined financial statements compiled by the Treasury which, together with individual statements, are published periodically in the Treasury Bulletin. Summary statements of the financial condition of Government corporations and other business-type activities, as of September 30, 1976, are shown in the Statistical Appendix.

Government-wide financial management

Improving availability of information on budget and fiscal data.—In accordance with requirements of the Congressional Budget and Impoundment Control Act of 1974 (Public Law 93–344) which amended the Legislative Reorganization Act of 1970, Treasury, in conjunction with the Office of Management and Budget, the Congressional Budget Office, and others, assisted the General Accounting Office in reviewing a glossary of terms to provide standard terminology and definitions for use by Federal agencies in providing fiscal, budgetary, and program-related data and information to the Congress. The glossary was published in November 1975. Treasury also furnished technical assistance to GAO in its efforts to develop congressional sourcebooks for executive branch inventories of program evaluation activities, recurring reports to the Congress, and information systems and sources.

Joint Financial Management Improvement Program.—During the fiscal year, two major projects were undertaken. First, a JFMIP project team studied the work processes associated with the financial management programs in the Farmers Home Administration. As a result, a new loan disbursement procedure was developed. This procedure should result in interest savings to both the Government and the public by handling the disbursement of loan funds on a more timely basis. The second project involves the Bureau of Alcohol, Tobacco and Firearms. JFMIP is working with ATF to develop a management information system which will provide Bureau decisionmakers with substantive data in a more efficient manner.

International Monetary Fund.—The Treasury, as U.S. correspondent with the International Monetary Fund for matters related to the Fund's government finance statistics project, sent a delegation headed by the Fiscal Assistant Secretary to the Fund's Seminar on Government Finance Statistics in Paris on March 23–25, 1976. The Treasury delegation contributed particularly in the area relating to the definition and treatment of nonfinancial public enterprises and public financial institutions. The Fund is working to resolve the institutional questions raised by the Treasury and other Fund member country delegations.

Selected statistics on finance data for fiscal 1974 are being collected by the Fund for publication in early spring of 1977. The Treasury furnished the Fund pertinent fiscal 1974 data for which Treasury is the source, as well as preliminary Federal sector data for fiscal 1974. With regard to finalized fiscal 1974 Federal sector and other relative statistical data, information sources from outside the Treasury sphere will furnish these data to Treasury for review and passage to the Fund by the end of 1976. Immediately thereafter, comparable data for fiscal years 1973 and 1975 will be furnished.

Emergency Loan Guarantee Board

The Secretary of the Treasury is Chairman of the Emergency Loan Guarantee Board, a three-man board consisting also of the Chairman of the Board of Governors of the Federal Reserve System and the Chairman of the Securities and Exchange Commission. The Board, established by law in August 1971 (15 U.S.C. 1841–1852), was authorized, upon making certain specified findings, to guarantee private bank credit to major business enterprises in an aggregate amount of up to $250 million. The Board's authority to enter into any new guarantee agreements terminated in December 1973.

The Board submitted a special report to Congress on June 28, 1973, which contained a description of the Board's operations together with a recommendation that the guarantee program not be continued beyond its termination date. Termination of the guaranteed loan program does not affect the Board's ability to carry out its obligation to Lockheed Aircraft Corp., the only borrower.

On October 9, 1975, the Board submitted its fourth annual report to Congress for the year ended July 31, 1975. In accordance with the requirements of the Emergency Loan Guarantee Act, the report fully describes the Board's operations during the year with focus on Lockheed Aircraft Corp. A fifth annual report is forthcoming for the period August 1, 1975, through September 30, 1976.

CAPITAL MARKETS AND DEBT MANAGEMENT

Capital Markets Policy

The progress made toward reduction in the growth of inflation during fiscal 1976 was reflected in the improved health of U.S. capital markets in general, and equity markets in particular. While this improvement in the capital markets was gratifying, concern remained as to the ability of firms to raise new equity capital through these markets. In this regard, the Treasury continued its efforts to develop tax and regulatory policies which would aid in the recovery of our capital markets and promote wider access to equity markets in particular. Included among these efforts was the Department's support for passage of comprehensive financial institution reform, embodied in the Financial Institutions Act of 1975, as well as participation in the implementation of the Securities Acts Amendments of 1975 and development of a central market system. Additionally, the Department continued its review of the Glass-Steagall Act restrictions on securities activities of commercial banks and released an issues paper on this topic entitled "Public Policy Aspects of Bank Securities Activities."[1]

In an effort to improve the Department's capital market operations, and in recognition of the interrelationship between the Department's debt market activities and its activities in the areas of equity market development and financial institutions reform, the Secretary created the Office of the Assistant Secretary (Capital Markets and Debt Management). The responsibilities of the Assistant Secretary (Capital Markets and Debt Management) include the traditional policymaking issues associated with the management of Treasury debt market activities, including Federal Financing Bank activities, as well as the legislative and policymaking issues dealing with corporate debt and equity market activities and municipal debt market regulation.

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1 See exhibit 16.

Federal Debt Management

In fiscal 1976 the Treasury financed a record deficit in an atmosphere of overall economic recovery and increased private demands for credit. Over the year as a whole, industrial production and housing improved, employment and incomes were up, and the rate of unemployment declined. Despite the improvement in economic activity, and the accompanying increase in total credit demands, inflation receded and market interest rates declined somewhat over the course of the year. In this relatively favorable financing climate, the Treasury refunded $26.1 billion of maturing coupon securities privately held and raised $79.6 billion of net new money in the private market. The increase in public debt outstanding for the year was a record $87.2 billion, which surpassed the $61.8 billion previous high of fiscal 1944 by $25.4 billion.

The Treasury acted aggressively in 1976 to lengthen the maturity structure of the debt, thus avoiding excessive refunding requirements in the near future which would compete with private borrowings and inhibit the expansion of private credit essential to finance the economic recovery. Debt restructuring was achieved primarily by (1) regular quarterly issues of long-term bonds and 7- to 10-year notes, and (2) regular issues of 2-, 4-, and 5-year cycle notes.

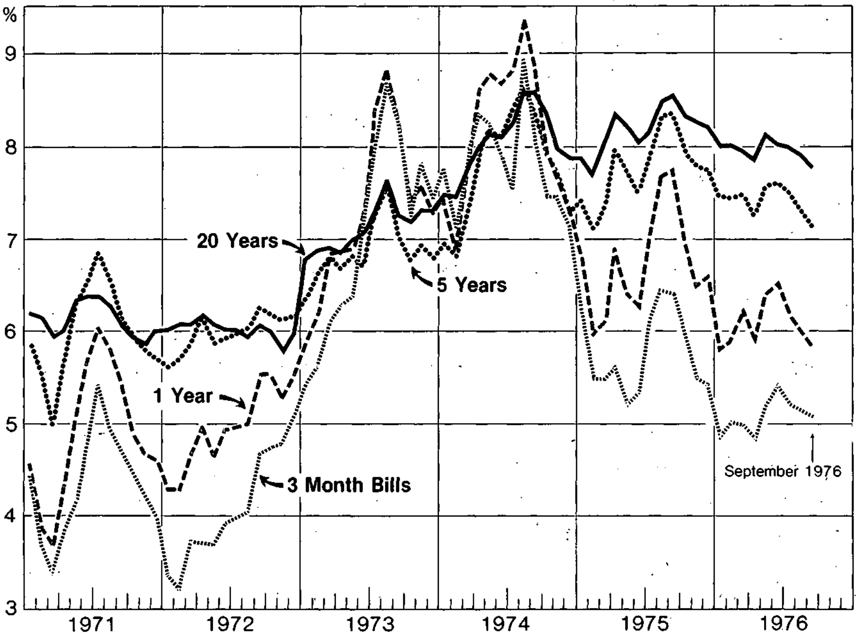
Total offerings of coupon issues to private investors in fiscal 1976 by maturity area were: $27.8 billion maturing within 2 years, $36.1 billion maturing in 2 to 7 years, $4.7 billion in the 7 to 10 year range, and $3 billion maturing in over 10 years.

To develop a broad market for the coupon financings of the size and frequency necessary to accomplish significant debt lengthening, the Treasury made use of the fixed-price subscription technique twice in fiscal 1976 and once during the transition quarter. In these offerings the price and interest coupon were set at the time of the announcement in order to elicit a large response from small investors. In February 1976, $6 billion of 7-year notes were sold to private investors, and in May and August 10-year notes were sold to private investors in amounts of $4.7 billion and $8 billion, respectively.

The Treasury achieved substantial "regularization" of coupon issues in fiscal 1976 by continuing its issues of 2-year cycle notes and by establishing new 4- and 5-year note cycles. The 2-year notes mature at the end of each month, 4-year notes at the end of each quarter, and 5-year notes at the middle of each quarter.

The shift in 1976 from short-term bill financing to longer term coupon financing resulted in a reversal of the 10-year decline in the average maturity of the debt. The average length of the privately held Treasury marketable debt had steadily declined from 5 years 4 months in June 1966

MARKET YIELDS AT CONSTANT MATURITIES 1971-1976[1]



[1] Monthly averages of daily market yields of public debt securities. Bank discount rates of Treasury bills.

to 2 years 4 months in February 1976, but increased to 2 years 9 months by the end of the transition quarter.

Financing operations

Fiscal 1976 began amid evidence that recessionary forces in the economy were dissipating. Following five consecutive quarters of significant decline, economic activity turned around in the second quarter of calendar 1975 and real GNP showed a modest increase of 1.6 percent at an annual rate, the first increase since 1973. In addition, housing starts had improved modestly and some progress had been made in reducing the backlog of unsold homes, but business fixed investment spending continued to decline. However, total employment improved for the third successive month in June 1975 and the unemployment rate declined to 8.6 percent of the labor force, down from 9.2 percent in May. On the inflation front the latest evidence indicated that the deceleration in inflation which began in the fourth quarter of 1974 had extended into the April–June 1975 period.

In the money and capital markets short rates had progressively declined over the course of fiscal 1975, while intermediate and long rates remained relatively high, but at the start of fiscal 1976 all rates were advancing. Federal funds rates were moving higher, and higher yields were posted on all maturities of commercial paper and on large certificates of deposit. In addition, major commercial banks had boosted their prime lending rate by

1/2 percentage point to 7 1/2 percent. This was the first increase in the prime rate since July 1974, when the rate reached a record 12 percent before falling steadily to 7 percent in June 1975. At this time, yields on Treasury securities were increasing primarily because of uncertainty about the course of monetary policy and the heavy Treasury financing requirements.

The Treasury ended fiscal 1975 with an operating cash balance of $7.6 billion, the lowest yearend level since the $5.9 billion at the end of fiscal 1969. To meet seasonal new cash needs, about $4.9 billion of new cash was raised in July through increases in each of the five regular weekly bill auctions and the 52-week bill auction. In addition, $3.3 billion of new money was raised in July through the sale of two coupon issues, a 4-year note and a 2-year note.

The 4-year note, which had been auctioned in June for payment in July, was the Treasury's first issue of an end-of-quarter 4-year cycle note. The note was auctioned at an average yield of 7.83 percent with the coupon set at 7 3/4 percent. Total tenders received amounted to $5.4 billion of which the Treasury accepted $1.8 billion. Commercial banks were allotted $1 billion, or 54 percent of the issue. Response to the auction of the 2-year note was favorable with tenders from the public again totaling $5.4 billion. The Treasury accepted $1.5 billion at an average yield of 7.52 percent and a coupon of 7 1/2 percent. Dealers were awarded $0.8 billion, or nearly 51 percent of this issue. Following this auction, rates increased due to the lack of secondary market interest in the new notes and in anticipation of the higher yields which were believed to be needed to successfully complete the Treasury August refinancing.

The terms of the August financing were announced on July 23 with the Treasury indicating that it would refund $4.8 billion of notes privately held maturing on August 15, 1975, and raise $1 billion in new cash with the auctioning of three new securities.

The new securities offered were $3 billion of 2 3/4-year notes, $2 billion of 7-year notes, and $0.8 billion of 25-year bonds. Response to the auctions was quite favorable. On July 29 the Treasury received $5.7 billion of tenders for the $3 billion of 2 3/4-year notes, including $0.9 billion in noncompetitive tenders. Nearly $3.1 billion was accepted at an average yield of 7.94 percent with a 7 7/8 percent coupon. Commercial banks were allotted $1.8 billion, or 60 percent of the issue. The next day about $3.7 billion of tenders were received from the public for the $2 billion of 7-year notes. For this issue, tenders as low as $1,000 were acceptable. The $2 billion of accepted tenders included $0.3 billion of noncompetitive tenders. The average yield was 8.14 percent which resulted in a coupon set at 8 1/8 percent. Commercial banks and dealers combined took 81 percent of the issue with banks taking 42 percent, or $847 million, and dealers $793 million, or 39 percent. In the final part of the refunding private investors submitted $2 billion of tenders for the $0.8 billion of 25-

Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1976 and transition quarter

[In millions of dollars]

Date	Description	Cash offerings: For new money	Cash offerings: For refunding	Allotted to Federal Reserve and Gov't accounts	Total	Average auction yield (percent)
1975	NOTES AND BONDS					
Apr. 1	1 1/2 percent note, Apr. 1, 1980 1	....	(*)	....	(*)	.....
July 9	7 3/4 percent note, June 30, 1979	1,782	....	....	1,782	7.83
July 31	7 1/2 percent note, July 31, 1977	1,516	....	....	1,516	7.52
Aug. 15	7 7/8 percent note, May 15, 1978	535	2,516	1,372	4,423	7.94
Aug. 15	8 1/8 percent note, Aug. 15, 1982	353	1,663	902	2,918	8.14
Aug. 15	8 3/8 percent bond, Aug. 15, 1995-2000	140	661	313	1,114	8.44
Aug. 29	8 1/4 percent note, Aug. 31, 1977	2,011	....	10	2,021	8.25
Sept. 4	8 1/2 percent note, Sept. 30, 1979	2,081	....	....	2,081	8.54
Sept. 30	8 3/8 percent note, Sept. 30, 1977	1,263	1,930	33	3,226	8.44
Oct. 1	1 1/2 percent note, Oct. 1, 1980 1	....	2	....	2	.....
Oct. 7	8 percent note, Feb. 28, 1978	2,110	....	5	2,115	8.10
Oct. 22	8 1/8 percent note, Dec. 31, 1978	2,517	....	....	2,517	8.14
Oct. 31	7 1/2 percent note, Oct. 31, 1977	3,156	....	....	3,156	7.55
Nov. 17	7 7/8 percent note, Nov. 15, 1982	141	2,377	384	2,902	7.92
Nov. 17	8 3/8 percent bond, Aug. 15, 1995-2000	1,001	....	150	1,151	8.23
Dec. 31	7 1/4 percent note, Dec. 31, 1977	1,053	1,500	212	2,765	7.28
1976						
Jan. 6	7 1/2 percent note, Dec. 31, 1979	2,006	....	....	2,006	7.50
Jan. 26	7 3/8 percent note, May 15, 1981	2,020	....	....	2,020	7.40
Feb. 2	6 3/8 percent note, Jan. 31, 1978	925	1,397	189	2,511	6.49
Feb. 17	7 percent note, Feb. 15, 1979	1,666	1,426	1,600	4,692	7.05
Feb. 17	8 percent note, Feb. 15, 1983	3,244	2,775	1,939	7,958	.....
Feb. 17	8 1/4 percent bond, May 15, 2000-05	217	185	215	617	8.09
Mar. 3	6 5/8 percent note, Nov. 30, 1977	2,628	....	....	2,628	6.62
Mar. 17	7 1/2 percent note, Mar. 31, 1980	2,069	....	....	2,069	7.54
Mar. 31	6 3/4 percent note, Mar. 31, 1978	922	2,143	97	3,162	6.76
Apr. 1	1 1/2 percent note, Apr. 1, 1981 1	....	(*)	....	(*)	.....
Apr. 5	7 3/8 percent note, Feb. 15, 1981	2,628	....	....	2,628	7.38
May 17	6 1/2 percent note, Apr. 30, 1978	1,086	1,188	300	2,574	6.61
May 17	7 7/8 percent note, May 15, 1986	2,267	2,480	472	5,219	.....
May 17	7 7/8 percent bond, Feb. 15, 1995-2000	358	393	117	868	8.19
June 1	7 1/8 percent note, May 31, 1978	1,043	1,442	82	2,567	7.16
June 10	7 5/8 percent note, June 30, 1980	2,185	....	....	2,185	7.71
June 30	6 7/8 percent note, June 30, 1978	640	1,999	692	3,331	6.99
	Total notes and bonds	45,563	26,077	9,084	80,724	.....

Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1976 and transition quarter—Continued

[In millions of dollars]

Date	Description	Cash offerings: For new money	Cash offerings: For refunding	Allotted to Federal Reserve and Gov't accounts	Total	Average auction yield (percent)
	BILLS (MATURITY VALUE)					
	Change in offerings of regular bills:					
1975						
	July-September	14,234	....	....	14,234	......
	October-December	12,678	....	....	12,678	......
1976						
	January-March	7,243	....	....	7,243	......
	April-June	60	....	....	60	......
	Total change in regular bills	34,215	....	....	34,215	......
	Other bill offerings:					
1975						
Aug. 8	6.280 percent, 18-day, maturing Aug. 26, 1975	1,000	....	....	1,000	......
Sept. 5	6.175 percent, 13-day, maturing Sept. 18, 1975	849	....	....	849	......
Sept. 5	6.156 percent, 20-day, maturing Sept. 25, 1975	700	....	....	700	......
Dec. 5	5.823 percent, 139-day, maturing Apr. 22, 1976	2,002	....	....	2,002	......
Dec. 8	5.220 percent, 10-day, maturing Dec. 18, 1975	602	....	....	602	......
Dec. 8	5.140 percent, 18-day, maturing Dec. 26, 1975	601	....	....	601	......
1976						
Apr. 8	4.834 percent, 14-day, maturing Apr. 22, 1976	2,503	....	....	2,503	......
June 8	5.520 percent, 9-day, maturing June 17, 1976	2,010	....	....	2,010	......
	Total other bill offerings	10,267	....	....	10,267	......
	Total offerings—fiscal 1976	90,045	26,077	9,084	125,206	......
	NOTES AND BONDS					
Apr. 1	1 1/2 percent note, Apr. 1, 1981[1]	....	(*)	....	(*)	......
July 9	7 5/8 percent note, Aug. 15, 1981	2,586	....	....	2,586	7.63
July 30	6 7/8 percent note, July 31, 1978	2,855	....	....	2,855	6.95
Aug. 16	6 7/8 percent note, Aug. 15, 1979	1,370	919	700	2,989	6.91
Aug. 16	8 percent note, Aug. 15, 1986	4,811	3,228	1,476	9,515	......
Aug. 16	8 percent bond, Aug. 15, 1996-2001	588	395	592	1,575	8.01
Aug. 31	6 5/8 percent note, Aug. 31, 1978	1,298	1,597	54	2,949	6.67
Sept. 14	6 7/8 percent note, Sept. 30, 1980	2,141	....	....	2,141	6.93
Sept. 30	6 1/4 percent note, Sept. 30, 1978	1,188	1,681	326	3,195	6.30
	Total notes and bonds	16,837	7,820	3,148	27,805	......
	BILLS (MATURITY VALUE)					
	Change in offerings of regular bills:					
1976	July-September	307	....	....	307	......
	Total change in regular bills	307	....	....	307	......
	Total offerings—transition quarter	17,144	7,820	3,148	28,112	......

* Less than $500,000.

[1] Issued in exchange for 2 3/4 percent Treasury bonds, investment series B-1975-80.

year bonds which were auctioned on July 31, at an average yield of 8.44 percent with a coupon set at 8 3/4 percent. Dealers acquired $0.5 billion, or over 58 percent of the offering.

At the time of the August refunding announcement, the Treasury also disclosed its projected new cash needs for the last half of calendar 1975, estimated to be $41 billion. This was $3 billion more than previously announced in mid-June. Although the August refunding package was generally in line with market expectations, some investors were surprised at the $3 billion upward revision of the Treasury's financing needs in the second half of 1975.

In order to meet the major part of its new money requirements through the first week of September, the Treasury indicated that an additional $3.5 to $4 billion would be borrowed in late August and early September through issues of 2- and 4-year notes, and $3 to $3.5 billion would be raised between mid-August and mid-September by additions to the regular weekly bill auctions. As it turned out, the Treasury raised $4.6 billion of new money through Treasury bills in August, $3.6 billion from increases in regular weekly bill auctions and $1 billion from an 18-day bill added to outstanding bills maturing on August 26. The large supply of Treasury securities as well as expectations that the supply would continue to be heavy throughout the year reduced investor interest in the auctions of the two new coupon issues.

The first of the two cash offerings in August was a 2-year note auctioned on August 14 at an average yield of 8.25 percent. This was 75 basis points above the average yield in the July auction of securities of comparable maturity. The Treasury accepted $2 billion of the $5 billion in tenders submitted by the public, including $0.5 billion of noncompetitive tenders. The coupon was set at 8 1/4 percent. Commercial banks were allotted $1.2 billion, or nearly 60 percent of the issue.

The second of the cash offerings in August was a 4-year 1-month note auctioned on August 21 for payment September 4. This was the second of the Treasury's 4-year cycle notes. This auction also encountered investor resistance and resulted in an average yield of 8.54 percent, the highest rate on a Treasury note in over a year. About $2.1 billion of the $4.4 billion in public tenders was accepted, including 90 percent of the amount of notes bid for at the highest yield and $0.5 billion of noncompetitive tenders. The interest rate on the notes was set at 8 1/2 percent. Commercial banks and dealers acquired 72 percent of the issue, with $1 billion, or 50 percent, allotted to commercial banks and $448 million, or 22 percent, awarded to dealers.

The cautious atmosphere that prevailed in the financial markets in August carried over into September as investor uncertainty was largely influenced by the large financing needs of the Treasury, the continuing financial crisis in New York City, and signs that economic activity was perhaps recovering faster than expected, which gave rise to growing concern about renewed inflationary pressures. During the month, short-term interest rates changed very little with rates on Treasury bills fluctuating in a narrow range. However, yields on Treasury coupon-bearing securities rose slightly.

September 3 brought the Treasury announcement of two cash management bills totaling $1.5 billion to be auctioned on September 4 and issued on September 5. These cash management bills were reopenings of outstanding bills maturing in 13 and 20 days. Investors submitted $3 billion of tenders for the $0.8 billion of 13-day bills accepted at the average rate of 6.29 percent and $3.2 billion of tenders for the $0.7 billion of 20-day bills accepted at the average rate of 6.28 percent.

On September 10, the Treasury announced its cash requirements for the remainder of the year and its financing plans for September. With expenditures running ahead of earlier projections and having decided to maintain a higher average cash balance, the Treasury raised its estimates of needed financings in the second half of 1975 to $44–$47 billion, $3–$6 billion more than the $41 billion figure estimated in August.

The Treasury's September financing plans called for $4 billion in new cash to be raised by adding $1 billion to the refunding of the $2 billion of maturing 2-year notes, by the addition of $1 billion to the auction of 52-week bills, and by the auction of $2 billion of 29-month notes. The announcement had a depressing effect on the coupon market initially. However, in the September 16 auction of 2-year notes, an unexpectedly large amount of noncompetitive tenders resulted in about 45 percent of the $3.2 billion issue being purchased by individual investors and smaller financial institutions. This resulted in a relatively small amount allotted to dealers, which left the notes in a favorable trading position. Total tenders received amounted to $6.9 billion of which $1.4 billion represented noncompetitive bids. The average yield of 8.44 percent was 19 basis points above the average yield at the auction of similar notes a month ago. The coupon set on this issue was 8 3/8 percent.

The improved market tone following the auction was reinforced by the release of the Consumer Price Index for August which showed a rise at only a 2-percent annual rate, the smallest monthly increase in 3 years. In the auction of the 29-month note on September 24 for payment on October 7, bidding was aggressive and resulted in an average yield of 8.10 percent and a coupon of 8 percent. The Treasury accepted $2.1 billion of the $3.9 billion of tenders. Noncompetitive bids from individuals and smaller financial institutions again accounted for a sizable proportion of the issue, about $1.1 billion. Response to the sale of the September 52-week bill was good, and the Treasury accepted $1.9 billion of the $5.2 billion of submitted tenders, $1.1 billion of which was for new money. In addition, another $2.1 billion of new money was raised during the month through increases in the regular weekly bill auctions.

In October, interest rates in the money and bond markets fell sharply as Federal Reserve monetary policy eased and the Treasury revealed that its remaining debt financing for the year would be easy to manage. Over the course of the month, prices on Treasury coupon issues improved substantially, helped in part by increased investor preferences for high-quality securities and by moderate business financing needs.

In the October 7 auction of 38-month notes the average yield was 8.14 percent. The Treasury accepted $2.5 billion of the $3.3 billion in tenders and set the coupon at 8 1/8 percent. Commercial banks and dealers accounted for 85 percent of the issue, 56 and 29 percent, respectively. At midmonth, the auction of $3 billion of 2-year notes resulted in an average yield of 7.55 percent. This was 89 basis points lower than the yield on $3 billion of 2-year notes auctioned on September 16. The Treasury accepted $3.2 billion, including $0.6 billion of noncompetitive bids, and set a coupon of 7 1/2 percent.

On October 22, the Treasury announced that its borrowing requirements for the remainder of 1975 would amount to between $8 billion and $11 billion of new cash with $1.1 billion to be raised in auctions of notes and bonds by the end of October in connection with the November quarterly refunding. Another $0.5 billion to $1.5 billion would be obtained by the sale of coupon issues later in the year, and the remaining $5.5 to $8.5 billion would be raised as additional amounts in Treasury bill auctions. Despite this potential increase in the supply, bill rates, which had declined throughout the month, continued to decline and fell 95 to 160 basis points in October. For the month as a whole, the Treasury raised $4.2 billion of new money from bills, $1.1 billion from the 52-week bill and $3.1 billion from additions to regular weekly bill auctions.

The November quarterly refunding consisted of an offering of $2.5 billion of 7-year notes and $1 billion of 24-year 9-month bonds to refund $2.4 billion of notes held by the public maturing November 15 and to raise $1.1 billion in new cash. The long bond was a reopening of the 8 3/8 percent bonds maturing in August 2000. The refunding offering was fairly in line with what market participants expected, and both issues were very well received.

The 7-year notes were auctioned October 29 to yield 7.92 percent with the coupon set at 7 7/8 percent. Total tenders received amounted to $4.5 billion and the Treasury accepted $2.5 billion, including $0.4 billion of noncompetitive bids. Commercial banks acquired $1.1 billion, or 45 percent, and dealers were awarded $1.0 billion, or 41 percent. The next day the $1 billion of 24-year 9-month bonds was auctioned at an average yield of 8.23 percent. Total tenders received for the issue amounted to $2.2 billion. Dealers acquired nearly 70 percent of the issue. With this sale of $1 billion of long bonds the Treasury had used nearly all of its authority to borrow from the public up to $10 billion in long bonds without regard to the 4 1/4-percent interest rate ceiling.

Interest rates in the money and bond markets stabilized in November after dropping sharply in the previous month. While slightly easier conditions were present in the Federal funds market, reports of very large weekly increases in the money stock produced doubts that the monetary authorities would promote further declines in interest rates in the near term. Although the Federal Reserve did not alter its stance, the market looked for an eventual tightening. As a result, investors marked time and interest rates declined no further. Events in the troubled municipal bond sector also aided in stabilizing rates as two favorable developments helped to ease the New York City crisis. The State legislature passed a plan designed to avoid a New York City default on its maturing notes, and President Ford stated that he would propose legislation to provide short-term loans to the city to be administered by the Treasury.

During the month, the Treasury met its cash needs by increasing the size of its regular weekly bill auctions and the 52-week bill auction. For the month $2.8 billion was raised from the regular weekly bill auctions and $1.2 billion from the 52-week bill auction. At the end of the month the Treasury announced plans to raise $3.2 billion of new money in the Treasury bill market in early December through auctions of $2 billion of 139-day cash management bills on December 2, and through auctions of $0.6 billion of 10-day cash management bills, and $0.6 billion of 18-day cash management bills on December 5.

Interest rates rose in early December, but declines later in the month more than offset earlier increases. The continued concern of market participants that the Federal Reserve might tighten money market conditions and the large volume of new corporate and U.S. Government issues contributed to the upward pressure on rates.

The 139-day bills auctioned on December 2 represented an additional amount of the 26-week bills dated October 23, 1975, due April 22, 1976. About $5.3 billion of public tenders was received and the Treasury accepted $2 billion at an average yield of 5.82 percent. In the auction held on December 5 the average yield was 5.22 percent on the $0.6 billion of 10-day bills and 5.14 percent on the $0.6 billion of 18-day bills. In addition to the new money raised through cash management bills, on December 9, the Treasury announced that $3 billion of new cash would be raised through coupon-bearing obligations during December. This financing involved an auction of $2.5 billion of 2-year notes on December 16 to refund $1.5 billion of maturing notes held by the public and to raise $1 billion in new cash, and an auction of $2 billion of 4-year notes on December 22. The offerings were larger than some market participants had anticipated so rates on Treasury coupons inched upward through mid-December as dealers reduced their inventories of securities in preparation for the auctions.

Response to the auction of 2-year notes was favorable and $1.1 billion was raised in new cash. Tenders from the public amounted to $4.3 billion.

The Treasury accepted $2.6 billion, including $0.7 billion of noncompetitive tenders, at an average yield of 7.28 percent. The coupon rate was set at 7 1/4 percent. Commercial banks were awarded $1.6 billion, or 63 percent of the issue, while dealers received $0.4 billion, or 17 percent. The 4-year notes were auctioned on December 22 for payment on January 6, 1976. The auction attracted $4.3 billion of public tenders with the Treasury accepting $2 billion at the average yield of 7.50 percent and an identical 7.50 coupon. Commercial banks and dealers were awarded 84 percent of issue, with $1 billion, or 50 percent, going to commercial banks and $0.7 billion, or 33 percent, to dealers. Excluding this end-of-quarter 4-year cycle note paid for in January, gross market borrowing from private investors amounted to $59.2 billion in the July–December 1975 half of fiscal 1976. Treasury bills accounted for $28.9 billion and coupon securities $30.3 billion. On a net basis the Treasury raised $48.6 billion of new money from private investors with Treasury bills accounting for $28.9 billion and coupon securities $19.7 billion.

At the end of the first half of fiscal 1976, business statistics continued to show that the cyclical recovery in economic activity was improving and that the pace of recovery had picked up toward yearend, following a marked slowdown in the fall. In the bond market yields were well below their levels of November. Money market rates, meanwhile, had dropped back to the levels of last spring. Federal funds and 90-day Treasury bills were both around 5 1/8 percent, while 3-month commercial paper was down to around 5 3/4 percent and the prime rate was cut to 7 1/4 percent.

In January interest rates continued to fall sharply, particularly short-term rates, with some rates falling to their lowest levels in more than 3 years. When the Federal Reserve reacted to the sluggishness of the money supply growth by pushing the Federal funds rate down further to 4 3/4 percent, money market rates continued their steep descent. The Federal Reserve discount rate was lowered from 6 percent to 5 1/2 percent, and the prime rate was reduced first to 7 percent and later to 6 3/4 percent. Rates on Treasury bills continued their recent sharp declines despite sizable additions to outstanding bills through increases in regular weekly auctions totaling $2.7 billion in new money. Rates on the 3-month Treasury bill dropped almost steadily over the month. On January 26, the average issuing rate was 4.76 percent, about 45 basis points below the rate set at the final auction in December and the lowest rate since the auction of November 6, 1972. The 52-week bill auctioned on January 7, at 5.58 percent, down 86 basis points from the yield at the December 10 auction, raised $1.1 billion in new cash.

Yields on coupon securities, however, reversed course before mid-month as market participants were concerned about the pace of recovery and the heavy borrowing needs of the Treasury. As a consequence, the Treasury's two-part offering in January totaling $4.5 billion to refund $1.6

billion of maturing issues and to raise $2.9 billion of new cash was given an unenthusiastic reception.

The Treasury's January financing plans called for the auction of a 5-year 4-month note, the first issue in the Treasury's 5-year note cycle, and a 2-year note. In the auction of the longer note on January 13, the Treasury accepted $2 billion of the $3.3 billion of public tenders at the average yield of 7.40 percent and set a coupon rate of 7 3/8 percent. Commercial banks and dealers acquired most of the issue, $1.1 billion, or 55 percent, and $0.7 billion, or 32 percent, respectively. The shorter 2-year note was auctioned on January 14 to refund $1.6 billion of bills, $1.4 billion of which was held by the public, and raise $0.9 billion in new cash. The auction drew $3.6 billion of tenders and the Treasury accepted $2.3 billion at the average yield of 6.49 percent and a coupon rate of 6 3/8 percent. To get the desired $2.3 billion, the Treasury accepted 89 percent of the notes bid for at the highest yield of 6.51 percent. Again commercial banks and dealers acquired most of the issue—$1.3 billion, or 54 percent, by commercial banks and $0.6 billion, or 26 percent, by dealers.

On January 27 the Treasury announced its expected borrowing requirements for the first half of 1976 as well as the offerings in its February financing operation. The Treasury revealed it expected to borrow between $35 billion and $40 billion in the market during the first 6 months of 1976 and in its February financing it intended to refund $4.3 billion of maturing publicly held debt and raise about $2.5 billion in new money. To be auctioned were $3 billion of 3-year notes, $3.5 billion of 7-year notes, and $0.4 billion additional outstanding 8 1/4 percent bonds maturing in 2005 (which exhausted the remainder of the Treasury's authority to issue $10 billion of bonds not subject to the 4 1/4-percent ceiling).

In auctions on February 5, the Treasury sold $3.1 billion of 3-year notes at an average yield of 7.05 percent with a coupon rate set at 7 percent, and $0.4 billion of 29-year 3-month 8 1/4 percent bonds at an average yield of 8.09 percent. Small investors accounted for $0.5 billion of the notes and $25 million of the bonds. In its offering of $3.5 billion of 7-year notes, the Treasury fixed the coupon at 8 percent to be issued at par. The fixed-price subscription technique, which had not been used in the past 6 years, caught the market by surprise. The response to the offering was so enthusiastic that the issue was heavily oversubscribed with requests totaling $29.2 billion. Because of the great demand for the issue, the Treasury had to change the amount of fully allotted subscriptions from $500,000 to $200,000. Individuals alone were allotted $2.3 billion of the issue.

Despite the restrictive subscription approach, public sales resulted in an enlargement of the issue to $6 billion, $2.5 billion more than originally intended. This boosted new cash raised to $5.1 billion and reduced somewhat the Treasury's borrowing requirements in the months ahead.

Moreover, mainly because of the excellent reception given to the fixed-price offering of 7-year 8 percent notes, the decline in the average length of the marketable interest-bearing debt privately held, which had fallen to 2 years 5 months at the end of January, was reversed and increased to 2 years 7 months.

Later in the month an additional $2.6 billion of new money was raised through the auction on February 20 of a 21-month note at an average yield of 6.62 percent and a coupon rate of 6 5/8 percent. As is generally the case in cash sales of shorter maturity coupon issues, commercial banks and dealers bid successfully for most of the issue. Commercial banks received $1.5 billion, or 57 percent of the issue while dealers received $0.6 billion, or 22 percent. In the Treasury bill market $2.4 billion of new money was raised in February, $1.6 billion through additions to the regular weekly bill auctions and $0.8 billion from an addition to the 52-week bill.

During most of February, activity in the money and securities markets was conducted in a more comfortable economic climate. The rate of inflation slowed again. Employment expanded further and the unemployment rate dropped 0.2 percentage point to a 14-month low of 7.6 percent. Interest rate movements were mixed. Short-term rates moved up while longer term yields changed very little or edged lower. This was generally true also in March as interest rates were about unchanged over the month as a whole. Around mid-March Congress approved an increase in the amount of bonds exempt from the 4 1/4-percent interest ceiling from $10 billion to $12 billion and extended the allowable maturity of note issues (which are not subject to a rate ceiling) from 7 years to 10 years.

New cash raised in March consisted of $1.1 billion in Treasury bills and $3 billion in coupon issues as the Treasury continued efforts to meet its cash needs for the first half of 1976. On March 5, $2.1 billion of new cash was obtained by the auction of a 4-year note at an average rate of 7.54 percent and a coupon rate of 7.50 percent. This issue was an end-of-quarter 4-year cycle note. Total tenders received from the public amounted to $5.4 billion. The $2.1 billion of accepted tenders included $0.7 billion of noncompetitive bids. On March 18, $0.9 billion was raised with the sale of $3.1 billion of 2-year notes sold at an average yield of 6.76 percent with the coupon rate set at 6 3/4 percent. Noncompetitive bids accounted for $0.7 billion of this issue also. An additional $2.6 billion of new cash was raised with the auction of a 4-year 10 1/2-month note on March 24 for payment April 5, 1976, at an average yield of 7.38 percent. The coupon on this issue was set at 7 3/8 percent. The notes were well received by market participants. Nearly $5.1 billion of tenders were submitted by the public, including $0.5 billion of noncompetitive tenders. Commercial banks were allotted $1.2 billion and dealers $0.9 billion, 46 and 32 percent, respectively.

No other coupon securities were issued in April, but the Treasury picked up $2.5 billion of new money to meet seasonal cash needs with the issuance of a 14-day cash management bill on April 8. The 14-day cash management bills represented an additional amount of 26-week bills dated October 23, 1975, and maturing April 22, 1976. The bills were auctioned on April 7 for payment on April 8. About $7.6 billion of tenders were submitted of which the Treasury accepted $2.5 billion at an average yield of 4.91 percent. In addition, activity in the regular weekly bill auction and 52-week auction resulted in $0.6 billion of new cash. About $1 billion of new cash was raised through enlarging the amount of the 52-week bill, part of which was offset by the net $0.4 billion paydown in regular weekly bills.

In April, unemployment declined and inflation held at about a 6-percent annual rate. The economic recovery continued, but at a slower pace. Interest rates in the money and bond markets declined through most of April but posted sharp increases near the end of the month. While yields on most Treasury coupon securities closed the month at about the same levels as at the end of March, Treasury bill rates declined steadily most of April. In the April final weekly auction the 3- and 6-month bills were sold at average yields of 4.91 percent and 5.29 percent, respectively, about 6 and 7 basis points below their levels at the end of March. At the regular monthly auction of 52-week bills the average rate was 5.65 percent, down 14 basis points from the rate obtained on the March 31 sale of 52-week bills.

After modest declines over most of the month, yields on Treasury bills and coupon securities rose to new highs for the year in late May. Average issue rates on 13-week bills were 67 basis points higher at the last weekly auction in May than in April's last auction, while the 26-week bill rate was up 72 basis points. Firmer conditions in the money market for Federal funds and the crowded calendar for new corporate and municipal issues were mainly responsible for the increase in yields. Interest rates on all money market instruments also rose in May, and at month's end most banks raised their prime lending rate from 6 3/4 percent to 7 percent. Meanwhile, on the economic front, the index of leading indicators rose 1.4 percent in May, the largest increase in 10 months; personal income rose $11 billion, or at a 9.8-percent annual rate of growth; employment rose and the unemployment rate fell 0.2 percentage points; and residential construction improved. However, retail sales were off and fell $1.1 billion in May.

The Treasury's May quarterly refunding was announced on April 28. Three new securities were offered to refund $4.1 billion of privately held Treasury notes maturing on May 15 and raise $2.2 billion in new cash. The offering consisted of $2 billion of 2-year notes, $3.5 billion of 10-year notes to be sold in a fixed-price offering at par, and $0.8 billion of reopened 7 7/8 percent bonds. The announcement was well received and bidding interest was good.

For the 2-year notes $4.4 billion of public tenders were submitted in the May 4 auction and $2.3 billion was accepted, including $0.6 billion of noncompetitive tenders. Successful bids resulted in a 6.61 percent average yield and a 6 1/2 percent coupon. Commercial banks were allotted $1.2 billion, or 55 percent of the issue.

About $3.5 billion of 10-year notes were to be issued to the public with the coupon set at 7 7/8 percent. This was the first time the Treasury used its new authority to issue notes with a maturity of up to 10 years. The 7 7/8 percent coupon drew approximately 41,000 subscriptions totaling $8.9 billion in the May 5 offering. Subscriptions for $500,000 or less amounted to $3.9 billion and these were accepted in full. Because of the substantial response, larger orders were only allotted 15 percent of amounts tendered. Total accepted subscriptions from the public amounted to $4.7 billion, $1.2 billion more than originally sought.

Yields were rising as the May 7 bond auction approached. The auction attracted good interest and about $0.8 billion of tenders for the 7 7/8 percent bond were accepted from the public at an average yield of 8.19 percent. Dealers were awarded $0.5 billion, or 62 percent of the issue.

The entire May refunding operation raised about $3.7 billion in new cash and increased, by 3 months, the average length of the marketable interest-bearing public debt privately held to 2 years 8 months. Most of this increase was achieved through the sale of the Treasury's fixed-price 10-year note.

On May 13, a $2.3 billion offering of 2-year notes was announced to refund $1.4 billion in notes maturing May 31 and raise about $0.9 billion of new cash. The average yield on the new notes auctioned on May 19 was 7.16 percent, 55 basis points above the 2-year note auctioned May 4. The accepted tenders amounted to $2.5 billion of the $4.7 billion tenders received from the public. Just over $1 billion was for new cash. A 7 1/8 percent coupon was assigned to the issue. Commercial banks acquired $1.3 billion, or 53 percent of the notes.

In the Treasury bill market the $0.9 billion of new money raised in the regular monthly auction of the 52-week bill was nearly offset by paydowns of $0.8 billion in regular weekly bills during the month of May. The same procedure was true in June when the Treasury raised $0.5 billion of new cash with its 52-week bill that was more than offset by a $1.2 billion decline in regular weekly bills.

Unlike May, in June interest rates in the money and bond markets halted their upward movement and edged slightly back toward lower levels. During the month, the Treasury auctioned a 2-year note and a 4-year 1-month note to raise $2.8 billion in new cash. In addition, $2 billion of cash management bills were sold and redeemed during the month.

The June 3 auction of 4-year 1-month notes had been announced on May 18. The $2 billion offering for new cash attracted good investor interest. About $2.2 billion of the $5.1 billion of tenders was accepted. With the yield on accepted competitive bids set at 7.71 percent, a 7 5/8 percent coupon was placed on the 4-year cycle note which began trading at a premium in the secondary market.

On June 4, the Treasury announced the June 7 auction of $2 billion in cash management bills. The 9-day bills, issued June 8, represented an addition to an outstanding issue of bills maturing June 17, 1976. Over $6 billion of tenders were received and the average rate of the accepted $2 billion was 5.52 percent.

June 15 brought the announcement of the 2-year Treasury note auction to be held on June 21. The issue was thought to be quite manageable. About $2 billion of notes held by the public were refunded and $0.6 billion of new cash was raised when the Treasury accepted $2.6 billion of the $4.2 billion of tenders received from the public. The average yield was 6.99 percent and a 6 7/8 percent rate was set. Commercial banks acquired $1.4 billion, or 54 percent of the issue.

With this 2-year note issue the Treasury sold $53.1 billion of securities to the public during the January–June half of fiscal 1976, compared with $59.2 billion in the July–December half year. New cash raised in the second half of the fiscal year amounted to $31 billion compared with $48.6 billion in the first half, with coupon issues accounting for $27.3 billion and Treasury bills $3.7 billion. In the first half of fiscal 1976, bills represented a much larger percentage of the new cash raised, 59 percent, compared with 12 percent in the second half.

At the end of June rates on most Treasury bills were 10 to 25 basis points below their May levels. Yields on intermediate- and long-term securities also declined, reflecting good market demand for existing supplies as well as for the Treasury's last note auctioned in fiscal 1976, a 5-year 1-month note for payment on July 9.

The economic outlook was mixed at the end of fiscal 1976. Productivity and GNP continued to grow, but at much slower rates than in the January–March 1976 quarter. An increasing labor force was the main reason for the 0.2-percent increase in the unemployment rate to 7.5 percent in June. Consumer spending was lagging, but capital spending grew at a 9.6-percent annual rate during the April–June quarter. Prices rose faster in the April–June period than in January through March, but wages grew at a lesser rate. The economy was still advancing, but not enough to restore full confidence in the recovery.

On June 30, the Treasury received authority to issue up to $17 billion of bonds held by the public with interest rates exceeding 4 1/4 percent. The previous limit was $12 billion and on June 30, the public held $10.4 billion.

On this same date the statutory debt limit of $400 billion was temporarily increased from $627 billion to $636 billion through September 30, 1976, $682 billion through March 31, 1977, and $700 billion through September 30, 1977. Debt subject to the limit at the end of June totaled $621.6 billion.

Fiscal 1976 ended in a firm market atmosphere with interest rates in the money and bond markets declining. At this time the monetary aggregates were growing at a slow pace and market participants saw little reason for the Fed to alter its position on the growth of the money supply and interest rate stability.

Since the Treasury had a healthy $14.8 billion operating cash balance, market participants expected no great increase in Treasury securities in the near future.

July economic data was both encouraging and discouraging. New orders for nondefense capital goods jumped by a record amount. The index of leading indicators rose 0.5 percent, posting its 17th consecutive monthly gain. Industrial production increased only 0.2 percent in July, the smallest increase in 9 months, while personal income rose 1 percent, its largest gain in 9 months. Retail sales declined and, while total employment posted a slight increase, the large number of new workers entering the labor market pushed the unemployment rate up from 7.8 percent to 7.9 percent.

The first issue in the transition quarter was the 5-year 1-month note sold for new cash on June 19 for payment on July 9. This 5-year cycle note was received very well and about $2.6 billion of the $5.5 billion of public tenders was accepted. The average yield was 7.63 percent and a 7 5/8 percent coupon was set.

There were no coupons maturing during July but a second note issue for new cash, a 2-year note, was announced on July 14, to be auctioned on July 20. Interest in the auction was good and $2.9 billion of the $4.8 billion in tenders received from the public was accepted. A 6 7/8 percent coupon was set when the average yield on accepted bids came to 6.95 percent. About $0.3 billion of the accepted amount was noncompetitive bids. The issue commanded a small premium in the secondary market and was bid up 19/64 over the auction price in before-issue trading the following week.

In the Treasury bill market rates continued to move downward and wound up generally 15 to 40 basis points below their June levels. Coupon yields were down slightly for the month as a whole. In the money market the Federal funds rate averaged 5.31 in July, down 17 basis points from their June average. Rates on commercial paper, 90-day bankers acceptances, and 90-day negotiable CD's also fell. A few banks reduced their prime lending rate 1/4 point to 7 percent in late July.

Market participants remained divided over what course Federal Reserve monetary policy would take. Since a lower Federal funds rate did not seem probable, the consensus was for stable interest rates in the near future. Meanwhile, the market was anxiously awaiting the forthcoming Treasury announcement of its August financing plans.

Economic performance was mixed again in August. Retail sales rose at a 2.3-percent seasonally adjusted rate while housing starts reached a seasonally adjusted annual rate of 1.54 million units, its highest level since April 1974. Industrial production rose for the 17th consecutive month.

However, both the index of leading indicators and durable goods orders fell by 1.5 percent in August. Capital spending was unusually low for the current level of business expansion, and the economy continued to operate well below capacity.

The Treasury had announced its plans for the August financing on July 28. The midsession review of the 1977 budget, issued in July, estimated a $20 billion transition quarter deficit. The Treasury estimated that $15 to $17 billion in new borrowing was required to finance the deficit and meet its other requirements in the transition quarter. Since $5.5 billion of this borrowing had been completed in July, only $9.5–$11.5 billion was needed.

About $4.5 billion in privately held notes maturing on August 15 were to be refunded and $2.5 billion in new cash was to be raised. Three new issues were announced: $2 billion of 3-year notes to be auctioned August 3; $4 billion of 10-year notes to be sold by the subscription method at a fixed price on August 4; and $1 billion of 25-year bonds to be auctioned August 6. The announcement was well received and even stirred demand for some outstanding issues. The 3-year note auction produced strong investor bidding. The average yield on accepted competitive bids was 6.91 percent and the Treasury assigned a 6 7/8 percent coupon. About $2.3 billion of the $5.4 billion in public tenders was accepted, including a high $0.7 billion in noncompetitive tenders.

Public response to the 10-year note was tremendous and resulted in the issue being substantially oversubscribed. Plans to accept all subscriptions of $500,000 or less accompanied by a 20-percent deposit were scaled down to accept only amounts of $300,000 or less. Subscriptions above $500,000 accompanied by the 20-percent deposit were accepted in the amount of $300,000, while all subscriptions without the 20-percent deposit were rejected. About $8 billion of the $24.6 billion in public subscriptions was accepted. This was $2 billion more than originally planned. The issue immediately began trading at a premium as dealers attempted to acquire inventories.

The note was well distributed with the bulk of it going to banks and individuals while dealers received very little. Because more cash was raised than planned, Treasury borrowings for the near future were scaled down.

Rounding out the refunding was the 25-year bond maturing August 15, 2001. This issue also drew good response. The average accepted yield was 8.01 percent. Of the $2.5 billion in public tenders, $1 billion was accepted. An 8 percent coupon was assigned. The three new issues raised almost $6.8 billion in new cash.

Due to the August financing and especially the fixed-price 10-year note sale, the average length of the marketable interest-bearing public debt held by private investors rose from 2 years 6 months to 2 years 10 months.

In line with market expectations, a 2-year note was announced on August 13. This $2.5 billion offering was auctioned August 19 to refund

Disposition of marketable Treasury securities excluding regular bills, fiscal 1976 and transition quarter

[In millions of dollars]

Date of retirement	Securities: Description and maturing date	Securities: Issue date	Redeemed for cash or carried to matured debt	Exchanged for new issue at maturity	Total
1975	NOTES AND BONDS				
Aug. 15	5 7/8 percent note, Aug. 15, 1975	Feb. 15, 1971	5,092	2,587	7,679
Sept. 30	8 3/8 percent note, Sept. 30, 1975	Sept. 4, 1973	2,009	33	2,042
Oct. 1	1 1/2 percent note, Oct. 1, 1975	Oct. 1, 1970	30	....	30
Nov. 15	7 percent note, Nov. 15, 1975	Aug. 15, 1971	2,581	534	3,115
Dec. 31	7 percent note, Dec. 31, 1975	Nov. 15, 1973	1,519	212	1,731
1976					
Feb. 15	6 1/4 percent note, Feb. 15, 1976	Feb. 15, 1969	1,217	2,522	3,739
Feb. 15	5 7/8 percent note, Feb. 15, 1976	Aug. 15, 1972	3,713	1,232	4,945
Mar. 31	8 percent note, Mar. 31, 1976	Apr. 9, 1974	2,191	97	2,288
Apr. 1	1 1/2 percent note, Apr. 1, 1976	Apr. 1, 1971	27	....	27
May 15	6 1/2 percent note, May 15, 1976	May 15, 1969	2,304	393	2,697
May 15	5 3/4 percent note, May 15, 1976	Feb. 15, 1972	2,306	496	2,802
May 31	6 percent note, May 31, 1976	Mar. 25, 1975	1,498	82	1,580
June 30	8 3/4 percent note, June 30, 1976	May 15, 1974	2,011	692	2,703
June 30	7 1/2 percent note, Aug. 15, 1976	Oct. 1, 1969[1]	89	....	89
	Total coupon securities		26,587	8,880	35,467
	BILLS				
1975	Other:				
Aug. 26	6.280 percent (18-day)	Aug. 8, 1975	1,000	....	1,000
Sept. 18	6.175 percent (13-day)	Sept. 5, 1975	849	....	849
Sept. 25	6.156 percent (20-day)	Sept. 5, 1975	700	....	700
Dec. 18	5.220 percent (10-day)	Dec. 8, 1975	602	....	602
Dec. 26	5.140 percent (18-day)	Dec. 8, 1975	601	....	601
1976					
Jan. 31	6.560 percent (292-day)	Apr. 14, 1975	1,397	189	1,586
Apr. 22	5.823 percent (139-day)	Dec. 5, 1975	2,002	....	2,002
Apr. 22	4.834 percent (14-day)	Apr. 8, 1976	2,503	....	2,503
June 17	5.520 percent (9-day)	June 8, 1976	2,010	....	2,010
	Total other bills		11,664	189	11,853
	Total securities—fiscal 1976		38,251	9,069	47,320
	NOTES AND BONDS				
Aug. 15	7 1/2 percent note, Aug. 15, 1976	Oct. 1, 1969	3,003	1,102	4,105
Aug. 15	6 1/2 percent note, Aug. 15, 1976	Feb. 15, 1973	2,216	1,667	3,883
Aug. 31	5 7/8 percent note, Aug. 31, 1976	Mar. 3, 1975	1,608	54	1,662
Sept. 30	8 1/4 percent note, Sept. 30, 1976	Sept. 30, 1974	1,697	326	2,023
	Total coupon securities		8,524	3,149	11,673
	Total securities—transition quarter		8,524	3,149	11,673

[1] Government agency holdings redeemed prior to maturity by authority of the Department of the Treasury.

$1.6 billion of privately held notes maturing August 31. Of the $4.3 billion in public tenders, $2.9 billion was accepted, including $0.3 billion submitted noncompetitively. A 6 5/8 percent rate was set when the average yield came to 6.67 percent.

This average yield of 6.67 percent was 28 basis points below that of July's offering of 2-year notes as bill and coupon rates continued to decline through August. Interest rates on money market instruments moved slightly lower also or remained unchanged from July levels. The release of the Federal Open Market Committee policy record for the committee's July 20 meeting revealed a lower tolerance range of 4 3/4 to 5 3/4 percent for the Federal funds rate, which encouraged most market participants.

On August 25, a 4-year note auction was announced for August 31 to raise $2 billion in new cash. Bidding for the issue was aggressive and the average yield of 6.93 percent on accepted tenders was 78 basis points below the June 3 auction of 4-year 1-month notes. A 6 7/8 percent coupon was set on the issue and about $2.1 billion of the $5.4 billion in public tenders was accepted, including $0.5 billion of noncompetitive bids.

With the August financing operations accomplished smoothly and with the inflation outlook improving, rates on outstanding intermediate- and long-term issues continued to decline. Likewise, Treasury bill rates generally declined over the course of the month. However, in September rates on both bills and coupons reversed their downward trend near the end of the month.

A $2.5 billion issue of 2-year notes was announced on September 13, to be issued September 30. This was the last issue offered in the transition quarter. The September 21 auction drew $5.2 billion in tenders in a good market climate. The average yield was 6.30 percent, 37 basis points below the August 19 auction of 2-year notes. The $2.9 billion of accepted public tenders refunded $1.7 billion of notes held by the public maturing September 30. A 6 1/4 rate was assigned to the issue.

Gross offerings to the public in the transition quarter totaled $25 billion, $17.1 billion of which was for new cash.

Only $0.3 billion in new cash came from bill issues as the Treasury continued to rely more on coupon issues for new money as it restructured the debt. Of the $16.8 billion in new money raised in coupon issues, $5.3 billion was in 2-year cycle note issues. About $6.1 billion was raised with issues maturing in 2 to 7 years. The 10-year 8 percent note raised $4.8 billion and the 25-year 8 percent bond raised $0.6 billion.

The quarter ended with $5.7 billion of authority available to the Treasury to issue bonds with more than a 4 1/4-percent interest rate. A $17.4 billion cash balance was held in the Treasury on September 30, while the public debt stood at $634.7 billion.

Changes in Federal securities

Federal securities include the marketable and nonmarketable debt issues of the Department of the Treasury as well as those obligations issued by Federal agencies which are part of the unified budget totals and in which there is an element of Federal ownership. The Federal agency securities included are the participation certificates of the Government National Mortgage Association, the debt issues of the Export-Import Bank of the United States and the Tennessee Valley Authority, Postal Service bonds, Defense family housing mortgages, and various guaranteed issues of the Federal Housing Administration.

Federal securities outstanding at the end of fiscal 1976 totaled $631.3 billion—$87.2 billion, or 16 percent, more than the $544.1 billion outstanding at the end of fiscal 1975. Total Treasury public debt issues outstanding amounted to $620.4 billion, an increase of $87.2 billion, while Federal agency issues outstanding totaling $10.9 billion were about the

Federal debt and Government-sponsored agency debt

[In billions of dollars]

Class of debt	June 30, 1974	June 30, 1975	June 30, 1976	Sept. 30, 1976
Public debt securities:				
Marketable public issues by maturity class:				
Within 1 year	139.9	163.9	204.2	206.1
1 to 5 years	77.2	101.9	127.0	131.1
5 to 20 years	44.4	41.3	49.5	57.3
Over 20 years	5.1	8.4	11.9	13.2
Total marketable issues	266.6	315.6	392.6	407.7
Nonmarketable public issues:				
Series E and H savings bonds	61.9	65.5	69.7	70.8
U.S. savings notes[1]	.5	.4	.4	.4
Investment series bonds	2.3	2.3	2.3	2.3
Foreign government series:				
Dollar denominated	23.4	21.6	19.9	19.2
Foreign currency denominated	1.6	1.6	1.6	1.6
Other nonmarketable debt	1.5	.9	2.2	3.0
Total nonmarketable public issues	91.3	92.3	96.1	97.3
Government accounts series (nonmarketable)	115.4	124.2	130.6	128.6
Non-interest-bearing debt	1.0	1.1	1.2	1.1
Total gross public debt	474.2	533.2	620.4	634.7
Federal agency securities:				
Government National Mortgage Association	4.4	4.3	4.2	4.1
Export-Import Bank of the United States	2.9	2.6	2.6	3.0
Tennessee Valley Authority	2.7	2.1	2.1	2.0
Defense family housing	1.4	1.3	1.2	1.1
Other	.6	.6	.8	.8
Total Federal agency debt	12.0	10.9	10.9	11.0
Total Federal debt	486.2	544.1	631.3	645.7
Government-sponsored agency securities:				
Federal home loan banks	18.6	21.2	19.4	19.1
Federal National Mortgage Association	25.2	28.2	29.9	30.7
Federal land banks	11.1	14.2	16.1	16.6
Federal intermediate credit banks	8.0	9.5	10.3	10.8
Banks for cooperatives	2.5	2.9	3.7	3.9
Government-sponsored agency debt	65.4	76.1	79.3	81.1

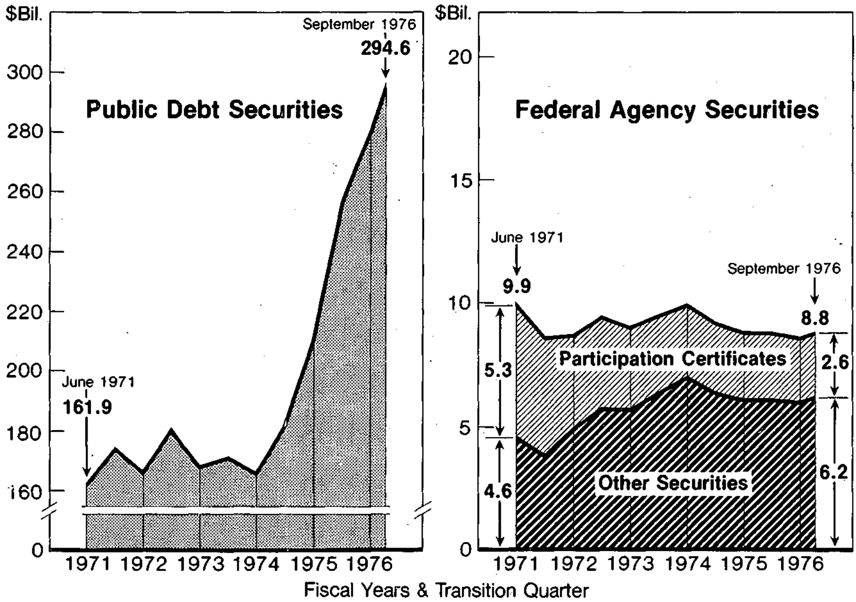
[1] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.

same level as a year ago. Outstanding marketable Treasury securities at the end of fiscal 1976 amounted to $392.6 billion, up $77.0 billion from fiscal 1975. Treasury bills accounted for $32.6 billion of the increase in marketable debt, Treasury notes $41.5 billion, and Treasury bonds $2.8 billion. By the end of the transition quarter, Federal securities outstanding reached a level of $645.7 billion, $634.7 billion of public debt securities and $11.0 billion of Federal agency issues.

Ownership

Private investors held $385.0 billion of the $631.3 billion of Federal debt issues outstanding at the end of fiscal 1976. The Federal Reserve System and Government accounts held the remaining $246.3 billion. Net Federal borrowing from the public, which includes the Federal Reserve and foreign investors, amounted to $82.8 billion in fiscal 1976, an alltime high. This was $32 billion more than the $50.9 billion borrowed in fiscal 1975. In fiscal 1976 private investors acquired $73.1 billion, or 88 percent

PRIVATE HOLDINGS OF MARKETABLE FEDERAL SECURITIES



of the funds borrowed from the public, while the Federal Reserve System absorbed $9.7 billion, or 12 percent.

Private investors also held $72.9 billion of federally sponsored agency issues, an increase of $1.4 billion for the year. Federally sponsored agency securities held by the Federal Reserve System and Government accounts increased $1.8 billion to a level of $6.4 billion.

Nonmarketable public debt increased $10.2 billion in fiscal 1976, just $0.3 billion more than in fiscal 1975. Special nonmarketable securities issued only to Government accounts and trust funds such as the Federal old-age and survivors insurance trust fund increased $6.4 billion and accounted for nearly 63 percent of the total increase in nonmarketable debt. Savings bonds and notes outstanding increased by $4.2 billion, while special nonmarketables to foreign investors declined $1.7 billion. Other nonmarketables increased $0.3 billion.

Government-sponsored agencies, while subject to some degree of Federal supervision, are privately owned. Thus, they are not included in the unified budget totals, and their obligations are not included in Federal debt. In fiscal 1976, the outstanding debt of Government-sponsored agencies increased $3.2 billion compared with $10.7 billion a year ago.

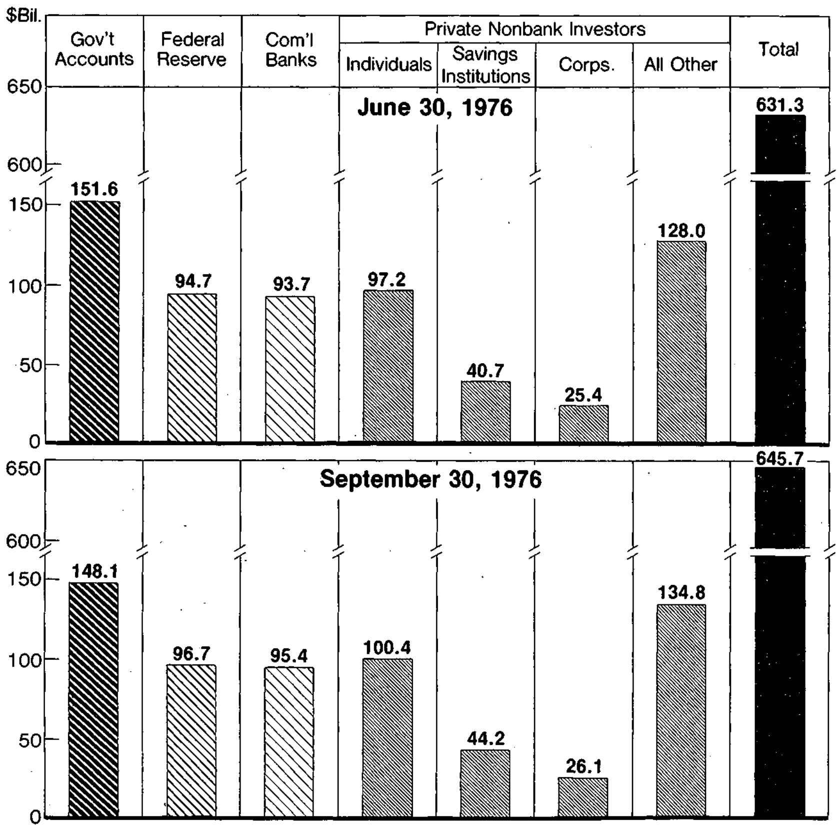
Individuals.—Individuals increased their holdings of public debt securities $9.3 billion compared with $6.3 billion in fiscal 1975. About $4.2 billion, or 45 percent of the increase, was in savings bonds, while other securities, mostly marketables, increased $5.1 billion. More than half of the increase in marketable securities was a result of the large response by individual investors to the fixed-price subscription technique used by the Treasury in the February and May refundings. On June 30, 1976, individuals held $96.4 billion of public debt securities. Holdings of U.S. savings bonds and notes amounted to $69.6 billion, and holdings of other Treasury securities were $26.8 billion.

Insurance companies.—In fiscal 1976 insurance companies increased their holdings of public debt securities $3.4 billion compared with $1.2 billion in fiscal 1975. Holdings of Federal agency issues increased only slightly. At the end of the fiscal year, insurance companies held $10.5 billion of public debt securities and $0.4 billion of Federal agency issues.

Savings institutions.—Public debt securities held by savings and loan associations increased $4.1 billion in fiscal 1976 compared with 0.4 billion in fiscal 1975. Holdings of Federal agency securities were down slightly. At the end of fiscal 1976, savings and loan associations held $8.5 billion of public debt securities and $0.4 billion of Federal agency issues.

Mutual savings banks held $5.1 billion of public debt securities at the end of fiscal 1976, an increase of $1.5 billion compared with a gain of $1.0

OWNERSHIP OF FEDERAL SECURITIES



billion in fiscal 1975. Holdings of Federal agency securities changed slightly, and at the end of fiscal 1976 were just under $0.4 billion.

State and local governments.—At the end of fiscal 1976, State and local governments held $39.5 billion of public debt securities. This represented a gain of $9.9 billion compared with $1.3 billion added a year ago. The increase in holdings was the largest ever for this investor group. Holdings of Federal agency issues increased $0.2 billion to a level of $3.7 billion.

Foreign and international.—Foreign investors held $70.6 billion of public debt securities at the end of fiscal 1976, an increase of $4.6 billion compared with $9.2 billion added a year ago. Holdings of marketable issues increased $6.3 billion while foreign special nonmarketables declined $1.7 billion. Holdings of Federal agency securities were about the same as last year, $20 million, at the end of fiscal 1976.

Nonfinancial corporations.—Corporations added $11.8 billion of public debt securities to their holdings in fiscal 1976 compared with $2.4 billion last year. More than 70 percent of the increase was in Treasury bills as corporations sought to rebuild balance sheet liquidity. At the end of fiscal 1976, corporations held $25 billion of public debt securities. Holdings of Federal agency issues were about the same as in fiscal 1975, $0.4 billion.

Other private nonbank investors.—Other private nonbank investors increased their holdings of public debt securities $5.7 billion in fiscal 1976 compared with an increase of $9.8 billion in fiscal 1975. Holdings of Federal agency securities increased $0.2 billion. At the end of fiscal 1976, these investors held $29.0 billion of public debt issues and $0.6 billion of Federal agency securities.

Commercial banks.—In the absence of strong business loan demand, commercial banks continued to be heavy purchasers of public debt securities in fiscal 1976 and acquired $22.8 billion. This was $7.0 billion more than the increase in fiscal 1975. From a total of 30 coupon offerings to private investors for refunding and new cash in fiscal 1976, with a gross volume of $71.6 billion, commercial banks initially acquired $34.8 billion, or nearly 49 percent. At the end of fiscal 1976, commercial banks held $91.8 billion of public debt securities, which was only $2.0 billion less than the post-World War II peak of $93.8 billion in February 1946. Holdings of Federal agency securities totaled $1.9 billion, down slightly from fiscal 1975.

Federal Reserve System.—In fiscal 1976, the Federal Reserve System increased its holdings of public debt securities $9.7 billion, compared with $4.3 billion a year earlier. Holdings of Federal agency securities increased slightly. At the end of fiscal 1976, the System held $94.4 billion of public debt securities and $0.3 billion of Federal agency issues.

Government accounts.—Holdings of public debt securities by Government accounts increased $4.3 billion in fiscal 1976 compared with $7.1 billion in fiscal 1975. Special nonmarketable securities held by these accounts increased $6.4 billion while holdings of marketables declined

Estimated ownership of public debt securities on selected dates 1966–76

[Dollar amounts in billions]

	June 30, 1966	June 30, 1974	June 30, 1975	June 30, 1976	Sept. 30, 1976
Estimated ownership by:					
Private nonbank investors:					
Individuals:[1]					
Series E and H savings bonds	$49.2	$61.4	$65.0	$69.2	$70.5
U.S. savings notes[2]	....	.5	.4	.4	.4
Other securities	23.5	18.8	21.7	26.8	28.8
Total individuals	72.8	80.7	87.1	96.4	99.7
Insurance companies	10.0	5.9	7.1	10.5	11.6
Mutual savings banks	5.0	2.6	3.6	5.1	5.3
Savings and loan associations	7.3	r3.9	r4.3	8.5	8.8
State and local governments	24.5	28.3	29.6	39.5	39.1
Foreign and international	[3]11.6	[3]56.8	66.0	70.6	74.6
Corporations	14.2	10.8	13.2	25.0	25.7
Miscellaneous investors[4]	9.5	r13.4	r23.2	29.0	34.1
Total private nonbank investors	[3]154.9	[3]202.4	r234.1	284.5	298.9
Commercial banks	54.8	53.2	r69.0	91.8	93.3
Federal Reserve banks	42.2	80.5	84.7	94.4	96.4
Government accounts	64.3	138.2	145.3	149.6	146.1
Total gross debt outstanding	[3]316.1	[3]474.2	533.2	620.4	634.7
			Percent		
Percent owned by:					
Individuals	23	17	16	16	16
Other private nonbank investors	26	26	28	30	31
Commercial banks	17	11	13	15	15
Federal Reserve banks	14	17	16	15	15
Government accounts	20	29	27	24	23
Total gross debt outstanding	100	100	100	100	100

r Revised.

[1] Including partnerships and personal trust accounts.

[2] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.

[3] Adjusted to reflect the reclassification in July 1974 of outstanding non-interest-bearing special notes issued to the International Monetary Fund and other international lending institutions. The adjusted amounts were $3,810 million at the end of fiscal 1966 and $825 million at the end of fiscal 1974.

[4] Includes nonprofit institutions, corporate pension trust funds, nonbank Government security dealers, certain Government deposit accounts, and Government-sponsored agencies.

$2.1 billion. Holdings of Federal agency issues increased slightly. At the end of fiscal 1976, Government accounts held $149.6 billion of public debt securities and $2.0 billion of Federal agency issues.

Federal Financing Bank

The Federal Financing Bank (FFB) was established under legislation enacted in December 1973 to centralize Federal and federally assisted borrowings. The bank has become the vehicle through which most Federal agencies finance programs that would otherwise involve the sale or placement of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and sales of assets. The major exceptions to date are title XI ship mortgage bonds, federally guaranteed tax-exempt housing and urban renewal notes and bonds, and Government National Mortgage Association asset sales. The FFB itself obtains financing by borrowing from the Secretary of the Treasury, and Treasury borrowing to meet the needs of the FFB is reflected in the public debt accounts.

Summary of Federal Financing Bank holdings, beginning fiscal year 1974

[In millions of dollars]

Obligation	Holdings end of period				Net change in holdings			
	Fiscal 1974	Fiscal 1975	Fiscal 1976	T.Q.	Fiscal 1974	Fiscal 1975	Fiscal 1976	T.Q.
On-budget agency debt:								
Tennessee Valley Authority	....	1,435.0	2,180.0	2,738.0	....	1,435.0	745.0	558.0
Off-budget agency debt:								
Export-Import Bank of the United States	....	4,049.4	4,984.6	4,768.1	....	4,049.4	935.2	-216.5
U.S. Postal Service	500.0	1,500.0	2,748.0	3,248.0	500.0	1,000.0	1,248.0	500.0
U.S. Railway Association	....	33.9	85.9	96.8	....	33.9	51.4	11.5
Agency assets:								
Farmers Home Administration	....	5,000.0	8,800.0	9,650.0	....	5,000.0	3,800.0	850
Health, Education, and Welfare medical facilities loan program	2.0	62.1	118.7	125.7	2.0	60.1	56.6	7.0
Rural Electrification Administration	....	....	166.4	353.7	....	....	166.4	187.3
Secretary of the Treasury (N.Y.)	....	....	....	1,082.1	....	....	....	1,082.1
Small Business Administration	....	....	164.4	160.0	....	....	164.4	-4.4
Government-guaranteed loans:								
Chicago, Rock Island & Pacific Railroad	....	....	....	5.6	....	....	....	5.6
Defense foreign military sales	....	111.7	898.9	1,106.6	....	111.7	787.2	207.7
General Services Administration	....	45.1	68.8	75.0	....	45.1	23.7	6.2
Housing and Urban Development New Communities Administration	....	21.0	27.5	37.5	....	21.0	6.5	10.0
National Railroad Passenger Corporation (Amtrak)	....	317.5	567.5	602.4	....	317.5	250.0	34.9
Overseas Private Investment Corporation	....	5.5	5.4	5.4	....	5.5	-.1	....
Rural Electrification Administration	....	254.8	948.0	1,159.9	....	254.8	693.2	211.9
Small business investment companies	....	47.5	70.7	90.9	....	47.5	23.2	20.2
Student Loan Marketing Association	100.0	240.0	400.0	405.0	100.0	140.0	160.0	5.0
Washington Metropolitan Area Transit Authority	....	177.0	1[illegible]	177.0	....	177.0	....	....
Total	602.0	13,300.5	22,411.5	25,887.7	602.0	12,698.5	9,110.8	3,476.5

On September 30, 1976, FFB holdings of Federal agency and Government-backed obligations totaled $25.9 billion, having increased by $9.1 billion in fiscal 1976 and by $3.5 billion in the transition quarter. (See tables 1 and 2.) FFB purchases of assets of on-budget Federal agencies, especially of the Farmers Home Administration, accounted for a major portion of FFB financing activity. Purchases of New York City loans from the Secretary of the Treasury under the New York City Seasonal Financing Act of 1975 also contributed to the relative importance of agency assets in the FFB portfolio on September 30, 1976.

FFB holdings of loans guaranteed by other Federal agencies nearly tripled between June 30, 1975, and September 30, 1976. This occurred without adding to the number of agencies whose guarantee programs were financed through the FFB.

During the second session of the 94th Congress, legislation was enacted to provide for additional agency guarantees of obligations by several new programs. It is expected that these new programs will add substantially to existing potential for expansion of FFB financing activity during fiscal 1977.

New York City's Financial Situation

During fiscal 1976, the Department was substantially engaged in matters relating to the financial situation in New York City. At the direction of the President, departmental officials monitored events on a daily basis through the early months of the fiscal year, engaging in numerous discussions with representatives of New York City, New York State, as well as with the private sector.

During September and October of 1975, the Secretary and other Department officials made numerous formal and informal appearances before committees of Congress considering possible legislative action.[1] In addition, the Department participated in the development of amendments to chapter IX of the bankruptcy laws, to deal with the practical and legal problems which might be precipitated by a large municipal bankruptcy.

In December 1975, the New York City Seasonal Financing Act of 1975 (Public Law 94-143) was enacted, giving the Secretary of the Treasury authority to extend short-term seasonal loans for essential services in aggregate amounts not to exceed $2.3 billion during the course of a fiscal year. To implement the act, the Department entered into a credit agreement with New York City, New York State, and the State-created Emergency Financial Control Board, setting forth the terms and conditions of the loan relationship between New York City and the Treasury. During fiscal 1976, $1.26 billion in loans was extended and repaid with interest prior to the end of the fiscal year.

The loan program is based on New York City's July 1 fiscal year. Accordingly, the loans advanced during the transition quarter in the

[1] See exhibit 15.

amount of $1.075 billion are scheduled to be repaid during the last 3 months of New York City's fiscal year—April–June.

The loan program is administered by the Office of New York Finance, which reports to the Assistant Secretary for Capital Markets and Debt Management. The office is staffed by 14 professionals, 11 of whom are located in Washington. The remainder are located in a branch office established in New York City. The office is responsible for handling loan transactions under the Seasonal Financing Act, as well as for monitoring on a daily basis the financial condition of New York City, evaluating the reports provided the Treasury pursuant to the credit agreement and advising the Assistant Secretary as to matters relating to the loan program.

DOMESTIC ECONOMIC POLICY

The Secretary of the Treasury is the chief Government adviser to the President on fiscal and financial affairs and thus plays a key role in the formulation and execution of domestic economic policy. In discharging these responsibilities, the Secretary obtains primary support from the Assistant Secretary for Economic Policy.

The Assistant Secretary for Economic Policy informs the Secretary and other top policy officials of current and prospective economic developments and contributes to the determination of appropriate economic policies. He is assisted in these functions by his own Deputy and by the Counsellor to the Secretary, and he can call on the services of other Treasury offices, including the Office of Financial Analysis, which is under his direct supervision.

The Assistant Secretary for Economic Policy, or his delegate, regularly represents the Treasury on a variety of interagency groups and from time to time at meetings of the Organization for Economic Cooperation and Development in Paris. He supervises the analysis within Treasury of economic trends, participates in the decisionmaking process on Treasury debt management operations, and explains administration economic policy through speaking engagements, congressional testimony, and other public appearances.

The Assistant Secretary for Economic Policy also participates with the Secretary in the Troika, which develops the official economic projections and advises the President on alternative courses of action. Other Troika members are the Council of Economic Advisers and the Office of Management and Budget. Within Treasury, the staff support for Troika activities in the general economic area is provided by the Office of Financial Analysis and in the tax area by the Office of Tax Analysis.

The economic projection for calendar year 1976 developed within the

Troika and described in the January 1976 Economic Report of the President and the Budget of the United States Government for Fiscal Year 1977 called for an increase in the aggregate demand for goods and services of about 12 1/2 percent from 1975 levels. Of this increase, roughly 6 to 6 1/2 percent was expected to be a rise in the volume of economic activity and 6 percent to be inflation. (In contrast, real output fell by about 2 percent in 1975 and prices rose by more than 9 percent.) Economic activity accelerated more rapidly than expected early in the year followed by some deceleration in the rate of growth, so that for the full calendar year 1976 real growth appears to be falling into the projected range. Progress in containing inflation has clearly been greater than expected, and the estimated rate of advance of prices has been lowered to the 5-percent range.

During the course of fiscal 1976 and the transition quarter, the domestic economy moved from the initial phases of cyclical recovery into a period of moderate growth which should form a foundation for a sustainable long-term expansion. Federal budget deficits were held below what had been expected for both fiscal 1976 and the transition quarter, and though still very large, the deficit is expected to narrow in fiscal 1977. Monetary policy remained on a fairly steady course of moderate expansion. Inflation continued to be the major threat to a period of sustained growth but considerable progress was made in dampening inflationary pressures.

OFFICE OF THE GENERAL COUNSEL

The General Counsel, appointed by the President by and with the advice and consent of the Senate pursuant to an act of Congress approved May 10, 1934, is the chief law officer of the Department of the Treasury. As the chief law officer, the General Counsel administers the Legal Division, composed of all attorneys performing legal services in the Department and all nonprofessional employees providing support to the attorneys, and is responsible for all of the legal activities of the Department.

The primary role of the General Counsel is to serve as the senior legal and policy adviser to the Secretary of the Treasury and other senior Treasury officials. As such, the General Counsel reviews the legal considerations relating to policy decisions affecting the management of the public debt, administration of the revenue and customs laws, international economic, monetary, and financial affairs, law enforcement, and other departmental activities. Other responsibilities include providing general legal advice wherever needed, coordinating Treasury litigation, preparing the Department's legislative program and comments to the Congress on pending legislation, reviewing the Department's regulations for legal sufficiency, and counseling the Department on conflict of interest and ethical matters. The General Counsel also is responsible for hearing appeals to the Secretary of the Treasury from administrative decisions of bureau heads or other officials.

The General Counsel manages the Legal Division through the Deputy General Counsel, the Assistant General Counsels, the Chief Counsels, and the Legal Counsels. The Chief Counsel for the Internal Revenue Service, Assistant General Counsel—Tax Legislative Counsel, and the Chief Counsel for the Comptroller of the Currency report directly to the General Counsel. The remaining Assistant General Counsels, Chief Counsels, and Legal Counsels report to the General Counsel through the Deputy General Counsel. In addition, the Office of Director of Practice is part of the Legal Division under the supervision of the General Counsel.

Legislation

During fiscal 1976 and the transition period, the General Counsel provided the Department's views to the Congress on nearly 1,500 bills on non-tax-related matters pending before the Congress. In addition, the Legal Division participated in drafting a number of legislative proposals during this period. Among the more significant were:

1. Proposed legislation for the renewal of the revenue sharing program (the State and Local Fiscal Assistance Act of 1972) which was submitted to the Congress by the President. The renewal legislation was subsequently approved by the Congress and signed by the President on October 13, 1976 (Public Law 94–488).
2. Legislation to amend the Bretton Woods Agreements Act to authorize U.S. acceptance of proposed amendments to the International Monetary Fund Articles of Agreement, and U.S. consent to an increase in its quota in the International Monetary Fund. This was introduced in the Congress as H.R. 13955.
3. Legislation to allow for U.S. participation in a replenishment of the resources of the Inter-American Development Bank. This bill was consolidated with two other bills, authorizing participation in the African Development Fund and providing for entry of nonregional countries and the Bahamas and Guyana into the Inter-American Development Bank, and became law on May 31, 1976 (Public Law 94–302).

Litigation

The Legal Division is responsible for formulating the Department's position on litigation involving Treasury activities and for working with the Department of Justice in the preparation of litigation reports, pleadings, trial and appellate briefs, and assisting in trying all cases in which the Department is involved.

There are many thousands of individual cases pending in the U.S. Customs Court, the U.S. Tax Court, and other Federal courts. Only a few of the more significant cases will be mentioned in this report.

In *Federal Energy Administration et al.* v. *Algonquin SNG et al.*, and the consolidated case of *Commonwealth of Massachusetts et al.* v. *Simon et al.*, several Northeastern States and their Governors, and several public utilities brought suit against the Secretary of the Treasury and the Administrator of the Federal Energy Administration challenging, on various statutory and constitutional grounds, Proclamation No. 4341, issued by the President on January 23, 1975, which imposed supplemental license fees on the importation of oil or certain petroleum products into the United States. The Supreme Court decided that provisions of the Trade Expansion Act of 1962 gave the President the authority to impose the license fees to protect the national security in the face of excessive oil imports. The decision confirms that the President, in exercising his authority to adjust imports in the interest of national security, may utilize means more varied and flexible than the imposition of quotas.

In *United States* v. *Yoshida International, Inc.*, the Court of Customs and Patent Appeals reversed the U.S. Customs Court decision and upheld the authority of the President to impose a 10-percent additional duty on most imported articles pursuant to Presidential Proclamation No. 4074. Although the plaintiff in *Yoshida* decided not to apply to the Supreme Court for certiorari, the issues have been raised in a separate case, *Alcan Sales Division of Alcan Aluminum Corp.* v. *United States*, and the Supreme Court is considering a petition to grant certiorari in that case.

In two cases, *United States Steel Corporation* v. *Simon* and *Zenith Radio Corporation* v. *Simon*, Treasury's 70-year-old policy under the countervailing duty law of not considering rebates or remissions of indirect taxes upon exportation to be bounties or grants under that law was challenged in the Customs Court. These cases, still pending in the Court, have serious implications for U.S. trade, since a high proportion of total exports to this country are relieved from indirect taxes of various types upon exportation.

In *Goolsby* v. *Simon* a Federal district court granted the Government's motion to dismiss the case, holding that the Uniform Relocation Assistance Act and the National Environmental Policy Act of 1969 were inapplicable to a recipient government's capital project in which revenue sharing funds were used. The plaintiff has appealed this decision and the case is presently pending before the Fifth Circuit Court of Appeals.

In *Logan and Logan* v. *Secretary of State, Secretary of the Treasury, Chairman and the Board of Governors of the Federal Reserve System, and Federal Reserve Bank of New York*, a class action suit was brought on behalf of all U.S. citizens who hold certified claims against the Government of Czechoslovakia, seeking to compel the United States to vest, sell, and distribute the proceeds from the sale of 18.4 metric tons of gold allegedly belonging to Czechoslovakia as well as blocked Czechoslovakian property. The court dismissed the case, holding, as the United States argued, that the Governments of the United Kingdom and France had a sovereign interest in the gold, so the doctrine of sovereign immunity precluded the court from exercising its jurisdiction over the gold, and that the authority of the United States to take action against Czechoslovakian property is discretionary and cannot be mandated by the court. The plaintiffs have appealed this decision.

Regulations

In October 1975, the Office of the Chief Counsel for Revenue Sharing prepared civil rights regulations which are among the most comprehensive nondiscrimination regulations found in any agency of the Federal Government. These regulations became effective on October 22, 1975, and are found in 31 CFR, part 51.

During the fiscal year the Office of the Chief Counsel of the Office of Foreign Assets Control prepared a substantial number of technical amendments to the Foreign Assets Control Regulations designed to update these regulations prior to their republication in pamphlet form.

Also during fiscal 1976, the Office of the General Counsel assisted in the development of a system of making recurring Government payments such as those to social security recipients without recourse to check instruments. These efforts resulted in publication of regulations codified at 31 CFR, part 210.

OFFICE OF THE UNITED STATES TREASURER

The Treasurer of the United States is also the National Director of the U.S. Savings Bonds Division. In one or both of these capacities, she has spoken to more than 100 gatherings across the Nation during the period of this report, and to audiences such as businessmen, bankers, educators, farm and conservation groups, labor conventions, and women's groups. As a spokesman for Treasury programs and policies, she addresses the subjects of general economic conditions; the Department's responsibilities; the role of the free market in the economy; and the value of thrift and the role of savings bonds for individuals and the Nation.

The Treasurer has responsibilities in the area of reviewing and endorsing U.S. currency, and was active in helping to promote the new $2 bill which went into circulation April 13, 1976.

As chairman of departmental Bicentennial activities, the Treasurer took an active role in helping to develop a diverse program to highlight the history and responsibilities of the second oldest department in the executive branch. Treasury activities included:

- Issue of special coins and medals in honor of the Bicentennial.
- Nationwide Bicentennial youth debates, in which more than 9,000 winners received Treasury medals made by the Bureau of the Mint

and copies of the Declaration of Independence by the Bureau of Engraving and Printing.

- A series of exhibits at the Main Treasury Building highlighting the Department's role in international economic policy, in raising funds in the capital market, and in financing our national economic development; and saluting Treasury women past and present. Treasury also mounted Bicentennial exhibits in Milwaukee, Wis., Houston, Tex., Geneva, Switzerland, and Brussels, Belgium.
- A departmental display at the U.S. Bicentennial Exposition on Science and Technology at the Kennedy Space Center, Fla., highlighting the use of science and technology in law enforcement, bank regulation, and manufacture of stamps and money.

Other special activities included preparing a departmental cube exhibit, which depicted the history and functions of the Department's 12 bureaus for use by civic groups; loaning artifacts to the Freedom Train; and the appearance of the Treasurer on a television "Bicentennial Minute." The Treasurer also assisted in the preparation and dedication of the Treasury Time Capsule, a granite capsule which contains artifacts and statements by current Department of the Treasury officials and which will be opened 100 years from now for the Nation's Tricentennial celebration. The Secretary's inscription on the capsule reads: "America's greatest resource is the vibrant heritage of a free people. May we have the wisdom and the vision to nourish this birthright forever."

ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS

Six operating bureaus of the Department of the Treasury are supervised by the Assistant Secretary (Enforcement, Operations, and Tariff Affairs), who is assisted by three deputies and three staff offices (Offices of Law Enforcement, Operations, and Tariff Affairs). The bureaus are U.S. Customs Service, Bureau of Engraving and Printing, Bureau of the Mint, U.S. Secret Service, Federal Law Enforcement Training Center, and the Bureau of Alcohol, Tobacco and Firearms. The policies and operations of the Office of Foreign Assets Control are also directed by the Assistant Secretary. In addition, the Assistant Secretary acts as the principal adviser to the Secretary on all law enforcement matters under the jurisdiction of the Treasury, including review and coordination of the enforcement responsibilities of the Internal Revenue Service.

Law Enforcement and Operations

The Deputy Assistant Secretary (Enforcement), with the assistance of the Office of Law Enforcement, supervises the Federal Law Enforcement

Training Center, the U.S. National Central Bureau of Interpol, and the law enforcement activities of the U.S. Secret Service, the Bureau of Alcohol, Tobacco and Firearms, and the U.S. Customs Service. During the period covered by this report, the Deputy Assistant Secretary continued his review of all Treasury law enforcement policies and programs, with particular attention to legislative programs affecting the bureaus such as those relating to gun control, additional jurisdiction for the Secret Service, and the availability of materials to law enforcement agencies.

The Deputy Assistant Secretary (Operations), with the assistance of the Director, Office of Operations, exercises general line supervision, as delegated, over all bureau activities, with special attention to cost-effective design and execution of programs, assignment of appropriate resources, efficiency of management, coordination of programs within Treasury and with other departments, review of senior personnel appointments, and monitoring of management information reports.

Antinarcotics program

With increased administration emphasis on drug abuse, Treasury continued a high level of antinarcotics activities. The Department participated in activities of the Cabinet Committee on International Narcotics Control, the Cabinet Committee on Drug Law Enforcement, and the Domestic Council Drug Abuse Task Force. Treasury efforts emphasized evaluating the cost-effectiveness of foreign narcotics assistance programs, formulating recommendations which led to an expanded Customs role in the drug program, focusing on the narcotics trafficker's fiscal resources through revitalization of tax enforcement aimed at high-level drug traffickers, and expanding efforts to reduce the tremendous amounts of money illegally taken out of the country either to purchase drugs or to transfer drug profits to safe and secret bank accounts abroad.

A U.S.-sponsored resolution urging governments to outlaw the financing of narcotics trafficking and to exchange information to identify persons committing such offenses was adopted unanimously by the United Nations Economic and Social Council. The United States-Swiss Mutual Assistance Treaty in Criminal Matters, which becomes effective in January 1977, should expedite the exchange of information concerning persons engaged in criminal activities, including alleged drug traffickers. Exploratory discussions have been held or are underway with a number of other countries concerning mutual assistance agreements to disrupt the financing of transnational crimes.

The U.S. Customs Service concluded agreements with counterpart organizations in Mexico and Austria to increase cooperation in the suppression of customs offenses, including the smuggling of narcotics and other contraband.

Organized crime

The Deputy Assistant Secretary (Enforcement) supervised the participation of the Secret Service, Customs, and ATF in the organized crime strike forces of the Department of Justice, and promoted more active participation in the work of these strike forces by the special agents of IRS.

Anti-terrorism

The Deputy Assistant Secretary (Enforcement) represented the Treasury in the Working Group of the Cabinet Committee to Combat Terrorism, supervising and coordinating the participation of the Secret Service, Customs, and ATF on subcommittees of that group.

Financial recordkeeping

Treasury regulations, issued as part 103, 31 CFR, under the authority of Public Law 91–508, require financial institutions, including banks and brokerage firms, to keep certain basic records that have a high degree of usefulness in the investigation of tax, regulatory, or criminal matters. The Assistant Secretary (EOTA) has responsibility for the administration of these regulations, which also provide for reports of the international transportation of monetary instruments, reports of interests in foreign bank accounts, and reports of unusual domestic currency transactions.

The Federal bank supervisory agencies, the Securities and Exchange Commission, the Federal Home Loan Bank Board, the National Credit Union Administration, and the IRS have been delegated enforcement responsibilities under the general supervision of the Assistant Secretary.

During the last half of fiscal 1976, Treasury cooperated with the Commerce, Consumer, and Monetary Affairs Subcommittee of the Committee on Government Operations of the House of Representatives in the subcommittee's review of the implementation of the provisions of titles I and II of Public Law 91–508. On June 28, 1976, the Assistant Secretary testified in detail concerning the history and implementation of the regulations.[1]

As a result of information obtained by IRS and Drug Enforcement Administration, it was determined that certain banks have been used by drug traffickers to conceal large currency transactions, which should have been reported in accordance with Treasury regulations referred to above. In order to deter similar violations in the future, new bank examination procedures for reviewing currency transactions were developed and implemented with the cooperation of the Federal bank supervisory agencies.

In fiscal 1976, the IRS received an estimated 25,000 Forms 4789, Currency Transaction Report, and processed 50,633. The Customs Service received 23,967 Forms 4790, Report of the International Transportation of Currency or Monetary Instruments. During the same

[1] See exhibit 31.

period, 15,646 banks, 13,812 credit unions, and 3,496 savings and loans were examined for compliance with the regulations.

Protective responsibilities

Beginning in November 1975, the Deputy Assistant Secretary (Enforcement) conducted a critique of Secret Service protection techniques and methods. This critique was directed by the Secretary of the Treasury following assaults on the President in fall 1975. The purpose of the critique was to determine all means by which the Secret Service could improve its protective operations and its techniques for receiving and evaluating intelligence.

The Assistant Secretary (EOTA) approved and published proposed regulations, in compliance with Public Law 94–196, for the Secret Service to reimburse State and local governments which use their resources to protect foreign diplomatic missions and temporary domiciles.

During fiscal 1976 and the transition quarter, the Assistant Secretary maintained continuous liaison with the Advisory Committee on Candidate Protection, which authorized protection for 12 Presidential candidates during the primary campaigns, beginning in October of 1975. During the transition quarter, the Office of Law Enforcement processed requests for protection made by candidates of minor parties.

Counterfeiting

Counterfeiters in fiscal 1976 produced approximately $35 million in counterfeit U.S. currency, down 28 percent from the alltime high of $48.6 million established last year. In the transition quarter, counterfeit production amounted to $5.5 million.

Fiscal 1976 losses to the public dropped to $3.37 million from $3.60 million in fiscal 1975, with the Secret Service seizing almost $32 million of the counterfeiter's total output before it reached victims. In the transition quarter, losses to the public were $1.1 million with seizures amounting to $4.4 million.

Federal Law Enforcement Training Center

In the summer of 1975, the Federal Law Enforcement Training Center underwent a major transformation as it moved from a downtown office building in Washington, D.C., to a 1,500-acre facility at the former Naval Air Station (Glynco) in Brunswick, Ga. The facility, capable of accommodating a constant training load of 750 students, was Treasury's first experience in operating a complete remote establishment requiring maintenance of extensive buildings and grounds and providing a resident population housing, food, and recreation as well as training.

Training operations at the new site began the first week in September, with Secretary Simon and a full panoply of congressional and Georgia dignitaries dedicating the new Center on September 12, 1975. For interim rehabilitation of buildings and grounds, the Center expended $2 million. A design master plan calls for some new structures and more extensive adaptation of existing facilities, utilizing a congressional appropriation of $28 million. When this major construction program is completed in fiscal 1979, the Center's facilities for law enforcement training will be unequaled anywhere in the world.

As the student load stabilizes near the Center's capacity, the new facility will not only enhance the quality of law enforcement training but also reduce per capita cost. During the year ended September 30, 1976, an estimated $5 million was saved in student per diem costs alone.

In fiscal 1976, the Department of Health, Education, and Welfare and the Federal Protective Service of the General Services Administration were added as participating agencies.

Firearms and explosives control program

The Gun Control Act of 1968 and regulations thereunder provide the basis for programs of ATF aimed at preventing the illegal possession and misuse of firearms by criminals. Title XI of the Organized Crime Control Act of 1970, which regulates explosives, establishes the authority for ATF programs aimed at curbing the acquisition and misuse of explosives by criminals. Most criminal investigations within the latter program involve actual or attempted bombings, followed by investigations of the thefts of explosives.

On June 19, 1976, President Ford's law enforcement message to the Congress called for a four-part effort stressing the rights of law-abiding Americans and deemphasizing the rights of criminals. In addition to measures for tightening the enforcement of existing gun laws, the President proposed, and the Department drafted, new firearms legislation which included mandatory sentencing and a ban on the manufacture and sale of cheap handguns known as "Saturday Night Specials."

To achieve these ends, the President directed ATF to employ and train 500 additional special agents and to double its investigative efforts in the Nation's 10 largest metropolitan areas. With White House approval, this was later expanded to 11 areas.

Treasury requested a supplemental budget of approximately $20 million for the purpose of implementing the President's program in all of the 11 standard metropolitan statistical areas (SMSA's), but a House/Senate Appropriations Conference Committee approved only sufficient funding for 3. The SMSA's of Boston, Chicago, and Washington, D.C., were selected as a pilot project. The objectives of Operation Concentrated Urban Enforcement (CUE) are to develop Federal criminal cases against persons using firearms and explosives in criminal activities in the Nation's largest cities; to reduce or eliminate major illegal sources of "street type" firearms and explosives located outside the SMSA's; and to trace all firearms seized or retained in crimes committed within the target areas to determine, among other things, the type of firearms used, the sources of those firearms, and the retail and subsequent purchasers of them.

Interpol

In fiscal 1976, the U.S. National Central Bureau (USNCB), International Criminal Police Organization (Interpol), assisted local, State, and Federal law enforcement agencies with 771 foreign criminal investigative requests and foreign law enforcement with 2,907 criminal investigative requests. These figures reflect an increasing workload that has been due, in part, to the USNCB's continued efforts to inform these agencies concerning the assistance which Interpol can provide in criminal investigations with transnational aspects.

The Chief of the USNCB briefed the 94 U.S. attorneys during their annual meeting. With the cooperation of the U.S. Attorney Advisory Committee, a followup program was initiated to inform local prosecutors. Each U.S. attorney was provided with a list of the State and county prosecutors in his area, together with a supply of Interpol brochures and annual reports for distribution. The Chief of the USNCB also briefed the U.S. Marshals from across the country at their annual meeting.

The USNCB had an exhibit booth and literature at the International Association of Chiefs of Police conference in Denver, Colo., in September 1975, as well as at the National Sheriffs Association's annual conference in Chicago, Ill., in May 1976.

Interpol briefing and orientation classes have become a part of most Federal law enforcement agent training classes. The agents are then able to provide more accurate information about Interpol's capabilities to the local and State police.

In October 1975, Treasury led the U.S. delegation to the 44th Interpol General Assembly in Buenos Aires, Argentina. The General Assembly, representing 122 member countries, adopted substantive resolutions in the areas of international fraud (white collar crimes); traffic in stolen or misappropriated motor vehicles; taking of hostages; illicit drug trafficking; prevention of currency counterfeiting; recruitment of police officers for juvenile delinquency work; and bilateral police agreements.

During the fiscal year, the United States, through Treasury's coordination, participated in Interpol international symposiums on juvenile delinquency, violent crimes committed by organized groups, drug trafficking, crimes in seaports, computerized search files, prediction of crime, Interpol telecommunications, forensic sciences, and the European Regional Conference.

Cargo security program

The Department, through the Customs Service, is conducting a visible, effective, and multifocused program in the area of cargo security. Aspects of this program include high-security warehouses, security seals, theft information systems, merchandise quantity control, cargo statistical analyses, surveys of cargo-handling terminals and procedures, and investigations of crimes involving international cargo.

The Customs Service, with its unique physical presence of Federal officers at all points where international cargo arrives and is stored awaiting clearance, is in a pivotal position to operate and enforce cargo security programs.

Under Customs imported merchandise quantity control program, there were 323 seizures for manifesting violations in fiscal 1976, which led to penalties assessed against carriers in the amount of $8.9 million.

A vigorous program to reduce false manifesting of containerized cargo was pursued. During the year, the program was credited with recovery of $0.9 million in extra duty and taxes, the discovery of $8.4 million in unmanifested merchandise, and the assessment of fines and penalties in the amount of $2.1 million.

A new high-security seal was proposed for mandatory use on all port-to-port in-bond carload and container lot movements of cargo in Customs custody.

ATF continued its extensive reporting network on theft of firearms from interstate shipments. Since the inception of the program, commercial carriers have voluntarily reported to ATF 2,265 incidents involving the theft of approximately 14,200 firearms. Forty-six criminal cases have been perfected against 84 defendants. Forty-one of the defendants were either presently or formerly employed by the carrier.

Treasury enforcement communications system (TECS)

TECS provided direct communication capability between the constituent Treasury law enforcement organizations: Customs, ATF, and the Intelligence and Internal Security Divisions of IRS. The system also provided access to other law enforcement information through interface with the FBI National Crime Information Center and the national law enforcement teletype system.

Inquiries during fiscal 1976 produced 2,264 pieces of positive information, or "hits," and resulted in 1,687 arrests. The total of terminals on line rose to 673.

Realignment of ATF

A major activity of the Office of Law Enforcement was a study of the operations of the Bureau of Alcohol, Tobacco and Firearms that culminated in a realignment of the Bureau's organization for handling its criminal enforcement responsibilities. On August 30, 1976, the Under Secretary, with the approval of the Secretary, ordered the realignment, to be effective December 1. At the end of the transition quarter an implementation group, under the direction of a three-member steering committee, one of whom was the Director of the Office of Law Enforcement, was completing plans to put the realignment into effect.

Engraving and printing

A basic realignment of the Bureau of Engraving and Printing into three functional areas (Administration, Operations, Research and Engineering) was approved by the Department and made effective in fiscal 1976.

Reissuance of the $2 bill as a Federal Reserve note, series 1976, marked a program of major import to the Bureau. Not simply a commemorative issue, the $2 note is designed to become a permanent part of U.S. currency. The production goal of 400 million $2 notes by July 4, 1976, was exceeded by the Bureau on April 30 with a total of 419 million $2 notes produced and delivered.

Productivity was improved and savings realized by mechanization of currency trimming operations, shrink wrapping of currency bricks, and stamp bookforming, and the use of plastic in the banding of currency. The Bureau is also experimenting with an all-wood pulp currency paper and with machine counting of currency. Both promise significant productivity improvement and savings.

The Bureau in fiscal 1976 was in the final phases of acquiring total in-house capability for gravure cylinder manufacture. After manufacturing phase-in, all attendant shipping and security costs will be eliminated.

Exterior areas of the Bureau were refurbished in anticipation of the influx of Bicentennial visitors. During fiscal 1976, 619,515 visitors took the tour of engraving and printing operations, with an additional 159,315 in the transition quarter.

Customs services

During fiscal 1976 and the transition quarter, respectively, the Customs Service collected a record $4.9 billion and $1.4 billion in duties and taxes, processed over $113 billion and $31 billion of imported goods, and cleared 269 million and 106 million arriving persons, 78 million and 22 million vehicles, 353,000 and 106,000 aircraft, and 129,000 and 39,000 vessels.

Under Customs enforcement mission, merchandise seized, including illicit drugs, prohibited articles, undeclared merchandise, etc., was valued at $660 million and $31 million. There were over 23,000 and 7,000 drug seizures, including 368 and 45 pounds of heroin, 1,030 and 236 pounds of cocaine, and 380 and 58 tons of marijuana. During fiscal 1976, Customs also seized 21.4 million units of polydrugs.

Customs air interdiction program utilized, for the first time, the NORAD/FAA long-range radar in concert with its own mobile ground-based radars for detection and tracking of smuggler aircraft along the southern border. The prime example of this coordination, Operation Star Trek, resulted in 262 aircraft detections and 43 intercepts.

During fiscal 1976, Customs launched a major currency control program to identify and prevent the transfer of funds destined to support smuggling activities.

Import and export statistics depend upon data collected by the Customs Service. In fiscal 1976 and the transition quarter, respectively, customs officers, located at some 100 ports of entry, verified 6 million and 1.5 million line items on 3.3 million and 850,000 entries filed, and transmitted approximately 8.5 million and 3 million export and import documents to the Bureau of the Census. These vital trade statistics also served for the establishment and enforcement of commodity quotas, of which Customs administered more than 700.

Customs played an important role in the full range of programs of the Customs Cooperation Council, an 80-member international organization with headquarters in Brussels, which promotes cooperation in customs enforcement measures and the facilitation of international trade.

Mint

The Mint produced over 12.6 billion domestic coins in fiscal 1976, a moderate reduction from the 13 billion plus produced in fiscal 1975, and 3.1 billion coins in the transition quarter. Productivity was improved by the acquisition of new carbide blanking dies, high-speed quad-strike presses and by the automation of the coin pallet tracking system.

The extraordinary demand for pennies subsided in fiscal 1976 and resulted in inventory gains at both the Mint and Federal Reserve banks. Closing inventories at the Mint of 3.2 billion coins were up 1.9 billion, or 146 percent, over the 1.3 billion held in inventory at June 30 last year, and rose to 3.7 billion at the end of the transition quarter.

The Mint participated extensively in activities of the Bicentennial, producing 45 million congressionally authorized, 40 percent silver Bicentennial coins. Also, orders for Bicentennial gold and silver medals exceeded expectations, resulting in increased activity in the production, packaging, and shipping of these items.

The Mint deposited $757 million in the general fund of the Treasury, principally from seigniorage, during fiscal 1976 and an additional $112 million during the transition quarter.

The fiscal 1976 cycle of the continuing audit of U.S.-owned gold at Mint institutions was completed. During this cycle, about 12 percent of the gold stored at Bureau of the Mint depositories was audited and found to be intact. An additional 5 percent was audited during the transition quarter.

A contract study of U.S. coinage system requirements to the year 1990 was completed and was under review at the end of fiscal 1976.

Tariff Affairs

The Office of Tariff Affairs was established in 1971 to provide policy direction, review, and final action on recommendations by the Customs

Service on administration of the Antidumping Act and countervailing duty law. The office is also responsible for policy review in other actions under the tariff laws, including classification, value marking, and quota regulations.

Amended antidumping regulations, consistent with the amendments to the Antidumping Act contained in the Trade Reform Act of 1974, became effective on July 26, 1976. They required more detailed injury information in line with the additional responsibilities placed upon the Secretary of the Treasury to determine at the initial stage of a case whether there is substantial doubt on the question of injury to the domestic industry. The new regulations also provided for the first time for a discontinuance of an investigation on a company-by-company basis. Another new provision in the regulations permitted a retroactive withholding appraisement in certain situations; e.g., when price assurances given as part of the basis for a revocation are violated.

Compared with 10 cases begun in fiscal 1975, 27 investigations were initiated in fiscal 1976, and 1 during the transition period. Treasury reached 11 final affirmative determinations during fiscal 1976, with 2 of these cases resulting in a formal dumping finding. During the transition period, four additional final affirmative decisions were issued, one of these a formal dumping finding.

During fiscal 1976, 10 countervailing duty investigations were commenced, with an additional 4 investigations initiated during the transition period. During fiscal 1976 Treasury issued 25 final countervailing duty decisions. In 13 of these cases countervailing duties were imposed, 6 of which were the subject of a waiver; 11 cases resulted in negative determinations and 1 in a termination. During the transition period, three cases resulted in the imposition of countervailing duties, one of which involved a waiver. This represents an increase from fiscal 1975, when only five final countervailing duty decisions were issued, with three of those involving affirmative decisions.

During the transition period, the Treasury invited comments on that section of its antidumping regulations dealing with treatment of circumstances of sale, and on its proposed countervailing duty regulations. Final adoption of new countervailing duty regulations should occur during the next fiscal year.

TAX POLICY

Legislation

During fiscal 1976, the administration proposed substantial income tax cuts accompanied by limits on Government spending. The goal was to stimulate economic activity, to reduce tax burdens on individuals and businesses, and to restrain the expanding size of Government. Tax reform also received the administration's guidance and support as the Congress continued to deliberate on those measures. The administration's reform proposals were directed at substantially reducing the number of individuals with high economic incomes who pay little or no tax, encouraging economic growth through more capital formation, encouraging job creation, making estate and gift taxation more equitable, particularly with respect to farms and closely held business, and helping State and local governments borrow needed funds.

Tax reduction.—President Ford proposed to the Congress on October 6, 1975, a permanent $28 billion income tax cut program tied to equivalent Federal spending cuts. The program included $20.7 billion in personal income tax reductions concentrated at low- and middle-income levels and $7 billion of business tax cuts to encourage investment in productive facilities. The individual income tax cut proposals would have increased the personal exemptions from $750 to $1,000, reduced tax rates for individuals, and replaced the present minimum and maximum standard deduction by a single flat standard deduction of $1,800 for single persons and $2,500 for married persons filing jointly ($1,250 for married persons filing separately). Also proposed were business tax cuts which would have reduced the maximum corporate tax rate from 48 percent to 46 percent, continued the current reduction in the tax rate on the first $50,000 of taxable income, made permanent the 1975 Tax Reduction Act increase in the investment credit from 7 percent (4 percent in the case of public utilities) to 10 percent, and provided tax relief to electric utilities.

The House passed its version of a tax cut in H.R. 10612 on December 4, 1975, and the Senate passed its version in H.R. 5559 on December 15, 1975. The House-Senate conferees reached agreement on the Senate's version, H.R. 5559, which was an $8.4 billion compromise tax cut for 6 months. The Congress voted its adoption on December 17, 1975, and sent the bill to the White House. President Ford vetoed H.R. 5559 on December 17 because it was an inadequate tax cut amounting to only $18 billion on a full-year basis and provided no spendings limitation. By contrast, the President's proposed tax cut would amount to $28 billion with a dollar-for-dollar spending cut. In addition to the bill's inadequate overall tax cut and lack of spending-cut commitment, the President stated that the smaller tax cut extension in the bill would not give middle-income individuals a fair share of the tax cut. The House sustained the President's veto on December 18, 1975.

Public Law 94–164, the Revenue Adjustment Act of 1975, approved by the President on December 23, 1975, was a short-term compromise on tax reduction and spendings limitation. The act extended with some modification the 1975 tax cuts and withholding rates for the first 6 months of 1976. The act also contained a declaration of policy on spending control and a commitment to reduce the spending level in fiscal 1977 equal to any reduction in taxes after June 30, 1976, if conditions warranted. The major provisions of the Revenue Adjustment Act were: (1) An increase in the minimum standard deduction from $1,600 to $1,700 for single persons and from $1,900 to $2,100 for married persons filing jointly; (2) the percentage standard deduction was continued at 16 percent of adjusted gross income but the maximum standard deduction was increased from $2,300 to $2,400 for single persons and from $2,600 to $2,800 for married persons filing jointly; (3) an increase in the $30 nonrefundable tax credit for each taxpayer and dependent to the greater of $35 per capita or 2 percent of the first $9,000 of taxable income; (4) an extension of the earned income credit; and (5) an extension of the 20-percent corporate tax rate on the first $25,000 of taxable income, 22-percent rate on the next $25,000, and 48-percent rate in excess of $50,000.

The President, however, continued to urge that his larger tax cut proposal be enacted permanently. In his state of the Union address on January 19, 1976, President Ford renewed his proposal for the $28 billion permanent income tax cut. The effect on tax year 1976 of this proposal would be tc apply the smaller congressional tax cuts for the first 6 months and the larger administration tax cuts for the second 6 months and thereafter. The President's fiscal 1977 budget, presented on January 21, 1976, assumed congressional approval of his tax cut recommendation to become effective July 1, 1976. The proposed reductions would be permanent and would give individuals and corporations about $10 billion more a year in tax cuts than they would receive if the 6-month tax cut extension enacted in December 1975 were applied on a full-year basis.

The Senate Finance Committee, when it approved its version of the tax reform bill, H.R. 10612, on June 10, 1976, agreed to make permanent the tax cuts set to expire June 30, 1976, but the Senate, because of the numerous tax revision measures, could not complete action on H.R. 10612 in time permanently to extend the tax cuts. The Senate tacked a temporary tax cut extension on House-passed bill H.R. 10051, relating to tax treatment of certain life insurance distributions. The Congress passed H.R. 10051 on June 29, 1976, which froze tax withholding rates and corporate tax rates for estimated tax payments through August 30, 1976, thus continuing for 2 months the tax cuts which would have expired June 30, 1976. President Ford approved the legislation, Public Law 94–331, on June 30, 1976. Public Law 94–396, approved on September 3, 1976, extended the existing withholding rates one-half month through September 15, 1976. Another half-month extension, through September 30, 1976, was enacted in Public Law 94–414, approved on September 17, 1976. Finally, a permanent tax cut was enacted in Public Law 94–455, the Tax Reform Act of 1976. The basic tax cut provisions of the act made permanent the temporary tax cut provisions of the Revenue Adjustment Act of 1975 including the standard deduction increases and the $35 nonrefundable tax credits for each taxpayer and dependents, but extended, through 1977, the earned income credit under the individual income tax and the 20-percent tax rate on the first $25,000 of taxable income and the $50,000 surtax exemption under the corporate income tax.

Tax reform.—At the beginning of fiscal 1976, the House Ways and Means Committee continued its examination of the Federal tax system. The committee had reached tentative decisions during fiscal 1975 and in substance had adopted Treasury's tax reform proposals of April 30, 1973. A major bill was prepared by the committee in 1975 but it was not reported.

On July 8, 1975, Secretary Simon in testimony before the committee renewed the administration's request for tax reform legislation. Even though the draft committee bill was somewhat less strict than the Treasury proposals, the Secretary stated that on the whole the draft bill was reasonable and acceptable. The committee bill included the Treasury's concept of a minimum taxable income intended to deal with the problem of taxpayers with high economic incomes who pay little or no income tax. The bill also included the Treasury's concept of a limitation on artificial accounting losses intended to deal with tax avoidance by means of tax shelters. Other provisions included tax simplification, elimination of withholding tax on foreign interest income, lengthening of the holding period to 1 year for long-term capital gains, a progressively smaller portion of long-term capital gain to be taxable if assets are held for long periods, and administrative provisions relating to tax return preparers, declaratory judgments regarding the status of charitable organizations, and withholding taxes on gambling winnings. The Secretary also supported the committee's intent to deal with disclosure of tax returns and tax return information. The Secretary also offered a proposal to limit industrial development bond financing. He also requested that the committee support the existing DISC (domestic international sales corporation) provisions because of the vital need for investment capital and urged adequate assessment of DISC's importance for exports and employment. The Secretary discussed extensively the importance of capital formation. He also offered new tax proposals relating to electric utilities.

On July 31, 1975, Secretary Simon in testimony before the committee made specific capital formation proposals which included the integration of corporation and individual income taxes. In addition, he proposed measures to encourage individuals to increase their savings for investment.[1] In his March 22, 1976, statement to the Ways and Means Committee, the Secretary presented the administration's position on revision of estate and gift taxation.[2]

The Ways and Means Committee reported a comprehensive tax reform bill, H.R. 10612, on November 12, 1975, and the House passed the bill

[1] See exhibit 33.
[2] See exhibit 36.

on December 4, 1975. The Senate Finance Committee reported its version of H.R. 10612 on June 10, 1976. After considerable amendment, the Senate approved the bill on August 6, 1976, and the conferees reached agreement on September 13, 1976. [Public Law 94–455, the Tax Reform Act of 1976, was approved by President Ford on October 4, 1976.] In addition to the tax cut provisions discussed earlier, the act:

Restructured and increased the present "add-on" type of minimum tax (adopted in lieu of the administration's proposals for an alternative minimum taxable income).

Restricted the amount of immediately allowable deductions in tax-shelter ventures in real estate, farming, oil and gas, movies, equipment leasing, and sports franchises.

Restructured the maximum marginal tax on "earned income."

Lengthened the holding period for long-term capital gains.

Liberalized the tax treatment of capital losses and the loss carryover.

Limited the deduction for nonbusiness interest.

Provided some tax simplification (and in some instances liberalized tax treatment) by restructuring the tax tables for individuals, the deduction for alimony, the retirement income credit, the child care deduction, the sick pay and military disability exclusions, and the moving expense deduction.

Tightened up the deduction for expenses attributable to the business use of homes, the rental of vacation homes, deductions for attending foreign conventions and for travel expenses away from home by State legislators, and the tax treatment of qualified stock options.

Terminated use of exchange funds as a capital gains tax avoidance device.

Restructured the throwback rules for distributions of accumulation trusts and the treatment of multiple trusts.

Restructured and extended the 10-percent investment credit.

Liberalized and restructured the tax treatment of employee stock ownership plans.

Extended the period for net operating loss carryover and restricted potential abuse.

Revised the tax treatment of foreign income of individuals, controlled foreign corporations and their shareholders, foreign taxes and the foreign tax credit, and Western Hemisphere trade corporations, China Trade Act corporations, and corporations operating in Puerto Rico and U.S. possessions.

Restricted tax benefits for taxpayers participating in international boycotts and bribe-produced income.

Restricted certain DISC benefits.

Provided new or revised rules for confidentiality and disclosure of tax returns and return information and for income tax return preparers, assessments, withholdings, and other administrative matters.

Provided tax incentives to encourage the preservation of historic structures.

Provided for establishment of individual retirement accounts for nonworking spouses.

Liberalized the limitation on contributions to certain H.R. 10 plans and retirement deductions for Armed Forces Reserves and National Guard.

Revised the treatment of private foundation set-asides and payouts.

Provided declaratory judgments regarding tax-exempt status of charitable organizations.

In addition, the 1976 act repealed and revised obsolete and rarely used provisions of the Internal Revenue Code. Almost 150 Code sections were repealed and deletions were made in about 850 other Code sections. The deletion of the so-called deadwood did not affect tax policy or result in substantive changes.

Secretary Simon in his December 3, 1975, speech at the annual conference of the Tax Foundation urged basic tax reform which would completely redesign and restructure the income tax to make it simple, equitable, and efficient.[3] [At the signing of the Tax Reform Act of 1976 on October 4, 1976, President Ford requested the Secretary of the Treasury to study the potential for restructuring and simplifying the present tax code and to report to him in December 1976.]

Energy tax program.—In fiscal 1976, the administration continued its initiative to enact tax and other measures related to energy. On July 8, 1975, Secretary Simon presented to the Ways and Means Committee the Labor-Management Committee's recommendations released by the White House on June 13, 1975. The proposals would revise the tax laws applicable to electric utilities by (a) increasing the investment tax credit to 12 percent for certain utility facilities; (b) permitting immediate investment credit on progress payments on construction; (c) extending 5-year amortization for pollution control facilities until 1981; (d) providing a 5-year amortization for costs incurred in converting from a petroleum-fueled generating facility; (e) permitting depreciation of construction progress expenditures during the construction period; and (f) allowing utility shareholders to defer taxes on reinvested dividends. The proposal regarding the investment credit and depreciation would apply only if the tax benefits are "normalized" for ratemaking purposes.

The President's state of the Union address in January 1976 renewed the request for action on an electric utilities program. In addition, the administration renewed its request for residential energy conservation credit that would stimulate homeowners expenditures for thermal effi-

[3] See exhibit 34.

ciency improvements such as storm doors and windows and insulation of existing homes. The administration also proposed treating, for a limited period, geothermal drilling and precommercial development expenditures as research and experimental expenditures to be immediately written off against income. The objective was to provide an incentive during development of geothermal projects. In testimony before the Senate Finance Committee on March 17, 1976, Secretary Simon renewed the administration's utilities tax proposals.[4]

Earlier, H.R. 6860, which provided a national energy conservation program, had been passed by the House on June 19, 1975 (Secretary's Annual Report for fiscal 1975). The Senate Finance Committee reported an amended H.R. 6860 on August 27, 1976. The amendments substituted several tax provisions designed to encourage greater energy conservation and efficiency and to stimulate development of alternative forms of energy to natural gas and oil. An increase in the gasoline tax of one-half cent per gallon for a 3-year period would increase revenues sufficiently to offset revenue losses from the tax incentives, some of which are administration proposals with modifications. The incentives would be directed at residential energy conservation and efficiency, at business investment in alternatives or supplements to the use of oil and natural gas, and other related energy development, use of equipment, etc. By the end of the period, no further congressional action had taken place, although some energy-related reform measures were included in the Tax Reform Act of 1976.

Capital formation.—During fiscal 1976, the administration proposed revision of the tax laws to mitigate the substantial bias under the income tax against savings and investment and against equity financing as compared with debt financing. On July 31, 1975, in testimony before the Ways and Means Committee, Secretary Simon proposed the integration of the corporation and individual income taxes. The intent was to encourage more equity investment by eliminating the burden of double taxation of dividend distributions by corporations. Double taxation would be eliminated by providing, in part, for a deduction at the corporate level for dividends paid out, in part, for a gross-up of dividends and a credit at the shareholder level for corporate taxes paid. The Ways and Means Committee organized a Task Force on Capital Formation to study the subject in detail and to report during the next Congress. In his testimony before the Senate Finance Committee on March 17, 1976, on tax revisions and tax cuts, Secretary Simon renewed these capital formation proposals, but on budgetary grounds recommended deferring a phase-in of the integration proposal until 1978.[4]

Estate and gift taxes.—During fiscal 1976, the administration proposed substantial estate and gift tax relief. The relief would (1) in the case of a

[4] See exhibit 35.

small business interest or a family farm liberalize the present provisions for installment payment of estate tax; (2) increase the estate tax exemption from $60,000 to $150,000; and (3) completely exempt transfers between spouses from estate and gift tax. The proposal for liberalization of the installment payment provisions was announced in the President's 1976 state of the Union address; the other aspects of the proposal were presented by Secretary Simon to the Senate Finance Committee on March 17, 1976, and to the House Ways and Means Committee on March 22, 1976.[5] On August 2, 1976, the Ways and Means Committee reported the bill, H.R. 14844, which would provide extensive revision of the estate and gift tax laws. The bill incorporated most of the administration's proposals. However, the Senate, which amended and approved the general tax reform bill, H.R. 10612, on August 6, 1976, included therein estate and gift tax revision amendments. Public Law 94–455, the Tax Reform Act of 1976, included higher estate tax exemptions, provided relief for smaller businesses in the form of more liberal valuation and tax payment methods, and more liberal tax-free transfers between decedent and spouse. In addition, the law imposed more capital gains taxes on inherited assets when sold and restricted tax avoidance of generation-skipping by limiting the use of trusts for that purpose.

Aiding State and local governments.—To make State and local borrowing more effective and equitable, the administration revised its taxable municipal bond proposal included in the April 1973 tax proposals. The revised bond proposal was presented by Under Secretary Yeo on January 21, 1976, in testimony before the House Ways and Means Committee.[5] The proposal is intended to broaden the market for State and local bonds by providing the option to local governments to issue taxable bonds. In addition, the proposal would eliminate the tax-exempt status of industrial development bonds. The Federal Government would pay an interest subsidy equal to 30 percent of the net interest expense on qualified State and local obligations on which the issuer agrees to pay federally taxable interest. On April 8, 1976, the House Ways and Means Committee reported on H.R. 12774, which would provide for a taxable bond option with a 35-percent subsidy of the interest yield, but the bill was not considered by the House.

Social security and railroad retirement.—To assure the future financial stability of the social security system, the President proposed in his 1976 state of the Union address, effective January 1, 1977, a payroll tax increase for employees and employers. The current social security tax rate is 5.85 percent for each employee and employer. Under this proposal, in 1977 the tax rate would be 6.15 percent on a maximum wage base of $16,500.

Social security legislation enacted in 1972 and 1973 provided for increasing automatically the maximum amount of annual earnings to be

[5] See exhibit 17.

taxed and credited toward old-age, survivors, disability, and health insurance. Automatic adjustments become effective January 1 of a given calendar year. The most recent increase became effective January 1, 1976, when the base was raised from $14,100 to $15,300. (The base will be $16,500 effective January 1, 1977.)

Public Law 94-202, approved January 2, 1976, provided for the institution of an annual wage-reporting system effective after 1977 for social security and Federal income tax purposes instead of quarterly wage reporting. Annual wage reporting will affect the determination of the annual taxable wage base subject to social security taxes. Beginning with the taxable wage base to become effective January 1, 1981, annual rather than quarterly "average earnings" will be used in the formula to determine the tax base.

Public Law 94-92, approved August 9, 1975, amends the Railroad Unemployment Insurance Act to increase unemployment and sickness benefits for railroad workers. The benefits increase is financed by an increase in the employing carriers' contribution rates beginning January 1976. No change is made in the amount of payroll ($400 per month) subject to the contribution rate. A sliding-scale tax rate schedule is provided which inversely relates the rate level to the balance of money in the railroad unemployment insurance account fund.

Unemployment compensation.—The unemployment compensation program is a Federal-State insurance system designed to provide temporary wage loss compensation to workers if unemployed. Funds accumulated from payroll taxes permit payment of benefits to unemployed insured workers. The Federal Government and the States impose employer payroll taxes. If a State law meets Federal requirements, employers receive a 2.7-percent credit against the 3.2-percent Federal payroll tax. The effective Federal tax therefore is 0.5 percent. The Federal tax is imposed on taxable wages defined as wages up to $4,200 per year.

H.R. 10210, the Unemployment Compensation Amendments of 1976, passed by the Congress on October 1, 1976, increases the limit on the Federal tax base and increases the tax rates primarily to replenish exhausted unemployment compensation funds. The taxable wage base limit is raised from $4,200 to $6,000, effective January 1, 1978. This change would require, in effect, that the States tax the first $6,000 of earnings (rather than $4,200). The net Federal payroll tax is increased temporarily from 0.5 percent to 0.7 percent, effective January 1, 1977, and will be reduced back to 0.5 percent after all advances to the Federal extended unemployment compensation accounts are repaid. [The President approved the act, Public Law 94-566, on October 20, 1976.]

Excise taxes.—Public Law 94-280, approved May 5, 1976, extended for 2 years, to September 30, 1979, the temporary excise rate increases and temporary taxes used to finance the highway trust fund.

Public Law 94–455, the Tax Reform Act of 1976, changed the tax on large cigars from a bracket system to specific rates based on the intended retail price to an ad valorem tax on 8 1/2 percent of the wholesale price. A number of regulatory excises, which were imposed many years ago such as the taxes on imported oleomargarine, white phosphorus matches, and adulterated butter were repealed by the "deadwood" part of the act as other laws now provide for controls over these products. The attachment of certain equipment to trucks was excluded from the definition of "further manufacture" while credit or refund of tax was provided for parts added to light-duty trucks in connection with the first retail sale.

Other legislation.—Public Law 94–81, approved August 9, 1975, provides for nonapplication of the depreciation recapture rules in certain tax-free liquidations involving tax-exempt organizations.

Public Law 94–202, approved January 2, 1976, amends the Code provisions regarding the collection of U.S. taxes on articles produced in the Virgin Islands and transported to the United States.

Public Law 94–236, approved March 19, 1976, provides that certain New York City pension funds may hold and acquire notes or bonds of the city of New York without being in violation of the "exclusive benefit" rules or prohibited transactions provisions.

Public Law 94–253, approved March 31, 1976, provides tax treatment for exchanges under the final system plan for the Consolidated Rail Corporation (ConRail).

Public Law 94–267, approved April 15, 1976, permits tax-free rollovers of distributions from employee retirement plans in the event of plan termination.

Public Law 94–331, approved June 30, 1976, permits a life insurance company to disregard a distribution during the last month of its taxable year, determined to have been made out of the policyholders' surplus account, if such distribution is returned to the company not later than the due date for filing its income tax returns (including extensions).

Public Law 94–396, approved September 3, 1976, changes the tax treatment of the gain on the lapse of options to buy or sell securities.

Public Law 94–401, approved September 7, 1976, permits a WIN credit not to exceed $1,000 paid or incurred by a taxpayer to an eligible employee whose services are performed with a child day care services program.

Public Law 94–414, approved September 17, 1976, changes the treatment of affiliated banks for purposes of common trust fund provisions of the Code.

Administration, interpretation, and clarification of tax laws

The Department of the Treasury, during fiscal 1976, issued 44 final regulations, 16 temporary regulations, and 45 notices of proposed rulemaking relating to matters other than alcohol, tobacco, and firearms taxes. The Department issued 10 final regulations and 13 notices of proposed rulemaking relating to alcohol, tobacco, and firearms taxes. In addition, it published a discussion draft of proposed regulations on the taxation of fringe benefits and issued a revision of the Internal Revenue Service's Statement of Procedural Rules. Two of the final regulations, 13 of the temporary regulations, and 14 of the notices of proposed rulemaking were issued under the Employee Retirement Income Security Act of 1974.

During the transition quarter, the Department issued 12 final regulations, 2 temporary regulations, and 10 notices of proposed rulemaking relating to matters other than alcohol, tobacco, and firearms taxes. Three of the final regulations, both of the temporary regulations, and three of the notices of proposed rulemaking were issued under the Employee Retirement Income Security Act of 1974. In addition, there were six final regulations and two notices of proposed rulemaking to alcohol, tobacco, and firearms taxes.

Among the subjects dealt with in these regulations and proposed regulations were: The tax credit for purchase of a new principal residence, social security taxes, domestic international sales corporations, industrial development bonds, participation and vesting requirements for qualified pension plans, percentage depletion, the provision of joint and survival annuity benefits by a qualified pension plan, qualification as a custodian for individual retirement accounts and qualified pension plans, tax treatment of long-term contracts, capital construction funds for vessels, the definition of a medical research institute, the investment credit for movies, the 1975 tax rebate, child care expense deduction, personal exemption credit, the foreign tax credit, the farm recapture provisions, employee stock ownership plans, retroactive amendments to qualified employee benefit plans, and current taxation of shipping profits.

DISC report

Pursuant to the Revenue Act of 1971, the Treasury submitted to the Congress its third annual report on the operation and effect of the DISC legislation. The report covered DISC year 1974 (essentially calendar year 1973).

Tax treaties

Bilateral income tax treaties with the U.S.S.R., Poland, Romania, and Iceland were ratified in fiscal 1976 and are now in force. Income tax treaties with Israel, Egypt, the United Kingdom, and Korea were signed during the year and have been submitted to the Senate for approval. Income tax treaties with the Republic of China (Taiwan) and the Philippines are approaching completion. Negotiations and technical discussions on income tax treaties were conducted with Brazil, Canada, Hungary, India, Spain, and Yugoslavia, and estate tax treaty discussions were held with Germany. On May 18, 1976, the Treasury issued a press release listing all countries with which income tax treaty discussions were in various stages of progress, and releasing the text of the current model income tax treaty.

Participation in international organizations

Treasury representatives participated in the work of the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development (OECD), including membership on a number of working parties of the Committee. Treasury representatives also attended the annual general assembly of the Inter-American Center of Tax Administrators (CIAT), the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, sponsored by the United Nations, and the UNESCO conference on the taxation of copyright royalties.

Treasury representatives appeared before a panel convened under the General Agreement on Tariffs and Trade to defend the DISC provisions.

INTERNATIONAL AFFAIRS

Trade and Raw Materials Policy

Fiscal 1976 was a transitional period for the international trade community. The world economy, led by the United States and other major industrial countries, began to recover from the most severe recession since the 1930's. The developed and developing countries held extensive consultations and devoted a substantial amount of effort to formulating policies that would convert this recovery into a sustained economic expansion. A major goal of these efforts was to assure that a free and open world trade environment prevails so that the increased benefits to be derived from such a system can be shared by all.

From 1974 through late 1975 growth of the global economy and, in turn, world trade was severely depressed. The real output of the major industrialized nations fell suddenly and sharply and the volume of world trade declined for the first time since World War II. Significant pressures were experienced by countries with domestic and balance of payments problems to adopt protectionist measures. The emerging recovery and the extensive international consultations relieved these pressures to some extent. However, serious problems remain. A significant increase in energy prices could, for example, substantially undermine the economic progress made by Western economies thus far, developed as well as developing countries alike, and thereby lead to renewed pressures for protectionism.

The Department of the Treasury has played an active and substantive role in dealing with international trade issues during fiscal 1976. In close cooperation with the executive departments, Treasury has worked hard to promote a free and open international trading system.

Response to protectionism

Despite significant pressures created by the global economic decline and increased energy prices there was not a general retreat toward protectionist measures during fiscal 1976. There were, however, exceptions to this norm. A number of countries, both developed and developing, which were experiencing serious balance of payments and internal problems, instituted trade restrictive measures. These measures included quantitative restrictions, import surcharges, prior import deposit schemes, and tariff rate quotas. Fortunately, for the most part, these measures were not extensive in their coverage and were temporary in nature.

During fiscal 1976, the United States was in the forefront in opposing the introduction of new or the intensification of existing restrictive trade practices. Our leadership was demonstrated by the active role the United States played in the economic summit conferences in Rambouillet[1] (November 1975) and Puerto Rico[2] (June 1976). At both conferences the United States stressed the close relationship between international trade and national economic policies, the need to ensure greater stability in world economic and financial conditions, and opposition to measures which would distort trade and lead to a resurgence of protectionism.

With these objectives in mind, the participants of the Rambouillet summit (the United States, France, Britain, Japan, West Germany, and Italy) agreed that the current multilateral trade negotiations (MTN) should aim at achieving substantial tariff cuts, even eliminating tariffs in some areas, at significantly expanding agricultural trade, and at reducing nontariff measures to provide for a maximum possible level of trade liberalization.[3]

The United States received authority to enter into negotiations with the passage of the Trade Act in January of 1975. Following passage of the act the MTN were able to progress from a largely preparatory stage to a substantive negotiating stage.

The major industrialized countries have agreed in principle to attempt to conclude the current round of negotiations by 1977. Substantial progress was made during fiscal 1976 toward this goal; however, in the coming year greater efforts must be made if we are to complete the negotiations by 1977. Thus far the United States has been a strong, positive motivating force in the MTN, encouraging progress toward a liberalization of trade. We will continue to press for progress in these negotiations, advocating freer and more open trade.

[1] See exhibit 51.
[2] See exhibit 60.
[3] See exhibit 39.

The United States, in June of 1976, also joined with other members of the Organization for Economic Cooperation and Development (OECD) to reaffirm the OECD trade pledge for the second consecutive year. The pledge represents a mutual commitment by signatories to avoid the imposition of trade or other current account restrictions for balance of payments reasons. The U.S. call for a renewal of the pledge emphasized the interdependence of the world economic system, the need for cooperation, and the need to adopt policies that would assure free and open world trade. The United States also stated its intention to work within the OECD and other international organizations for the complete liberalization of trade for the benefit of all nations.

U.S. commodity policy

The U.S. international commodity policy was elevated to a new level of recognition during 1975–76 with wide-ranging and positive policy initiatives pursued by officials of Treasury, State, and other agencies in a number of important international fora. U.S. international commodity policy, which was formulated under State-Treasury leadership within the interagency framework, was first enunciated by Secretary Kissinger at Kansas City in May 1975. Then, at the U.N. Seventh Special Session in September 1975 he proposed a set of policy initiatives including: Establishment of a producer-consumer forum for every key commodity to discuss ways to improve the efficiency, growth, and stability of commodity markets; creation of a development security facility in the IMF to provide developing countries compensatory financing assistance for shortfalls in their export earnings; a "major international effort" to promote the development of raw material resources in developing countries; and proposals to increase food production in developing countries, food aid to those countries, and world food security through a system of grain reserves.[4]

The first major task of the interagency Commodity Policy Coordinating Committee (CPCC), which was established at the Assistant Secretary level in December 1975 and is jointly chaired by Treasury and State, was to formulate a "Comprehensive Approach to Commodity Policy."[5] The final program formulated by the CPCC was a forthcoming set of proposals designed to coordinate U.S. participation in a number of important international fora during the coming year. It was aimed at finding constructive means to fulfill many of the objectives put forth in the UNCTAD Secretariat's October 1975 proposed "Integrated Program," which is widely supported by developing countries, and at fulfilling objectives agreed upon by developed countries.

The first of the major international fora in which the United States participated during 1976 was the Conference on International Economic Cooperation (CIEC) at Paris, which was organized by Ministers of

[4] See exhibit 38.
[5] See exhibits 40 and 43.

developed and developing countries, to begin an intensified North-South dialog. The Ministers established 4 commissions (Energy, Raw Materials, Development, and Financial Affairs), each consisting of 15 members, 10 from developing countries and 5 from industrialized countries. Treasury was designated as the lead agency for the Financial Affairs Commission and took an active role in the other commissions. The Commission on Raw Materials (CORM) examined problems in commodities and the range of possible solutions to these problems. The CORM met in February, March, April, June, and July 1976 to discuss investment, trade, production, buffer stock arrangements, and compensatory financing for developing countries suffering balance of payments difficulties, and will meet again in October and November to develop recommendations for followup action in other fora. The December Ministerial meeting will attempt to resolve remaining differences in agreed resolutions based on these recommendations.

The United States and other IMF members implemented the proposal to liberalize provisions of the existing IMF compensatory financing facility. The United States also recommended setting aside part of the new IMF trust fund for concessionary loans or grants to the poorer developing countries, which were highly dependent on commodity exports and which suffered shortfalls on export earnings. That proposal was not accepted by other members of the IMF, however. The revised IMF compensatory financing facility has drawings already authorized this year totaling nearly SDR 1.7 billion during the period 1966–75. Drawings by developing countries this year have amounted to SDR 1.1 billion.

Another major focus for the North-South dialog on commodity issues was the Fourth United Nations Conference on Trade and Development at Nairobi, Kenya, in May 1976. In a spirit of cooperation with developing countries, the United States, with some reservations, joined in the consensus on the UNCTAD IV Resolution on Commodities. By doing so, the United States agreed to participate in preliminary commodity meetings to determine the nature of problems affecting commodities and to examine, without commitment, measures which might be appropriate for each product. The United States participated in the first of these meetings, on copper, in September 1976 and will participate in meetings for other commodities during late 1976, 1977, and early 1978. Although many countries see these conferences leading directly to negotiations of commodity agreements, the United States has made no prior commitment to participate in any such negotiations.[6]

The United States also agreed, by signing the Nairobi Resolution, to participate, without any commitment, in preparatory meetings to examine whether further arrangements for financing buffer stocks, including common funding, are desirable. After they have taken place, the United

[6] See exhibit 43.

States will decide whether to participate in the negotiating conference for a common fund, scheduled for March 1977.

Another U.S. policy initiative called for in the "Comprehensive Approach" was the International Resources Bank (IRB) proposal, which was refined following its rejection at UNCTAD IV[7] and which has received increasing support, especially from other industrial countries. The basic functions of the IRB would be to: Mobilize and encourage the flow of foreign capital, management, and technology to raw material projects in developing countries, when participants in projects invite IRB assistance; encourage adherence to standards of equity and observance of contractual undertakings by host countries and private companies participating in resource projects; and minimize political obstacles to achieving the rational international allocation of capital investment in raw material resources by providing an international mechanism for political risk. The IRB proposal is scheduled to receive further discussion in the Raw Materials Commission of CIEC. The IMF/World Bank Development Committee has agreed to consider studying the IRB proposal and the feasibility of including it in the World Bank group.

The U.S. Government believes that free operation of commodity markets is preferable to agreements and other mechanisms that regulate markets. It is, however, ready to consider specific proposals for commodity agreements, on a case-by-case basis, where they can improve the operation of the market. In some cases, we have found commodity agreements appropriate and not detrimental to U.S. economic interests. For example, in September 1976 the Senate approved U.S. participation in the Fifth International Tin Agreement, which went into force on July 1, 1976. In addition, the Senate ratified in August 1976 U.S. participation in the Third International Coffee Agreement, effective on October 1, 1976, and an extension of the International Wheat Agreement. We have also agreed to participate in the negotiations of a new international sugar agreement. In other cases, we found that commodity agreements were inappropriate, as, for example, in the case of cocoa.

In addition to working with the United States and other developed countries in a number of international fora, developing countries have sought to improve their economic position by means of groups comprised entirely of developing countries. However, international producer associations during the 1975–76 period generally failed to advance their goal of increasing commodity prices for the sole benefit of the developing countries.

Agricultural commodity developments

Coffee.—The new International Coffee Agreement is an improvement over previous agreements, but it still contains provisions such as producer

[7] See exhibit 72.

country export quotas, that may be troublesome. However, during the current period of coffee shortage and high prices the quotas are suspended. Moreover, in the event that quotas do become effective, the agreement does contain provisions to assure flexibility in the assignment of quotas based on export performance and the level of individual country stocks of coffee. Therefore, new and more efficient producers will not be unduly discriminated against. Treasury played a major role in assessing the likely economic impact of the old ICA. On the basis of this assessment, the United States successfully negotiated additional protection for consumers.[8]

Wheat.—The United States has also long been a member of the International Wheat Agreement. U.S. ratification of the extension of the IWA until June 30, 1978, was important to the continuation of ongoing discussions of proposals for an international system of grain reserves. The IWA currently has no economic provisions—they have been suspended since 1971—but the council does serve as an effective framework for the exchange of information and the coordination of food aid.[8]

Grain reserves.—The United States has proposed, in the London discussions, a system of internationally coordinated nationally held grain reserves to enhance world food security. Participating countries would be required to accumulate or draw down their reserve stocks of grain in response to production above or below trend respectively. There would be no direct relation between prices and reserve stock management. The burden of holding reserves would be borne by developed country exporters and importers. Access to reserves would be denied nonparticipants. Discussions on grain reserves proceeded at a slow pace as other countries have explored reserve proposals containing price provisions and the feasibility of shifting discussions to other fora. The United States resisted both of these initiatives.

Grain sales.—In another area of agricultural commodity policy, the United States completed negotiations with the Soviet Union for a 5-year grain sale agreement, effective on October 1, 1976. Under the terms of the agreement, the U.S.S.R. agreed to purchase a minimum quantity of 6 million metric tons of U.S. wheat and corn per year. Additionally, options allowing purchases up to 8 million tons per year and providing for consultations before purchases above 8 million tons were also included. Treasury supported the U.S.-U.S.S.R. agreement because it does eliminate some of the uncertainty surrounding Soviet grain import requirements and the market disruptions associated with the large, unpredictable Soviet grain purchases in the past. Because of the uniqueness of the Soviet situation and the greater market efficiency achieved through the grain sales agreement, Treasury supported the agreement.

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[8] See exhibit 43.

Cocoa.—Negotiations of the Second International Cocoa Agreement, which the United States chose not to join, were also conducted during fiscal 1976. A thorough evaluation of potential costs and benefits of the agreement showed that it was unworkable and that the export quota provision would be a serious threat to normal market operations.

Rubber.—After working on a price stabilization scheme throughout most of 1975–76, the Association of Natural Rubber Producing Countries submitted a proposal at the June 1976 International Rubber Study Group meeting. However, the proposal was a statement of general objectives and principles and did not include a description of the mechanisms of the scheme and how they might work. The leading natural rubber producers are expected to ratify a specific stabilization agreement in November 1976.

Bananas.—The Union of Banana Exporting Countries (UPEB), whose charter was provisionally approved in 1974, was formally established in Panama on January 23, 1976. However, Ecuador, the world's largest exporter, remains outside the group. A major goal of UPEB is the establishment of an international banana agreement with production goals and an export quota system.

Mineral commodity developments

Tin.—In September, the Senate ratified U.S. participation in the Fifth International Tin Agreement.[8] This is the first Tin Agreement the United States has joined and the decision was based on an interagency analysis of the impacts on the U.S. economy. The Fifth Tin Agreement and U.S. participation in it is expected to reduce price fluctuations, foster stable supplies, and reduce fluctuations in developing country export earnings from tin.

Bauxite.—The 11 members of the bauxite producer group, the International Bauxite Association (IBA), at their meeting in November 1975, failed to approve a minimum pricing policy and instead recommended that IBA producers adopt minimum price levels. Individual bauxite producers continued in 1975–76 to attempt to raise export earnings, within the loose cooperative framework of the IBA, through increased export taxes or renegotiation of contracts with aluminum companies.

Copper.—In June 1976, the Conference of Ministers of the Intergovernmental Council of Copper Exporting Countries (CIPEC) failed to reach agreement on a way of either continuing, eliminating, or phasing out its 15 percent export restriction. As a consequence, the CIPEC provision for export restrictions expired June 30.

Iron ore.—In October 1975, the Association of Iron Ore Exporting Countries (AIOEC) was formally inaugurated at a Ministerial meeting in London and disclaimed any intention of functioning as an iron ore cartel.

[8] See exhibit 43.

Law of the Sea

Treasury representatives served on the U.S. delegation to the third U.N. Law of the Sea Conference. The Conference, which held a spring and summer 1976 session in New York, has endeavored to draft a single comprehensive treaty package which will include a judicial system, fish conservation, navigation, marine pollution, marine scientific research, coastal states rights, and deep ocean mining. The United States has important objectives in all of these areas. No one of them can be compromised in order to achieve progress in another. The revenue sharing, resource and commodity policy issues implicit in the deep ocean mining provisions of the Conference are particularly difficult, and, unless settled satisfactorily, could prevent agreement on a package.[9] Treasury has endeavored to ensure that the final treaty package is consistent with the U.S. commodity policy of permitting the efficient production of resources.

The developing countries have also taken the position that only the operating arm of the proposed International Seabed Authority, the Enterprise, should have the guaranteed right to conduct mining activities. As a compromise, in 1975, the developed nations, both capitalist and Socialist, proposed the establishment of a parallel system of exploitation. Under this system, all states and their publicly or privately owned mining companies would have assured access to the seabed along with the Enterprise. The developed states also agreed to set aside half of the known mine sites for the Enterprise and the developing countries.

Many developing countries have expressed doubts about the parallel system on the grounds that it did no good to set aside part of the mine sites for the Authority if it did not possess the financial resources or the technology to exploit these sites. In view of this concern, at the summer 1976 session in New York, the U.S. Government informed the Conference that we would be prepared to agree to a means of financing the Enterprise so that it could begin mining operations in the same time frame that state and private operators began operations.

Prior to the next session, in May of 1977 in New York, Treasury and the U.S. delegation will be working closely with other countries to finalize this proposal. It is expected that all states which join the Authority will help to finance the Enterprise. Profits from the Enterprise will be used to assist developing nations. That session will determine if indeed it is possible to negotiate a "package" treaty. Meanwhile, Congress will be considering unilateral legislation that would assure U.S. firms' rights to mine the deep ocean will be protected.

East-West trade

Progress in the development of U.S. commercial relations continued in fiscal 1976, despite the legislative restrictions on the normalization of

[9] See exhibit 41.

East-West trade relations contained in title IV of the Trade Act of 1974 and the Export-Import Bank legislation of 1974. The total turnover of U.S. trade with Communist countries in 1975 was $3.98 billion, up substantially from the 1974 total of $3.24 billion.

The East-West Foreign Trade Board, established by the President on March 27, 1975, with Secretary Simon as Chairman and Assistant Secretary Parsky as Executive Secretary, met several times during the year. During the brief period the Board has been in existence, it has dealt with numerous questions of significant importance to the development of East-West trade. The most persistent of these has been the normalization of U.S. commercial relations with the U.S.S.R., the nonmarket economy countries of Eastern Europe, and the People's Republic of China.[10] Among other activities, the Board and its working group have closely monitored the purchases of grain by the Soviet Union over the past year and a half as well as the negotiation of the U.S.-U.S.S.R. Long Term Grain Sales Agreement which was concluded in October 1975, entered into force on October 1, 1976, and will run to September 30, 1981. The Board, at the request of the Board of Directors of the Eximbank, has also provided policy advice concerning proposed Eximbank financing of projects in the nonmarket economies.

On June 2, 1976, President Ford forwarded to the Congress his recommendation that Congress approve extension of the waiver authority as provided in section 402 of the Trade Act of 1974, allowing the United States-Romanian trade agreement to remain in force for another year. Congress, by not voting in either House against extension, allowed the agreement to remain in force.

Secretary Simon, as honorary Director, attended the annual meeting of the Board of Directors of the U.S.-U.S.S.R. Trade and Economic Council in October 1975. In June 1976, the Secretary visited Poland and Romania for wide-ranging meetings with Ministers responsible for economic affairs. While in Poland the Secretary participated in the exchange of instruments of ratification of the convention on the avoidance of double taxation.[11] In Romania Secretary Simon participated in the opening of the third session of the U.S.-Romanian Economic Council and delivered a message of support from President Ford.

Investment and Energy Policy

During 1975 and 1976, the United States continued its efforts to maintain a favorable climate for international investment. As a result of these efforts, the Organization for Economic Cooperation and Development (OECD) adopted a declaration designed to promote a stable and open environment for international investment. The United States also

[10] See exhibit 37.
[11] See exhibit 42.

proposed that the OECD undertake an exercise designed to reduce impediments to international flows of portfolio capital. There have also been domestic and international initiatives in which Treasury participated to develop procedures to curb illicit payments in international commerce. Additionally, the benchmark survey of foreign investment in the United States was completed, and the Committee on Foreign Investment in the United States considered several proposed investments.

The Treasury's role in the development of a comprehensive energy policy primarily focused upon economic and financial issues, from both a domestic and international perspective. This focus included concern over capital formation and financing problems in developing new sources of energy. In addition, the Department has been involved with the issues of recycling surplus financial reserves of the oil-producing countries, the economic problems of energy deficient developing countries, and other international trade and financial aspects of energy resources.

Several legislative measures have been enacted which contributed to our national and international energy policy. These measures have included provisions for a national strategic petroleum reserve; standby allocation, rationing, and other authorities for use in the event of an emergency; development and production of the Naval Petroleum Reserves; price decontrol of selected products and gradual decontrol of crude oil prices; and several energy conservation programs. These provisions will assist in reducing our energy vulnerability.

International investment

Foreign Portfolio Investment Study.—Pursuant to the Foreign Investment Study Act of 1974, the Treasury and Commerce Departments completed their respective studies of foreign portfolio and direct investment in the United States and have reported their results to Congress. Each study consisted of a benchmark statistical survey and analysis and research into various aspects of foreign portfolio and direct investment in the United States.

The term "foreign portfolio investment" generally refers to foreign investments in U.S. securities that do not involve any significant influence on the management of the enterprise. The definition used for the purpose of this study covers investments in the United States in voting stocks involving less than 10 percent ownership by the foreign investor, in nonvoting stocks, and in debt instruments with maturities of more than 1 year by persons residing in foreign countries (other than nonvoting stock and debt owned by a "direct investor"). It should also be noted that the term "foreign" includes U.S. nationals residing abroad and excludes foreign nationals residing in the United States.

Among the highlights of the survey,[1] an important finding was that for various reasons foreign portfolio holdings of U.S. stocks were about 37

[1] See exhibit 47.

percent higher than previously estimated. However, considering the long period of time—33 years—since the previous benchmark, the differences between the survey results and the previous estimates suggest that the conceptual and institutional structures of our current reporting systems are adequate.

International Investment Survey Act of 1976.—In October 1976 the President signed legislation which broadens the U.S. Government's existing authority for collection of data on foreign investment in the United States and U.S. investment abroad. The act also mandates that benchmark surveys for foreign portfolio and direct investment in the United States and for direct investment abroad be undertaken every 5 years and that a one-time survey of U.S. portfolio investments abroad be undertaken.

Proposed International Banking Act of 1976.—This bill (H.R. 13876) was proposed by the House Committee on Banking, Currency and Housing to provide for Federal regulation of foreign banks operating in the United States. The bill passed the House by a large margin, but, because of several controversial features in the bill, the Senate took no action. The issue of foreign bank regulation is expected to be taken up by the 95th Congress.

H.R. 13876 would have had far-reaching effects on the operations of foreign banks in the United States. Some provisions of the act would have provided increased operating authority for foreign banks, while others would have subjected them to increased Federal regulation or supervision similar to existing regulations on large, domestically owned banks.

Treasury testified for the administration in support of the bill with certain modifications where it was felt that no added protection of U.S. interests would result or where certain provisions might lead to retaliation on the extensive activities of U.S. domestic banks operating abroad.

Committee on Foreign Investment in the United States.—During this 15-month period, the interagency Committee on Foreign Investment in the United States, established in May 1975 under the chairmanship of Treasury to monitor and to coordinate the formulation of U.S. policy on foreign investment here, considered a number of issues in this area. Several included investment proposals that the Committee examined pursuant to its specific responsibility of reviewing foreign investments in this country which might have major implications for the U.S. national interests. One was the joint venture of the Government of Romania and the Island Creek Coal Co., a subsidiary of the Occidental Petroleum Corp. Another was the bid by Societe Imetal, a French firm, to take over Copperweld Corp. A third was the proposed investment by the Government of Iran in the Occidental Petroleum Corp. In each of these cases the Committee decided that it had no objection to the proposed transaction.

Among the other functions the Committee performed was the coordination of executive branch positions on the International Investment Survey Act of 1976 (Public Law 94–472). The Committee also served as a forum for interagency discussion of questions that have arisen in international negotiations.

OECD investment package.—On June 21, 1976, the member governments of the OECD (except Turkey) jointly adopted a Declaration on International Investment and Multinational Enterprises, which consists of a package of instruments designed to promote a stable and open environment for international investment.

The OECD Declaration addresses three areas of concern regarding international investment. First, the member countries declare that they should treat foreign investors no less favorably than they treat domestic enterprises in similar circumstances. Secondly, they agree to minimize possible damage to other member countries of official incentives or disincentives to foreign direct investment. Finally, they recommend guidelines for the behavior of multinational enterprises, including expectations regarding disclosure of information, financing, competitive practices, taxation, employment and industrial relations, illicit payments, and the transfer of technology. Along with this, they state their general responsibilities toward multinational enterprises (MNE's), for instance, to treat them in accordance with international law.

U.N. Commission on Transnational Corporations (TNC's).—The Commission on TNC's decided at its second meeting in Lima, Peru, in March 1976 to attach high priority to the formulation of a code of conduct. Early in 1977, an intergovernmental working group will begin discussions aimed at producing an annotated outline to serve as a basis for discussion of the code.

Other tasks the Commission will undertake include the following: (1) Establishment of a comprehensive information system; (2) research on the political, economic, and social effects of the operations and practices of MNE's; (3) organization of a technical cooperation program; and (4) work leading to a definition of MNE's.

U.S. proposal in the OECD Committee on Financial Markets.—In order to further liberalize international flows of portfolio capital, Secretary Simon proposed at the OECD Ministerial meeting on June 22, 1976, that the Committee on Financial Markets be charged with identifying the various obstacles to international flows of portfolio capital and establishing a procedure for consultations with a view toward reducing such impediments.

A U.S. note on the proposal was circulated to delegations in the Committee. It noted that there are various kinds of impediments to capital flows in addition to official restrictions, which are currently reviewed in connection with country observance of the OECD Code of Liberalization of Capital Movements. Many procedures and requirements established by the private financial communities in major capital markets may have inhibiting effects on international flows of portfolio capital.

The program proposed by the United States envisions a measured three-step effort: (1) Identifying impediments to international flows of portfolio capital, (2) explaining the rationale for each impediment, and (3) discussing how particular impediments may be reduced or eliminated. The Committee is to consider the U.S. proposal at its November 4–5, 1976, meeting.

Questionable corporate payments abroad.—Among the provisions of the Declaration on International Investment and Multinational Enterprises adopted in June 1976, the OECD member countries made recommendations to MNE's regarding illicit payments, at the suggestion of the United States. It is stated in the guidelines for MNE's that enterprises should not render—and they should not be solicited or expected to render—any bribe or other improper benefit, direct or indirect, to any public servant or holder of public office.

In March 1976 the United States proposed that a comprehensive international agreement to curb corrupt practices in international commerce be negotiated in the United Nations. Subsequently, the Economic and Social Council took action by establishing an intergovernmental working group on the problem. The group is charged with examining the problem of corrupt practices and elaborating in detail "the scope and contents of an international agreement to prevent and eliminate illicit payments * * * in connection with international commercial transactions." The first meeting of this group is scheduled for October 1976 and it is expected to report back to the Council at its session in the summer of 1977.

The U.S. proposal would provide for an agreement that would deal not only with those who offer illicit payments but with those who solicit and receive them as well.

In March 1976, President Ford established a Cabinet-level Task Force on Questionable Corporate Payments Abroad to conduct a coordinated review of the problem of bribery and to recommend any new actions it might consider necessary. The task force, of which Secretary Simon is an active member, explored the nature and extent of the illicit payments problem and reviewed the activities of the U.S. Government agencies that were dealing with it. As a result of that investigation, a number of options were submitted to the President to supplement existing measures.

In June 1976, the President announced that he had directed the task force to prepare legislation to require reporting and disclosure of certain payments by businesses to foreign governments. The task force drafted the Foreign Payments Disclosure Act, transmitted by the President to Congress on August 3, 1976.

The bill requires reporting to the Department of Commerce of certain classes of payments made by U.S. businesses and their foreign subsidiaries and affiliates in relation to business with foreign governments. It covers a broad range of payments relating to government transactions, as well as political contributions and payments made directly to foreign public officials. The bill was not acted upon by Congress in the last session, but is expected to be given a full hearing in the next session.

International investment and capital flows (OPEC investors)

The financial reserves accumulated by the oil-exporting countries, which generated considerable public and congressional interest following the quadrupling of oil prices, continue to be a source of sizable inflows to the U.S. capital markets. Of the estimated $42 billion in total accumulations by the Organization of Petroleum Exporting Countries (OPEC) in 1975, about $10 billion was invested in the United States in both long- and short-term instruments. In contrast to the investment patterns of the oil-exporting countries in 1974 and early 1975, there has been a trend toward longer term holdings in the United States. Approximately 60 percent of flows into the United States in 1975 were in long-term banking and portfolio investments. In the first 6 months of 1976, long-term investments in the United States by the oil-exporting nations were increasingly in Treasury bonds and notes and were well ahead of last year's pace. Oil-exporting country purchases of U.S. stocks this year, at $1.1 billion through June, were also ahead of last year's purchases. Treasury interprets this preference for longer term investments as an expression of confidence in the security and profitability of investments in the United States.

International Energy Agency (IEA)

As a result of the 1973 Arab oil embargo, 19 industrialized oil-consuming countries established the IEA to help coordinate their international energy policies. The goals of these policies are to reduce dependence upon imported oil through conservation, accelerated development of indigenous resources, and shared research and development. To meet supply emergencies, the IEA updates methods to restrain demand and share existing supplies equitably. Treasury participated in meetings of the Governing Board and in the Standing Groups on Emergency Questions, Long-Term Cooperation, and the Oil Market.

Standing Group on Emergency Questions.—Progress was made in developing procedures necessary to implement the sharing of fuel assets in emergencies under terms of the agreement. The Emergency Management Manual, completed in preliminary form, reflected all of the basic decisions, goals, and procedures for emergency operations. Tests were successfully run on processing data which would be needed under emergency conditions. Plans were also completed for the full-scale testing of all emergency procedures later this year.

Standing Group on Long-Term Cooperation.—Agreements have been made to facilitate cooperation among IEA members in solving energy supply and demand difficulties. Treasury participated in several international working groups developing guidelines for energy investment incentives, for the joint international research efforts, and for the implementation of the minimum safeguard price.

Standing Group on Oil Market.—Treasury has participated in this group and in particular in its Ad Hoc Working Group on Capital Investment and Financial Structure. This group is undertaking an evaluation of the feasibility of forecasting the energy industry capital requirements for OECD countries, and the ability of the industry to finance such capital investments.

Conference on International Economic Cooperation (CIEC)

The dialog between the industrialized nations of the North and the developing nations of the South took a major step forward in December 1975 with the establishment of the CIEC.[2] The CIEC involves 27 representatives from developed countries and oil and nonoil developing countries and carries a 1-year mandate "to initiate an intensified international dialog on the international economic situation, to address problems, and to further international economic cooperation for the benefit of all countries and peoples." Due to its limited participation and generally less formal procedures, the CIEC has proven to be a useful forum for discussing a large variety of international issues of mutual concern.

Discussions in the CIEC are taking place simultaneously in four different commissions: The Energy Commission, the Raw Materials Commission, the Development Commission, and the Financial Affairs Commission. Following are brief accounts of the work conducted so far in the individual commissions.

Energy Commission.—Treasury participated actively in the Energy Commission, which provides the only formal mechanism for oil producers, consumers, and developing nations to try to strengthen cooperation and develop common goals and solutions to the world's energy problems.

The Commission's work has been divided into two phases. The first phase, analytical in nature, was completed in July and considered, among other issues, the effects of higher oil prices on the world economy and the problems of effecting a smooth transition from a hydrocarbon-based economy to one based increasingly on alternative energy sources. Treasury participated in the work of this phase, including work on the effects of the 1974–75 oil price increases on the U.S. economy and the energy deficient developing countries. In addition, Treasury participated in the development of a U.S. proposal for an International Energy Institute, designed to bring technical and managerial expertise to assist in the development of world energy resources, particularly the indigenous resources of the energy deficient developing countries.

Raw Materials Commission.—During the first half of 1976, the Raw Materials Commission reviewed a number of issues related to the raw materials industry especially as they relate to the developing countries.

[2] See exhibit 44.

The two most predominant issues were (1) access to developed country markets for LDC exports of raw materials and processed products and (2) the purchasing power of the LDC's resulting from raw materials exports. The United States has been generally sympathetic with LDC efforts to increase their access to markets of developed countries. The United States has urged the LDC's to solve their problems of purchasing power by diversifying their productive base and increasing their production. The LDC's have been promoting the indexation of raw material prices to the prices of the exports of developed countries as a means of protecting their purchasing power. The United States strongly opposes this approach as inefficient and impracticable.

The adoption of the Resolution on Commodities (An Integrated Program for Commodities: UNCTAD 93 (IV)) at Nairobi in May of 1976 has in large measure overtaken the work of the Raw Materials Commission. However, the LDC's in the Commission are intent on using it as a forum to persuade the developed countries to react more favorably toward the LDC-sponsored solutions to raw material problems, especially during discussions under the Integrated Program which will take place through the end of 1978.

Development Commission.—The Development Commission was established "to facilitate arrangements which seem desirable in the area of cooperation for development." Specifically, the Commission has explored a varied list of development-oriented issues: Trade, balance of payments, food and agriculture, infrastructure, transfer of resources, industrialization, transfer of technology, foreign investment, and the poorest developing countries. Increasingly, the agenda item "transfer of resources" has assumed a dominant position in the Development Commission's deliberations since two key interests of the developing countries, indebtedness (also discussed by the Financial Affairs Commission) and official development assistance, are included under this item. The March 1976 session of the Development Commission produced the first so-called "energizing" document of the Conference, a brief, noncontroversial statement of consensus on the International Fund for Agricultural Development, calling on all countries in a position to contribute to the Fund to inform the U.N. Secretary-General before April 15 of the amounts of their initial contributions.

Financial Affairs Commission.—The Financial Affairs Commission has held substantive discussions on such topics as world balance of payments trends, the financing of developing country payments deficits, treatment of the financial assets of oil-producing nations, private direct investments in developing countries, access of developing nations to capital markets, and the debt situation facing developing nations.

The foreign indebtedness of nonoil LDC's has surfaced as one of the principal concerns in the Financial Affairs Commission's discussions, as nonoil developing countries have pressed for acceptance of generalized debt relief. While the United States may provide debt relief for individual developing countries in cases of actual or imminent default, the United States does not subscribe to the use of debt relief as a development assistance measure nor to the application of generalized debt-relief or similar schemes for groups of developing countries.

In examining the overall financial situation in nonoil LDC's, the United States has acknowledged the transfer of resources to these nations as a critical issue in the dialog. In this regard, the United States not only has examined debt and development assistance issues but has pursued efforts that will improve LDC access to capital markets and has studied various proposals which can lead to more direct investment in nonoil LDC's.

Energy policy

The energy crisis has created intense and detailed interest by the public and the Congress. Some progress has been made in implementing a national energy policy, but it is not complete. Treasury officials have responded to congressional and public inquiries and invitations to speak at hearings presenting their views on a wide range of energy issues and energy-related legislation and regulatory policy. Treasury's participation in the Energy Resources Council involves analysis and recommendation of options for our national energy policy. In particular, Treasury's interests have centered on the financial and economic aspects of energy availability, as well as the area of taxation. Analyses have been made in such major energy policy areas as financing synthetic fuels development, uranium enrichment through competitive private programs, effects of dismemberment of the major oil companies, deregulation of natural gas, options for transporting Alaska natural gas to the lower 48 states, and energy taxes.

Synthetic fuels.—Treasury participated in the effort to promote the development of synthetic fuels through analysis of the financial assistance provisions in the legislation proposed by the administration. Treasury officials testified before congressional committees on this aspect of the legislation.[3]

Energy Independence Authority.—The staff worked with other agencies on the administration proposal for an Energy Independence Authority to promote development of energy resources. Treasury representatives testified before a congressional committee on this proposal.

Uranium enrichment.—Treasury staff was consulted about the financial and economic aspects of commercialization of the uranium enrichment industry. A Treasury representative testified before a congressional committee on this subject.

Alaskan natural gas transportation.—A major energy project is the transportation of natural gas from Alaska. The Treasury wrote a section on financing such a transportation system in the Interior Department report: "Alaskan Natural Gas Transportation Systems," a report to the

[3] See exhibit 46.

Congress pursuant to Public Law 93–153, December 1975. In addition, the financing aspects of this large project have been under continuous study. Treasury officials have testified about the problems of financing this project before congressional committees and the Federal Power Commission.[4]

Divestiture of major oil companies.—Treasury performed extensive analysis of the effect of divestiture on the oil industry, the economy, and the Nation's energy outlook.[5] The result was a published staff study entitled "Implications of Divestiture."

Strategic petroleum reserves.—Through review of environmental impact statements and the FEA (Federal Energy Administration) plan for strategic petroleum reserves, Treasury assisted in the development of this important emergency measure.

Interagency cooperation

Treasury staff participated in various important interagency task forces and committees:

Intergovernmental Coordinating Committee.—This Committee coordinated the work of Federal agencies with the States in the development and implementation of energy programs and policies.

Geothermal Advisory Council.—To facilitate and encourage the development of geothermal energy, Treasury took part in the development of policies for the encouragement of geothermal projects.

Nuclear energy policy coordination.—Treasury supplied staff expertise to the Energy Resources Council subcommittee which integrates the procedures of Federal agencies relating to the development of nuclear energy.

Energy information.—In view of the congressional interest in energy information as expressed in the Energy Policy and Conservation Act, the FEA was instrumental in establishing the Federal Interagency Council on Energy Information. This Council coordinates the collection and consolidation of energy information used by all Government agencies.

Presidential Task Force for Reform of FEA Regulation.—This task force was established to simplify and make improvements in the FEA price and allocation regulations.

Liquefied natural gas (LNG).—Treasury representatives participated in the interagency Task Force on Liquefied Natural Gas in implementing a new national policy regarding LNG imports.

International Monetary Affairs

World economic and financial developments

The world economy.—By the beginning of fiscal 1976, the world as a whole was nearing the trough of the worst recession in post-World War II history. The likely course of future recovery and expansion was still

[4] See exhibit 45.
[5] See exhibit 48.

unclear, and most industrial countries looked to the United States to lead the recovery and provide them with a substantial degree of export-led growth.

As of July 1, 1975, only the United States and Japan had entered the recovery phase of the cycle. This revival—soon to enter the expansion stage—spilled over to the other industrial countries both through direct effects, e.g., trade expansion, and through indirect psychological influences. The U.S. upswing clearly affected the confidence levels of European businesses and consumers. A return to more normal inventory levels, following the massive inventory adjustments experienced by the major countries during the downturn, provided the basis for the recovery and expansion stages of the cycle that emerged during the fiscal year.

In the first half of fiscal 1976, the recovery became statistically more evident as the industrial world experienced real growth of some 4.3 percent, with the largest OECD members growing at a 5-percent annual rate. The turn of the year brought increased recognition of the fact that the recovery was indeed picking up speed and strength. In some countries the recovery was led by increased consumer expenditures as the extraordinarily high savings rates of the 1973–75 period were reduced to more normal levels and by inventory rebuilding. In others such as Japan the recovery was primarily export led. In general, investment expenditures remained relatively low by historical standards following roughly 2 years of negative real investment. One direct result of the real investment decumulations has been that plant and equipment capacity has not expanded at normal rates and, when adjusted for depreciation and the inefficiencies of existing capacity brought about by the effect of higher oil prices on relative factor inputs, has probably declined. Consequently, room for noninflationary expansion is more limited than in earlier recovery periods as "bottleneck" situations in some industrial sectors may be reached more quickly than during previous cycles.

In fiscal 1976, inflation subsided somewhat from the extremely high rates of the first half of fiscal 1975 and the major country GNP deflators increased 8.3 percent (annual rate) after rising 10 percent in the last half of fiscal 1975. Even with this improvement, inflation rates remained substantially in excess of acceptable levels.

The strength of the recovery/expansion in the last half of fiscal 1976 began to affect inflationary pressures as cost-of-living increases quickened in a number of the major countries between January and June 1976.

Structural shifts.—In addition to the failure to adjust to higher oil prices, during the decade of the 1960's and into the 1970's, structural shifts have been taking place that have altered the basic shape of many of these industrial economies.

Higher inflation rates have become more difficult to eradicate in the context of indexed wages and liberal retirement schemes, increased welfare transfers, strikes and unemployment benefits, and other factors leading to large public sector deficits which have been financed in larger part by money creation.

The share of national income going to wages and compensation increased significantly. Between 1960–64 and 1974–75 the share of consumption in relation to domestic product has also risen: In Italy from 47 to 60 percent; in the United Kingdom from 64 to 71 percent; in Sweden from 62 to 69 percent; and in Germany from 54 to 62 percent.

At the same time as governments have assumed a larger role in domestic economies, the proportion of government (national, state, and local) expenditures to GDP (gross domestic product) has shown substantial increase. In the Netherlands, Sweden, and the United Kingdom, government expenditures (purchases of goods and services, capital outlays, and gross transfer payments) now equal more than 50 percent of GDP.

While government expenditures have been rising, so have the budget deficits. Public sector borrowing in Italy, for example, in 1975 equaled 15 percent of gross national product; in the United Kingdom the figure was 11 percent.

Perhaps the most serious (in terms of longer term real growth effects) structural shift has occurred in the relative growth rates of real gross fixed investment and real private consumption expenditures. In the OECD area as a whole, real fixed investment growth rates have declined substantially between the sixties and the seventies from an annual rate of growth of 6.5 percent in 1963–69 to 3.9 percent in 1970–74. While real private consumption expenditures also grew less rapidly in 1970–74 than during the earlier period, the difference was substantially less—from 4.9 percent in 1963–69 to 4.0 percent in 1970–74. During the 1974–75 recession real consumption continued growing at 2.5–3.5 percent rates while fixed investment declined each year, at 4–4.5 percent rates.

It is apparent that this structural shift will need to be reversed and growth rates for real investment in the OECD area increased if overall growth is to be at a level sufficient to promote full employment.

The severity of the recent recession led to substantially reduced real investment rates, lower real growth rates, and resulting lower growth of productive capacity in most major countries. Unless this is made up, capacity limits could be reached at an unusually early stage in the upturn. Although it is difficult to estimate the margin of unused capacity with a high degree of accuracy, recent trends suggest that it may be lower than earlier estimates suggested. Capacity utilization in some industries in some countries is already quite high and there is a clear danger of the reemergence of bottlenecks unless investment in key sectors is quickly increased. In addition, changes in relative input prices resulting from the exorbitant increase in energy prices have rendered a portion of existing capital stock obsolete and may well have raised required capital output ratios for the future. The economic and political need to develop new sources of energy, as well as emphasis on pollution control facilities, will also increase investment requirements tremendously over the next decade.

In short, the need to make up for low investment ratios earlier in the 1970's, sectoral pressures on capacity, technical obsolescence, and the objectives of greater energy self-sufficiency and pollution control all require increasing the share of private capital formation in GNP. Maintaining (or restoring) the historical share of GNP going into fixed investment will not suffice. These structural shifts cannot be reversed overnight but there is a serious question as to whether the patterns now prevailing are compatible with sustained growth, high levels of employment, and external equilibrium.

Payments patterns and financing developments.—The unexpectedly rapid economic expansion that occurred during the course of the fiscal year in most of the industrial world was reflected in a return to sizable current account deficits for the industrial countries as a group. In consequence, the deficits of the LDC's and the nonmarket economies declined significantly, although remaining at a high level, while OPEC members in the aggregate experienced current account surpluses somewhat above last year's level.

The dramatic shifts in the external positions of major industrial countries in calendar 1975 toward larger current account surpluses or smaller deficits were, to a large extent, the result of both recession-induced reductions in final import demand and major adjustments in inventory positions. Reversal of this pattern resulted in a dramatic swing in the opposite direction. For example, the U.S. position swung from a small current account deficit in 1974 to a sizable surplus in 1975 and back to a trade deficit of $2.9 billion in the first half of 1976. The United States now expects a swing in the current account balance between 1975 and 1976 on the order of $12 billion.

There is not likely to be any financing problem in the aggregate sense for the OECD area, but several individual countries are facing difficulties. They may find it more difficult to obtain the financing they seek in 1977 and will be under much heavier pressure to reduce their deficits. These problems have resulted from attempts during 1974–75 to maintain employment and real growth despite a worldwide recession, from continuing adjustment costs resulting from sharply higher oil prices, and from failure to allow exchange rates to adjust to market conditions, resulting in a loss of competitiveness.

A substantial number of industrial countries attempted to mitigate the severity of the 1973–75 expansion-recession by accepting and financing deficits (both current account and budget) rather than by limiting aggregate domestic demand. Much of the external debt undertaken in the process was medium term and financed imports for consumption rather than investment. This only resulted in a postponement of adjustment and a sizable buildup in the absolute level of both external and domestic debt. The debt service flows necessary to amortize these debts are substantial and are beginning to be burdensome for some countries since the funds have not, by and large, been used to increase export production which would aid in servicing the increased debt. In a number of cases lenders have begun to see the large debt accumulations (not just the result of oil price increases) as being potentially troublesome and are becoming more selective in their credit extensions.

Current projections suggest that perhaps 18 members of the OECD will experience current account deficits this year, but for the large majority of these countries normal capital market financing, official borrowings, and use of reserves will provide adequate external finance to cover the deficits. A few may face some financing difficulties, although they have not yet exhausted their access to private markets or international institutions.

For the nonindustrial world increased demand for raw material imports reflecting the strength of the recovery in the industrial world is resulting in both higher volumes and prices for nonoil LDC exports. In light of external debt limitations a number of LDC's have recently accepted more reasonable growth targets that will result in lower import growth. The favorable shift in terms of trade (other than oil) and external demand may produce a reduction of perhaps $8 billion in the aggregate deficit positions of the non-oil-producing LDC's in 1976. This improvement, however, is not likely to be equally spread among nonoil LDC's and the net improvement in the external position of the nonoil LDC's as a group may camouflage financing difficulties of individual countries.

The transformation of the Communist countries from essentially balanced external positions to substantial trade deficits in the last 2 years is a noteworthy development in the world economy. It is currently estimated that the nonmarket economies of Eastern Europe, the U.S.S.R., and the People's Republic of China experienced substantial deficits in trade with the West during 1975. Perhaps as much as a $10 billion deficit on current account was financed by the West (including OPEC) last year. While important export markets, the Communist countries are also heavy borrowers in Eurocurrency medium-term credit and bond markets. The Western financial capital involved—both through capital markets and through official trade credits—has become substantial.

The third beneficiary of the industrial countries' recovery will be OPEC members, as recovery results in increased demand for oil imports. Many OPEC members have increased imports faster than had been expected with the result that more members are now expected to be in deficit and others to have very small surpluses in 1976, although the group as a whole will continue to have a large surplus. OPEC member governments are increasingly becoming aware of expenditure restraints and a number of countries have publicly reduced government spending plans and are thus likely to experience lower import growth rates than in the previous year.

Foreign exchange developments and operations.—The performance of the foreign exchange market has improved progressively during the 3 years of experience under the system of generalized floating rates which evolved following the breakdown of the par value system. As in previous years, there were periods during which exchange rate movements for particular currencies were large, but there was increased recognition in the market that rate movements reflected underlying economic and financial conditions in the world economy, and the foreign exchange markets have functioned in a way that has facilitated the flow of international trade and payments. At the Rambouillet economic summit meeting in November 1975, agreement was reached to intensify consultations among Finance Ministers and central banks on underlying economic conditions, to work towards greater economic stability, and to act to counter disorderly conditions in the foreign exchange market.[1] The understandings reached at the meeting also formed the basis for subsequent agreement on the provisions relating to exchange arrangements to be incorporated in amendments to the IMF Articles of Agreement, and thus set the stage for agreement by the IMF Interim Committee in January 1976 on a comprehensive revision of the Articles.[2]

Movements in exchange rates for the U.S. dollar in terms of the major foreign currencies were mixed over the period under review. As noted in other sections in this report, high rates of inflation persisted in all countries, but wide differences in inflation rates and economic performance among countries also persisted, which explains much of the diversity in exchange rate movements during the period. Relative to the group of currencies participating in the European common margins "snake" arrangement, the dollar rose by more than 10 percent in value during the first half of fiscal 1976, following a comparable decline during fiscal 1975. The rate was little changed in the second half and depreciated during the transition quarter. The dollar's value increased by large amounts relative to the Italian lira and the pound sterling, with most movement occurring after the first half of the fiscal year. The dollar also rose somewhat against the French franc, particularly after that currency's departure from the EC snake in mid-March 1976. The dollar declined slightly in value relative to the Canadian dollar, the Japanese yen, and the Swiss franc. On a trade-weighted average basis, the dollar appreciated by about 5 percent in terms of other OECD currencies, almost entirely during the first half of the fiscal year. On this measurement it remained quite steady over the second half and the transition quarter, with the appreciation against some currencies, principally the pound sterling and the Italian lira, offset by a depreciation relative to others, notably the Canadian dollar and the currencies remaining in the EC snake.

Changes in the U.S. dollar values of major foreign currencies during the 15-month period are:

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[1] See exhibit 51.
[2] See exhibit 53.

Canadian dollar, +6 percent; Japanese yen, +3 percent; Swiss franc, +2 percent; German mark, −3 percent; French franc, −18 percent; U.K. sterling, −24 percent; Italian lira, −26 percent.

The appreciation of the dollar early in the fiscal year reflected the effects of reversal of a number of developments which had been a factor in its depreciation in terms of several major foreign currencies during the preceding several months. U.S. interest rates rose relative to those in other major centers; economic recovery in the United States proceeded in advance of that in a number of other industrial countries; and the United States appeared to be gaining control over inflation.

Foreign exchange market operations by the Federal Reserve early in the fiscal year were undertaken primarily to purchase foreign currencies, chiefly German marks, needed to repay outstanding swap indebtedness with foreign central banks incurred earlier in 1975 and in late 1974. Such swap debts had reached a peak in excess of the equivalent of $1 billion. Among the major foreign authorities, the Japanese, German, and Italian authorities sold dollars in the market to provide support for their respective currencies, while the Swiss authorities purchased dollars to curb appreciation of the Swiss franc. The French authorities, after countering some speculative pressure prior to the French franc's reentry into the EC snake arrangement on July 10, purchased dollars as their currency appreciated in terms of the German mark and other EC snake participants.

In October 1975, easing of interest rates on dollar-denominated deposits, concern over the possibility of a New York City default, and release of economic indicators suggesting that the recovery of the U.S. economy might be slowing influenced the market. During a brief period of dollar selling in the markets, the dollar depreciated against nearly all major foreign currencies. The Federal Reserve purchased a small amount of dollars, against German marks, to counter market disorder, reversing these transactions during ensuing weeks. In November and December, market conditions improved and, while the U.S. economic recovery slowed, it remained well in advance of that in the rest of the world. Substantial demand for Swiss francs continued, however, and the Swiss authorities intervened to curb further appreciation of the Swiss franc. As noted earlier, the French authorities also made large dollar purchases. The Italian and the Japanese authorities continued to sell dollars to counter pressure on their currencies. Throughout the latter part of calendar 1975, the pound sterling was steady in terms of the dollar, and the Bank of England gained dollars from market operations.

In the second half of the fiscal year, movements in the values of major foreign currencies in terms of the dollar were more a reflection of developments in individual foreign countries than of events in the United States. In general, these movements were indicative of the ability of the system to respond to changes in underlying economic circumstances. To help counter disorderly conditions in the markets for sterling and Italian lira, U.S. authorities provided short-term swap assistance to the Bank of England and to the Bank of Italy.

Early in calendar 1976, the Italian lira depreciated, at times sharply, following the resignation of the Government. After a sizable depletion of its foreign exchange reserves through intervention in support of the lira over a period of several months, the Bank of Italy withdrew from the market beginning January 21, allowing the lira, floating freely, to depreciate further. Following the formation of a new government in February, the Bank of Italy reentered the market at the beginning of March. Capital flight from Italy continued, however, and the Bank of Italy drew a total of $500 million on its swap line with the Federal Reserve during the quarter.

The British pound depreciated abruptly in early March, and the 2 1/4-percent exchange rate margins of the EC snake currencies came under significant pressure. The markets anticipated further movements in currency exchange rates to reflect divergent price and external account performances and outlook among the major industrial countries, and substantial intervention in both dollars and European currencies was undertaken by participating countries to maintain the EC snake margins. The German central bank purchased very large amounts of foreign exchange, particularly the currencies of other EC snake participants. On March 15, the French franc abandoned the EC snake arrangements and depreciated by about 4 percent. In addition, the Belgian and Dutch authorities suspended their narrower 1 1/2 percent Benelux exchange rate margins. The Bank of England also intervened on a large scale, selling dollars in the market to curb the depreciation of sterling. Although the dollar was not itself the major focus of attention, exchange market conditions became unsettled from time to time, and the Federal Reserve periodically sold German marks to counter disorderly trading conditions. The yen had begun to appreciate in December after depreciating throughout most of 1975.

After the Italian lira reached a low point in early May, the Italian authorities applied a temporary 50-percent, 90-day deposit requirement on virtually all purchases of foreign currencies and introduced other measures designed to limit speculation against the lira. Sterling continued to experience strong selling pressure and, early in June, short-term standby lines of credit totaling $5.3 billion were made available to the Bank of England by major industrial countries, including $1 billion each by the U.S. Treasury Exchange Stabilization Fund and the Federal Reserve System. By the end of the fiscal year, the British had drawn slightly more than $1 billion against these credit lines, including $200 million each from the U.S. Treasury and Federal Reserve.

Following departure of the French franc from the EC snake arrangement, the currency band was maintained although the Netherlands guilder and Belgian franc experienced renewed selling pressure periodically and depreciated toward their lower limits against the German mark. The Swiss franc continued to experience substantial demand and reached record levels against both the German mark and the dollar. In response, the Swiss authorities indicated that they were prepared to intervene massively and further tightened restrictions on franc transactions. The Canadian dollar also appreciated, probably reflecting both high Canadian interest rates, particularly relative to U.S. rates, and large external borrowing.

Strong selling pressure on sterling developed in the third quarter of 1976. The British authorities responded by raising interest rates, increasing the minimum lending rate to a record 13 percent. Trading in EC snake currencies during the transition quarter was dominated by widespread expectations that the German mark would be revalued relative to the other participating currencies. Federal Reserve intervention during the third quarter was limited to sales of $25 million equivalent of DM at times when trading became unsettled, purchases of about the same amount of DM at other times, and purchases of Belgian francs to reduce outstanding swap debt to the Belgian National Bank. Selling pressures on the French franc intensified early in the third quarter, but the franc subsequently appreciated. Bank of Italy intervention gains early in the quarter permitted repayment in full of the $500 million drawing on the Federal Reserve swap line earlier in the year. But selling pressure on the lira reemerged, as funds placed with the Bank of Italy in May under the 3-month deposit requirement began to be withdrawn and with the passing of seasonally large demand for lire. Germany's gold collateral loan to Italy was extended, with the Italian authorities repaying $500 million of the $2 billion outstanding. The Japanese yen appreciated by 5 percent during the quarter. Following heavy trading in Canadian dollars during late June and early July, the market calmed and the Canadian dollar declined briefly, rising again toward the end of the transition quarter.

Gold market prices, as measured by the London fixings, declined during the fiscal year, by $42.45 per fine troy ounce to $123.80 on June 30, 1976. Following the U.S. Treasury auction of 500,000 ounces at $165.05 on June 30, 1975, gold traded in the $163–$165 range in July and August. In September 1975 the price declined to an average of $144 and traded close to that level through December 1975. In January 1976 the price moved down to an average of $132 and traded fairly narrowly around that level through March before gradually drifting to the $126 level in June. The price dipped further in July and August, and was at the level of $116 at the end of September.

International monetary reform

During fiscal 1976, agreement was reached on the main elements of a new international monetary system. The agreement reached on January 8 in Jamaica by the Interim Committee of the International Monetary

Fund[3] concluded nearly 5 years of international debate and negotiation on international monetary reform and represents the most fundamental change in the international monetary order since the postwar system was constructed at the 1944 Bretton Woods Conference. The proposed amendment to the IMF's Articles of Agreement and increase in IMF quotas agreed upon in Jamaica are a major contribution to the effective functioning of the international monetary system and fulfill critical U.S. policy objectives in the international economic area. At the end of fiscal 1976, the proposed amendment and quota increase were awaiting ratification by member countries, and legislation to authorize U.S. acceptance of the proposed amendment and consent to the proposed increase in the U.S. quota was under consideration in the Congress.[4]

Negotiations on reform of the international monetary system formally began in July 1972 with the creation of the IMF's Committee on Reform of the International Monetary System and Related Issues (Committee of Twenty). The events leading up to the formation of this Committee, as well as the issues considered by it, were set forth in detail in the Annual Reports of the Secretary of the Treasury for fiscal years 1972–74.

The Committee of Twenty negotiations achieved substantial progress toward consensus on the general outlines of a reformed system during 1972 and 1973, looking toward a system providing for adjustable par values and floating exchange rates, effective and symmetrical inducement to balance of payments adjustment on the part of countries in both surplus and deficit, and elevation of the special drawing right (SDR) to a position as unit of account and central reserve asset of the system in place of gold.

The Committee of Twenty negotiations were, however, overtaken by a rapid escalation of worldwide inflation, widespread resort to exchange rate floating in early 1973, and the major alteration of the world payments structure resulting from the sharp increases in oil prices in late 1973 and in 1974. The Committee decided, in light of the instability then existing in the world economy and major uncertainty about the future, that it would be impractical and undesirable to try to agree upon and implement in the near future a highly structured reform of the international monetary system, and decided instead that the reform process should take a more evolutionary course. At its final meeting in June 1974, the Committee made several recommendations for immediate action and for further work on possible amendments to the IMF Articles of Agreement:

1. Establishment of a senior policy-level body (the present Interim Committee) in the IMF to oversee the operations and evolution of the monetary system and to undertake further work on amendments to the IMF Articles of Agreement.
2. Establishment of a Development Committee under the joint

3 See exhibit 53.
4 On Oct. 20, 1976, President Ford signed this legislation (Public Law 94-564).

auspices of the IMF and International Bank for Reconstruction and Development (IBRD) to carry forward the study of the broad question of the transfer of real resources to developing countries.
3. Creation of a special IMF oil facility.
4. Adoption of a new procedure for valuing the SDR in terms of a basket of currencies.
5. Adoption of a set of guidelines for floating exchange rates developed by the Committee of Twenty.

The Interim Committee, on which the United States is represented by the Secretary of the Treasury, was formally established in October 1974 and immediately entered into intensive negotiations concentrating on two broad areas: The formulation and implementation of actions to deal with immediate economic and financial problems, and amendment of the IMF Articles of Agreement, with longer term implications for the structure of the international monetary system. By August 1975, agreement in principle had been reached in the Interim Committee on measures to phase gold out of a central role in the monetary system and on details of an expansion of IMF quotas.[5] Exchange arrangements remained the key unresolved issue.

Important impetus was given to the Interim Committee negotiations by the Rambouillet economic summit meeting in November 1975, at which understandings were reached on the provisions regarding exchange arrangements to be incorporated in the amended Articles of Agreement. On the basis of these understandings, the way was cleared for agreement by the IMF membership on the text of a specific amendment. And, on January 8, 1976, in Jamaica, the Interim Committee reached a comprehensive agreement on outstanding international monetary issues,[6] combining long-term structural reforms of the international monetary system with measures to meet immediate balance of payments financing needs.

The Jamaica agreements.—The agreements reached by the Interim Committee at Jamaica involved major revisions of the international monetary arrangements established at the 1944 Bretton Woods Conference, while preserving the basic objectives of that system. Thus, the broad objectives of promoting international monetary cooperation, facilitating the exchange of goods, services, and capital among countries, and providing resources for temporary balance of payments financing needs are reaffirmed, while certain operational aspects of the IMF and of the system are being revised to conform to the evolving needs of the international economy. The reforms of the system that have been agreed upon are designed to promote a smoothly operating monetary order and to avoid the shocks and disequilibria which arose under the Bretton Woods system and which ultimately led to its collapse.

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[5] See exhibit 49.
[6] See exhibit 53.

The final Jamaica package included agreements in the following areas, some of which had been reached in principle at earlier stages in the negotiations:

1. Amendment of the IMF Articles pertaining to exchange arrangements.
2. Actions to further reduce the role of gold in the system, many of which also involve amendment of the Articles.
3. Other amendments to the Articles dealing with the special drawing right and with the operations and organization of the Fund.
4. An increase in the financial resources of the Fund.
5. Measures designed to increase members' access to IMF resources.

The proposed amendment to the Articles of Agreement will become effective upon its acceptance by three-fifths of the IMF's members having four-fifths of the total voting power.

Exchange arrangements.—A central achievement of the reform negotiations was the agreement reached on new provisions relating to exchange rate arrangements to replace the obsolete par value provisions of the present Articles. The changes endorsed by the Interim Committee in Jamaica reflect recognition and agreement that future efforts must focus on achievement of the underlying economic stability that is a prerequisite for exchange rate stability, rather than on action to peg or manage exchange rates. This constitutes a fundamental reorientation of the Bretton Woods exchange rate provisions and a concentration on the real determinants of monetary stability—stability in underlying economic and financial conditions—rather than on the exchange rate consequences which were the focus of Bretton Woods.

This change in focus underlies the new Article IV, "Obligations Regarding Exchange Arrangements." This critical part of the Articles provides the legal framework and nucleus of a new system. In summary, the new article IV contains five major provisions:

First, the article provides for specific obligations of each member to promote underlying stability. Each member must, with due regard to its circumstances, "endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability," and "seek to promote stability by fostering orderly underlying economic and financial conditions."

Second, the article provides wide latitude for a member country to adopt specific exchange arrangements of its choice. Each member must collaborate with the Fund and with other members to assure orderly exchange arrangements, but the article does not insist on par values or any particular exchange rate regime. It permits a range of exchange rate practices—including floating; common margins arrangements such as those presently applied by a number of European countries; and pegging to another currency, to a basket of currencies, or to the SDR.

Third, the article requires that members avoid manipulating exchange rates or, more generally, the international monetary system, to prevent effective balance of payments adjustment or to gain an unfair competitive advantage. This requirement is aimed at promoting responsible exchange rate behavior, the avoidance of competitive undervaluation and beggar-thy-neighbor policies. It can, moreover, yield a major improvement over Bretton Woods, in providing for symmetrical Fund examination of surplus as well as deficit countries.

Fourth, the article provides authority for the IMF to oversee the compliance of each member with its obligations—the undertakings to promote stability, to avoid manipulation that prevents adjustment or gives an unfair advantage, and to collaborate with the Fund and with other members to assure orderly exchange arrangements. This authority for Fund surveillance gives the Fund the task of applying a global perspective to actions of those members that cause adjustment or other problems for other members.

Fifth, the article provides a framework for decisions on future evolution of the system by high majority vote if modification is called for to meet future needs.

In summary, the new article IV contains the essential elements of a balanced, realistic, and workable system, monitored by the IMF. Member countries have freedom to pursue exchange practices of their choice, but undertake important commitments for responsible behavior—to follow stable economic and financial policies, and to avoid actions that distort world production, trade, and investment to the harm of others. The IMF, for its part, will pay less attention to such procedural questions as whether a currency is floating or fixed, but will have broad new authority to oversee the system to promote its effective operation and to oversee the compliance of members with their obligations. These obligations are designed to minimize international tensions in exchange matters, while at the same time giving member countries greater freedom to choose the exchange procedure they wish to utilize.

The IMF is the focal point of the system. The IMF is to oversee both the system to ensure its effective operation and the compliance of each member with the obligations set out in the new article IV. Members are obliged to provide the Fund with the information necessary for intelligent surveillance of their exchange rate policies. In addition, the Fund is called upon to adopt "specific principles" for the guidance of members with respect to those exchange rate policies to assure that manipulative practices are avoided. In the Bretton Woods system the Fund's attention was more likely to be directed toward a member in times of crisis, and more narrowly focused toward exchange markets. By contrast, under the new system, Fund consultations with members are likely to be more continuous, more broadly based, more concerned with the real international impact of a country's actions, and directed to all countries.

Gold.—In the second main area of the Jamaica agreement, the following measures will be adopted to promote a further reduction in gold's role in the international monetary system:

1. The official price of gold in the IMF Articles will be abolished, and gold will lose its formal position as unit of account for the system—e.g., for expressing the value of currencies, for determining the value of the SDR, and for calculating members' rights and obligations in the Fund. While gold has already ceased to perform many of the functions of unit of account and reserve asset in practice, formal recognition of these changes is basic to the international demonetization of gold.

2. All requirements for the use of gold in transactions between the Fund and its members—e.g., in quota subscriptions, in payment of charges, and in replenishment operations—will be eliminated. In addition, the IMF will be prohibited from accepting gold, unless there is a decision to the contrary by an 85-percent majority vote. Existing requirements for use of gold in members' transactions with the Fund are to be replaced in most cases with requirements to use SDR's or, if so decided, members' currencies.

3. It was agreed to begin disposal under the authority of the present IMF Articles of Agreement of 50 million ounces of gold held by the IMF (about one-third of its total holdings), 25 million ounces to be sold at public auction for the benefit of developing countries and 25 million ounces to be sold to IMF members in proportion to their quotas.

4. The IMF will be empowered to dispose of its remaining gold holdings in a variety of ways and by an 85-percent majority vote in each case.

Furthermore, in order to assure that, for a transitional period while these changes are taking effect, gold does not reemerge as an important monetary instrument, the Group of Ten countries—the major gold-holding nations—have agreed to the following arrangements, which came into force on February 1, 1976: (1) That there be no action to peg the price of gold; (2) that the total stock of gold now in the hands of the IMF and of the monetary authorities of the Group of Ten will not be increased; (3) that the parties to these arrangements agree that they will respect any further conditions governing gold trading that may be agreed to by their central bank representatives; and (4) that each party agrees that these arrangements will be reviewed by the participants at the end of 2 years and then continued, modified, or terminated. Any party to these arrangements may terminate adherence to them after the initial 2-year period. Other nations may also adhere to these arrangements (Switzerland and Portugal have done so).

Special drawing rights.—In parallel with phasing down gold's monetary role, the new system provides an expanded role for the special drawing right, and modifies certain of the rules governing that asset.

When the SDR was originally created in 1968, its value was established in terms of gold and linked to currencies through their par values, essentially through the par value of the dollar. With the suspension of gold convertibility of the dollar and the widespread move away from par values, it became unrealistic to value the SDR in terms of par values and difficult to determine the rates to be used in IMF transactions. To overcome this problem, agreement was reached on an interim basis to value the SDR in terms of a weighted basket of the market exchange rates of 16 major currencies, with the dollar representing approximately one-third of the basket. Such a basket valuation technique is particularly well-suited to a world of widespread floating of exchange rates, and the Fund has subsequently operated without difficulty.

Under the amended Articles, the link between the SDR and gold is severed. The SDR replaces gold as the common denominator of the system, and as the unit for measuring IMF rights and obligations. The SDR's value will continue to be determined by the present basket technique. The possibility is provided for future modification in the valuation technique in the event there is a widespread view that a different technique is needed. A majority of 85 percent is required for a change in the valuation principle or a fundamental change in the application of the valuation principle. Other, more technical changes require a 70-percent vote. A provision for modification of the SDR valuation technique is needed because the present basket was introduced on an interim, somewhat experimental basis, and because an evolution in exchange arrangements could make it appropriate to shift to a different valuation technique.

The SDR is expected to take on an increasingly important role, not only as a unit of account used in measurements, but also as an asset used in transactions. With respect to its use as an asset, the amended Articles obligate members to collaborate with the Fund in their policies on reserve assets toward the objective of making the SDR the principal reserve asset of the international monetary system. In addition, the SDR takes over from gold the preferred status as asset to be received by the Fund in payment of charges, in meeting repurchase obligations, and to be accepted by members in exchange for currencies replenished by the Fund.

A number of technical steps have been taken to improve the SDR's quality and usability so that it may better fulfill its purposes. Thus countries will have greater freedom to enter into SDR transactions with each other on a voluntary basis; the possible uses have been expanded; and the Fund may broaden the categories of holders—though not beyond official entities—and the operations in which they engage. Also, the decisions for altering certain policies governing SDR's are made easier such as the terms and conditions governing approved transactions, and the rules that require countries to "reconstitute" or repurchase after a certain period some of the SDR's they have used.

At the same time that these rules governing use of the SDR's are being eased, important safeguards have been retained which help assure that the SDR will remain a widely accepted and valued asset. Thus, the limit on members' obligations to accept SDR's is retained, and IMF quotas remain the basis for new SDR allocations.

The reduction in the monetary role of gold contained in the agreements represents major progress toward an objective held for many years by the United States and many other countries. Gold is a valued commodity, but clearly not a sound basis for an international monetary system. The provisions in the new system reducing gold's role and expanding that of the SDR represent a move toward realism and stability.

IMF operational and organizational changes.—The negotiation of a comprehensive amendment of the IMF Articles provided an opportunity for introducing needed operational changes. The original Articles were heavily focused on the mechanics of the monetary system and contained detailed rules and regulations which did not contain either scope for flexibility in day-to-day operations or scope for adaptation over time.

In light of these problems, a large number of changes are proposed affecting IMF operations. The purpose is to modify obsolete provisions, to simplify operations, and to adopt structural changes. Among the modifications are the following:

1. Usability of currencies is assured. Under the present Articles, countries, regardless of the strength of their external positions, can effectively prevent use of their currencies by the Fund for loans to others. Agreement to the usability of IMF currency holdings has been consistently promoted by the United States and was considered essential, in part because quota subscriptions can be paid in full in national currencies under the amended Articles. Under the amended Articles, there are provisions to ensure that the Fund's holdings of all currencies will be usable by the Fund in accordance with its policies. Similarly, members will be required to provide their currencies to other members when that currency has been specified by the Fund for repurchase. This agreement will add substantially to the Fund's usable resources at present and in the future and will strengthen its ability to provide balance of payments assistance to members.

2. The Fund's authority to invest is made explicit. Currencies not in excess of the Fund's reserves can be invested in income-producing and marketable obligations of international financial organizations or of the members whose currencies are used for the investment.

3. The Fund's policy on repurchase (repayment) is modified. The provisions in the present Articles are obsolete and cumbersome, being more appropriate to a par value system than to present arrangements. The amendment provides the Fund with authority to establish policies on repurchase appropriate to the needs of the system.

Organizational changes of the IMF are also being made. Most important is a provision which would permit, by 85 percent majority vote, the establishment of a Council, with decisionmaking power, to replace the present Interim Committee, which is an advisory body. The Council would be charged with supervising the management and adaptation of the international monetary system, including the continuing operation of the adjustment process, and development in global liquidity.

Increase in IMF quotas.—IMF quotas will be expanded by approximately SDR 10 billion, to a new total of SDR 39 billion (a 33.6-percent increase). The U.S. quota in the Fund will be increased by SDR 1,705 million, from SDR 6,700 million to SDR 8,405 million. As a result of changes in quota shares agreed in the negotiations, the United States will experience a slight reduction in its voting share in the IMF to just under 20 percent. This change will be accompanied, however, by an increase in the majority required for decisions of major policy significance in the IMF from 80 percent to 85 percent.

Increased access to IMF resources.—The Jamaica agreements also contained a number of measures to expand members' access to IMF resources in the present world economic situation. These steps are listed below and described in following sections:

1. Members' access to regular IMF credit resources has been temporarily expanded.
2. A major liberalization of the IMF's compensatory financing facility has been implemented.
3. A trust fund, designed to utilize the profits on sales of IMF gold for the benefit of developing countries, has been established.

IMF operations

During fiscal 1976, the IMF experienced a further substantial increase in lending, with purchases of currencies (drawings) by IMF members reaching a record SDR 7.6 billion (about $8.9 billion),[7] a 46-percent increase over drawings in fiscal 1975. Drawings during the transition quarter amounted to SDR 1.3 billion. This increase reflected significant growth in drawings from the IMF's regular resources and from some of the IMF's special facilities—the compensatory financing facility, the buffer stock facility, the extended Fund facility, and the oil facility.

Regular IMF resources.—Purchases under the IMF's regular resources during fiscal 1976 amounted to SDR 2,218 million by 27 countries, and during the transition quarter amounted to an additional SDR 320 million. Over this 15-month period, the United Kingdom was the single largest borrower, with drawings of SDR 1.4 billion followed by South Africa (SDR 246 million) and Argentina (SDR 160 million). Principal currencies drawn from the IMF were the U.S. dollar, the French franc, the German

[7] Conversions from SDR's to dollars in this section are made at the rate of $1.17 equals SDR 1. This is the fiscal 1976 monthly average dollar/SDR exchange rate. The value of SDR's is determined by a basket of 16 currencies whose values fluctuate daily in response to changes in market exchange rates.

mark, and the Japanese yen. Special drawing rights were drawn from the IMF in the amount of SDR 448 million during fiscal 1976 and SDR 13.5 million during the transition quarter.

Repayments of outstanding drawings (repurchases) totaled SDR 630 million for fiscal 1976 and SDR 113 million for the transition quarter. Currencies used in repurchase included German marks (SDR 104 million), U.S. dollars (SDR 67 million), Japanese yen (SDR 31 million), and French francs (SDR 27 million). Repurchases with special drawing rights amounted to SDR 443 million.

As of September 30, 1976, cumulative drawings under the IMF's regular resources, from the beginning of IMF operations, amounted to SDR 31,075 million, of which SDR 9,762 million was in U.S. dollars. Cumulative repurchases amounted to SDR 17,920 million, of which SDR 4,792 million was in U.S. dollars.

The U.S. reserve position in the IMF increased to SDR 2,790 million during fiscal 1976 and 3,416 million during the transition quarter as a result of net purchases of U.S. dollars by other countries amounting to SDR 1,212 million.

As a temporary measure, pending implementation of the proposed amendment to the IMF Articles of Agreement, members' access to regular IMF credit resources was increased by 45 percent in January 1976 as a means of assisting in meeting exceptional financing needs.

There was no activation during fiscal 1976, nor during the transition quarter, of the General Arrangements to Borrow (GAB). These arrangements for lending to the Fund, established in 1962 by the 10 major industrial country members of the Fund, including the United States, are designed to supplement the IMF's resources needed to cope with developments that threaten to impair the operations of the international monetary system. Commitments to the GAB, which totaled the equivalent of approximately SDR 5,500 million on September 30, 1976, were most recently renewed on October 29, 1974, for a period of 5 years. The U.S. share in the GAB is $2 billion.

IMF oil facility.—The IMF oil facility was a temporary facility created in 1974 and designed to respond to emergency balance of payments financing needs arising from sharply increased oil prices, and has been described in earlier Annual Reports. New lending from the facility was terminated on March 31, 1976. Drawings from this facility were made by 55 countries and totaled the equivalent of SDR 6,902 million during the period of its operations.

The resources available to the oil facility were derived from loans to the IMF by the oil-exporting countries and by a number of developed countries. These loans will be repaid by the Fund over the 4- to 7-year maturity of drawings from the oil facility. Interest charges on oil facility drawings are based on the cost of borrowings by the oil facility, and averaged 6.9 percent under the 1974 facility and 7.6 percent under the 1975 facility.

On August 1, 1975, the IMF established a subsidy account under a trust arrangement separate from the IMF, to reduce the effective rate of charges on oil facility drawings by the least developed IMF members most seriously affected by the increased price of petroleum. The account will be financed by voluntary national contributions, which are expected to total approximately SDR 160 million and to make possible an interest subsidy of approximately 5 percentage points for eligible borrowers from the oil facility. Subsidy payments from the account will be made over the 1976–83 period. The first subsidy payments to 18 IMF members were disbursed in July 1976 and totaled SDR 14 million.

IMF commodity-related financing arrangements.—The IMF has two commodity-related facilities in operation, a compensatory financing facility and a buffer stock facility. The IMF compensatory financing facility was established in 1963 and liberalized in 1966 and again in 1975. In order to be eligible to draw from the facility, a member must: (1) Be experiencing a shortfall in export earnings that is temporary and substantially beyond its control, (2) have an overall balance of payments need, and (3) agree to cooperate with the IMF in finding appropriate solutions to its balance of payments difficulties.

Following a recommendation of the Interim Committee, the IMF substantially liberalized the compensatory financing facility in December 1975. The liberalization, which was strongly supported by the United States, provided for: (1) Elimination of the existing limit of 10 percent on forecasts of annual export growth in the postshortfall period, an important factor in the calculation of compensable export shortfalls; (2) increased quota limits on compensatory financing drawings, from 25 percent of quota in any 12-month period to 50 percent of quota, and from 50 percent of quota on total drawings outstanding to 75 percent of quota; in addition, elimination of the 75 percent of quota limit on combined compensatory and buffer stock drawings; (3) requests based on shortfall period of which export data are estimated for up to 6 months; and (4) modification of the rules relating to reclassification of drawings from the IMF's regular resources into compensatory purchases to permit reclassification to be made within 18 months, instead of 6 months, from the date of the ordinary drawings.

The amount of export shortfall eligible for compensation is calculated as the difference between export in the shortfall year and the average annual level of exports in a 5-year period centered on the shortfall year (i.e., taking into account export forecasts for the 2 succeeding years), and subject to the quota limits noted above. Drawings from the facility are subject to the same charges and repurchase obligations as apply to the regular resources (presently 4 to 6 percent annual charge and repurchases over 3 to 5 years).

During the 13 years since the compensatory financing facility was established, 57 countries have made 104 drawings. As of September 30, 1976, drawings totaled cumulatively SDR 3,039 million and outstanding drawings amounted to SDR 2,270 million. Drawings amounted to SDR 1,777 million in fiscal 1976 and to SDR 862 million in the transition quarter. Purchases increased rapidly following the December 1975 liberalization of access to this facility and drawings in the first three quarters of calendar 1976 amounted to substantially more than total drawings during the preceding 13 years of the facility's existence.

The second IMF commodity-related financing arrangement—the buffer stock facility—was created in 1969 to assist members having balance of payments needs in financing their contributions to international buffer stocks that meet specified IMF criteria. Drawings from the buffer stock facility carry the same interest rate and repayment provisions as do regular IMF drawings, except that disbursements of funds from an international buffer stock to a member must be used to repay drawings from the buffer stock facility. Loans from this facility are subject to the condition that a member borrowing from the facility must cooperate with the IMF to find appropriate solutions to its balance of payments difficulties. Countries may draw up to 50 percent of quota under the facility. As noted above, the 1975 liberalization of the compensatory financing facility eliminated the 75-percent quota limit on combined compensatory and buffer stock drawings.

Under the terms of the facility, an international buffer stock could be eligible for IMF financing if it met criteria designed: (1) To ensure that all IMF members, whether or not they participate in the buffer stock, are treated equitably by the buffer stock arrangement, and in particular that consumers as well as producers participating in the arrangement are able to have an effective voice in decisions on its operations; (2) to provide that the buffer stock pricing policies contribute to earnings stabilization, that stock accumulations and sales balance out over the medium term, that excessive use is not made of quantitative controls, and that funds from the IMF are used only for financing related to acquisition of stock; and (3) to prevent long-term restriction of supply as a means of artificially maintaining prices above a long-term trend.

Two international buffer stocks—tin and cocoa—were declared eligible in 1970 and 1973, respectively, under the IMF's criteria for financial support from this facility, although funds have been drawn only with respect to the tin buffer stock. Total drawings have amounted to SDR 30 million by five countries. SDR 0.3 million in drawings was outstanding as of September 30, 1976.

Extended Fund facility.—The extended Fund facility, created on September 13, 1974, is designed to provide medium-term balance of payments assistance to IMF members in support of comprehensive programs of structural economic adjustment. In order to draw from the extended Fund facility, a member must prepare and adhere to a comprehensive multiyear program of structural reform approved by the IMF. Credits may be provided over a 3-year period, subject to adherence to the agreed program, in contrast to the normal 1-year limit on the availability of regular IMF resources under standby arrangements. Drawings from this facility have longer repayment periods (4 to 8 years) than do drawings from the IMF's regular resources, and bear a slightly higher interest rate in the later years. A country may draw up to 140 percent of its quota under this program but not in excess of 165 percent of its quota from both this source and from the IMF's regular resources combined. (The joint limit was temporarily raised to 176 percent of quota pursuant to the temporary expansion of access to the IMF's regular resources.)

As of September 30, 1976, extended Fund arrangements had been approved for two countries—Kenya and the Philippines—for SDR 67 million and SDR 217 million, respectively. In August 1975, Kenya drew SDR 8 million and in September 1976, the Philippines drew SDR 90 million under their respective arrangements.

Trust fund.—The IMF established on May 5, 1976, a trust fund designed to utilize the profits on sales of IMF gold for balance of payments assistance on concessional terms to 61 low-income developing country members. The origin of the concept of the trust fund, first proposed by the United States in November 1974, was described in the fiscal 1975 Annual Report.

The trust fund and IMF gold sales meet two major objectives of the United States in the international economic area: Further reduction in the international monetary role of gold, and mobilization of resources to meet urgent balance of payments financing needs of the poorest developing countries in the present period of exceptional payments imbalance.

The trust fund, which is legally separate from the IMF but managed by it as trustee, will be financed mainly from profits on the sale of IMF gold amounts received in excess of the present official price of gold (about $42 per ounce). The trust fund may also accept national contributions. Sales of a total of 25 million ounces of gold at public auction will be held over a 4-year period beginning June 2, 1976. Sixteen auctions of 780,000 ounces each have been scheduled for the first 2 years at approximately 6-week intervals. As of September 30, 1976, the IMF had conducted three auctions, yielding an average price of $119.15 per ounce of gold and total profits of $184 million.

Developing country members of the IMF will receive a direct transfer of part of the profits on IMF gold sales in proportion to their quotas in the IMF. The balance of the profits will be available to the trust fund for balance of payments credit to eligible countries. In order to borrow from the trust fund, an eligible member must have a balance of payments need and must have in place an economic program designed to improve its balance of payments situation. Trust fund loans will carry a 10-year repayment term, including a grace period of 5 years, and an interest rate of one-half of 1 percent. Initial disbursements on loans under the trust fund are expected to occur early in calendar 1977.

Financial Support Fund

The proposed Financial Support Fund was described in some detail in last year's Annual Report. In brief, the Support Fund is designed as a temporary financial mechanism—a "safety net"—to encourage cooperation in energy and economic policy by supplementing other sources of financing in the event participating OECD members cannot obtain elsewhere, on reasonable terms, financing needed to avoid recourse to restrictive trade policies, capital controls, or undue restraints on domestic economic activity. Despite the continued satisfactory operation of international financial markets as a whole, there is no assurance that each OECD member country will be able to attract adequate financing on reasonable terms. The potential danger is that a country could be moved to adopt inappropriate policies because of the unavailability of such financing—or out of concern that financing would not be available in the future—and that other countries would take similar policy actions to protect their own positions. The risk is that recourse to such policies could spread quickly and result in serious disruptions of the world economy, reduction of worldwide economic well-being, and less cooperation in energy policy. This risk is shared by all countries, as are the benefits to be gained through avoidance of such policies.

The Financial Support Fund is designed to protect against this risk by providing an assured source of financing to participating OECD countries, whose policies will determine both whether the world economic order remains liberal and open and whether the oil-importing countries will succeed in reducing their dependence on unstable and excessively costly energy sources. If the Fund's resources are used, specific policy conditions on its loans will be prescribed in order to assure cooperative solutions to mutual economic and energy problems.

The Financial Support Fund will comprise total member country quotas of SDR 20 billion (about $23 billion at the dollar/SDR rate of exchange prevailing in the latter part of fiscal 1976), with the U.S. quota amounting to SDR 5,560 million (about $6.5 billion), or about 27.8 percent of the total. Participants' quotas will determine their share in financing loans made by the Fund, their share in risks in loans made by the Fund, their voting rights (each member has a number of votes in proportion to its quota), their maximum financial liability to the Fund, and the amount they may borrow from the Fund.

The United States expects to meet its share in the financing of loans made by the Financial Support Fund through the issuance of guarantees covering market borrowings by the Fund. The United States could, however, choose to extend direct loans to the Fund, for market considerations or other reasons. Such loans would be extended from the Exchange Stabilization Fund under existing authority.

Negotiation of the agreement establishing the Financial Support Fund was initiated in the Group of Ten and completed by a temporary working party of the OECD. The agreement was signed, subject to necessary legislative action, by the United States and most other OECD member countries in Paris on April 9, 1975, and had been ratified by 15 OECD members by the end of fiscal 1976—Austria, Belgium, Canada, Denmark, Germany, Greece, Iceland, Japan, New Zealand, Norway, Portugal, Sweden, Switzerland, Turkey, and the United Kingdom. Three other countries—Ireland, France, and the Netherlands—had completed necessary domestic procedures but had not yet deposited instruments of ratification. The legislative process is still underway in six countries—Australia, Finland, Italy, Luxembourg, Spain, and the United States.

Proposed legislation authorizing U.S. participation in the Financial Support Fund was submitted to the Congress on June 6, 1975. Early in fiscal 1976, hearings on U.S. participation in the Financial Support Fund were held by the Senate Foreign Relations Committee and the Subcommittee on International Trade, Investment and Monetary Policy of the House Committee on Banking, Currency and Housing. The Secretary testified again before the Senate Foreign Relations Committee on behalf of the Support Fund on March 26, 1976, and the legislation was favorably reported. On June 4, 1976, the Secretary testified on behalf of the Support Fund before the Senate Committee on Banking, Housing, and Urban Affairs, reemphasizing the need for U.S. participation in the Fund. As of September 30, 1976, however, the legislation had not been approved by either the House or the Senate.

Organization for Economic Cooperation and Development

The OECD continues to serve as one of the primary international sites for consultation and cooperation on economic and financial policy issues among its 24 member states. In addition to carrying forward its long-established role of regularly examining the economic conditions prevailing in its member states as well as various aspects of economic, fiscal, and monetary policy, the OECD has intensified its activities in the areas of energy, commodities, and relations with the developing countries, through the new bodies mentioned in last year's Annual Report. With respect to these latter activities, the OECD played a significant role by providing a means for the developed countries to discuss the issues in the ongoing North-South dialog that has been taking place during 1976 at the Conference on International Economic Cooperation (CIEC) in Paris.

At the annual Ministerial-level meeting of the OECD Council held in

Paris on the 21st and 22d of June 1976,[8] which was attended by Secretary Simon as well as Secretary Kissinger, OECD Ministers agreed that in the growing economic interdependence among nations member governments bear a great responsibility to promote noninflationary growth, employment, and social progress not only among their countries but for the world at large. The Ministers recognized that the steady economic growth necessary to restore full employment and satisfy rising expectations will not prove sustainable unless further progress is made towards eliminating inflation. Principles were agreed to guide national economic policies in achieving the moderate but sustained economic growth which would produce these results.

The Ministers renewed for an additional year their Declaration on Trade of 1974, constituting a pledge to avoid restrictive actions on trade and other current external transactions which could lead to reprisal by others and impair the process of economic recovery.

Acting in a new area of interest, the Ministerial meeting agreed that cooperative action among member countries could improve the foreign investment climate and encourage the positive contribution multinational enterprises can make to economic and social progress while minimizing difficulties that may arise from their activities. To implement this approach, Ministers approved a series of investment understandings including national treatment of foreign-owned enterprises, the use of official incentives and disincentives to international investment, and voluntary guidelines for multinational enterprises.

Ministers also reaffirmed their governments' commitment to improved relations with developing countries as expressed in the Declaration on this subject adopted at last year's meeting.

The Economic Policy Committee and its subgroups on growth (Working Party 2) and on prices and costs (Working Party 4) continued to devote particular attention to evaluation of the factors contributing to unacceptably high inflation in circumstances of low or moderate economic activity accompanied by persistently high levels of unemployment. Working Party 3, which is concerned with policies for the promotion of better payments equilibrium and to which the U.S. delegation is led by the Under Secretary of the Treasury for Monetary Affairs, focused its attention on the sharp swing in the external payments positions and related financing requirements of member countries. A Temporary Working Party, to which the U.S. delegation is also headed by Treasury, continued its work on financial and economic issues arising out of the dialog with oil-exporting and other developing countries and also reviewed the payments position of smaller OECD countries.

Generally, Treasury representatives participated extensively in a broad range of OECD activities, leading or joining in the work of U.S. delegations

[8] See exhibit 59.

to, among others, committees dealing with questions concerning international investment and multinational enterprise, trade, export credits, energy and the International Energy Agency, commodities, fiscal affairs, financial markets, and relations with developing countries.

U.S. balance of payments

The main balance of payments development during fiscal 1976 was a sharp swing in the merchandise trade balance, from a roughly $9 billion annual rate surplus in the July–December 1975 half to a $6 billion annual rate deficit in the January–June 1976 half. Because of its timing, this shift is best examined on a half-year rather than full fiscal year basis.

U.S. merchandise trade, July 1974–September 1976

[Balance of payments basis, seasonally adjusted; in $ billion, rounded]

	Half-year totals				Quarter
	July-Dec. 1974	Jan.-June 1975	July-Dec. 1975	Jan.-June 1976	July-Sept. 1976
Exports (+)	51.6	52.9	54.2	55.3	29.6
Agriculture	10.9	10.9	11.3	11.2	6.3
Other	40.8	41.9	42.9	44.1	23.2
Imports (−)	−55.4	−48.1	−49.9	−58.3	−32.6
Fuels	−15.2	−13.6	−14.9	−17.1	−10.0
Other	−40.2	−34.5	−35.0	−41.2	−22.6
Trade balance	− 3.7	4.7	4.3	− 3.0	− 3.0
(Balance excluding agricultural exports and fuel imports)	(0.6)	(7.4)	(7.9)	(2.9)	(0.6)

NOTE.—Half-year data, due to seasonal adjustment on a calendar-year basis, will not add precisely to fiscal-year totals.

Summary of U.S. international transactions

[Millions of dollars]

	Fiscal 1975	Fiscal 1976	T.Q.*
Exports of goods and services	148,364	154,817	42,577
Merchandise, excluding military	104,360	109,706	29,581
Other goods and services	44,004	45,111	12,996
Imports of goods and services	−139,618	−143,419	−41,708
Merchandise, excluding military	−103,084	−108,456	−32,614
Other goods and services	−36,534	−34,963	−9,094
U.S. Government economic grants	−2,939	−2,536	−1,461
Remittances, pensions, and other transfers	−1,753	−1,797	−464
U.S. assets abroad, net (increase/capital outflow (−))	−31,405	−35,530	−8,901
U.S. official reserve assets, net	−1,220	−2,604	−407
Other U.S. Government assets	−3,029	−3,416	−1,454
U.S. private assets	−27,156	−29,510	−7,040
Foreign assets in the United States, net (increase/capital inflow (+))	22,222	21,307	8,471
Foreign official assets	13,138	9,212	3,013
Other foreign assets	9,084	12,095	5,458
Statistical discrepancy	5,129	7,154	1,485

* Preliminary July-September 1976, seasonally adjusted.
Source: Survey of Current Business, December 1976, published by U.S. Department of Commerce, Bureau of Economic Analysis.

The major factor in this surplus-to-deficit swing on net merchandise trade was the strong recovery of U.S. import demand, by the third (January–March) quarter of fiscal 1976, to more or less cyclically normal levels—following an extraordinary slump during the second (January–June) half of fiscal 1975 associated with general recession and massive inventory adjustments in the U.S. domestic economy. Between the July–December 1974 and the January–June halves of fiscal 1975 there was a roughly $10 billion annual rate slowdown in U.S. nonfuel imports, which between the first and second halves of fiscal 1976 was completely reversed again.

A second important factor contributing to this change on total trade account was a combined cyclical and trend increase in the volume of petroleum imports, reflecting rising consumption plus declining domestic production, that was compounded by rising oil-import prices.[9] The recession-period decline in U.S. total fuel imports was both briefer and smaller than for other imports, and the net increase in such fuel imports between first-half fiscal 1975 and second-half fiscal 1976 was roughly $4 billion on an annual rate basis.

Agricultural exports, after holding steady at roughly a $22 billion annual rate, through both fiscal 1975 and fiscal 1976, have risen somewhat further in the transition quarter.

The U.S. trade balance excluding agricultural exports and fuel imports has shifted over this period (all amounts on annual rate basis) from (a) a roughly $1 billion surplus in the July–December 1974 half of fiscal 1975 to (b) recession-related temporary surpluses of roughly $15 billion in both of the two following half years, to (c) continuing but much smaller surpluses, of almost $6 billion and roughly $2 billion, respectively, in the January–June half of fiscal 1976 and the transition quarter.

Treasury foreign exchange reporting system

Throughout fiscal 1976 the Treasury foreign exchange reporting system staff worked actively to improve the system for the current reporting of portfolio capital movements transactions. This work was done primarily through visits and communications with selected current and potential reporters to discuss both conceptual and operational problems and to review procedures for correct reporting. These efforts not only produced significant amounts of previously omitted data but also improved reporters' understanding of the reporting requirements and the importance of the data.

In support of the President's reporting reduction program, three periodic reports were discontinued as of June 30, 1976. These were the monthly Preliminary Summary to Treasury Foreign Exchange Form B–1; the annual Form C–4, "Short-Term" Liquid Claims on "Foreigners" in Countries Not Listed Separately on Form C–3; and the quarterly Form

[9] See exhibit 57.

S–4, Foreign Debit and Credit Balances. Notice of the amendments to the Treasury Regulations revoking the reports was published in the Federal Register on June 29, 1976.

At the close of the fiscal year, revision of reporting forms was underway to eliminate through consolidation at least five other separate reports required by law.

Treasury foreign currency reporting system

On October 29, 1975, revised bank report forms were instituted to resolve reporting problems which had arisen with the initial forms, to increase the usefulness of the reports to the bank regulatory agencies, and to measure more precisely the foreign exchange market phenomena being studied.

In response to the President's reporting reduction program, action was undertaken to drop one nonbank report form, Foreign Currency Form FC–3a, and to revise reporting thresholds on another nonbank report form, Foreign Currency Form FC–3.

Developing Nations

International development banks [1]

In the 15-month period, the Congress appropriated $695.6 million for the resources of the international development banks for fiscal 1976 and $745.5 million for fiscal 1977, as shown in the table below:

U.S. participation in international development banks
[$ millions]

Institution	Authorization	Appropriation	
		Fiscal 1976	Fiscal 1977
International Development Association—IV		320.0	375.0
Inter-American Development Bank:			
Paid-in	120.0		20.0
Callable	1,530.0		200.0
Fund for Special Operations	600.0	225.0	50.0
Asian Development Bank—Ordinary Capital:			
Paid-in		24.1	24.1
Callable		96.5	66.4
Asian Development Fund		25.0	
African Development Fund	25.0	5.0	10.0
Total	2,275.0	695.6	745.5

The international development banks committed $8,992 million to over 80 developing countries in fiscal 1976. The distribution of commitments by institution was as follows: World Bank group, $6,878 million; Inter-American Development Bank (IDB), $1,231 million; and Asian Development Bank (ADB), $883 million.

To put into perspective the importance of these banks to development assistance generally, total lending flows from the international develop-

[1] See exhibit 67.

ment banks are equal to over 66 percent of the total official development assistance from OECD countries in calendar year 1975.

As of September 30, 1976, the United States was behind the schedules observed by other nations contributing to the international development banks. Although the United States is the largest single contributor to the banks, other donors together contribute more than twice as much. Contributions from other donors thus complement the U.S. subscriptions and increase the financial impact of these institutions, which stress the role of market forces in the effective allocation of resources, the development of outward-looking trading economies, the critical role of private enterprise, and the importance of spreading development benefits to the poorer people of developing countries.

The World Bank group

The International Bank for Reconstruction and Development (IBRD) and its affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC), committed $6,878 million for development projects in their member countries in fiscal 1976. This volume represents a 13-percent increase over the fiscal 1975 level and a 66-percent increase over the lending level in fiscal 1974. The IBRD made new loans of $4,977 million ($658 million more than in the preceding fiscal year) while new IDA credits were $1,655 million (compared with $1,576 million in fiscal 1975). New IFC investments in equity and loans to the private sector totaled $245 million in fiscal 1976 (compared with $212 million in fiscal 1975 and $203 million in fiscal 1974). As of June 30, 1976, total IBRD loans outstanding amounted to $26,091 million, total IDA credits outstanding were $10,450 million, and total IFC cumulative net commitments were $1,507 million. During the transition quarter, the IBRD made new loans of $814.7 million, IDA extended new credits of $325.7 million, and IFC made new loans and investments of $2.5 million.

IBRD and IDA lending is increasingly concentrated in agriculture and rural development. For the second consecutive year lending to agriculture and rural development was greater than for any other sector. Agricultural projects accounted for 27 percent of total lending in fiscal 1976. Other important sectors of IBRD/IDA lending in 1976 included development finance companies and industry (21 percent), transportation (22 percent), and electric power (14 percent). IFC investments were concentrated in iron and steel (27 percent), relending for industry (18 percent), textiles (16 percent), construction materials (5 percent), and chemicals (3 percent).

The IBRD and IDA committed funds for 214 development projects in 76 countries in fiscal 1976. The distribution of commitments by region was as follows: Africa, $891 million; Asia, $2,807.7 million; Latin America, $2,448 million; and Europe, the Middle East, and North Africa, $1,485.6 million. India was the largest individual borrower ($894 million), while

Indonesia was second ($517 million), and Brazil third ($498 million).

IFC commitments during fiscal 1976 went to 33 enterprises in 23 developing countries. By region, IFC commitments went to 4 projects in Europe ($92.0 million), 10 projects in Asia ($75.8 million), 9 projects in Latin America ($36.5 million), 8 projects in Africa ($34.0 million), and 1 project in the Middle East ($7.0 million). Yugoslavia received the largest individual total ($50 million), with Korea second ($47.8 million), and Turkey third ($38.5 million).

At the annual meeting of the World Bank in Washington in September 1975, Secretary Simon set forth a range of proposals as part of the U.S. program to assist the developing countries.[2] As a matter of high priority, Secretary Simon proposed the creation of a development security facility in the IMF to help meet the balance of payments needs of primary producing countries arising from temporary shortfalls in export earnings due to circumstances primarily beyond their control. He pledged U.S. support for a major capital expansion of the IFC, the only member of the World Bank group which is designed exclusively to promote private investment. Finally, the Secretary stressed the importance of sound financial policies for the World Bank group and the appropriateness of a substantial increase in World Bank capital. During the fiscal year, progress was made in achieving these objectives. The first step in strengthening the Bank's financial structure has been the development of a lending rate formula which covers both the cost of funds to the Bank in world financial markets and the administrative and liquidity costs of the Bank. On June 1, 1976, the Bank's interest rate was raised from 8.5 percent to 8.85 percent and on July 1 from 8.85 percent to 8.9 percent.

The lending operations of the IBRD are financed by paid-in capital subscriptions, funds borrowed in capital markets and from governments and central banks, sales of participations, principal repayments on loans, and earnings on loans and investments. The IBRD's net outstanding funded debt increased by $2,360 million during fiscal 1976 to $14,647 million. As of June 30, 1976, 25 percent of the Bank's obligations were held by investors in the United States, 21 percent in Germany, 10 percent in Japan, 8 percent in Saudi Arabia, and 7 percent in Switzerland. The remaining 29 percent of outstanding borrowings were held by investment institutions, including central banks and government agencies in more than 80 countries.

In May 1976, the Executive Directors of the IBRD recommended that the Bank be authorized to increase its capitalization by $8.4 billion from its 127 member countries. In order to participate in the IBRD capital increase, the United States requires congressional authorization. The Secretary of the Treasury forwarded a legislative proposal in June 1976. The 94th Congress took no action on this legislation. Under the proposal,

[2] See exhibit 50.

the United States would subscribe to 13,005 shares of capital at a cost of $1,568.9 million. Of this amount, 10 percent would be paid-in and 90 percent would be in the form of callable capital. The U.S. share would represent approximately 19 percent of the proposed increase. As a result, U.S. voting power in the IBRD would decrease from 22.6 percent to 21.9 percent, a shift consistent with our policy of burden-sharing. The IBRD capital increase is an important element in U.S. foreign assistance policy as the United States considers the Bank to be an indispensable source of capital for the developing countries. The proposed increase would allow the Bank to maintain its current level of commitments until the 1980's.

During the year, IBRD gross borrowings reached a record level of $3,811 million, up nearly 8 percent from $3,510 million borrowed in fiscal 1975. The main source of borrowed funds to the Bank changed substantially in fiscal 1976. In the preceding 3 years, governments and central banks were the major sources, supplying 59 percent of total borrowed funds in fiscal 1973, 80 percent in fiscal 1974 and 75 percent in fiscal 1975. In 1976, governments and central banks supplied 35 percent of borrowed funds, while private markets supplied 61 percent of the total. The remaining 3 percent was borrowed by the Bank from the interest subsidy fund established during the year to permit concessional lending from the "third window" of the IBRD. This was a new and temporary source of funds to the Bank.

The principal suppliers of borrowed capital in fiscal 1976 were the United States ($1,275 million), Germany ($666 million), and the petroleum-exporting countries ($445 million, of which Kuwait accounted for $155 million).

During fiscal 1976, IDA granted new credits totaling $1,655 million, an increase of $79 million over fiscal 1975. IDA credits are funded primarily by member country contributions, grants from the net income of the IBRD, repayments of credits, and earnings. During the year, the United States contributed $320 million toward the first U.S. installment of IDA's fourth replenishment. Usable resources of IDA, cumulative to June 30, 1976, amounted to $11,514 million, consisting of $10,100 million in member contributions, $1,125 million in transfers from IBRD net income, and the remainder from earnings, participations in credits, and repayments on outstanding credits.

The United States has taken the lead in publicly supporting a major expansion of IFC capital through statements made by Secretary Simon at the annual meeting of the IBRD/IMF in September 1975 and by Secretary of State Kissinger at the U.N. Seventh Special Session in the same month. Agreement was reached on the general principles and amounts to be raised at gatherings of the IFC's principal shareholders in Paris in November 1975 and in New York in January 1976. Of the proposed U.S. subscription, $44.6 million would be appropriated in fiscal 1978 and $33.4 million each in fiscal 1979 and fiscal 1980. The proposal would result in a substantial reduction—from 33 percent to 25 percent—in the U.S. share of IFC capital, a reduction consistent with our policy on burden-sharing.

Inter-American Development Bank

During fiscal 1976, the IDB committed a total of $1,231 million from its two windows, for a 16-percent increase in lending over the previous fiscal year. Of this amount, $586 million was lent on conventional terms from Ordinary Capital resources and $645 million on concessionary terms from the Fund for Special Operations (FSO). In addition, the IDB committed $129.5 million in funds administered by the Bank for various donors, primarily from the Venezuelan trust fund (VTF). During the transition period, the IDB committed $284.4 million ($108.5 million in Ordinary Capital resources and $175.9 million from the FSO). Cumulative lending by the IDB from its own resources totaled $9.3 billion as of September 30, 1976. Of this amount, $4.2 billion had been lent from Ordinary Capital, $4.4 billion from the FSO, and $0.7 billion from other resources, primarily the U.S. Social Progress Trust Fund (SPTF).

The power and agriculture sectors received most of the funds committed during 1976. About 28 percent ($339 million) went to power and 23 percent ($283 million) to agriculture. On a cumulative basis, agriculture has received the largest amount, 23 percent, or $2.1 billion; power has received the next largest amount, 21 percent, or $1.9 billion.

Lending operations of the IDB are financed mainly from capital subscriptions, borrowings in international capital markets, and members' contributions to the FSO. At the end of fiscal 1976, the total subscribed capital of the IDB was $6,248 million, of which $983 million was paid-in and $5,265 million was callable. The resources of the FSO amounted to $5,436 million. U.S. subscriptions to IDB capital shares were $2,409 million, or 38.6 percent of the total. Including contributions authorized, but still pending appropriation, the United States has accounted for $3,640 million, or 70 percent of total resources contributed to the FSO. As of September 30, 1976, the United States had appropriated its final installment to the FSO replenishment initiated in 1970.

In fiscal 1976, the IDB placed long-term borrowings of $369 million equivalent in international capital markets, including $150 million in the United States. In addition, the Bank sold $34 million in 2- and 5-year bonds to central banks in Latin America. The Bank's funded debt amounted to $1,816 million equivalent as of June 30, 1976.

At the 1976 annual meeting of the IDB in Cancun, Mexico, Assistant Secretary Parsky, as U.S. Temporary Governor, announced that final congressional action was expected shortly on a bill authorizing the United States to vote for the new replenishment of the Bank's resources as well as for the amendments permitting nonregional membership in the Bank.[3] This legislation was signed into law on May 31, 1976, and Secretary Simon,

[3] See exhibits 63 and 71.

as the U.S. Governor to the IDB, voted on June 1, 1976, in favor of the amendments to the Bank's charter necessary to bring the replenishment and nonregional membership exercises into effect.

Under the terms of the replenishment agreement, the regional member countries will provide the Bank with $6,145 million in additional resources over the 1976–79 period, of which $5,100 million would consist of assigned subscriptions to capital shares ($332 million paid-in and $4,768 million callable) and $1,045 million in contributions to the FSO. In voting for the replenishment resolutions, the United States also formally agreed, subject to appropriation of the necessary amounts by the Congress, to subscribe to $1,650 million in capital ($120 million paid-in and $1,530 million callable) and to contribute $600 million to the FSO. The legislation also permitted Secretary Simon to vote on the nonregional membership resolution. Nine nonregional countries (Belgium, Denmark, Germany, Israel, Japan, Spain, Switzerland, the United Kingdom, and Yugoslavia) formally joined the Bank on July 9, 1976, and Austria, the Netherlands, Italy, and France are expected to become members before the end of calendar year 1976. Together, the 13 nonregional countries will subscribe to $434.3 million ($72 million paid-in and $363 million callable) in IDB shares and contribute an equal amount to the FSO.

At the annual meeting of the IDB, Mr. Parsky commended the Bank for expanding its lending to the agriculture sector and its assistance to the poorest peoples of Latin America. He urged, however, that both the Bank management and the Board of Directors give more attention to the implementation aspects of loans, improving estimates and control of project costs, and increasing the supervision of projects currently underway. He also suggested that consideration be given to canceling balances in old, slow-disbursing loans in order to free up scarce resources. Additionally, he suggested that the limited resources of the FSO be reserved for those countries most in need of concessional assistance and that middle-income countries increasingly switch their borrowing to Ordinary Capital and the Venezuelan trust fund. He underscored the U.S. conviction that the Bank should increase its support to the private sector in Latin America through greater lending to productive enterprises outside the public sphere and through loans to credit institutions which assist in mobilizing domestic savings.

On September 16, 1976, the IDB Board of Directors voted to increase its lending rate on capital loans to 8.6 percent, resulting from adoption of a proposal for a new lending rate system for loans financed from ordinary and interregional capital. The proposal was prompted by concerns arising from the sharp increase in the Bank's annual level of disbursements and borrowings, and the possible adverse impact this would have on the Bank's creditworthiness in international capital markets in the absence of an interest rate which fully covers costs and permits an accretion to reserves. The proposal provides for a new lending interest rate adjusted each July

1, based on a two-part formula: A calculation of the Bank's borrowing costs during the past year plus a spread to cover the Bank's administrative and liquidity costs.

Asian Development Bank

During fiscal 1976, the Asian Development Bank committed a total of $883 million, of which $669 million were Ordinary Capital loans, and $214 million from Special Funds/Asian Development Fund. As a result, the Bank's cumulative loans stood at $2,944 million at June 30, 1976, $2,207 million from Ordinary Capital and $737 million from Special Funds. Lending during the transition quarter brought cumulative loans outstanding as of September 30, 1976 to $2,267.4 million from Ordinary Capital and $741.8 million from Special Funds. Since the Bank's inception in 1966, public utilities have received the largest amount of ADB loan funds ($1,030 million, or 35 percent) followed by industry ($670 million, or 23 percent), and agriculture and agro-industry ($661 million, or 22 percent). In fiscal 1976, agriculture, including agro-industry, was the largest beneficiary of Bank lending, accounting for $262 million, or almost 30 percent of total lending.

The Bank obtains its resources for Ordinary Capital from subscriptions to the Bank's Ordinary Capital stock. Cash for disbursements is provided by paid-in capital subscriptions, funds borrowed in private capital markets and from governments and central banks (backed by callable capital subscriptions), repayments of principal and interest on loans, and net earnings on investments. Special Funds/ADF loan resources come from member country contributions, set-asides from Ordinary Capital earnings, and repayments of loans.

On June 30, 1976, the Bank's subscribed Ordinary Capital stock totaled $3,202 million. The administration's request for a second U.S. installment of $120.6 million to the first Ordinary Capital increase was approved on June 30, 1976, and the United States subscribed that amount to the ADB on July 27, 1976, raising the total U.S. capital share to $482.5 million. This subscription, plus a Canadian special increase of $156 million effective on September 1, 1976, raised the level of Bank capital to $3,479 million as of that date.

In fiscal 1976, the Bank borrowed $539 million in international capital markets—an amount exceeding its cumulative borrowings through fiscal 1975. Of the $539 million total the ADB raised $225 million in the United States, $82 million from the Netherlands, $67 million from Germany, and $50 million from Japan. At the end of fiscal 1976, the Bank's total funded debt stood at $917.3 million.

In November 1975, Bank management proposed a second general capital increase for the ADB equal to 135 percent of capital subscribed as of mid-1977 to finance Ordinary Capital lending from mid-1977 through 1981. This would total about $4.96 million (of which 15 percent would have been paid-in capital) and permit Ordinary Capital lending to rise by about $75 million per year from 1977 through 1981. Discussion in the Board continued through early calendar 1976 with U.S. representatives urging efforts by the Bank to improve its financial policies so as to reduce its dependence on paid-in capital. On September 7, 1976, the Board of Directors voted to recommend to the Board of Governors ratification of a 135-percent increase in 1977 subscribed capital including 10 percent paid-in capital. The U.S. Director voted against the proposal, stating that while the United States fully supported a capital increase, it was concerned about the level of paid-in capital being requested.

By the end of calendar 1975, the Asian Development Fund had nearly exhausted its commitment authority, having only $40.9 million available for new loans. Aware of this impending situation, representatives of ADF donor countries met during the spring and summer of 1975 to negotiate a replenishment of these resources. During these negotiations, a general formula was developed whereby most donors agreed to contribute to the fund amounts equal to approximately 150 percent of their original contributions. The United States reiterated its continuing support for the ADF, but stated it could not give any commitment on the size or timing of a U.S. contribution. Recognizing the U.S. reservation, in December 1975, the Board of Governors approved a 1976–78 replenishment of the ADF totaling $830 million. The United States abstained on the resolution, noting that the suggested U.S. contribution of $231 million was too high. Foreseeing this position, the resolution permitted donors to change their contribution levels subject to the approval of ADB Governors. After consultations with the Congress, in June 1976, the administration requested that the U.S. contribution be set at $180 million. On September 10, 1976, the ADB Governors approved the new U.S. level and a reduction in the New Zealand contribution to $5.4 million from $9.2 million. These downward adjustments were partially offset by a $34 million increase in the Canadian contribution.

The ninth annual meeting of the Board of Governors of the ADB was held in Jakarta, Indonesia, in April 1976. At the time, the head of the U.S. delegation expressed continuing American support for the ADB and identified the major issues of interest to the United States.[4] He stated that the United States supported the ADB's emphasis on increasing lending to the agriculture sector and programs which directly benefit the rural poor. He commended the Bank management's efforts to increase the utilization of appropriate intermediate technology and to mobilize cofinancing for development projects, thus contributing to a more efficient use of the Bank's capital resources. The U.S. delegate also called on the Bank to explore the feasibility of equity investments in productive, employment-creating enterprises permitted by the Articles of Agreement.

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[4] See exhibit 68.

African Development Fund

The African Development Fund (AFDF) was created on July 3, 1973, as the concessional lending affiliate of the African Development Bank (AFDB). The fund is designed to channel non-African resources into the African development process and to help meet the need for softer terms for projects in those African nations which could not borrow at the terms offered by the AFDB.

At the end of fiscal 1976, the fund membership included 12 European countries, Canada, Brazil, Japan, Saudi Arabia, and the AFDB representing all of its member states. The membership remained the same through the transition quarter. The United States expects to join the institution before the end of calendar 1976.[5] In anticipation of U.S. membership, the Governors of the fund adopted a resolution at the annual meeting of the African Development Bank and Fund in Kinshasa, Zaire, in May 1976, permitting the United States to join as soon as the U.S. Congress passed the necessary legislation.

Congress subsequently authorized U.S. membership at a level of $25 million and appropriated $5 million in the fiscal 1976 budget and an additional $10 million in the fiscal 1977 budget for an initial U.S. contribution of $15 million. With the U.S. contribution, total resources pledged to the fund are expected to amount to $410 million, up from an initial figure of $100 million in 1973.

The growth in the fund's lending activities has been consistent with the growth in resources. In calendar 1974, the first full year of the AFDF's operation, its lending totaled $46.2 million. In 1975, the rate of lending almost doubled to $92 million. The fund expects to lend $100 million in 1976, and plans to increase the amount again in 1977 and beyond. All loans carry a service charge of 0.75 percent per annum on the disbursed amount with a repayment period of 50 years, including a 10-year grace period. The fund has concentrated primarily on the development of agriculture and transportation, but has also been active in lending to the public utility, health, and education sectors.

Outlook for the developing countries

In 1974 and 1975, the historic pattern of moderate current account deficits was broken by the twin shock of higher oil prices and severe recession among the industrial economies. Aggregate deficits of the oil-importing developing countries in 1974 and 1975 were on the order of $27 billion and $35 billion, respectively, including transactions that were financed by official grants.

As a result of the economic expansion now underway in the industrial world and domestic policy adjustment by the less developed countries (LDC's) the deterioration of aggregate current account deficits turned

[5] See exhibit 63.

around. Consequently the 1976 total is expected to fall to about $27 billion—about $8 billion less than in 1975. Nevertheless, this deficit still is large by historical standards.

The deficits in general have to date been financed without grave difficulties. In 1974 and 1975, in addition to traditional flows such as official bilateral, multilateral, and private direct investment flows, $4–$5 billion was provided in the form of OPEC loans and grants. These OPEC flows only partially offset the $11 billion annual increase in the direct cost of oil imports and they were not distributed among developing countries in proportion to costs. One to two billion dollars were provided by IMF credit, including the oil facility, and reserves were drawn down by $1 billion in 1975 (they increased $3 billion in 1974). The remainder of the deficits was financed by borrowing from private capital markets at the unprecedented rate of $9–$10 billion each year largely in the form of commercial bank lending (including Euroborrowing).

The greatly expanded flows of capital to nonoil developing countries, in the aggregate, offset the deterioration of the balance of payments caused by the recession and provided time to permit adjustment to the structural impact of oil prices to take a form less abrupt than severe cutback in imports. The combined impact of higher oil costs and recession, however, slowed down growth in the developing countries. From 1970 to 1973, the average growth rate of these countries was around 6 percent. For 1975 and 1976, the World Bank has estimated growth rates at 2.2 percent and 4.4 percent, respectively.

Net borrowing from private capital markets is continuing to take place, in part because countries are allowing reserve levels to rise substantially after last year's decline—the only year in more than a decade in which developing country reserves declined. Assuming OPEC capital flows to developing countries continue at the level reached in 1975 and total official bilateral and multilateral flows are on the order of $20 billion in 1976, then some $7 billion of the aggregate deficit plus an amount equivalent to the increase in reserves will have to be financed (net) by a combination of IMF credit, direct investment, and borrowing from private capital markets.

Although the record of the first half of 1976 does not indicate that financing problems will arise in the aggregate, individual countries may experience difficulties in adjusting their economies. The low-income countries will continue to pose a special problem in this regard. Most of these countries have experienced very slow growth in recent years and are heavily dependent upon concessional resource flows. The absolute magnitude of their deficits is not large, but increased bilateral and multilateral assistance may have to be directed toward these countries.

While the 1976 deficit of the nonoil LDC's appears to be financially manageable, continuation of large current account deficits has implications which extend beyond the short term (particularly on external debt and growth). These countries will have to actively pursue internal adjustment to structural changes and to modify the level and composition of imports to maintain the momentum of their development efforts. Inappropriate or ineffective policies will impair the long-term prospects for growth.

Development Committee

The Development Committee, a joint Ministerial committee of the World Bank and International Monetary Fund, was established in October 1974 to focus on the broad question of the transfer of real resources to the LDC's. Last year's Annual Report discussed the work of the Development Committee at its first three meetings.

The fourth meeting of the Development Committee was held in Washington in September 1975. The Committee agreed to ask the Executive Directors of the IMF to continue their work on the trust fund and stressed the contribution that the World Bank's third window would make toward meeting the capital needs of the developing countries. The Committee also agreed that the Executive Board of the IBRD should give prompt consideration to a selective increase in the capital of the IBRD and received a report from the Working Group on Access to Capital Markets.

At its January 1976 meeting in Kingston, Jamaica, the Development Committee noted the decision of the Interim Committee to establish the trust fund to provide balance of payments assistance to low-income countries, as well as understandings reached regarding increased access to IMF resources. The Committee received an interim progress report from its Working Group on Access to Capital Markets and urged expanded use of cofinancing arrangements by the World Bank and the regional development banks. The Committee also supported an early increase in the capital of the International Finance Corporation and expressed its strong support for a substantially enlarged fifth replenishment of the International Development Association.[6]

At its June 1975 meeting, the Development Committee agreed to establish a Working Group to review regulatory and other constraints affecting LDC access to capital markets, and to continue its study of proposals to support LDC access to private markets, including a possible multilateral guarantee fund. During fiscal 1976, the working group met five times to consider issues related to access to capital markets.

At its first meeting in July 1975, the working group agreed upon a status report on its initial activities to the Development Committee. The working group devoted its second meeting in October 1975 to an informal seminar with seven representatives of banks and other institutions active internationally in private capital markets. At its third meeting in November 1975, the working group reviewed the possible use of multilateral guarantees and prepared an interim progress report for the Development Committee. The

[6] See exhibit 62.

fourth meeting of the working group in April 1976 examined regulatory impediments to market access, improved secondary markets for LDC obligations, and possible approaches to the use of multilateral guarantees. At its fifth meeting, the working group drafted a second interim report for the Development Committee, following its discussion on capital market regulations, guarantees, cofinancing, and technical assistance.

The original 1974 parallel resolutions of the World Bank and the IMF establishing the Development Committee provided that at the end of 2 years, the Boards of Governors of the Bank and the Fund would review the performance of the Committee and take such action as they deemed appropriate. [At the joint Fund/Bank annual meeting in Manila in October 1976, the Governors agreed to extend the Committee's mandate unchanged for another 2 years.]

Investment security

The CIEP Interagency Coordinating Group on Expropriation, whose membership includes the Departments of State, Treasury, Defense, and Commerce, was established in fiscal 1972 to implement President Nixon's policy statement of January 19, 1972, on expropriation. During fiscal 1976 and the transition quarter, the Group reviewed the continuing trend in several developing countries toward a diminished role for foreign private investment and the Group took several steps to strengthen the implementation of U.S. policy.

In several developing countries, the governments have taken steps to expropriate significant portions of U.S. investment. While the United States recognizes a country's right to expropriate a foreign investor for a public purpose, the U.S. Government expects that its investors will receive prompt, adequate, and effective compensation. To achieve satisfactory settlements, the Interagency Group employs a variety of diplomatic instruments.

A recent major expropriation in Peru is particularly noteworthy. At the request of the Peruvian Government and the U.S. company, a U.S. Government delegation reached a negotiated settlement with the Government of Peru. President Ford had named a personal representative to head the delegation to negotiate a conclusion of this dispute that was fair to both the Government of Peru and the U.S. company. In this case, the U.S. delegation was able to develop and express independent views on the merits of the key issues such as tax claims and valuation. The delegation was assisted in developing these independent views through access to information which the U.S. Government had gathered and assessed through its own resources and by commissioning an outside consultant to establish a reasonable range of values for the expropriated property. Therefore, the delegation was able to encourage both parties to exhibit greater flexibility and eventually was able to reach settlement acceptable to both sides, which satisfied our right under international law to receive prompt, adequate, and effective compensation when the property of a U.S. investor is expropriated. The U.S. Government role in this case may provide a useful precedent for enabling the U.S. Government to play a constructive role in other appropriate expropriatory situations.

In the third quarter of fiscal 1976, a policy review was completed which produced several steps to strengthen the implementation of U.S. policy on expropriation. Most importantly, the review resulted in a proposal to increase the capital of the International Finance Corporation from $108 million to $648 million in order to diversify the sources of foreign investment in developing countries. The proposal has been submitted to Congress for authorization. A second policy review was requested by the Economic Policy Board on July 15 and is continuing.

Delinquent debt and reschedulings

The total principal outstanding on post-World War II debts owed the United States was $36.7 billion on December 31, 1975. As most of this debt is a result of U.S. Government foreign aid and export credit programs undertaken during the last 30 years, it is not surprising that a high proportion of it, nearly 70 percent by value, is owed by non-oil-exporting developing countries.

Since World War II, the vast majority of these debts have been paid on time. During calendar years 1974 and 1975, the United States collected almost 6 billion in U.S. dollars on principal and interest due on long-term credits, and the equivalent of almost $1 billion in principal and interest on foreign currency loans.[7] As of December 31, 1975, principal and interest due and unpaid 90 days or more on post-World War II debt amounted to $748 million. Although the total of delinquent debt was reduced during 1974 and 1975, about half is subject to special political or other factors, as in the cases of China and Cuba, which make prompt payment unlikely at this time.[8]

On January 30, 1976, Secretary Simon submitted to Congress the administration's second annual report on developing countries external debt and debt relief provided by the United States. (The report is required by section 634 (g) of the Foreign Assistance Act of 1961, as amended in 1974.) The report is comprehensive, containing detailed information on the debt situation of major debtor countries and the means by which the United States and other creditor countries have dealt with debt service problems.

On March 4, 1976, a bilateral agreement was signed with Pakistan rescheduling approximately $203 million in debt service falling due over the 5-year period 1975–79. This agreement, effective as of April 22, 1976, implemented an understanding reached on June 28, 1974, with Pakistan

[7] This excludes indebtedness prepaid by the Government of India and simultaneously granted back according to mutually agreed terms specified in the original agreements of indebtedness.

[8] See exhibit 66.

by the World Bank in its capacity as Chairman of the Pakistan Consortium. U.S. implementation of a 1973 understanding, under which the United States agreed to reschedule approximately $23 million in debt falling due during fiscal 1974, was also formalized in the 1976 agreement. Under the 1974 World Bank understanding, other creditors will provide the equivalent of $454 million in debt relief over the 4-year period 1975–78. All creditors agreed that the terms of relief would be at a grant element of no less than 62 percent.

Directly related to the agreement with Pakistan and the 1971 war which resulted in the independence of Bangladesh is an agreement by the Government of Bangladesh to assume liability for projects visibly located in its territory. In the bilateral agreement signed on March 4, 1974, and effective on April 22, 1976, the United States will reschedule $85 million in debt service obligations being assumed by Bangladesh. The United States and other creditors have agreed that the loans assumed by Bangladesh will be rescheduled on terms equivalent to a minimum of 84 percent grant element. Bangladesh will also assume responsibility for servicing $2.6 million in Export-Import Bank loans which will not be rescheduled.

In response to Zaire's serious problems in meeting its debt obligations, the Paris Club creditors concluded an ad referendum rescheduling agreement on June 16, 1976. Under the terms of this agreement, principal and interest not yet settled for the period January 1, 1975, to June 30, 1976, and principal payments only for the second half of 1976 are to be rescheduled. In the upcoming months, bilateral agreements between Zaire and its creditors will be negotiated to implement formally the Paris Club agreement.

Local currency management

One of the responsibilities of the Secretary of the Treasury is to determine which foreign currencies held by the United States are in excess of normal requirements. The purpose of this determination is to assure maximum use of local currencies in lieu of dollars.

During fiscal 1976 the decision was made to remove two countries, Tunisia and Poland, from the excess currency list after the following fiscal year. This leaves only five excess currency countries—Burma, Egypt, Guinea, India, and Pakistan. As local currency receipts have decreased and in-country expenses have increased, countries have lost their excess status. When this has happened, special foreign currency programs, conditioned on the availability of excess funds, are phased out. These programs involve scientific and research projects which usually have some political benefit, but because of their lower priority might not otherwise be funded were it not for the availability of excess currencies.

Bilateral assistance

The Department of the Treasury participates in the U.S. Government development finance program through its membership in the National Advisory Council on International Monetary and Financial Policies, on the Overseas Private Investment Corporation (OPIC) Board of Directors, and on various interagency committees designed to coordinate economic assistance programs. Treasury's principal concerns are to promote the efficient utilization of bilateral assistance resources and to assure that bilateral aid objectives remain consistent with overall U.S. economic interests and the operation of U.S. multilateral aid efforts.

The three principal institutions responsible for administering U.S. bilateral economic assistance programs are the Agency for International Development (AID) (development loans and grants and supporting assistance), the Department of Agriculture (Public Law 480 food for peace program), and OPIC (war and political risk insurance and direct financing of U.S. private investments in developing countries).

Agency for International Development.—As a member of the Development Loan Committee of AID, Treasury focuses primarily on the economic impact of AID development programs in the recipient country and on the latter's economic policy performance. During fiscal 1976, AID committed nearly $2.3 billion in loans and grants for specific projects and supporting assistance. This total was about $200 million less than the amount committed in 1975. Of the $2.3 billion, $1.5 billion was in grants and $801 million in loans.

Public Law 480.—Treasury is represented on the Interagency Staff Committee, which reviews all Public Law 480 proposals. Treasury looks primarily at the impact of this program on the U.S. balance of payments and the domestic economy. During fiscal 1976 and the transition quarter, Title I sales agreements were signed with participating governments and private trade entities for a total value of $913.9 million, higher than the previous year but nevertheless down significantly from the levels of earlier years. Title II donations totaled $247.4 million, roughly $100 million lower than the previous year.

Overseas Private Investment Corporation.—The Department of the Treasury is represented on OPIC's 11-man public/private Board of Directors. OPIC administers two major programs to encourage U.S. investment in the developing countries: Investment insurance against the political risks of expropriation, inconvertibility, and war, revolution, and insurrection; and investment finance which provides both direct loans and commercial risk guarantees.

OPIC issued $1,222 million in investment insurance in fiscal 1976, a slight increase from the $1,211.9 million issued in fiscal 1975. The financing program guaranteed $16.994 million of new investment in the developing countries and extended $10.75 million in direct lending during fiscal 1976.

Relations with developing nations

The Office of Developing Nations was formed in April 1976 to provide a focal point for coordinating Treasury's policies and operations with LDC's. This responsibility, which had previously been divided among several offices, includes continued staff support for joint cooperation commissions with Mid-Eastern and South Asian countries, except Saudi Arabia, which is handled by the Office of Saudi Arabian Affairs formed in June 1974, and for other bilateral cooperative arrangements with developing countries. Because of the significant influence on international finance and commerce exerted by member states of OPEC, analysis and projection of OPEC balance of payments has received priority attention. Similarly, the balance of payments outlook for the LDC's as a group and its impact on world payments and financing patterns has been closely studied.

The OPEC countries' current account surplus declined in 1975 to an estimated $40 billion from the record figure of $70 billion in 1974. This reflected a dramatic increase in imports combined with a reduction in oil revenues owing to reduced world demand. Some of the more populous countries and smaller oil producers (Algeria, Ecuador, Gabon, and Indonesia) moved into a deficit position in their current account. Saudi Arabia alone accounted for almost half of the aggregate current account surplus.

Following the decline in 1975, OPEC oil revenues are projected to increase to $115 billion during 1976, as a result of the improving world economy and the October 1975 oil price increase, with the aggregate OPEC surplus reaching $43 billion. A slowing of import growth, which had already begun in 1975, will continue in 1976 owing to port congestion and other physical constraints in several countries and financial constraints in others.

Those countries which moved into deficit in 1975 are expected to remain in deficit, while the sparsely populated Persian Gulf countries will account for an even larger share of the aggregate surplus in 1976. Future trends in the combined OPEC current account will be affected in an important way not only by the demand for oil and natural gas but, to a large extent, by several factors affecting their import levels.

On the one hand, a key physical constraint should be alleviated as projects designed to expand port capacity, especially in the Persian Gulf, are completed beginning in 1977. Manpower shortages in those states will continue to necessitate reliance on imported labor. Service contracts with foreign governments and firms will remain an important supplement to available domestic human resources.

On the other hand, several of the countries now in deficit or in near-deficit may experience increasing financial constraints. Many of them have already turned to the Eurodollar market to obtain supplemental financial resources necessary to carry out their development plans. It can be expected that both the number of OPEC countries seeking loans and the amounts involved will increase. At the same time, some of these countries have already begun to reassess their development plans and to scale expenditure targets downward in response to the elimination of their payments surpluses.

Regarding disposition of the OPEC surplus, the trend toward longer term investment appears to be continuing. The proportion of the surplus invested in the United States has also been rising, from 20 percent of the total in 1974, to 24 percent in 1975, and 35 percent during the first half of 1976.

Middle East.—During the period under review, continuing efforts were made to strengthen U.S. trade and financial relationships with the countries of the Middle East. Treasury continued to provide support for the joint commissions established with a number of Mid-East countries and to participate in their activities. These efforts are aimed at providing a sound basis for peace and stability in the area and to facilitate attainment of our goals in the fields of energy and economic policy.

In pursuit of these objectives, in February and March 1976, the Secretary visited Saudi Arabia, Egypt, Israel, Syria, and the United Arab Emirates. In Saudi Arabia he led the U.S. delegation to the second meeting of the United States-Saudi Arabian Joint Commission on Economic Cooperation, which in its 2-year history has emerged as a central element in strengthening U.S. economic relationships with Saudi Arabia.

The joint communique issued at the end of the meeting in Riyadh reviewed the progress made under several major project agreements and discussed future areas of cooperation.[9] Six separate projects, wholly financed by the Saudi Government through a trust fund set up in the Treasury, will entail the expenditure of over $113 million, much of it in the United States. The U.S. representation to the Joint Economic Cooperation Commission office in Riyadh is working successfully with Saudi officials in monitoring ongoing projects and in developing new areas of program activity.

The Secretary's visit to Egypt, building upon foundations laid during President Sadat's visit to the United States in the fall of 1975, further demonstrated the U.S. commitment to work constructively with the Egyptians to resolve Middle Eastern and domestic problems. The United States-Egypt Joint Cooperation Commission has been instrumental in assessing Egypt's specific problems and directing technical assistance and other programs toward their solution. The Commission's Joint Working Group on Economic and Financial Cooperation, chaired on the U.S. side by the Assistant Secretary for International Affairs, has concentrated its efforts on working with the Egyptian Government to improve the climate

[9] See exhibit 64.

for private investment in Egypt and to encourage greater participation by the U.S. private sector in Egypt's economic development. Accordingly, the United States signed a tax treaty with Egypt, an Egypt-United States Business Council was established to promote cooperation between the two business communities, and assistance was given in identifying specific obstacles to approval and implementation of key investment proposals.

The Assistant Secretary for International Affairs is a member of the United States-Iran Joint Commission for Economic Cooperation, and Treasury officials participated in meetings of the Commission's Joint Committee on Economics and Finance in September 1975 and August 1976.

Secretary Simon is the U.S. Chairman of the United States-Israel Joint Committee for Investment and Trade and headed the U.S. delegation to the second meeting of the Committee in Jerusalem on March 1, 1976. While in Jerusalem, the Secretary signed an agreement establishing the United States-Israel Binational Industrial Research and Development Foundation which, after entry into force, will provide funds for mutually beneficial cooperation in industrial research and development activities.[10] On November 20, 1975, the Secretary signed a tax treaty with Israel which is now before the Senate. Treasury was also instrumental in helping launch the Israel-United States Business Council, consisting of representatives of the U.S. and Israeli private sectors, which is expected to complement the work of the governmental Joint Committee.

Policy and actions on the Arab boycott.—As a result of the greatly expanded financial and business relationships between the United States and the Mid-East Arab States, attention was increasingly focused on problems surrounding the Arab boycott of Israel. Several bills aimed at countering the impact of the boycott on U.S. firms were introduced in the Congress, and Secretary Simon and other senior Treasury officials gave the administration's position on these bills in testimony before congressional committees and in public statements.[11] The legislative process culminated in passage by the Congress of the Tax Reform Act of 1976, which included denial of certain tax benefits to U.S. persons for cooperation with or participation in international boycotts.

Latin America.—The importance of economic and financial relations with Latin America was highlighted by Secretary Simon's trip to Chile, Brazil, and Mexico in May 1976. Events leading to announcement of a $600 million swap arrangement with Mexico in September 1976 demonstrated in a dramatic way the firm resolve of the U.S. Government to support Mexico's efforts to strengthen its economy.

The Secretary's visit to Brazil aimed at resolution of several specific trade problems and establishment of closer economic cooperation

[10] See exhibit 65.
[11] See exhibit 73.

between the two Governments. A joint communique issued by Secretary Simon and Finance Minister Simonsen[12] summarized the results of the visit, including settlement of several important bilateral trade disputes and announcement of the two Ministers' agreement to establish and cochair a consultative group on trade, investment and financial issues.

The Secretary's visit to Chile had a twofold purpose: (1) To encourage the Chilean Government in its efforts to correct the severe economic imbalances of the past and in its stated desire to meet its responsibilities to creditors throughout the world; and (2) to discuss the human rights situation in Chile and its implications for United States-Chile economic cooperation.

In conversations with Chilean officials, including President Pinochet, Secretary Simon emphasized that U.S. support of Chile's economic efforts depended on the Chilean Government's commitment to the protection of human rights. The Secretary met with Finance Minister Cauas and other Chilean officials, who pointed to a number of measures they were taking to improve the human rights situation in Chile, including the release of political prisoners under the parole program and other programs.[13]

In Mexico, Secretary Simon had the opportunity to meet with President Echeverria and other top officials to discuss the state of the Mexican economy and U.S. economic relations with that country. In light of the December 1975 agreement to expand and extend the swap agreement which the United States has had with Mexico for many years, developments in Mexico's balance of payments situation were the subject of continuing discussions between Mexican and U.S. officials. The Mexican Government decided to break with its long tradition of maintaining a fixed parity for the peso and announced floating of the exchange rate on September 1, 1976, resulting in a substantial devaluation.

The Mexican Government made arrangements with the IMF and the United States to obtain substantial resources in support of a program to adjust its balance of payments. On September 20, the Treasury and the Federal Reserve System announced arrangements with the Government of Mexico whereby short-term drawings up to $600 million would be available to the Bank of Mexico to counter disorderly exchange market conditions during a transitional period pending the receipt of medium-term financing from the IMF. Drawings under these arrangements would have maturities of up to 90 days. Of this amount, and at the option of the Government of Mexico, the Federal Reserve System would make available amounts repaid in advance of maturity under the existing Federal Reserve System reciprocal currency arrangements up to $180 million. The remaining amounts would be made available by the Treasury through the Exchange Stabilization Fund under swap arrangements.

[12] See exhibit 70.
[13] See exhibit 69.

ADMINISTRATIVE REPORTS

ADMINISTRATIVE MANAGEMENT

Special studies, projects, and programs

Numerous studies and projects were completed by the management staff within the Office of the Assistant Secretary (Administration) which developed management systems and operating procedures to strengthen general organization effectiveness.

Office of the Secretary.—An evaluation of organizational responsibilities for overall planning procedures resulted in long-range planning and program evaluation functions being reassigned to the Office of Budget and Program Analysis. The integration of long-range planning with budgeting will strengthen overall planning efforts by highlighting the financial impact of the plans.

A comprehensive analysis has been made of the nature and status of the Office of Revenue Sharing compliance program. Research was conducted into the following substantive areas: Cooperative agreements with other Federal agencies, State human rights agencies, State audit agencies, and independent auditors employed by State and local governments; procedures for processing complaints; case histories of complaints; intergovernmental relations and public affairs activities in furtherance of the compliance program; and allocation of staff resources.

A review of the organization and operations of the Office of Foreign Assets Control studied its current operations in the context of changing political and economic circumstances caused by shifts in U.S. foreign and domestic policies. Specifically, the study addressed current and potential workload and operational effectiveness, and validated resource requirements.

A newly created Office of the Assistant Secretary (Capital Markets and Debt Management) includes programs formerly assigned to the Office of Debt Analysis, the Special Assistant (Debt Management), and the Office of Capital Markets Policy. Supervision and coordination of these functions by an Assistant Secretary recognizes their increasing importance and priority.

Disestablishment of the Office of Domestic Gold and Silver Operations became effective July 31, 1975. Those functions not terminated were transferred to the Office of the Assistant Secretary (International Affairs).

A study is underway to determine the feasibility of formalizing an agreement between the Departments of Treasury and Labor, and the Equal Employment Opportunity Commission. The agreement would attempt to foster consistent practices in the investigation of the employment practices of the financial institutions for which Treasury has contract compliance responsibilities.

Departmental.—The Department's policy on the in-house operation of commercial or industrial activities has been updated. Requirements of periodic review of in-house activities and procedures for approval of new starts have been revised to require more intensive analysis and justification.

As an expression of Treasury's commitment to make the Department more responsive to the consumer, a consumer representation plan was developed and promulgated throughout the Department by the Office of the Secretary. The plan includes actions which expand the opportunities that persons will have to present their views on any potential legislation, regulation, or program decision by Treasury which might affect them. A Special Assistant to the Secretary serves as coordinator of the consumer representation effort to insure effective solicitation and use of consumer views.

A comprehensive contract study of U.S. coinage has been completed. The study examined improved ways of making future coin demand projection to 1990, the ability of the coinage production-inventory-distribution system to meet demand, and the options which are open for changes to the sizes, denominations, and composition of coins.

A task force examined the feasibility and potential benefits of automating all or part of the budget process within the Department. The task force discussed the status of budget automation with other departments and agencies, Office of Management and Budget, General Accounting Office, and the Congressional Budget Office. The study produced a three-phased plan for automation of the Treasury budget process which would aline the budget and accounting systems in order to identify cost and performance of each program.

A management review of the civil emergency preparedness program is now in progress. The purpose of the review is to document the participating Treasury bureaus' views on the program's strengths and weaknesses. The findings will guide Treasury's approach with the Federal Preparedness Agency (FPA) and administration of the Department's emergency preparedness functions.

Management by objectives.—The departmental management by objectives program has been reemphasized Department-wide as an important management vehicle for focusing on short-term priority objectives to improve program operations. Treasury's success in managing by objectives, and the high visibility of the process, are due to the meetings between the Deputy Secretary and the bureau heads to review progress and identify potential problems.

Productivity.—The Department maintains a longstanding commitment to productivity management. To insure continued improvement, a management consultant firm conducted a review of the Department's productivity management efforts and accomplishments to date. Specifically, the review assessed the validity of current productivity measures, identified areas with immediate improvement opportunities, recommended changes to the existing measurement system, and developed an approach and recommendations for a Department-wide productivity management program to include improvement, measurement, costs, and quality of output. The review was conducted in headquarters and selected field locations of all Treasury bureaus with the exception of the Office of the Comptroller of the Currency and the Federal Law Enforcement Training Center. Those two organizations were excluded since significant projects for improving their organization and operations were currently underway.

A study of criminal enforcement activities in the Southeast region of the Bureau of Alcohol, Tobacco and Firearms is in progress. This pilot project was undertaken to demonstrate the feasibility of establishing usable productivity measures for the management of the Department's law enforcement programs.

Advisory committee management.—The Assistant Secretary (Administration), as departmental advisory committee management officer, continues to advise and assist all Treasury components in the application of procedures required by the Federal Advisory Committee Act (Public Law 92–463) and reviews advisory committee utilization and effectiveness.

Assistance to foreign governments and officials.—The Foreign Visitor Program office has provided orientation, educational, and training programs on a continuing basis to foreign visitors referred by the Agency for International Development (AID) and other agencies, both governmental and nongovernmental. In fiscal 1976 and the transition quarter, over 100 man-days have been involved in such activity. Visitors have come from less developed countries and also from Western Europe and other industrial areas of the world for more advanced and specialized consultations and training.

Emergency preparedness

The principal program emphasis this period has been on improving the overall Treasury readiness posture at the regional level. To accomplish this, staff visits were made to the 10 standard Federal regions to exchange information and ideas with FPA Regional Directors, Treasury regional preparedness coordinators, and other bureau personnel. They also assisted in the preparation for the regional readiness reviews that were conducted by Treasury and FPA teams during the latter part of fiscal 1976. The preliminary findings of these reviews indicate an overall improvement in the state of emergency preparedness at the regional level.

In spring 1976, the plans and procedures of the Department's emergency planning program were exercised and tested at national headquarters level and in two selected regions during the conduct of Federal civil readiness Exercise REX–76. The overall Treasury participation emphasized the testing of (1) contingency communications and operating plans/procedures, (2) damage estimate/assessment procedures, and (3) the practical implementation of lessons learned in Exercise REX–75. During the exercise, three action/control teams relocated to the Treasury emergency operating facilities, as appropriate for the play of the exercise scenario.

Other important activities conducted during the period included:

(1) Participation with other agencies in a major review of Civil Emergency Preparedness Policy Planning Guidance.

(2) Assisting in the preparation of a Federal Response Plan for Peacetime Nuclear Emergencies.

(3) Commencement of a management review of the administration of the Department's civil emergency preparedness program.

Treasury payroll/personnel information system

The Treasury Employee Data and Payroll Division was assigned two major projects in fiscal 1976: (1) Implementation of the Treasury payroll/personnel information system (TPPIS), and (2) improvement in reporting of minority statistics in the Department.

TPPIS is a major administrative project that encompasses all bureaus, the five existing automated Department payroll systems, and the individual bureau manual personnel processing systems. TPPIS will be a single automated system providing automated payroll and personnel processing, reporting, and cost center accounting. Further, TPPIS will employ remote intelligent terminals for data input and informational reporting. This will alleviate one of the serious deficiencies of current systems, which does not allow submitting offices to resolve errors immediately or control the data in the system.

In June 1976, the Secretary approved the implementation of TPPIS at two sites: (1) The IRS Detroit Data Center for 100,000 IRS employee accounts, and (2) the Bureau of the Mint San Francisco Computer Facility for 45,000 employee accounts of Treasury bureaus other than IRS.

The developmental phase of the TPPIS implementation project has been completed for bureaus other than IRS. Reporting requirements have been determined, user operating manuals developed and printed, and training packages developed and tested. The conversion phase began on September 26, 1976, with the conversion of the Bureau of Alcohol, Tobacco and Firearms to TPPIS. The conversion phase is expected to be completed in December 1977, including the conversion of IRS to TPPIS.

The management of the automated REST (reporting employee statistics in Treasury) system is a function of the Treasury Employee Data and Payroll Division. Several projects have been accomplished and are planned which improve both the quality and timeliness of minority statistical reporting.

Accomplishments include the mechanization of the annual Distribution of Employment by Percentile Bureau Report, considerably reducing staff hours needed for the manual compilation of statistics. In addition, an automated procedure has been developed to enter into the REST system certain personnel/payroll data from the payroll systems. This will reduce substantially the manual effort required at the bureaus and data processing facilities and also eliminate the cause of many errors.

Internal auditing

The Office of Audit made appraisals of selected audit activities at the Office of Revenue Sharing and the U.S. Secret Service, and another at the Bureau of Engraving and Printing was in progress at the end of the reporting period. A survey was also made of internal auditing at the Office of the Comptroller of the Currency.

The appraisal at the Office of Revenue Sharing identified opportunities to improve, within the constraints imposed by the size of its audit staff, the timeliness of processing external audit reports and compliance cases, the monitoring of State audit agreements, the accounting for the status of cases, and the control of case files. Action on recommendations in these areas is well underway.

The Office of Audit staff worked with a Customs task force on developing a cost management information system and also with the Treasury Employee Data and Payroll Division in implementing the Treasury payroll/personnel information system. Work on TPPIS is concentrating on reviewing the adequacy of internal controls, ensuring a proper conversion from the IRS system, and arranging for GAO involvement in the accounting system approval process. Focusing on issues raised in a Bureau of Alcohol, Tobacco and Firearms internal audit, a review of the ATF accounting system identified ways to improve accounting procedures and practices.

An audit was made of selected administrative policies of the U.S. Railway Association at the request of the Under Secretary. The resulting report commented on consulting contracts with former officers, documentation and criteria for official entertainment expenses, the reimbursement of employees electing to commute rather than to relocate, and other matters. Local and syndicated news coverage reinforced the principal conclusion of the examination that the USRA Board of Directors should become actively involved in the review and approval of compensation and fringe benefit policies.

A report on an audit of the Exchange Stabilization Fund contained recommendations intended to improve the management of outstanding advances, to encourage adherence to travel regulations, and to strengthen accounting controls in several other areas. Financial audits were also made of the working capital fund, the Treasury Historical Association, the closeout of economic stabilization program activities, and the Treasury Welfare Association.

The Director of the Office of Audit coordinates Treasury employee allegations of violations of the merit system that are inappropriate for normal grievance or appeals procedures. Able technical counsel is provided by specialists in the departmental Office of Personnel. Most of the allegations that are made concern the promotion process or adverse actions. Over 40 cases have been established in the last 2 years, and only 3 remain unresolved. A leveling off of new cases probably reflects elimination of an initial backlog.

How to increase reliance on grant audits made by non-Federal auditors emerged as the principal issue addressed in working with other agencies as a member of an Audit Reform Task Force and the National Intergovernmental Audit Forum. The staff also participated in departmental studies of productivity measurement.

Budget and program analysis

Pursuant to Treasury Order No. 200, Amendment 7, dated April 15, 1976, the Office of Budget and Finance was reconstituted as the Office of Budget and Program Analysis, including a Division of Budget and Long Range Planning and a Division of Program Analysis.

The Office of Budget and Program Analysis continued to develop policies and procedures and to direct and coordinate the formulation, justification, and presentation of short- and long-range budget estimates. During fiscal 1976, the estimates totaled $47.6 billion. The amount includes $2.6 billion for operating appropriations, $38.6 billion for public debt and other interest and miscellaneous accounts, and $6.4 billion for general revenue sharing. During the transition quarter, budget estimates totaled $12.2 billion and included $0.7 billion for operations, $9.9 billion for public debt and other interest and miscellaneous accounts, and $1.6 billion for general revenue sharing.

During the period of this report, staff of the office:

(1) Established and maintained controls on expenditures, number of personnel on roll, and motor vehicle fleet to comply with limitations and directives prescribed by OMB.

(2) Issued a directive establishing a Treasury financial resource management system. It revises the instructions pertaining to the Treasury long-range planning system and the spring budget preview. It also provides new instructions for evaluation and productivity plans. These functions and related reports are now combined as the spring review phase of an integrated financial resource management system.

(3) Gave special budgetary consideration and emphasis, including the

preparation of requests for budget amendments and supplemental appropriations and reimbursements, to programs of special concern to the administration. These included a supplemental appropriation of $13.4 million for the U.S. Customs Service ($9.6 million in fiscal 1976 and $3.8 million for the transition quarter) to enable it to respond to the new Presidential initiative concerning the interdiction of narcotics at U.S. borders; and $21.7 million in fiscal 1976 and the transition quarter for additional travel and other costs associated with protection of Presidential candidates and foreign dignitaries by the U.S. Secret Service.

(4) Obtained supplemental appropriations for the cost of pay increases authorized by Executive Order 11883, wage board actions, and administration action amounting to $84.6 million. An additional amount of $13.9 million of the increased pay costs was absorbed by application of management savings, reimbursements, and certain administrative action.

(5) Assisted in the preparation and presentation of budget requests for funds totaling nearly $700 million to be appropriated to the President for the U.S. share to the international financial institutions of which the Secretary of the Treasury serves as a Governor.

Personnel management

A new Government-wide position evaluation system was tested and applied in a number of Treasury field and headquarters offices. A 2-day workshop was given on the application of eight draft standards utilizing the new approach.

An evaluation review was completed of position management systems of the 13 personnel offices reporting to Office of Personnel.

The Department's average grade continues to be monitored. Since 1968, the Department's average grade has been relatively steady at about 7.7.

New regulations were developed to achieve uniformity in the administration of laws governing annual premium pay for administratively uncontrollable overtime, with a view toward reducing overtime costs.

The departmental guide on merit promotion was revised and issued. This material will assist bureaus in determining basic requirements which bureau plans must meet and will aid the Department in monitoring bureau activities.

Bureaus have continued to gain in making the development of their managers and executives a systematic process. In formal programs, 25 managers and executives attended the Federal Executive Institute in Charlottesville, Va., and over 220 attended the various programs of Executive Seminar Centers.

Emphasis has been placed on refining the formal upward mobility program and expanding the conceptual base to include all informal activities resulting in the movement/placement of underutilized and undertrained employees. Extensive research has been conducted preliminary to implementing an automated interbureau placement system. The bureaus have identified 708 target positions to be filled through formal upward mobility programs; of that number, 356 employees were in training and 277 had been placed into target positions as of September 30, 1976. Bureaus reported 11,320 employees participating in informal programs.

Efforts to improve bureau personnel management programs continued. During fiscal 1976, the Department conducted a nationwide followup evaluation of the Bureau of the Mint. Positive change as a result of last year's surveys was seen during followup evaluations in Secret Service, Customs Service, and Public Debt. Headquarters-level surveys were completed in ATF, Public Debt, and the FLETC.

As a joint venture of three executive departments, Treasury undertook the development of a training workshop in the onsite personnel management survey process to improve the expertise and effectiveness of evaluators.

In response to the Secretary's concern over the responsibility of managers and supervisors to clearly communicate standards of acceptable performance, the Employee Relations Staff published and distributed a handbook for Treasury managers and supervisors identifying their roles in the management of human resources.

Treasury's labor relations program continues to be an innovative, expanding, and dynamic force in the management process. Again, as in the previous fiscal year, Treasury led all Cabinet agencies in the extent to which its employees have organized. More than 96,000 employees are represented by 18 different unions in 9 Treasury bureaus. Over 90 percent of all eligible employees are now organized, and virtually all of these are covered by negotiated agreements. The trend toward increased third-party involvement in Treasury's labor-management relations continues. Union-management controversies involving unfair labor practice charges, impasses in negotiations, and questions of negotiability have been referred in increasing numbers to third parties for resolution.

Procurement and personal property management

During fiscal 1976 and the transition quarter, the negotiation of 42 blanket purchase agreements for use by all Treasury bureaus provided a savings in excess of $160,000. The consolidation of Treasury requirements for 562 undercover law enforcement vehicles, procured through GSA, resulted in a significant dollar savings over separate procurement methods and an improved quality of vehicle; vehicles purchased included compacts, intermediate-size and full-size sedans.

Treasury's personal property transactions included the reassignment within Treasury of property valued in excess of $800,000; transfer of personal property valued in excess of $2.7 million to other Federal agencies for their use; and the donation of personal property valued at approximately $1.1 million no longer needed by the Federal Government for use by State organizations and nonprofit groups. Treasury also obtained, without cost, personal property valued at over $5.6 million from other Federal agencies.

Real property management

The Federal Law Enforcement Training Center was established at the former Glynco Naval Air Station, Brunswick, Ga., in August 1975, on the basis of a right-of-entry permit granted to Treasury by the Department of the Navy. The formal transfer of the excess Navy land and structures to Treasury will be consummated by November 1, 1976. The space occupied by the Federal Law Enforcement Training Center at 1310 L Street, NW., Washington, D.C., has been reassigned to the U.S. Secret Service as an interim collocation site, to meet expansion needs and to serve as the first step toward the goal of total consolidation for Secret Service headquarters activities.

The Office of the Secretary opened a new field office in New York for the Office of Equal Opportunity Program. The existing field offices in Atlanta, Chicago, Houston, and Los Angeles were expanded in size to accommodate augmented staffs, and the Washington, D.C., field office was relocated to permit similar augmentation.

The U.S. Customs Service completed moving its headquarters offices into the Federal Building at 1301 Constitution Avenue, NW., Washington, D.C., on June 30, 1975. The move of Customs' computer operations into the building has been delayed until a renovation prospectus, which will permit the construction of a computer room, is approved.

The U.S. Secret Service pistol range will be relocated in November 1976 from the existing obsolete facility in the Main Treasury Building to a new range under construction in the 12th and Pennsylvania Avenue Federal Building. The vacated facility in Main Treasury will be reclaimed to expand the space available within the Main Treasury complex for office and storage functions.

Planning for the relocation of the Cash Room, including all of the necessary historical evaluations and approvals, was completed prior to the Bureau of Government Financial Operations' decision to discontinue the cash services function. The proposed new location on the first floor of the Treasury Building, just north of the west entrance, was planned and designed to receive the banking function and to free the Cash Room for conference and ceremonial use, and for possible restoration. The banking activity closed on July 1, 1976, and the Cash Room was vacated on August 1, 1976. The design and construction plans for the proposed new facility offer a viable possibility for the creation of another entrance to Main Treasury, should the need arise.

Major renovations in the Main Treasury complex are continuing. The installation of air conditioning in the first 2 of 10 zones was completed on March 31, 1976. Funds have been transferred to the General Services Administration for the initiation of renovation work in six additional zones, to take place over the next several years.

The relocation of Printing Management, including the Printing Procurement and Graphics Branches, to newly created office space in the basement of the Treasury Annex was completed in September 1976. This combined effort in space planning, interior design, and construction implementation by Treasury group forces will result in an annual reduction of about $17,500 in lease costs; it will also release for reassignment a large block of office space on the fifth floor of Main Treasury for expanding Office of the Secretary staff requirements. This and other measures to achieve better space utilization in the Main Treasury complex have already resulted in the reclamation of 24,000 square feet of previously unoccupied space for specialized operational use, and cost avoidances of about $380,000. Recurring annual savings are estimated to approach $1.8 million.

Printing management

The Federal Law Enforcement Training Center's move from Washington, D.C., to Brunswick, Ga., during the first quarter of fiscal 1976 made it necessary for Printing Management to prepare for printing support for the Center. Discussion resulted in an approved support arrangement which included the establishment of a duplicating facility and the transfer of a printing procurement officer from the Office of the Secretary to the FLETC.

The recent Printing Management physical consolidation now provides contiguous space for the Assistant Director and the immediate staff, and the Printing Procurement and Graphics Branches. The space is directly above the newly consolidated departmental printing plant in the Treasury Annex. Developmental expansion during fiscal 1976 now makes it possible to handle all printing requests, regardless of their complexity, for the Office of the Secretary and bureaus served.

A concerted effort by Printing Management during fiscal 1976 to upgrade the copying machine program was successful. One of the benefits was greater flexibility for the Office of the Secretary in acquiring various brands of copiers, systems, services, and supplies, resulting in cost savings, more dependable equipment, and better service to users.

The development of a plan for an office reorganization in the departmental printing plant began during fiscal 1976. It will produce greater job specialization, thereby facilitating production and efficiency in the office and, concomitantly, in the plant.

Fiscal 1976 realized the largest amount of printing ever produced in the Department of the Treasury, attributed largely to the construction of many sophisticated, full-color Bicentennial promotional pieces, especially in the numismatic area of the Bureau of the Mint. Other new programs such as the Freedom of Information and Privacy Acts generated additional printing and binding. The increased printing volume from these new laws is anticipated to continue in the future.

Physical security

Procedures were issued which require that all requests for security-type containers be reviewed by the Office of Physical Security. As a result of detailed reviews of a total of 56 requests within the Office of the Secretary, 20 were disapproved. With an average cost of $750 per container, this has resulted in a cost avoidance of $15,000 along with the attendant savings in space requirements and a reduction in the vulnerability of compromise of obsolete classified material.

An exhaustive survey was conducted of existing security alarm and protective systems in the Main Treasury and Annex Buildings and leased buildings in order to revalidate requirements. This survey determined the costs versus accrued benefits and resulted in the elimination, reconfiguration, and consolidation of certain alarms with an annual cost savings of approximately $9,000.

As mandated by Executive Order No. 11652, entitled "Classification and Declassification of National Security Information and Material," a concerted effort has been made to reduce the number of officials authorized to originally classify national security information and material. This effort has reduced by 77 percent the number of authorized classifiers, from 699 in 1972 to 162 in 1976, and also contributes to a reduction in the number of documents unnecessarily classified.

A new identification card was developed and issued to former departmental Presidential appointees which provides these individuals with a means for immediate access to the Main Treasury and Annex Buildings.

New building passes are being issued to personnel of the Office of the Secretary and those bureaus utilizing the same building pass system as the

Main Treasury and Annex Buildings. The accountability of previously issued passes did not provide for acceptable security. These new passes are an integral part of the new controlled-access procedures which have enhanced the security posture of these buildings.

Telecommunications

Telecommunications complex.—Construction work is in progress on the renovation of the first-floor vault complex of the Main Treasury Building. The complex will eventually contain the Treasury automated communications system (TACS), the new Centrex telephone system, and support activities for the two systems. The project is being monitored by both Real Property and Telecommunications activities and will be completed during calendar year 1976.

The consolidation of telecommunications activities and the replacement of obsolete equipment with electronic devices will make available approximately 5,000 square feet of office space within the Department.

Treasury automated communications system.—A request for proposal was issued in May 1976 asking vendors to bid on the automation of the existing Communications Center. A tour of the vault complex and a preproposal conference were held for approximately 50 representatives of interested vendors. Proposals have been received and are being evaluated by a team of representatives from the Telecommunications, Computer Science, and Procurement activities. A contract should be awarded by the end of 1976.

Treasury electronic telephone system.—Several interim steps in the conversion of the Treasury telephone system to Centrex II were accomplished in fiscal 1976. Currently about 15 percent of the telephones in the Department have been converted to the new service. The final step will occur with the conversion of the Main Treasury, Internal Revenue Service, and Customs Service in the first quarter of fiscal 1977.

Secretarial secure travel communications.—A portable communications trip package was developed during fiscal 1976 to provide direct secure message communications between overseas trip sites and the Treasury Communications Center. Traffic can be routed over international circuits, reducing the Treasury delegation's dependence upon State Department or Department of Defense facilities. A trip communications officer was assigned to accompany the Secretary during international travel. During 1976 and the transition quarter, he participated in five overseas trips. Planning is in progress to upgrade the portable teletype terminals to take advantage of the higher speed capabilities of the Treasury automated communications system, thus greatly reducing message handling times and transmission costs during future Secretarial travel.

Radio frequency program.—The law enforcement units of the Department have experienced difficulty with their mobile radio transmissions due to interference from weather broadcasts, which occupy the same frequency spectrum assigned to land mobile radio. Appeals have been made to the agency concerned and to the appropriate interagency committee in an attempt to resolve this conflict. Substantial steps were taken, but the situation remains unresolved.

Private communications for law enforcement.—A new family of electronic equipment which provides a limited degree of protection for voice communications was field-tested and demonstrated to potential users within the Department. The voice protection device (VP–II) was developed by the National Security Agency for use on mobile radio systems. A miniaturized hand-held version of the VP–II is under development. At this time, a requirement for approximately 2,000 of the devices has been identified.

Data encryption devices.—Development of encryption devices for computer data communications has started in the Federal Government. The Department has participated in joint efforts of the Internal Revenue Service, the Federal Reserve Board, the National Security Agency, and the National Bureau of Standards to develop prototype devices. The devices may become standard interface equipment for use by all Government agencies to satisfy unclassified data protection requirements.

Paperwork management

Implementation of new directives system.—Major emphasis has been directed toward implementation of the directives system developed in fiscal 1975. A goal of converting all policy issuances to the new codified system was established and significant strides were made, with 60 percent of the goal being accomplished.

Records disposition scheduling.—Surveys of files classification systems in the Office of the Secretary were undertaken as a means of assisting offices in the implementation of the schedules developed in fiscal 1975. This resulted in realistic scheduling of records for disposition and in installation of improved standardized files classification systems.

Privacy Act implementation.—In addition to traditional paperwork management functions, the Paperwork Management Staff also has responsibility for oversight of the administration of the Privacy Act of 1974 (Public Law 93–579). Most requests for information under the Privacy Act are directed toward the enforcement and revenue collection agencies of the Department—Customs Service, Internal Revenue Service, Bureau of Alcohol, Tobacco and Firearms, Secret Service, and Interpol. During the first year of operation, basic policy and practice were defined and three departmental reports were prepared.

International support

The International Support Staff served as the principal coordination point in the Office of the Secretary in the formulation and implementation of plans for the Secretary's reception held on September 2, 1975, in the Main Treasury Building, as part of the IMF/IBRD conference. This reception honored many foreign dignitaries and was attended by over 1,200 guests, including top elected and appointed officials of the Federal Government. This project created a wide range of challenges, as this was the first reception of its kind held within the building in recent years.

Secretary Simon and Deputy Secretary Gardner attended several high-level meetings which involved 8 trips abroad to 21 foreign countries. Administrative arrangements were coordinated by the International Support Staff.

Facilities management

A Facilities Management coordination program has been established to provide space planning services, improve space utilization, and coordinate work projects in the Office of the Secretary.

Facilities Management review of projects and related purchases has resulted in greater efficiencies and economy. Studies of office space utilization such as one completed for the Office of Tax Policy have resulted in reductions in space assignments and the housing of increased numbers of personnel within the Office of the Secretary space.

Environmental programs

The Assistant Secretary (Administration) approved environmental assessments concerning a proposed approval by the Comptroller of the Currency of an application for the establishment of a branch of a national bank, and an ATF proposal to relocate its headquarters laboratory from Washington, D.C., to nearby Maryland. Assistance was provided to the General Services Administration in the preparation of an environmental assessment concerning a GSA proposal to relocate and consolidate two Treasury bureaus in a newly constructed building in Washington, D.C., leased by GSA.

Treasury continued its participation as a statutory member of the Advisory Council on Historic Preservation (ACHP). In addition to such activities, the Department was involved with internal historic preservation matters as, for example, a Treasury-ACHP memorandum of agreement concerning an ATF permit action in connection with the proposed expansion of the facilities of a California winery. The agreement formalized measures to mitigate any adverse effect of the expansion on the historic character of existing winery facilities.

Department-wide energy conservation efforts during this period led to Treasury's placing second among 27 Federal agencies in energy reduction ratings for buildings and facilities. Treasury did experience some difficulty in energy conservation with respect to law enforcement vehicles and equipment. The nature of law enforcement operations precluded total attainment of mileage and gasoline usage reduction goals.

In the area of pollution abatement, action was completed in conjunction with the Environmental Protection Agency (EPA) and applicable State agencies concerning a Treasury-EPA consent agreement to terminate the use of the Bureau of Engraving and Printing's incinerator at its Washington, D.C., headquarters, and on an application for a National Pollutant Discharge Elimination System permit for the Customs Service Detector Dog Training Center, Front Royal, Va. Action in accordance with the Treasury-EPA agreement was completed well ahead of schedule and will contribute to improving air quality in Washington, D.C.

Safety

Treasury, with one of the oldest safety programs in the Federal Government, established a milestone with the inauguration of its "safety plan of action" project as required by the Secretary of the Treasury. The prototype plan, nearing completion by the Secret Service, will be the model for the remaining bureaus. The entire plan, which will be completed by the close of fiscal 1977, will encompass every element of the Code of Federal Regulations as applied to safety and health.

Highlighting the year's activities was the occasion of the 19th annual meeting of the Treasury Safety Council, attended by the Deputy Secretary, the top staff, and the heads of bureaus.

Treasury Historical Association

The Treasury Historical Association held its second annual meeting on April 15, 1976, at which a special Bicentennial annual report was issued.

There were several guest speakers including former Secretary of the Treasury John W. Snyder. Election of a new Board of Directors was held.

At a meeting of the new Board held on May 19, 1976, an election of officers resulted in the appointment of Dr. Charls E. Walker, Chairman, Richard R. Albrecht, President, Francine I. Neff, Vice President, Arthur D. Kallen, Treasurer, and Abby L. Gilbert, Secretary. Sid Sanders continues on as Executive Secretary.

Membership in the Association increased from 210 at the close of fiscal 1975 to 304 at the end of September 1976.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

The mission of the Bureau of Alcohol, Tobacco and Firearms (ATF) is: To reduce the misuse of firearms and the unsafe or insecure storage of explosives, and to assist other Federal, State, and local law enforcement organizations in reducing crime and violence in which firearms and explosives are used, through effective enforcement of the firearms and explosives laws of the United States; to assure that all revenue due under the Federal alcohol and tobacco tax statutes is collected, and to obtain, to the maximum extent possible, voluntary compliance with those laws; to suppress illicit manufacture and sale of nontaxpaid alcoholic beverages; to suppress commercial bribery, consumer deception, and other improper trade practices in the alcoholic beverage industry through effective administration and enforcement of the Federal Alcohol Administration Act; and to assure compliance with the wagering tax laws through effective enforcement of the criminal and forfeiture provisions of the Internal Revenue Code.

The primary ATF law enforcement goals are to keep firearms out of criminal hands and to deter criminal bombings, or if this is not successful, to obtain evidence to convict the persons performing or responsible for illegal acts involving firearms or explosives. The elimination of the manufacture and sale of illicit alcohol, ATF's original mission, is still a responsibility and one in which ATF has had substantial success.

Gangland violence in the 1930's prompted Congress to pass the National Firearms Act of 1934, which imposed a tax on automatic and other gangster type weapons and required their registration. This legislation was followed by the Federal Firearms Act of 1942, which regulated interstate commerce in firearms. Responsibility for both laws was assigned to ATF.

Firearms crimes in the 1960's, heightened by the assassination of a President, a Senator, and a prominent civil rights leader, brought enactment of the Gun Control Act of 1968. The act encompassed existing firearms laws enforced by ATF, and added new provisions. It was followed in 1970 by passage of title XI of the Organized Crime Control Act, which assigned explosives regulation and enforcement jurisdiction to ATF.

During fiscal 1976, ATF initiated a pilot program to curb crime involving the use of guns in three U.S. metropolitan areas. The Bureau also completed two studies—the first of their kind—which documented the use and source of crime handguns. Regulations governing the multiple sale of handguns by federally licensed firearms dealers became effective, curbing another source of weapons intended for criminal use. A program to identify and prosecute the Nation's most dangerous, armed criminals was intensified.

A total of $7.6 billion in alcohol and tobacco excise tax was collected by ATF in fiscal 1976—the third largest segment of U.S. revenue, following personal and corporate income taxes. The revenue collection for the transition quarter was $1.3 billion.

It became Bureau policy in fiscal 1976 to give public notice when deficient alcoholic beverage products are withdrawn from the market. ATF also intensified its regulatory enforcement program against trade practice violations. This included the publication of identifying information relating to ATF action against holders of alcoholic beverage operating permits. The Office of Regulatory Enforcement also took initial steps in conversion of distilled spirits products to metric standards of fill.

Criminal enforcement

In fiscal 1976, ATF made progress in several criminal enforcement areas: the initiation of Operation Concentrated Urban Enforcement (CUE); the identification of sources of firearms illegally purchased, possessed, and used by the criminal element; the arrest of significant criminals; the arrest of persons involved in theft of firearms from interstate shipments; the successful investigation and prosecution of persons involved in the illegal trafficking of firearms internationally; and the investigation of major conspiracies involving significant explosives, wagering, and liquor violations.

During the year, investigations resulted in 3,986 arrests by ATF special agents who made 6,915 seizures of contraband firearms, explosives, liquor, and vehicles valued at $1.5 million. Federal convictions in cases originated by ATF totaled 3,130. In addition, more than 20,000 investigations, including technical, regulatory, organized crime, and foreign assistance investigations were closed. For the transition quarter, there were 337 arrests, and 1,729 contraband seizures valued at $375,406. More than 5,000 investigations were closed.

Operation CUE was started in the Washington, D.C., area on February 16, 1976. Boston and Chicago were selected as the other two CUE cities. The primary objective of Operation CUE is to reduce the criminal misuse of firearms and explosives, and to perfect criminal cases against persons engaged in their illegal use, by the concentration of personnel and other investigative resources in major metropolitan areas. In fiscal 1976, 591 cases were investigated in this pilot program. In the transition quarter, Operation CUE was in full operation in the three pilot cities, with 675 investigations developed in the period.

Significant Criminal Enforcement Project.—This program was designed to accelerate the apprehension of armed and dangerous criminals who willfully violate Federal firearms, explosives, and wagering laws, and to assist State and local law enforcement officials in their fight against crime and violence.

In fiscal 1976, special agents identified 1,019 criminals meeting the project criteria; 684 armed and dangerous criminals were recommended for prosecution. At the fiscal yearend, 297 convictions had been obtained, resulting in the incarceration of 50 defendants. Some 239 others awaited sentencing. During the transition quarter, 255 significant criminals were identified, with 171 recommended for prosecution. A total of 74 convictions were obtained.

In one major case, special agents, utilizing concentrated undercover investigative techniques, interdicted and eliminated a major source of firearms being illegally supplied to the criminal element. As a result of this investigation, two members of the ring, both convicted felons, were arrested and charged with multiple violations of Federal firearms laws. A federally licensed firearms dealer was arrested and charged with illegal sales and recordkeeping violations.

Another ATF investigation involved several SCEP targets who were conspiring to damage and destroy, by means of homemade bombs, buildings and construction equipment located on various sites in the New York City area. The investigation resulted in successful prosecution of the executive director of a federally funded antipoverty organization and others for violations of the Federal conspiracy and explosives laws and interference with commerce by threats and violence.

International traffic in illegal firearms.—Illegal acquisition of firearms and explosives within the United States, destined for terrorist organizations in Ireland, Mexico, and other countries, requires constant investigative attention. Cases perfected by special agents under this project also involved gunrunning to Japan, Lebanon, Jamaica, and Canada.

In one notable case, ATF special agents arrested a foreign official involved in an attempt to divert into illegal channels 500 submachineguns intended for international shipment. Another significant investigation resulted in the conviction of two persons involved in the illegal gunrunning to Northern Ireland of 378 firearms and 140,000 rounds of ammunition.

ATF concluded a case involving a group of men of Syrian and Lebanese extraction, attempting to purchase illegally 500 firearms which were to be smuggled out of the United States concealed in door panels of an automobile. The investigation implicated 7 persons who had obtained 37 guns for this purpose. Three were convicted. One fled the country prior to arrest and is now a fugitive.

Project Identification.—During fiscal 1976, ATF completed and published the first documented national study of handguns involved in crimes. Based on a total of 10,617 crime handguns submitted from 16 major metropolitan cities, tracing revealed that 71 percent, or 6,538, of the handguns had a barrel length of 3 inches or less, and 61 percent, or 6,476, handguns were .32 caliber or less. These figures indicate that concealability is an overriding factor in the selection of crime handguns.

In fiscal 1976, special agents, utilizing the tracing section under Project Identification, assisted in the successful prosecution of Bobby Joe Keese, the person who, in 1974, kidnapped and murdered an American Consul in Hermosillo, Mexico. Testimony of ATF firearms technologists also helped convict Keese.

Explosives investigation.—The potential threat to public safety requires the Bureau to assign high priority to explosives investigations. During fiscal 1976, approximately 1,760 explosive incidents were investigated by special agents, including 723 bombings, 204 attempted bombings, 59 accidental detonations, and 141 incendiary incidents. In the transition quarter, 440 explosive incidents were investigated, including 181 bombings, 51 attempted bombings, 15 accidental detonations, and 35 incendiary incidents.

A typical case in the central United States involved several firebombings of businesses, one of which resulted in three firemen losing their lives. Through diligent investigative efforts, ATF agents obtained indictments against five well-known organized crime figures for the firebombings and the deaths of the three firemen.

ATF seized 116 vehicles valued at approximately $300,000 and monies in excess of $240,000. The Bureau, working with intelligence information and investigative leads received from other Federal, State, and local enforcement agencies, has recommended the Federal Government proceed with civil actions against $25 million in seizures retained as evidence by these various enforcement agencies.

Interstate firearms theft project.—Each year thousands of firearms are stolen while in transit between licensed firearms dealers, manufacturers, and importers. These stolen weapons are highly desired by the criminal element.

As of June 30, 1976, a total of 2,045 investigations into the theft of 13,400 firearms from interstate and foreign shipments have been made by ATF. Special agents have perfected 42 criminal cases against 75 defendants. The total number of firearms theft investigations at the end of the transition quarter was 2,150.

The pressure of intense ATF investigations coupled with successful prosecutions has caused an appreciable decline in the number of thefts. A typical investigation is one where a special agent in New York City, while working undercover, purchased 18 new .38 caliber revolvers, a short time later contracted for another purchase, and at the time of delivery recovered 155 revolvers. The firearms, stolen from an export warehouse at the JFK Airport, New York City, were consigned to the Bank of Bangkok, Thailand.

Assistance to other law enforcement agencies.—The Bureau, through the enforcement of law over which it has jurisdiction, provides investigative and technical assistance to State, local, and other Federal law enforcement agencies. A concentrated effort against crime and violence has resulted from this close cooperation and many criminals have been jailed. During fiscal 1976, ATF made 3,809 referrals of information to other agencies, many of which resulted in arrest and conviction for major criminal offenses. In the transition quarter, 352 information referrals had been made by ATF.

An example of an ATF referral: Acting on information from a confidential informant, ATF special agents gained the confidence of several violators, and obtained firsthand knowledge that the subjects possessed contraband. State agents then executed a search warrant on a suspect's premises, arrested five persons, and recovered five truckloads of stolen property valued at thousands of dollars. ATF also assists State and local enforcement agencies through Interpol.

Regulatory enforcement

Consumer protection.—Enforcement efforts continued against unlawful trade practices defined in the Federal Alcohol Administration Act. In fiscal 1976, permits of 21 alcohol beverage industry members were suspended for periods of from 2 to 20 days; 39 offers in compromise were assessed, totaling $176,000; several cases were referred to the Justice

Department for criminal prosecution. Five permits were suspended from July through October 1976. During this period, four offers in compromise were assessed.

More than 100,000 alcoholic beverage labels and 30,000 advertisements were reviewed to ensure compliance with Federal law and prevent deceptive labeling and advertising. A recall program was initiated to provide for removal of improperly labeled products from the marketplace. During the transition quarter, 25,000 labels and 7,500 advertisements were reviewed.

Public disclosure policy.—To aid consumers, ATF began on January 1, 1976, to make public notice when deficient alcoholic beverages are withdrawn from the market. This information is published, following any withdrawal, in the monthly ATF Bulletin. If a withdrawn product involves a health hazard, flagrant consumer deception, large quantities of a deficient product, or similar situations, a news release also is issued by Bureau headquarters. For lesser violations, news releases are issued at the regional level.

As part of its public disclosure policy, the Bureau began to list in its monthly bulletin actions against alcoholic beverage permitholders, where such action was initiated after January 1, 1976. This disclosure pertains to offers in compromise, permit suspensions, and revocations. ATF retained the option to issue news releases relative to these actions as a deterrent against further violations.

Metrication.—In fiscal 1975, an ATF decision permitted the wine industry to convert from U.S. to metric standards of fill. A similar decision pertaining to distilled spirits was adopted in fiscal 1976. The Bureau believes that conversion to metric standards is advantageous for consumers, industry, and Federal and State regulatory agencies.

Wine bottlers will convert to seven standard metric sizes by January 1, 1979; this conversion progressed during fiscal 1976. The metric sizes for wines are 100 ml., 187 ml., 375 ml., 750 ml., 1 liter, 1.5 liters, and 3 liters. Metric standards of fill will be mandatory for distilled spirits beginning January 1, 1980. Six metric sizes were approved: 50 ml., 200 ml., 500 ml., 750 ml., 1 liter, and 1.5 liters. Distillers will begin conversion to metric standards in fiscal 1977.

Wine-labeling terms.—In fiscal 1976, ATF proposed regulations to define the wine-labeling terms "appellation of origin" and "viticultural area." Both terms relate to a wine's origin. The ATF proposal would give added assurance of the origin of a wine within precise geographic boundaries. At public hearings in San Francisco and in Washington, D.C., in April 1976, it became evident that the proposal was controversial. The Bureau concluded that further study of the proposal was in order prior to any decision or action on these wine-labeling terms.

Ingredient labeling.—Proposed ATF regulations to require ingredient labeling of alcoholic beverages were the subject of public hearings in fiscal 1975. Testimony presented and comments received were overwhelmingly negative. The Bureau concluded that ingredient labeling was not desirable at this time and withdrew its proposal in fiscal 1976. The Food and Drug Administration has since announced that it intends to require ingredient labeling of alcoholic beverages.

Records and reports.—ATF and distilled spirits industry representatives have undertaken a major project to simplify records and reports required of distilled spirits bottlers. The aim of this joint effort is to lessen a burden on government and industry by adopting requirements more compatible with modern commercial accounting procedures and data processing equipment. The Bureau is hopeful that regulations to implement these plans can be issued in fiscal 1977.

Firearm and explosive inspections.—An important aspect of Operation CUE is the expanded program of firearms compliance inspections in the CUE cities of Boston, Chicago, and Washington, D.C. Inspection conducted as a part of CUE, as well as 28,000 additional inspections nationwide, were a valuable source of information on the diversion of firearms to criminal elements as well as a way of ensuring dealer compliance with Federal law.

With the assistance of the Mining Enforcement and Safety Administration (Interior), ATF inspected every explosive licensee and permittee in fiscal 1976. As a part of each inspection, ATF and MESA officers placed special emphasis on the security of explosives and the prompt reporting of losses and thefts to ATF.

Black powder.—Public Law 93-639, January 4, 1975, amended Federal regulations on the use of black powder and accessory items for antique firearms and devices. The law raised from 5 to 50 pounds the amount of commercially manufactured black powder which may be purchased for this purpose. In fiscal 1976, Bureau regulations were proposed to implement the amended law. Final regulations will become effective in fiscal 1977.

Technical and scientific services

Laboratories.—ATF laboratories provided technical and scientific support in enforcing the laws and regulations administered by the Bureau. Headquarters and regional laboratories also assisted, without charge, any requesting State or local law enforcement agency.

ATF continued its leading role in ink identification and tagging, adding many ink formulations to the more than 3,000 catalogued in the world's most complete ink library. Because of ATF initiative, 25 percent of U.S.-made inks are now tagged with a trace chemical, increasing the Bureau's ability to analyze and date questioned documents. The percentage of chemically tagged inks will more than double in fiscal 1977.

Voiceprint analysis, pioneered by ATF, gained wider acceptance in fiscal 1976. In two important cases, voiceprint analysis aided in the conviction of defendants who threatened the President of the United States, and of a murderer in Colorado. Seventy voiceprint cases were processed. Other important identification laboratory functions were firearms, toolmark, fingerprint, and handwriting examinations. The workload in these areas exceeded 2,436 cases. During the transition quarter, 603 cases were processed.

The broad range of forensic services performed included examination of hair, blood, arson and bomb debris, soil, metal fragments, and myriad other evidentiary materials. Analysis of materials required microscopy, complex chemical methods, X-ray equipment and sophisticated instruments to perform atomic absorption and neutron activation tests. Some 2,436 cases were processed.

The new rapid atomic absorption technique, developed by ATF for gunshot residue analysis, was one of the most requested forensic services. In a case that set a precedent in the Virgin Islands, an ATF gunshot residue analysis was introduced for the first time in a murder trial. The defendant was convicted.

In fiscal 1976, 13,844 items of evidence relating to 2,867 cases were submitted to the forensic laboratory for examination. Cases ranged from arson and bombings to assault with firearms. About 75 percent of this work was performed for some 400 State and local law enforcement agencies. Items of evidence examined during the transition quarter totaled 3,461.

New and better procedures for examination of evidentiary materials were developed. Other crime laboratory scientists and forensic students were trained in specialized methodology.

Most chemical laboratory work related to regulatory enforcement, chiefly tax classification and consumer protection. Examination of alcoholic beverage products included test for proof, fill, additives, harmful ingredients and proper labeling.

Formula submission doubled and analyses tripled for nonbeverage drawback products—foods, flavors, medicines—containing alcohol. A contributing factor was the ban on use of Red Dye No. 2 and chloroform in such products. The workload was accommodated by increasing the use of automated test techniques. Other testing guaranteed that industrial alcohol products—toilet preparations, industrial formulas—were labeled correctly. ATF ensured that both drawback and industrial products were constituted to prevent recovery of alcohol for beverage use.

New findings permitted ATF scientists better to distinguish cigar and cigarette tobaccos for tax purposes.

The chemical laboratory also tested foods, artificial flavors and other articles for compliance with regulations set by the Internal Revenue Service and the Food and Drug Administration.

During fiscal 1976, chemical laboratory scientists and technicians examined 4,778 samples, 6,214 formulas, more than 7,000 labels for specially denatured alcohol products, 2,075 samples and 3,430 formulas for nonbeverage food flavors and medicines, 8,635 alcoholic beverage samples, 65 tobacco samples, and 10 samples of excise tax products. More than 8,052 such examinations were conducted during the transition quarter.

Relocation.—During fiscal 1976, work began toward relocation of the ATF headquarters laboratories from Washington, D.C., to a new location in Rockville, Md. The Rockville facility will provide critically needed space and a more efficient and safer laboratory design.

National Firearms Act weapons.—NFA weapons, which include short-barreled shotguns and rifles, machineguns, silencers, and destructive devices, are controlled by ATF. In fiscal 1976, ATF processed 14,818 applications involving the manufacture, import and export, transfer, and registration of NFA weapons. A total of 2,711 certifications were prepared as documentary evidence for court proceedings. Some 3,705 applications were processed during the transition quarter. Certifications processed in the transition quarter totaled 678. The Bureau maintained the National Firearms Registration and Transfer Record, which is the control file for NFA weapons.

Imports.—Under provisions of the Gun Control Act of 1968 and the Mutual Security Act of 1954,[1] 17,075 import permits were issued in fiscal

[1] The International Security Assistance and Arms Export Control Act of June 30, 1976, superseded the Mutual Security Act as statutory authority for control of arms importation.

1976 for firearms, ammunition, and implements of war. Of these permits, 14,406 were for firearms, 1,352 for firearms and ammunition, 645 for ammunition, and 584 for other implements of war. Disapproved applications totaled 1,041. Import permits issued in the transition quarter totaled 4,269 during which time 260 applications were disapproved.

Firearms tracing.—The National Firearms Tracing Center traced domestic and imported firearms to the point of first retail sale for Federal, State, and local law enforcement agencies. A total of 39,761 trace requests were received, 59 percent of these from State and local agencies. By mid-1976, trace requests had increased to an annual rate of nearly 50,000. More than 13,000 gun trace requests were acted upon in the transition quarter. The Firearms Technology Branch also maintained the Bureau's firearms reference collection of more than 3,500 weapons.

Explosives technology.—Expertise in explosives tracing was expanded in fiscal 1976, providing much needed assistance to law enforcement agencies. A total of 626 traces were completed. For the transition quarter, 157 traces were completed. Funding approved for fiscal 1977 will enable ATF to develop a national explosives tagging system. The goal is a system to detect explosives prior to a bombing and to trace the source of explosives after a bombing.

An ATF-developed explosives mailer, to be used for shipment of small laboratory samples of explosives and bomb debris, is expected to be in service in fiscal 1977. The Bureau was appointed to a Federal Aviation Administration task force on explosives security at airports, and task force recommendations will be implemented at U.S. airports. An ATF representative also served on the research and development panel of the working group to combat terrorism.

Data processing.—ATF converted to a data processing system which provided a sophisticated report capability in the areas of property accounting and inventory control. The new system resulted in a saving of two man-years of analysis and development effort.

In support of Operation CUE, a management information system was developed for analysis of criminal enforcement case workload and resource utilization in the three CUE cities. The system is designed for expansion to other cities.

Administration

Financial management-planning system.—Design of this multiple-use system was completed in fiscal 1976. It is intended to monitor daily Bureau progress, yield valuable analysis data, improve resource allocation, automate many recurring and special reports, and facilitate decisions on program priorities.

Grade and age limits.—In line with the President's cost reduction program, ATF established GS–05 as a maximum entry recruitment level for both special agent and inspector positions. An age limit of 35 years for special agent recruits in classification series GS–1811 was approved by the Department and submitted to the Civil Service Commission. Implementation of the age limit requirement will begin in October 1976. Standard oral panel interview procedures for special agent positions are being implemented and will assure more uniform application of interview techniques for these positions.

Personnel management evaluation.—A full-scale review of regional offices was completed. Followup visits are scheduled to assess progress.

An ATF order, Personnel Management Evaluation Program, established the requirement for regional self-evaluation programs.

Labor and employee relations.—Fiscal 1976 marked the final year of the Bureau's first negotiated agreement with the National Treasury Employees Union which represents about 1,000 ATF employees. A new agreement is being negotiated.

During fiscal 1976, the Department of Labor ruled in favor of a Bureau position concerning employee rights, which is considered to have significance beyond ATF. The case concerned rights of employees under Executive Order 11491, as amended, in the area of labor-management relations.

ATF held that employees excluded from coverage of the order were not granted the same rights as Federal employees covered by the order. The Bureau's position was adopted, establishing the principle of agency authority, under the order, in the areas of personnel policies, practices and working conditions.

Training.—Through fiscal 1976, 1,335 employees completed training at the Federal Law Enforcement Training Center, Brunswick, Ga. ATF programs there were expanded. Also expanded was the Bureau's executive development program.

The redesigned inspector training program was completed by 133 inspectors. A self-instruction course for firstline supervisors had 26 participants and 12 graduates. ATF provided training, funded in part by the Law Enforcement Assistance Administration (Justice), to 41,460 employees of Federal, State, and local agencies.

Property management.—The capital assets property system was designed in fiscal 1976 to replace a less precise system in use since ATF became a separate Bureau in 1972. Unique numbers identify property items, and partial automation will reduce manual recordkeeping requirements.

Communications.—Equipment was integrated with the Treasury enforcement communications system to permit automatic transmission of data from headquarters to receiving sites. This eliminated a staffing requirement. Efforts to cut long-distance telecommunications costs resulted in an annual billing reduction of $70,000.

Equal employment opportunity.—Accomplishments included appointment and training of full-time regional EEO officers, EEO training for firstline supervisors, and onsite program reviews for six regions. Minorities and women filling special agent and inspector positions increased by 46. A program stressing the hiring of Spanish-speaking personnel in Dallas, New York, and San Francisco was instituted. Skills surveys, employee orientation, and supervisor seminars continued to stress the Bureau's upward mobility program.

Firearms records.—Records of federally licensed firearms dealers who discontinue their businesses are forwarded to regional offices. Inadequate storage space has presented a problem in retrieval of data from these records.

A three-region pilot program now provides for sending these records to the headquarters Distribution Center. There an open-ended filing system permits searches of indexed records in an average of 20 minutes, compared to a 2- to 5-hour average for unprocessed records. If the project is adopted Bureau-wide, records from all regions will be stored in the new system.

Paperwork reduction.—A study team identified 1,500 forms used at the regional and national levels. Many of the forms dated from the time ATF became a separate Bureau in 1972. A decision to centralize the ATF forms program resulted in the removal of 678 forms from the system.

Of 194 forms requiring reporting by the public, 49 were identified as being unnecessary. Most of these forms are required by statute or regulation. Work is underway to change such requirements and eliminate the forms. When completed, forms required of the public will be reduced by 25 percent.

Inspection

The Office of Inspection has four primary areas of responsibility: Protecting Bureau integrity; reviewing operational activities; auditing the Bureau's fiscal position; and implementing the Bureau's security program.

Integrity investigations.—During fiscal 1976, the Operations Review Division conducted 124 inquiries into allegations involving employee conduct. A total of 31 separate actions resulted from these investigations; 4 resignations, 11 adverse actions, and 16 clearances. A total of 31 employee conduct inquiries were completed in the transition quarter.

Operations review.—Reviews of the operations of 14 Criminal Enforcement district offices and Regulatory Enforcement area offices were used by management to initiate corrective action where necessary. The Division also supervised 75 investigations of accidents involving Bureau personnel or property.

Internal auditing.—Audits and surveys were conducted to appraise a broad range of financial management activities affecting administration, regulatory and criminal enforcement, and technical and scientific services. Special emphasis was placed on assessing the adequacy of the ATF accounting, procurement, and payroll systems. The audit staff also assisted the Operations Review Division in selected operational and integrity investigations. Development of this team concept has brought expertise of varying disciplines to bear on complex aspects of Bureau operations.

Decentralization of the Internal Audit Division began in 1975, with establishment of a staff in San Francisco. During fiscal 1976, additional internal auditors were located in Cincinnati and Dallas. This expansion of the internal audit program enabled ATF to perform timely audits of Bureau programs, react quickly to changing conditions and management needs, and conserve travel and per diem funds.

Security.—The Security Division conducted 546 employee background and security update investigations in fiscal 1976, and 137 in the transition quarter. The majority of these were background investigations of new employees, resulting principally from the initiation of Operation CUE.

Publications

ATF provides to the public and members of regulated industries a wide selection of publications relating to alcohol, tobacco, firearms, and explosives. Information in these publications explains citizen rights under ATF regulations, industry member requirements, and actions and new positions taken by ATF. Included in this listing of publications were Published Firearms Ordinances, The Explosives List, Monthly and Cumulative ATF Bulletins, Bomb Threats and Search Techniques, and Questions and Answers to the Gun Control Act.

Public affairs

Information services.—More than 70 news releases in the fiscal year, and 18 in the transition quarter, were prepared and distributed by the headquarters Office of Public Affairs, covering such topics as major firearms and explosives cases and important regulatory changes.

Congressional liaison.—Congressional liaison officers prepared more than 980 letters in response to congressional inquiries.

Public and industry liaison.—National and international meetings are an important contact point between ATF, law enforcement agencies, and regulated industries. A public affairs officer participated in 16 such meetings including the International Association of Chiefs of Police Convention and the AFL–CIO Industries Show. Four conferences were attended during the transition quarter.

Bicentennial.—The public affairs staff produced a film on ATF laboratory activities which was incorporated in a Bureau educational display at the U.S. Bicentennial Exhibit on Science and Technology at the Kennedy Space Center in Florida. Work was initiated on the ATF museum which will be located in Bureau headquarters.

Internal public affairs.—A summary of national newsclippings concerning ATF was prepared and published three times a week. A monthly newsletter was written, published and distributed to all ATF employees.

Disclosure

The Disclosure Office, which directs the Bureau's implementation of the Freedom of Information Act, as amended in 1974, and the Privacy Act of 1974, completed its first full year of operation. The following statistics cover the transactions of the office in fiscal 1976:

Freedom of Information Act requests, 291; requests granted in full, 80; requests granted in part, 33; requests denied, 25; administrative appeals, 11; appeals granted in full, 2; appeals granted in part, 7; appeals denied, 2; suits brought against ATF under the FOI Act, 4. Privacy Act requests, 287; requests granted in full, 159; requests granted in part, 64; requests denied, 14; administrative appeals, 7; appeals granted in full, 0; appeals granted in part, 7; appeals denied, 1. Total disclosures accounted for by ATF, 65,910.

OFFICE OF THE COMPTROLLER OF THE CURRENCY[1]

The Office of the Comptroller of the Currency was established in 1863 by the National Currency Act, redesignated in 1864 as the National Bank Act (12 U.S.C. 38). The Comptroller, as Administrator of National Banks, is charged with regulating and supervising the national banking system, within the scope of existing statutes and in such a manner as to best serve the public interest.

[1] Additional information is contained in the separate Annual Report of the Comptroller of the Currency.

Prevailing economic conditions in recent years were reflected in the generally conservative position of the banking industry. At yearend 1975, total assets of national banks had increased by 3.6 percent to approximately $554 billion, a relatively moderate rate of increase.

In order to respond more effectively to new and challenging developments in the banking industry, the Comptroller of the Currency commissioned the first major comprehensive review and evaluation of the Office, conducted by the independent management consulting firm of Haskins & Sells in 1974–75.

A series of major recommendations emerged from the study: Reorganization of the internal office structure on a functionally oriented basis, implementation of a program designed to monitor national banks in order to anticipate circumstances which might adversely affect the soundness or liquidity of individual banks or the national banking system in general, requirement of more timely reporting by national banks according to uniform principles of accounting and reporting, greater emphasis in bank examinations on analysis and interpretation of financial data and less emphasis on detailed verification procedures, unification of the financial budgeting process, budget data, and actual expense data into a system of responsibility accounting and reporting, and publication of guidelines for submission of applications for charters, branches, and other corporate functions.

Implementation of the study's recommendations commenced in September 1975. The Office's internal organization structure was revised to more properly meet the needs of effective supervision, regulation, and examination of the national banking system. A senior policymaking body, including both Washington and regional office personnel, was established to serve as counsel to the Comptroller's executive committee and to coordinate and manage all functional and operational activities.

To assist in the effective development and execution of Office policy, the Strategic Studies unit was established in September 1975, principally to identify, monitor, and assess significant developments in the financial services industry which are likely to impact the Office, the national banking system, and the public, and to recommend ways to respond to those developments. To closely monitor industry developments, the unit maintains frequent contact with leading national banks, securities analysts, and investment bankers. Its banking research group performs research studies on issues of current or potential importance to the Office and serves as a resource for servicing the needs of other units for information and analysis. Its statistics group is primarily responsible for receiving, processing, and editing national bank reports of condition and income and responding to public requests for report data.

A formal operations planning process currently is being implemented and refined by the Operations Planning unit created in September 1975. The planning process will ensure adoption of overall Office policy and operating objectives and will integrate the performance of all units toward those objectives. Each organizational unit of the Office annually submits a set of operating plans detailing specific performance objectives and action programs for a 5-year planning cycle. All plans are reviewed and evaluated by the planning unit and senior management based on actual performance.

The Division of Finance and Administration has been charged with the development and implementation of a cost-center responsibility budgeting process to: (1) Project, monitor, and control expenses and property; (2) employ available funds in the most efficient and profitable manner; and (3) implement an improved computer-based fiscal information system to provide more comprehensive and timely financial reporting. The division director, serving as the Comptroller's chief financial adviser, has been responsible for establishing specific guidelines for budget preparation and will coordinate and analyze all budget submissions on both the Washington and regional office levels. Budget implementation is scheduled for January 1977.

An operations review function was created in September 1975 to monitor and evaluate all phases of Office activities through frequent review of all Office policies, practices, and procedures. Operations review encompasses: (1) The operations review program which monitors the quality of the Office's performance of its bank supervisory and regulatory duties; (2) the internal audit unit which examines all facets of administrative operations through financial audits and performance reviews; and (3) the equal employment opportunity program which attempts to identify and resolve discriminatory practices. In March 1976, an EEO advisory committee comprised of Washington and regional office representatives was established to serve as a continuing consultative link of communication between management and the total work force on matters of an EEO nature.

Implementation of recommendations for the corporate functions area commenced with the appointment of a regional director for corporate activities for each of the 14 national bank regions. This action in perhaps the most fundamental area of the Office's activities reflects a major objective of delegating the responsibility for virtually all processing of applications to the regional offices. To facilitate the transfer of this function, the management study recommended the adoption of written policy guidelines for the approval or disapproval of corporate applications. Another important goal has been to streamline the processing of applications through revised forms instructions and internal processing procedures.

In ensuring the optimum standards for bank regulation and supervision, the Office conducts periodic examinations of all national banks to assess their soundness, performance, and compliance with banking statutes. The bank examination process, considered the factfinding arm of the Office's supervisory mission, has been reviewed and substantially revised. Major emphasis has been placed on evaluating banks' internal control systems so as to improve manpower utilization during examinations, verifying data available from bank records rather than developing similar data at the time of examination, and implementing advanced testing procedures, thereby increasing examination efficiency. The trust operations unit and banking operations units including the domestic, international, and EDP functions have revised examination procedures, improved the form and content of examination reports, and designed working papers and work programs to reflect the actual work performed during examinations and to support the conclusions reached.

The consumer affairs unit is responsible for protecting the rights of the public by ensuring bank compliance with the many consumer protection laws. Administration of this obligation is accomplished through the bank examination process and through the review and resolution of consumer complaints alleging violations of law. In 1975, an automated consumer complaint information system (CCIS) was developed to monitor the volume and type of complaints processed, to determine which banks have an inordinate number of complaints filed against them, and to utilize consumer complaints for policy program development. It is expected that consumer issues will intensify and increasingly affect legislative policies and regulatory responsibilities. In order to directly supplement the examination process, a new consumer examination is being developed to concentrate on bank compliance with consumer legislation, such as truth-in-lending, equal credit opportunity, and mortgage lending. Initially, the consumer examination will be performed independently, although integration with the regular commercial examination may occur sometime in the future.

The national bank surveillance system (NBSS) is one of the new functions which will most serve to improve the efficiency of examinations. NBSS is a computer-based, ratio-oriented early warning system identifying trends and conditions in individual banks and in the banking industry which may require special surveillance. A comprehensive bank data base includes data from reports of condition and income, past due loans, and bank examination reports. The statistical profile of each national bank compared with profiles of its peers and a newly developed action control system provide timely and useful information for bank surveillance and examination. The complete program includes specially trained NBSS specialists based in the Washington unit and in each region.

Since the principal resource of the Office is its people, the management of human resources represents a major functional responsibility. During the past 15 months, efforts have been directed toward implementing a progressive program of human resources management which will ensure that the bureau attracts, retains, and develops the most effective work force. The initial thrust has been directed toward establishing the organization, policies and programs necessary for effective recruitment, manpower planning, personnel development, compensation and benefits, and employee relations. To satisfy the organization's human resources needs, a national recruitment program has been designed to identify and recruit candidates with outstanding qualifications. Essential to the manpower planning program is the establishment of a computerized human resources information system, currently being developed.

In the field of personnel development, the main thrust is to provide quality professional continuing education and career development programs to produce and maintain a high level of excellence, particularly in the Office's force of approximately 2,300 commercial and trust bank examiners. In the compensation and benefits area, a progressive position management/classification program is being implemented which ensures the most effective and economical distribution of positions, pay equity, and optimum utilization of manpower resources. In addition, an improved employee relations program is being implemented by management which ensures consistent and equitable treatment of all employees.

OFFICE OF COMPUTER SCIENCE

The Office of Computer Science is the focal point for the ADP program in the Department. The Office has central management responsibilities for ADP planning, policy, and evaluation throughout the Department. Also, it furnishes computer processing and systems development services to the analytical, policy formulation, and administrative functions of the Office of the Secretary.

In fiscal 1976, the Department had 140 computer systems, used 30,200 work years, and spent $483,864,000 in the ADP program. These resources support nationwide programs such as tax administration, general revenue sharing, debt management and administration, analysis of alternative Federal tax policies, revenue collection, law enforcement, and protective intelligence.

The major departmental functions of the Office include continued work with the Internal Revenue Service on the proposed tax administration system. Assistance was provided also to the Bureau of Government Financial Operations, the U.S. Secret Service, the U.S. Customs Service, the Bureau of the Public Debt, and other bureaus and offices in planning new systems capabilities to support mission-related and administrative functions.

The Office of Computer Science is implementing a program to strengthen ADP management and performance in the Department. The key to this program is a new departmental directive which includes, in one place, all guidelines, policies, and procedures appropriate to the management of ADP.

The Office actively pursued its applications development functions during the reporting period. Major initiatives included the development of general purpose economic analysis systems to support Office of the Secretary components. These systems improve significantly the productivity of economists by minimizing their need to concern themselves with data processing considerations. Special projects include survey processing for the Office of Industrial Economics; generation of several large, complex data bases for the Office of Tax Analysis; and development of a system for the Office of Government Financing to handle a variety of functions including generation of the "quote sheet" and yield curves.

In the Computer Center, a principal achievement was the establishment of a user services group to help users have access to the services provided by the Center and to promote more cost-effective use of computer technology by the user community. Also, computer usage charges were reduced by 12 percent in fiscal 1976, reflecting improved efficiency and utilization of the Computer Center.

OFFICE OF DIRECTOR OF PRACTICE

The Office of Director of Practice is part of the Office of the Secretary of the Treasury and is under the supervision of the General Counsel. Pursuant to the provisions of 31 CFR, part 10 (Treasury Department

Circular No. 230), the Director of Practice institutes and provides for the conduct of disciplinary proceedings against attorneys, certified public accountants, and enrolled agents who are alleged to have violated the rules and regulations governing practice before the Internal Revenue Service. He also acts on appeals from decisions of the Commissioner of Internal Revenue denying applications for enrollment to practice before the IRS made under 31 CFR, section 10.4.

On July 1, 1975, there were 126 derogatory information cases pending in the Office under active review and evaluation, 6 of which were awaiting presentation to or decision by an administrative law judge. During the fiscal year, 127 cases were added to the case inventory of the Office, and 34 cases during the transition quarter. Disciplinary actions were taken in 56 cases by the Office or by an administrative law judge during the fiscal year, and 13 in the transition quarter. Actions for the fiscal year were comprised of 2 orders of disbarment, 29 suspensions (either by order of an administrative law judge or by consent of the practitioner), 23 reprimands, and 2 resignations; for the transition quarter, 10 suspensions and 3 reprimands. The actions affected 11 attorneys, 21 certified public accountants, and 24 enrolled agents in the fiscal year; 2 attorneys, 4 certified public accountants, and 7 enrolled agents in the transition quarter. Thirty-five cases in the fiscal year were removed from the Office case inventory after review and evaluation showed that the allegations of misconduct did not state sufficient grounds to maintain disciplinary proceedings under 31 CFR, part 10; 19 such cases were removed in the transition quarter. At the end of the fiscal year, there were 162 derogatory information cases under consideration in the Office. As of September 30, 1976, there were 164 cases so pending.

During the fiscal year, 15 attorneys, certified public accountants, and enrolled agents petitioned the Director of Practice for reinstatement of their eligibility to practice before the IRS. Favorable disposition was made on 13 of those petitions and reinstatement was granted. Four petitions were added during the transition quarter of which three received favorable disposition with reinstatement granted. Three petitions remained pending as of September 30, 1976. In addition, during fiscal 1976, there was one appeal from a denial by the Commissioner of Internal Revenue of an application for enrollment to practice before the IRS. This appeal remained pending at the close of the transition quarter.

Eight administrative proceedings for disbarment or suspension were initiated against practitioners before the IRS during fiscal 1976. Together with the 6 cases remaining on the administrative law judge docket on July 1, 1975, 14 cases were before an administrative law judge during the fiscal year. Four of those cases resulted in the acceptance of an offer of consent to voluntary suspension from practice before the IRS pursuant to 31 CFR, section 10.55(b) prior to reaching hearing. Initial decisions imposing disciplinary actions were rendered in four of the cases. In two cases, the initial decision of the administrative law judge was that the respondent be disbarred from further practice before the IRS. Two suspensions from practice before the IRS were invoked. At the end of the fiscal year, six cases were pending on the docket awaiting presentation to or decision by an administrative law judge and in the transition quarter, one case was added. Thus, on September 30, 1976, seven cases were pending before an administrative law judge.

During fiscal 1976, two cases were appealed to the Secretary from initial decisions by an administrative law judge. One case resulted in a reduction of the disposition made by the administrative law judge from disbarment to suspension. The other, on appeal from the initial decision rendered in fiscal 1975, resulted in an affirmation of the administrative law judge's order of disbarment. During the transition quarter, one appeal to the Secretary was made and was pending as of September 30, 1976.

During the fiscal year, the Office represented the Department in one employee appeal to the Civil Service Commission of an adverse action taken against him by a bureau of the Department.

Proposed regulations governing practice before the Bureau of Alcohol, Tobacco and Firearms were pending at year's end. Those regulations would provide the Director of Practice with parallel duties with respect to such practice as he has relative to practice before the IRS.

On March 21, 1975, the Director of Practice was named executive director for the Joint Board for the Enrollment of Actuaries. The Joint Board, formed pursuant to section 3041 of the Employee Retirement Income Security Act of 1974, is responsible for the enrollment of individuals who wish to perform actuarial services under the act and for the suspension and revocation of the enrollment of such individuals after notice and opportunity for hearing.

During the fiscal year, the Joint Board promulgated regulations governing the enrollment of actuaries before January 1, 1976. In addition, regulations governing standards of performance by enrolled actuaries and Joint Board regulations implementing the Freedom of Information and Privacy Acts were adopted. Two public hearings were held relative to those regulations. A third public hearing was held during the transition quarter relative to proposed regulations governing the enrollment of actuaries on or after January 1, 1976.

During the fiscal year, 3,753 applications for enrollment were filed. Of those, 2,417 were enrolled. There were 178 applications withdrawn and 59 applications were abandoned. Proposed denials were issued 1,241 applicants, of which 740 were denied enrollment. Including the undetermined proposed denials, 359 applications were pending at the close of the fiscal year.

To facilitate the regulations governing enrollment, three actuarial examinations were offered applicants for enrollment during the fiscal year. The examinations, scheduled at 58 cities, were coordinated by the executive director. In this connection, a total of 2,661 applications were processed.

The Joint Board had not adopted regulations governing revocation and suspension as of the fiscal year's close.

BUREAU OF ENGRAVING AND PRINTING

The Bureau of Engraving and Printing, the world's largest securities manufacturing establishment, designs and produces the major evidences of a financial character issued by the United States. It is responsible for the production of U.S. currency, postage stamps, public debt securities, and miscellaneous financial and security documents.

Finances

The regular operations of the Bureau of Engraving and Printing have been financed since July 1, 1951, by means of a revolving fund established pursuant to Public Law 656, August 4, 1950 (31 U.S.C. 181). Agencies which the Bureau serves are required to make reimbursement for all costs incidental to the performance of work or services requisitioned.

The total cost of sales and services was $111,289,000 for fiscal 1976 as compared with $101,269,000 in fiscal 1975. See the Statistical Appendix for detail.

In order to generate sufficient funds to cover direct and indirect costs of operations as well as to accumulate an adequate reserve for replacement of capital equipment, the Bureau included in the cost of its products a surcharge which, during fiscal 1976, amounted to $4,788,000.

Currency program

Currency deliveries in fiscal 1976 totaled 2.8 billion notes, approximately the same as the number produced in fiscal 1975. During the transition quarter, 0.7 billion notes were produced.

On November 3, 1975, the Secretary of the Treasury announced that the Bureau of Engraving and Printing would commence production of $2 Federal Reserve notes for first-day-of-issue on April 13, 1976, the anniversary of Thomas Jefferson's birth. During fiscal 1976, the Bureau produced over 400 million $2 Federal Reserve notes, representing approximately 14 percent of the total currency program. Supplanting one-half the face value of the annual requirement for $1 notes with $2 notes would permit savings in manufacturing costs estimated at $27 million over the next 5 years.

During fiscal 1976, the Bureau placed into operation six production models of currency overprinting and processing equipment (COPE). This equipment, acquired through lease-to-ownership financing, will reduce costs for currency manufacturing by approximately $1.8 million annually.

Several additional improvements in currency manufacturing were in progress, including automatic sheet counting, examining modifications, automated packaging, and revised work standards. Potential annual recurring savings are estimated to be $1.5 million.

Postage stamp program

Deliveries of U.S. postage stamps were 31.5 billion pieces in fiscal 1976, compared with 28 billion pieces in fiscal 1975. During the transition quarter, 6.9 billion stamps were produced.

As part of the continual modernization of Bureau operations, particularly in the labor-intensive postage stamp processing areas, the Bureau has contracted for 6 postage stamp booklet-forming machines capable of producing any variety of folded booklet containing from 2 to 36 stamps. Practical and production acceptance trials of a prototype were successfully completed. Two additional machines are scheduled for delivery in November 1976 and the remaining three machines during 1977. Savings from use of the six machines are estimated at $1 million annually.

Also planned is an automated book-stamp packaging system which will produce subpackages within master packages, a concept that permits the

U.S. Postal Service to improve field operations by maintaining the integrity of a sealed unit until delivery to the point of issue.

The Bureau also began utilizing glue instead of stitching for binding stamp and food coupon books, which is expected to save approximately $414,000 annually.

Food coupon program

Approximately 14 percent of the food coupon requirements were produced by the Bureau during fiscal 1976. The Bureau continued to assure a sufficient supply of food coupons for the Department of Agriculture through execution of contracts with two private sector firms. Responsibility included the establishment and monitoring of quality and security controls and procedures.

Presses

A multicolor intaglio web press purchased for the primary production of postage stamps in coil form became operational in November 1975, affording the Bureau improved capability to produce three-color coil stamps and multidenomination book stamps printed on a common sheet.

The proposed acquisition of a used two-color letterpress will effect savings in the printing of a number of securities by accomplishing face printings in one operation instead of two. Production of Treasury notes on the two-color letterpress will yield annual savings of $95,000 for an initial investment of $5,000 plus shipping and installation charges.

Delivery has been made of four high-speed intaglio sheet-fed presses for currency production, having capabilities far in excess of the presses being replaced. These new presses represent a segment of the Bureau's plan to modernize press equipment to decrease unit costs to the Federal Reserve System.

Inks

Significant progress has been made toward producing currency and postage stamps with water wipeable inks through the acquisition of a sheet-fed multicolor intaglio press. Advantages in using water wipeable inks include savings of large quantities of wiping paper used to remove excess ink from the engraved plate; reduction in the bulk of waste generated in the wiping operation; and the elimination of the use of more volatile solvents. Although the press is in the experimental ink-testing mode, it is made operational for producing postage stamps as production requirements warrant.

Quality control

The Quality Control Branch developed and implemented procedures for the new high-speed currency and postage stamp equipment to assure that the highest quality is maintained while the cost benefits of the equipment are maximized. These procedures incorporate the immediate feedback of information to operating personnel to preclude the manufacture of unacceptable products. The program provides additional confidence that the quality of circulated currency is consistently maintained at acceptable levels.

Internal audit program

An intensive program of internal audit provided for the evaluation and reexamination of operational efficiency and economy, and ensured compliance with prescribed regulatory directives. During fiscal 1976 and the transition quarter, 78 reports of audit were released and contained 408 recommendations for possible improvements which were referred for management consideration. Coverage included fiscal and management type audits and reviews of operations and programs, conducted on a scheduled, special, and unannounced basis.

Destruction of mutilated securities

The Bureau installed a system to destroy paper securities which eliminates the air pollution associated with the former incineration method. Improvements in the process originally envisioned produced immediate savings of $70,000 annually. Additional savings of $260,000 during fiscal 1977 and approximately $441,000 in fiscal 1978 are expected with the acquisition of additional equipment.

Safety

Because of the industrial nature of Bureau operations, employee safety is a matter of vital management concern. Safety management programs include comprehensive safety training; investigation and analysis of all accidents to identify standard cause factors; scheduled and unscheduled safety audits; incorporation of safety and health standards into the equipment acquisition cycle to insure safety coverage from initial design to the disposition stage; the establishment, implementation, and review of safety and health standards; and input and involvement by employee safety committees.

Labor-management relations

The Bureau fosters constructive and harmonious relationships with employees and labor organizations representing them. Special emphasis and attention is directed toward the conduct of all labor-management dealings within the spirit and intent of Executive Order 11491, as amended by Executive Order 11838 of February 6, 1975. At the close of the period, there existed within the Bureau grants of exclusive recognition to 17 AFL-CIO affiliate unions covering 25 craft units, 1 noncraft unit, 1 guard unit, and 1 GS clerical/technical unit.

Position management

During fiscal 1976, the Bureau's position management program was reviewed by the Office of Personnel, Department of the Treasury. Under the Bureau's program, a Position Management Board (PMB) was established to coordinate manpower planning activities, recommend policy and procedures to the Director, and allocate manpower. Reviews by the PMB were cited by the Department as constituting an excellent means of assuring utilization of sound position management principles and techniques. The report also indicated excellent participation in the program by both management officials and industrial relations specialists.

Management development

The current management development program emphasizes the identification and selection of individuals possessing those characteristics indicating potential for effective management in the Bureau of Engraving and Printing. For each managerial position filled, the proportion of managerial ability versus technical expertise is established. The evaluation-selection process includes identification of managerial skills by means of the assessment center technique.

Developmental positions have been identified for those with assessed managerial potential. The selection process for such positions stresses general managerial skills. Individual development plans designed for each candidate highlight the training and experience necessary for movement into the management sphere.

Seminars have also been developed for new and advanced managers which are designed around structural, technological, and management issues impacting upon the Bureau's operational effectiveness.

Personnel management reviews

A special study compared the Bureau's security guard position with similar positions in other agencies in terms of types of security programs operated, duties performed, grade levels, and pay structures. Analysis also included such factors as age distribution, employee turnover, average pay, differentials, and overtime during the past 5 years. Several courses of action were explored which would permit upgrading the guard position and/or its reclassification in the police series.

The Bureau participated in the Civil Service Commission's review of draft standards for the new factor evaluation system (FES) of classification. Thirteen positions were reviewed, audited, and redescribed in the FES format. These positions represent approximately 125 incumbents in the clerical, secretarial, professional, and technical series. In anticipation of this new system, FES training has been incorporated into the Bureau's basic supervisory training program.

A study was initiated to ensure accurate and expeditious processing of retirement applications. Findings indicated the need for a standard operating procedure manual and a monitoring system, which are now in the developmental stages.

Upward mobility

Thirteen employees were selected for placement into identified upward mobility positions, all of which are GS positions affording promotional opportunities beyond the target level. The process for selection into these positions included the assessment center technique, which was reviewed in the Civil Service Commission's Technical Memorandum 75–5, "An Overview of the Upward Mobility Assessment Center for the Bureau of Engraving and Printing."

A comprehensive review of the first year's program was made, resulting in revisions of the upward mobility program and promotion policies. Provisions have been made for greater emphasis and an improved framework for career counseling, a mechanism for acquiring basic skills judged to be lacking in some program participants, and greater flexibility in the application process as well as the selection process.

Awards

During fiscal 1976, 1,228 employees received special achievement awards and 30 employees received high quality pay increases, with nonrecurring savings of $143,394 being realized.

Under the employee suggestion phase of the program, 183 suggestions were received, of which 55 were adopted, with savings of $423,516.

During the transition quarter, 50 employee suggestions were received for consideration.

Eighteen superior work performance awards were presented to summer employees.

The awards program is being reviewed with emphasis on the concept of group awards based on the achievement of measurable objectives which can be linked to organizational improvement. Experimentation with production work teams has been conducted in preparation for broader implementation of this group concept.

A comprehensive study has been completed which assesses the impact of the mandatory linkage of the awards program with the performance evaluation system on the effectiveness of both programs. Major reviews of both programs are expected.

Service to the public

The exhibit phase of the Bureau's public relations program was accelerated to accommodate Bicentennial-related numismatic and philatelic events for the period from July 1, 1975, to the end of calendar year 1976. Security exhibits were provided for 15 scheduled activities. The Bureau produced a series of three distinctive Bicentennial souvenir cards which were released for first-day sale at the American Stamp Dealers Association's National Postage Stamp Show, New York, N.Y.; the International Philatelic Exhibition, Philadelphia, Pa.; and Stamp Expo '76, Los Angeles, Calif. In addition, souvenir cards were issued in conjunction with exhibit participation at the American Numismatic Association's annual conventions at Los Angeles, Calif., and New York, N.Y., as well as the Government-sponsored U.S. Bicentennial Exposition on Science and Technology at Cape Canaveral, Fla. Sales of souvenir cards not only responded to expressed public interest but also served to defray costs of participation by the Bureau at these events.

For the 15-month period, a total of 778,830 visitors utilized the public tour facilities of the Bureau, which continues to be one of the major attractions for visitors to the Washington area. The heavy influx of Bicentennial tourists during the summer months necessitated the issuance of admission tickets on a first-come-first-served basis, to assure equity and to accommodate the greatest number of persons.

OFFICE OF EQUAL OPPORTUNITY PROGRAM

Total program operations

The Office of Equal Opportunity Program is under the immediate supervision of the Assistant Secretary (Administration). It assists the Secretary and the Assistant Secretary (Administration) in the formulation, execution, and coordination of policies related to equal opportunity for Treasury employees and employment policies and programs of commercial banks, savings and loan associations, savings banks, and other financial institutions that are Federal depositaries or issuing and paying agents of U.S. savings bonds and savings notes.

Federal equal employment opportunity program

Improvement in the administration of Treasury's equal employment opportunity program was highlighted by increased emphasis on the Federal women's program and Spanish-speaking program. In conjunction with the observance of International Women's Year, a variety of new techniques were employed to increase the awareness of the need for equal employment opportunities for women. Some of the techniques employed included: workshops, seminars, and films on career development, upward mobility, and job interviewing skills; equal employment opportunity awareness sessions for managers; establishment of child care information centers; and a restructuring of Federal women's program committees.

Actions to strengthen the Spanish-speaking program include restructuring of the Spanish-speaking Program Coordinators Committee, development and utilization of specialized recruitment teams, and more reliance on the cooperative education program to increase the representation of Spanish-speaking employees. In addition, a 2-day seminar for bureau special emphasis program coordinators (Spanish-speaking program coordinators, upward mobility program coordinators, and Federal women's program coordinators) was held in February 1976 to build a team approach to the development and implementation of a results-oriented program.

A review of the EEO complaint processing system resulted in publication of the new appendix to the Department's equal opportunity regulations for the processing of complaints of discrimination, including procedures for age discrimination compliants. The Department still ranks among the best of the Federal agencies in the expeditious processing of complaints.

To increase the employment of minorities and women in professional positions, recruitment goals were established for a variety of occupations including revenue officer, revenue agent, special agent, attorney, and accountant.

The following table of Treasury full-time employment statistics for the period December 1968 through November 1975 shows a steady growth in minority employment indicating success in implementing the Department's affirmative action plan. These statistics show that black employment increased by 65.8 percent and Spanish-speaking by 271.8 percent over an 8-year period.

Contract compliance

During fiscal 1976, the Treasury contract compliance program instituted a variety of changes to improve operating efficiency and to assure uniform emphasis in the conduct of compliance reviews. A Standard Compliance Review Report Format (SCRRF) was developed to assure the full compliance review coverage as required by the Office of Federal Contract Compliance. Codified regulations and requirements as set forth under Executive Order 11246 were disseminated to all banks in addition to a contract compliance handbook. An additional regional office was opened in New York which will service the financial institutions in the State of New York and in the New England States.

Each regional office has instituted an affirmative action orientation program for banks scheduled for compliance reviews during the next quarter. This program presents bankers with an advance notice of the matters to be covered during the review and provides technical assistance

Department of the Treasury full-time employment by minority group status

	1968	1970	1972	1974	1975	Comparison 1974-1975		Comparison 1968-1975	
						No.	Percent	No.	Percent
Total employees*	82,155	88,351	102,813	r 114,686	122,648	7,962	7.0	40,493	49.2
Black	11,777	13,234	15,619	18,216	19,533	1,317	7.2	7,756	65.8
Spanish-American	1,052	1,489	2,247	3,437	3,912	475	13.8	2,860	271.8
American Indian	79	104	128	175	192	17	.1	113	143.0
Oriental	482	596	813	1,230	1,485	255	20.7	1,003	208.0
Other	68,765	72,928	84,006	91,628	97,526	5,898	6.4	28,761	41.8
GS 1-4:									
Total	19,120	18,867	24,126	25,526	28,174	2,648	10.3	9,054	47.4
Black	4,947	5,156	5,904	6,679	6,664	-15	-.2	1,717	34.7
Spanish-American	255	398	791	1,065	1,168	103	9.7	913	358.0
American Indian	25	33	45	84	57	-27	-32.1	32	128.0
Oriental	80	96	159	181	228	47	26.0	148	185.0
Other	13,813	13,184	17,227	17,517	20,057	2,540	14.5	6,244	45.2
GS 5-8:									
Total	19,480	23,826	27,601	33,295	33,064	-231	-.6	13,584	69.7
Black	2,708	3,467	4,290	5,569	5,822	253	4.5	3,114	115.0
Spanish-American	264	422	551	1,008	960	-48	-4.8	696	263.6
American Indian	26	30	35	50	49	-1	-2.0	23	88.5
Oriental	141	183	249	445	437	-8	-1.8	296	209.9
Other	16,341	19,724	22,476	26,223	25,796	-427	-1.6	9,455	57.9
GS 9-12:									
Total	28,893	28,960	32,321	35,580	36,639	1,059	3.0	7,746	26.8
Black	1,144	1,283	1,587	2,050	2,406	356	17.4	1,262	110.3
Spanish-American	332	389	519	803	820	17	2.1	488	147.0
American Indian	21	30	34	44	47	3	6.8	26	123.8
Oriental	186	203	222	368	491	123	33.4	305	164.0
Other	27,210	27,055	29,959	32,315	32,875	560	1.7	5,665	20.8
GS 13-18:									
Total	9,491	10,665	12,037	13,257	13,328	71	.5	3,837	40.4
Black	151	218	307	399	435	36	9.0	284	65.2
Spanish-American	35	54	88	136	130	-6	-4.4	95	271.4
American Indian	3	5	8	16	14	-2	-12.5	11	366.7
Oriental	55	67	90	105	131	26	24.8	76	138.1
Other	9,247	10,321	11,544	12,601	12,618	17	.1	3,371	36.5

* The totals include wage board personnel. Grade comparisons are for GS series only.
r Revised.

NOTE.—For figures for 1969, 1971, and 1973, see 1974 Annual Report, p. 116.

by the Compliance Staff in preparing necessary data. The orientation program has facilitated the review process and has clarified innumerable questions of how to prepare materials and reports required by the Office of Federal Contract Compliance.

Regional managers and headquarters staff have participated in each of the American Bankers Association's 11 affirmative action seminars and in similar seminars conducted by the National Association of Bank Women. These meetings have enabled Treasury, with minimum staff, to reach several thousand decisionmakers and especially those responsible for developing and implementing the banks' affirmative action programs.

During fiscal 1976, 15 show cause notices were issued to financial institutions as the first step in a possible sanction proceeding. In each instance where there was either no affirmative action plan and program or refusal to comply with the requirements, these notices were sufficient to effect results and subsequently were withdrawn.

Bank minority employment continues to increase impressively. In the latest data submitted to the Joint Reporting Committee, minority employment is now 16 percent, or 164,437 of a total of 1,042,984 employees, broken down as follows: 97,116 blacks; 2,463 American

Indians; 19,779 Orientals; and 45,079 Hispanic Americans, compared with under 40,000 employed in 1968 of a total of 800,000, representing 22,000 blacks; 12,000 Hispanic Americans; 5,000 Orientals; and 600 American Indians.

FEDERAL LAW ENFORCEMENT TRAINING CENTER

The Federal Law Enforcement Training Center (FLETC) is an interagency training facility formally established as an entity within the Department of the Treasury on March 2, 1970, under the supervision of the Assistant Secretary (Enforcement, Operations, and Tariff Affairs).

The Department of the Treasury, as lead agency for operating the Center, controls the Center's day-to-day activities. A Board of Directors, comprised of representatives at the Assistant Secretary level from the major departments which have agencies participating in the Center, and on which there are nonvoting members from the Office of Management and Budget and the Civil Service Commission, determines FLETC training policy, programs, criteria, and standards, and resolves conflicting training requirements.

The Center conducts basic and common advanced courses in criminal investigator and police training for participating agencies and furnishes facilities for the participating agencies to conduct advanced, inservice, refresher, and specialized (AIRS) training for their own law enforcement personnel. At present, 28 law enforcement organizations and units, representing most major executive departments and independent Federal agencies and the legislative branch, participate in Center programs.

In the 15-month period, participating status was extended to the Departments of Health, Education, and Welfare and of Housing and Urban Development, the Office of Investigation of the Department of Agriculture, and the Federal Protective Service of the General Services Administration. The Center also furnished training on a space-available basis to personnel from 23 other Federal, State, and local agencies.

At the end of the transition quarter, negotiations were continuing with the Department of Justice for the transfer to the FLETC of all training programs for law enforcement personnel of the Immigration and Naturalization Service.

Training facilities

The location of the Federal Law Enforcement Training Center was initially planned on federally owned land near Washington, D.C., but a lawsuit filed under the National Environmental Policy Act (NEPA) caused a 3-year delay in beginning construction of the facility and increased the estimated cost. Therefore, at the request of the Congress, Treasury, in conjunction with the General Services Administration, reviewed available Federal installations in the continental United States to determine if any could be utilized effectively for the law enforcement training program. Based on the results of that review and Secretary Simon's recommendation, the Congress in May of 1975 authorized the expenditure of $30 million for the adaptation of the former Glynco Naval Air Station, located on the southeast coast of Georgia near the city of Brunswick, as the Center's facility. Initial saving to the Government by locating this installation at Glynco was close to $37 million.

During the summer of 1975, the Center was able to renovate the essential portions of the facility and, in September 1975, began operations at Glynco. The Center was officially dedicated on September 12, 1975, by Secretary Simon, in the presence of Senators Talmadge and Nunn and Congressman Ginn, of Georgia; Congressman Steed, chairman of the House Appropriations Subcommittee for Treasury; Governor Busbee of Georgia; and Senators Bellmon and Domenici and Congressmen Holland and Levitas. Additional renovation is continuing and one of three existing, partially constructed dormitories has been completed.

A design master plan for the permanent facilities of the Center has been approved. The plan will concentrate basic course facilities in a core walking campus four blocks in size. It calls for accommodations for a constant population of 750 students; construction of a classroom building, a 72-point indoor firing range, a permanent driver training range, and additional physical training facilities; and the completion of the other dormitories begun but not completed by the Navy.

The Center's present facilities include buildings for administration, classrooms and training, dining, dormitories, instructor offices, procurement and supply, facilities engineering and maintenance, motor pool service station and garage, printshop, gymnasium, student center, convenience store, and auditorium; an outdoor firing range; an interim driver training range; a practical exercise project, which includes raid houses and a mock criminal court facility; an aquatic training pool; and athletic fields and courts.

Training programs

Criminal investigator training.—During the 15-month period, 25 classes were trained by the Criminal Investigator Training Division (CITD), with a total of 982 students graduating. Of these classes, two were completed in Washington, D.C., before the Center began operations at Glynco. The Criminal Investigator 7-week basic training program includes instruction in criminal law, criminalistics, legal and investigative techniques, and communication skills. In addition, the CITD staff conducted common AIRS training in advanced law enforcement photography referred to later in this report.

Police training.—The Police Training Division (PTD) conducted 30 classes in the basic 5-, 6 1/2-, 8-, and 12-week courses, graduating 1,002 officers. The 6 1/2-week basic course was initiated during fiscal 1976 for those agencies whose training needs were not as extensive as other participating agencies. Police subjects include criminal law, human relations, criminalistics, arrest techniques, and communication skills. In addition, 2- and 4-week AIRS programs have been developed by the PTD staff and will be scheduled during fiscal 1977. The PTD also provided assistance in AIRS courses administered by the participating agencies.

Special training.—With the transfer of operations from Washington, D.C., to Glynco, and the resulting expansion in Center staff and programs, the Special Training Division was established to provide for programs in physical training, firearms training, and driver training.

The physical training program serves trainees in the basic courses as well as many AIRS programs. Courses consist of training in arrest and self-defense tactics, physical fitness and agility, drownproofing/water survival, emergency medical techniques, first aid, cardiopulmonary resuscitation, and aerobic fitness. The Center's physical training facilities consist of a gymnasium, aquatic training pool, athletic fields, exercise room, and classroom, all of which were renovated from existing facilities.

The firearms training program covers the basic fundamentals of marksmanship, safety, police-type combat firing, and riot gun training, for all trainees in the basic program and those in several AIRS programs.

The driver training program serves police training students and some AIRS classes. In fiscal 1977, the training will be included in the criminal investigator training program. Available courses include basic driving course, advance basic with four-wheel drive course, defensive driving, bus training, patrol wagon training, and an 80-hour instructors course.

A significant achievement in the driver training program has been the avoidance of any physical injuries since driver training was incorporated as a Center program in 1974.

Advanced, inservice, refresher, and specialized training.—As part of its mission, the Center provides facilities to the participating agencies for the conduct of their advanced, inservice, refresher, and specialized training programs.

In fiscal 1976 and the transition quarter, 3,063 students, representing 6,442 man-weeks of training, participated in AIRS programs at Glynco. Agencies conducting programs during this period were Bureau of Alcohol, Tobacco and Firearms, IRS-Intelligence, U.S. Customs Service, National Park Service, U.S. Park Police, U.S. Marshals Service, U.S. Fish and Wildlife Service, National Marine Fisheries Service, and Department of State.

In addition, the Center staff conducted 6 classes in advanced photography, graduating 62 students. Common AIRS courses in advanced law enforcement refresher (4 weeks) and basic law enforcement refresher (2 weeks) will be added in fiscal 1977 within the Police Training Division.

Instructional services and curriculum development

The Instructional Services Division supported the instructional staff with systems for use in critiquing, evaluating, and reviewing practical exercises; design, illustration, and production of graphic arts for classroom programs; an improved management system for printed materials, audiovisual software, and audiovisual hardware; a doubling of the Center's circulating library collection and an expansion of operating hours; and development of a photographic service for instructional programs and public information. Goals for the coming year include addition of individual learning carrels to the library, updating of classroom controls for instructional aids and lighting, and improved productivity in present services.

Extensive work continued in improving and updating curricula and adapting courses to the needs of new participating agencies.

Management improvement

A major accomplishment for the Center has been its ability to train more students in improved facilities at a lower overall cost, thus increasing the quality of law enforcement throughout government. By housing and feeding students within the educational complex, the overall impact of the training was enhanced and savings of approximately $5 million were realized as compared with payment of full per diem.

FISCAL SERVICE

Bureau of Government Financial Operations

The functions of the Bureau are Government-wide in scope. It disburses by check, cash, or other means of payment for most Government agencies; settles claims involving loss or forgery of Treasury checks; manages the Government's central accounting and financial reporting system by drawing appropriation warrants, by maintaining a system of accounts for integrating Treasury cash and funding operations with the financial operations of disbursing and collecting officers and of Government program agencies including subsystems for the reconciliation of check and deposit transactions, and by compiling and publishing reports of budget results and other Government financial operations; provides banking and related cash services involved in the management of the Government's cash resources; under specified provisions of law is responsible for investing various Government trust funds; administers certain U.S. currency matters such as directing the various aspects of the issue, redemption, and custody of U.S. currency, and overseeing the destruction of currency unfit for circulation; provides central direction for various financial programs and practices of Government agencies; and directs a variety of other fiscal activities.

Disbursements and check claims

Disbursing operations.—A total of 665.9 million checks, savings bonds, and electronic funds transfer (EFT) payments were produced by the Division of Disbursement's 11 disbursing offices for more than 1,700 Government administrative offices from July 1, 1975, through June 30, 1976. Close to 98 percent of these payments were computer produced. The payments were produced at an average unit cost of $0.0428. In addition, more than 121 million computer-generated Federal tax deposit (FTD) forms were produced and mailed. In the transition quarter, 150.3 million checks, savings bonds, and EFT payments were produced; more than 27 million FTD forms were produced and mailed.

Significant achievements in fiscal 1976 and the transition quarter are as follows:

1. Treasury's EFT recurring payment system, a major element of the direct deposit system, was implemented. This system provides capability for the rapid computer-assisted transfer of funds between the Department of the Treasury, Federal Reserve banks, and member banks. Four Federal Reserve offices implemented EFT processing under a pilot program. Over 2.1 million EFT payments were processed (for issuance through the payment date of July 3, 1976) on behalf of recipients of social security, supplemental security income, and disability insurance benefits. During

the transition quarter, over 5.9 million EFT payments were processed (for issuance through the payment date of October 3, 1976) through 21 of 31 Federal Reserve offices designated as processing offices and representing 11 of the 12 districts. By the end of calendar year 1976, the remaining district, New York, will have been included in the system. Conversion of the civil service annuity file for EFT processing became effective with the July 1, 1976, payment date. Over 75,000 civil service EFT payments were processed for issuance through the payment date of October 1. Direct deposit of funds in financial organizations for revenue sharing payments was introduced during July 1976 with 635 direct deposit payments dated July 6. There were 18,317 direct deposit payments dated October 4. Of these, 13,008 were EFT payments, the first under revenue sharing.

During September 1976 certain deposits and nonbenefit payments such as grants, investments, replacement of lost composite checks, and unemployment compensation payments to States were included in the EFT system. Related terminal equipment was installed in headquarters and the Washington Disbursing Center to transmit commencing September 17 the financial data using the Federal Reserve communications system.

2. Of 37 agencies working toward automating their accounts payable by submitting magnetic tapes to disbursing offices for the issuance of vendor and miscellaneous payments, 9 automated in fiscal 1976, 2 during the transition quarter. Under the automated system, computer-generated cards which accompany many of the checks to be mailed to the addressee provide the check recipient with a permanent record of the purpose or object of the payment. Many objects can be included on one card, allowing a single payment for all. Use of the card eliminates the time-consuming manual processing of large quantities and various sizes of paper notices by the agencies and the disbursing offices, and reduces the number of inquiries concerning the purpose of payments.

3. Eleven additional production model check-wrapping systems were installed and became operational. The system manufactures an envelope from a roll of paper while simultaneously inserting a check and as many as three separate inserts. The envelope costs for mailing checks are consequently reduced. Approximately 324 million checks were wrapped in fiscal 1976, resulting in a savings of approximately $500,000.

4. During the latter part of January 1976, a new system was implemented for receipt of certain social security nonreceipt claims on tape and submission of stop payment data to the Division of Data Processing on magnetic tape. This new system reduced most of the clerical keypunching and typing functions required under the previous system of receiving paper claims and submitting paper stop payment requests and related punched cards to the Division of Check Claims. In addition, a magnetic tape is sent to the Washington Disbursing Center for issuance of substitute checks in lieu of paper documents previously furnished. The new system reduces clerical errors, speeds up the processing of nonreceipt claims and the issuance of substitute checks, and reduces the amount of paper used. Once the system is fully operational and the Social Security Administration is able to submit all claims on magnetic tape, it is estimated that 12 man-years and an annual savings of approximately $150,000 will be realized.

The following table is a comparison of the workload for fiscal years 1975 and 1976 and the transition quarter:

Classification	Volume 1975	Volume 1976	Volume T.Q.
Operations financed by appropriated funds:			
Checks and electronic funds transfers:			
Social security benefits	340,024,721	360,589,208	92,004,802
Supplemental security income payments	50,683,926	53,826,563	13,888,762
Veterans benefits	85,069,062	86,049,429	18,905,704
Income tax refunds	[1] 122,751,650	68,407,107	2,498,760
Veterans national service life insurance dividends	4,248,518	2,965,693	47,047
Other	[2] 100,754,343	70,690,757	17,639,001
Savings bonds	7,918,396	8,032,199	1,960,330
Adjustments and transfers	340,109	334,380	78,841
	711,790,725	650,895,336	147,023,247
Operations financed by reimbursements:			
Railroad Retirement Board	13,767,833	13,876,014	3,428,623
Bureau of the Public Debt (General Electric Co. bond program)	1,463,114	1,558,599	
Total workload—reimbursable items	15,230,947	15,434,613	3,428,623
Total workload	727,021,672	666,329,949	150,451,870

[1] Includes 54,612,071 tax rebates.
[2] Includes 30,291,958 special $50 payments.

Settling check claims.—During fiscal 1976, the Division of Check Claims processed 1.5 million requests to stop payment on Government checks. This resulted in 723,043 paid-check claims acted upon, including 108,097 referred to the U.S. Secret Service for investigation because of forgery, alteration, counterfeiting, or fraudulent issuance and negotiation. Reclamation was requested from those having liability to the United States on 143,808 checks.

During the year, 68,414 paid-check claims resulted in settlement checks to payees totaling $16.1 million; 4,885 claims resulted in settlement checks to endorsers totaling $1.3 million; and 33,911 claims resulted in payments to other agencies of $7.1 million for death and nonentitlement cases. In addition, 258,321 substitute checks valued at $132.9 million were authorized to replace checks that were lost, stolen, destroyed, or not received.

During the transition quarter, the Division processed 395,857 requests to stop payment on Government checks. This resulted in 210,990 paid-check claims acted upon, including 26,095 referred to the U.S. Secret Service for investigation. Reclamation was requested on 48,131 checks. During the quarter, 20,569 paid-check claims resulted in settlement checks to payees totaling $7.2 million, 1,932 claims resulted in settlement checks to endorsers totaling $490,287, and 14,560 claims resulted in payments to other agencies of $3.4 million for death and nonentitlement cases. In addition, 44,330 substitute checks valued at $32.0 million were authorized.

The project to further automate check claims operations is continuing. Stop payment requests for social security and supplemental security income checks are now submitted on tape and automatically processed by the computer.

Government-wide accounting

Government accounting systems.—The accounting information management system (AIMS) project, a large-scale systems development effort to redesign and modernize the accounting and financial reporting systems of the Bureau of Government Financial Operations, has attained significant milestones toward implementation of several important subsystems.

Development of a prototype electronic funds transfer telecommunications network was started in July 1975, and is now nearing the completion stage. In September 1976, the computer-to-computer link became operational between the Federal Reserve Bank of New York and the Treasury for transmission of payment and deposit messages, for transfer of funds between reserve accounts, and for performing accounting functions on the transactions as they occur. In a related area, the deposits-in-transit subsystem, a control, tracking, and reporting system designed to account for moneys received by or for the Government, has also reached the implementation stage. Standardized deposit and debit voucher forms, suitable for automated input processing, have been manufactured and are being distributed to all Federal agencies and to the banking community. In a parallel test operation, several agencies having a large volume of collection activity each month are submitting detail deposit and debit data on magnetic computer tape, and it is expected that these agencies will begin live submissions on magnetic tape by January 1977. The conversion of the central accounting system from second-generation magnetic tape files to a third-generation data base environment has been progressing on schedule. The analysis of the current system and initial design of the new data base was completed. In fiscal 1977, the data base design will be finalized and the data base created.

The Secretary approved a plan which calls for the development and publication of consolidated financial statements for the Government on an accrual basis. However, there are major conceptual issues which must be studied and resolved before useful and reasonably reliable consolidated financial statements can be prepared in accordance with generally accepted accounting principles applicable to the Federal Government. Accordingly, the Advisory Committee on Federal Consolidated Financial Statements was formed to advise, recommend, and lend vital staff assistance to the Secretary. The committee met in May and September of 1976 to discuss such conceptual issues as the format and coverage of the statements, pension fund liabilities, and valuation of assets, depreciation, and contingencies. Many of the broad conceptual issues are expected to be resolved before June 1977. A target date of February 1978 was set for publication of the first official report which will cover the fiscal year ending September 30, 1977.

Volume I of the Treasury Fiscal Requirements Manual for Guidance of Departments and Agencies (TFRM) was reissued in its entirety. A photocomposed camera-ready copy of the TFRM was produced through the use of a computer time-sharing text-editing system. The reissue of the manual furnished agencies with a single updated volume, and provides a more effective reference tool. Procedures were prescribed in volume I concerning: (1) Special fiscal yearend and transition quarter closing operations due to enactment of the Congressional Budget Act of 1974 (Public Law 93–344); (2) discontinuance of loan account reporting; (3) reports by agencies on unexpended balances of appropriations and funds; (4) information previously contained in Treasurer's Memorandums on requisitioning, preparation, and issuance of Government checks; (5) processing payments in the event of expired continuing resolutions; (6) reclassification of the —F3875 "Budget Clearing Account (Suspense)" from governmental to proprietary; (7) elimination of the requirement that appropriation warrants be countersigned by GAO; (8) elimination of funded checking accounts; (9) reporting requirements for grants, loans, credits, and contingent liabilities involving foreigners; and (10) wage and tax information to be provided to taxing authorities in compliance with the Privacy Act of 1974. Volume II of the TFRM, "Procedural Instructions for the Guidance of Federal Reserve Banks and General Depositaries Relating to Responsibilities Toward the Department of the Treasury," was released in part containing introductory material and procedures concerning the electronic funds transfer system. Also issued was Volume III of the TFRM, "Unfit Currency Regulations for the Guidance of Federal Reserve Banks."

The simplified intragovernmental billing and collection (SIBAC) system was expanded to include motor pool and supply billings processed by the General Services Administration, Federal Supply Service. Monthly billings for motor pool charges were implemented in November 1975, and bimonthly billings for supplies began in August 1976.

The accounting function for redeeming agency securities and interest payments for all remaining special agent accounts in Treasury, which had been maintained by the Bureau of Government Financial Operations, was transferred to the Bureau of the Public Debt effective May 1, 1976. Audits of agency securities and interest payments will continue to be performed by the Bureau of the Public Debt.

In response to a request from Congress for a report on the effect of extending the city income tax withholding provisions of Public Law 93-340 to cities and other jurisdictions with fewer than 500 Federal employees, a survey was sent to all agencies requesting cost data. From this study, Treasury concluded that while the administrative costs for withholding city income taxes in the jurisdictions with fewer than 500 Federal employees would be proportionately higher than for the over-500 areas, they would be reasonable in relation to the benefits to be gained by the localities.

To commemorate the Bicentennial, the American Revolution Bicentennial Administration (ARBA), in cooperation with the Bureau of the Mint, designed and produced gold medallions in three sizes for public sale. The Bureau of Government Financial Operations developed internal procedures to assure proper payment, transfer, and financial accounting and reporting for the gold needed to produce the medallions. Treasury realized a profit of $1.6 million from the sale of 19,830 fine troy ounces of gold to ARBA at a total sales price of $2.4 million.

Assets and liabilities in the account of the U.S. Treasury.—Table 53 in the Statistical Appendix shows the balances at the close of fiscal years 1975 and 1976 and the transition quarter of those assets and liabilities comprising the account of the U.S. Treasury. The assets and liabilities in this account include the cash accounts reported as the "operating balance" in the Daily Treasury Statement. Other assets included in the account of the U.S. Treasury are gold bullion, coin, coinage metal, paper currency, deposits in Federal Reserve banks, and deposits in commercial banks designated as Government depositaries.

Treasury's gold balance was $11,619.9 million at the beginning of the fiscal year, $11,598.3 million and $11,597.8 at June 30 and September 30, respectively. Sales for gold auctioned on June 30, 1975, amounted to $21.1 million and are reflected in the balances. Sales were made to the American Revolution Bicentennial Administration amounting to $419,235 in the fiscal year and $418,000 in the transition quarter.

Stocks of coinage metal stood at $402.1 million at beginning of fiscal

1976. The balance was $333.5 million at June 30 and $319.1 million at September 30. Such stocks included silver, copper, nickel, zinc, and alloys of these metals which are not yet in the form of finished coins.

The number of depositaries of each type and their balances on June 30 and September 30, 1976, are shown in the following table:

Depositaries [1]	June 30, 1976 Number of accounts	June 30, 1976 Balance	Sept. 30, 1976 Number of accounts	Sept. 30, 1976 Balance
Federal Reserve banks and branches	36	[2] $12,209,559,463	36	[3] $13,482,428,321
Other depositaries reporting directly to the Treasury:				
Special demand accounts	9	6,690,000	9	527,430,000
Other:				
Domestic	17	33,761,550	17	35,859,501
Foreign [4]	44	13,814,462	44	9,415,967
Depositaries reporting through Federal Reserve banks:				
General	1,489	46,377,211	1,426	26,431,269
Special (Treasury tax and loan accounts)	13,796	2,854,010,572	13,072	4,118,651,246
Total	15,392	15,164,213,257	14,605	18,200,216,303

[1] Includes only depositaries having balances with the U.S. Treasury. Excludes those designated to furnish official checking account facilities or other services to Government officers but not authorized to maintain accounts with the Treasury. Banks designated as general depositaries are frequently also special depositaries, hence the total number of accounts exceeds the number of banks involved.
[2] Includes checks for $234,510,600 in process of collection.
[3] Includes checks for $183,541,659 in process of collection.
[4] Principally branches of U.S. banks and of the American Express International Banking Corp.

Government officers deposit moneys which they have collected to the credit of the U.S. Treasury at Federal Reserve banks or at designated Government depositaries, domestic or foreign. Certain taxes are also deposited directly by the employers or manufacturers who withhold or pay them. All payments are withdrawn from the U.S. Treasury account. Cash deposits and withdrawals affecting the Treasury's operating balance are summarized in the following table for fiscal years 1975 and 1976 and the transition quarter.

Deposits, withdrawals, and balances in the U.S. Treasury account
[In millions of dollars]

	Fiscal 1975	Fiscal 1976	T.Q.
Operating balance at beginning of period	9,158	7,589	[1] 14,828
Cash deposits:			
Gross tax collections (selected)	291,746	299,802	75,039
Public debt receipts	388,251	462,771	121,128
Gas and oil lease sale proceeds	3,252	1,224	1,126
Other	271,155	276,869	13,642
Total cash deposits	954,404	1,040,663	210,935
Cash withdrawals:			
Public debt redemptions	348,116	393,594	106,354
Letter of credit transactions:			
Medicare	13,294	15,903	4,178
HEW grants	16,424	20,862	5,651
Unemployment insurance	11,915	16,339	3,101
Other (includes refunds and 1975 rebates)	566,224	586,720	89,065
Total cash withdrawals	955,973	1,033,417	208,349
Operating balance at close of period	7,589	14,835	17,414

[1] Total operating balance excludes "other demand deposits" effective July 1, 1976.

Investments.—The Secretary of the Treasury, under specific provisions of law, is responsible for investing various Government trust funds. The Department also furnishes investment services for other funds of Government agencies. At the end of the transition quarter, Government trust funds and accounts held public debt securities (including special securities issued for purchase by major trust funds as authorized by law), Government agency securities, and securities of privately owned Government-sponsored enterprises. See the Statistical Appendix for tables showing the investment holdings by Government agencies and accounts.

Issuing and redeeming paper currency.—The Treasury is required by law (31 U.S.C. 404) to issue U.S. notes in amounts equal to those redeemed. In order to comply with this requirement in the most economical manner, U.S. notes are issued only in the $100 denomination. U.S. notes represent only a very small percentage of the paper currency in circulation.

Federal Reserve notes constitute over 99 percent of the total amount of currency. The Bureau of Engraving and Printing prints and holds these notes in a reserve vault until needed by the Federal Reserve banks. The Bureau of Government Financial Operations accounts for Federal Reserve notes from the time they are delivered to the reserve vault by the Bureau of Engraving and Printing until redeemed and destroyed.

The Bureau also handles all claims involving burned or mutilated currency. During fiscal 1976, payments totaling $9.0 million were made to 51,603 such claimants and $2.4 million to 12,094 claimants during the transition quarter.

A comparison of the amounts of paper currency of all classes, issued, redeemed, and outstanding during fiscal years 1975 and 1976 and the transition quarter follows:

[In thousands]

	Fiscal 1975		Fiscal 1976		T.Q.	
	Pieces	Amount	Pieces	Amount	Pieces	Amount
Outstanding July 1	6,475,293	$70,100,055	6,808,126	$77,611,087	7,291,065	$84,599,973
Issues during period	3,062,447	22,478,294	3,207,354	22,275,951	711,357	5,164,905
Redemptions during period	2,729,614	14,967,262	2,724,415	15,287,064	660,728	3,575,263
Outstanding end of period	6,808,126	77,611,087	7,291,065	84,599,973	7,341,695	86,189,614

Details of the issues and redemptions for fiscal 1976 and the transition quarter and of the amounts outstanding at the end of each period are given by class of currency and by denomination in a table in the Statistical Appendix. Other tables in that volume give further information on the stock and circulation of currency and coin in the United States.

Data processing.—During the year, 822.6 million Treasury checks issued worldwide by civilian and military disbursing offices were paid and reconciled by the electronic check payment and reconciliation system, and during the transition quarter 174.6 million.

Improving the automated central accounting system embracing all cash financial operations of the Government continued as an ongoing project. This system, which brings together all of the cash transactions of the Federal Government, is the data base for Federal budget results published in the Monthly Treasury Statement of Receipts and Outlays of the U.S. Government and in the annual Combined Statement of Receipts, Expenditures and Balances of the U.S. Government.

In addition to providing computer services for entities within the Bureau, the Division of Data Processing converted about 45 million Federal tax deposits to magnetic tape for the Internal Revenue Service in fiscal 1976 and nearly 12 million in the transition quarter.

Banking and cash management

Federal depositary system.—The types of depositary services provided and the number of depositaries for each of the authorized services as of June 30, 1975, and June 30 and September 30, 1976, are shown in the following table:

Type of service provided by depositaries	1975	1976	T.Q.
Receive deposits from taxpayers and purchasers of public debt securities for credit in Treasury tax and loan accounts	13,722	13,796	13,072
Receive deposits from Government officers for credit in Treasury's general accounts	949	880	887
Maintain checking accounts for Government disbursing officers and for quasi-public funds	6,636	5,826	5,725
Furnish bank drafts to Government officers in exchange for collections	1,023	(*)	(*)
Maintain State unemployment compensation benefit payment and clearing accounts	43	43	43
Operate limited banking facilities:			
In the United States and its outlying areas	192	190	190
In foreign areas	227	219	218

* The number of depositaries providing this service at June 30, 1976, was insignificant (estimated at less than 25); therefore, this information will not be shown in subsequent reports.

Cash services.—During fiscal 1976, plans were finalized to discontinue entirely the cash services furnished by the Division of Cash Services to the public, Federal Government agencies, and banks in the Washington, D.C., metropolitan area. This action effectively reduced the Division to one major function, that of examining and settling mutilated currency claims, eliminated the need for 76 employees, and resulted in annual savings of $1.4 million.

These services were discontinued for two basic reasons: (1) The services furnished the public and Government agencies through the Cash Room could no longer be economically justified. For the public, the services consisted of the cashing of Treasury checks and the issuance and redemption of U.S. savings bonds. Local and many overseas Government offices were served by providing facilities where they could deposit receipts and other collections into the Treasury. These are services that can be provided entirely by the banking system at a lower unit cost. (2) The cash services to local area banks, i.e., selling coin and currency to the banks and buying their excess coin and currency, are by law functions of the Federal Reserve banks and therefore should more appropriately be performed by the Federal Reserve Bank of Richmond for the Washington area. Essentially, the providing of these services to the public and the banks by the Treasury was an anachronism left over when the subtreasury system was abolished in 1921.

The first step was taken on June 30, 1976, when the Cash Room was closed. Concurrent with the closing, arrangements were completed for Government agencies to make their deposits with either a commercial bank or a Federal Reserve bank. All indications are that those members of the public who formerly used the Cash Room facilities have been able to obtain the necessary services at local banking institutions with a minimum of inconvenience.

The second step, the discontinuance of cash services to local area banks, is divided into three phases: (1) Effective October 12, 1976, the Richmond and Baltimore Federal Reserve offices will begin serving the suburban Virginia and Maryland banks which obtained coin and currency through correspondent banks in Washington, D.C.; (2) beginning early in 1977, the Federal Reserve Bank of Richmond will begin providing currency services to banks located in Washington, D.C.; and (3) beginning sometime in 1978, upon completion of its new building, the Federal Reserve Bank of Richmond will provide coin services to the Washington, D.C., banks.

During the year, the Division of Cash Services processed over 51,000 mutilated currency claims and paid out $8.9 million in settlement thereof, and in the transition quarter, 12,000 claims with $2.4 million in settlement.

Methods of destroying unfit currency.—The Treasury continued during fiscal 1976 to encourage the use of more ecologically clean methods of destroying currency which is no longer fit for circulation. A total of nearly 3,000 tons of unfit currency are destroyed every year by methods tested and approved by the Treasury.

Two methods are used to destroy currency—incineration and pulverization. Incineration is still the more prevalent method, being used by 28 Reserve offices which account for 86 percent of the currency. Although incineration effectively destroys the currency, the equipment has to be very carefully controlled and correctly operated to keep its emissions within limits permitted by locally applicable air quality standards. Consequently, the Treasury has been encouraging the Reserve banks to convert to pulverization which grinds the currency to a fibrous residue or to very fine particles. Seven banks are now pulverizing the unfit currency and five others are ordering the necessary equipment.

Another ecologically clean destruction method which is on the horizon is the slicing, or shredding, of the currency into narrow strips. This method is being considered in connection with high-speed currency processing systems which are being developed. Shredding also has the advantage of using the least amount of energy among the three destruction methods described.

During fiscal 1976 currency destruction tests were made on equipment made by three different manufacturers. The Treasury approved one incinerator and one pulverizer for use in destroying unfit currency. At the present time, three manufacturers of incinerators and four manufacturers of pulverizers are authorized to supply equipment for this purpose.

Foreign currency management.—The Foreign Currency Staff's automatic funding concept of maintaining local currency bank balances sufficient only to meet the disbursing officers' immediate needs, first implemented in Latin America during fiscal 1975, has been expanded to include most European, African, and Asian countries. The Foreign Currency Staff expects to have automatic funding fully implemented worldwide in fiscal 1977. To date, balances in disbursing officers' operating accounts have been reduced by $29 million, which is resulting in recurring annual interest savings of approximately $2.1 million.

This same funding concept was implemented in June 1976, with one military disbursing officer at a projected annual interest savings of $250,000. The Foreign Currency Staff will approach the Department of Defense to solicit assistance in implementing the procedure for all military disbursing officers worldwide.

Processing Federal tax deposits.—Under provisions of Treasury Department Circular No. 1079, tax withholders and certain taxpayers are supplied with partially punched Federal tax deposit (FTD) cards which they forward to their banks with their tax payments. The FTD cards are then routed to Federal Reserve banks which complete the punching and forward them to the Treasury in Washington. The Bureau of Government

Financial Operations enters the data from the FTD cards on magnetic tapes which are furnished to the Internal Revenue Service for reconciliation with taxpayers' returns. While this procedure is still in effect, a new procedure for processing Federal tax deposits was implemented on a pilot basis in May 1976 with depositaries serviced by the Kansas City Federal Reserve Bank. It provides for the taxpayer to present his tax payment and FTD card to his bank which daily forwards a report of the total amount of the deposits received to the appropriate Federal Reserve bank. The bank also forwards a copy of the report, together with the FTD cards, to the Internal Revenue Service for reconciliation with the taxpayers' returns. This procedure is targeted to completely replace the old procedure by January 1977. It will eliminate the processing of the FTD cards by the Bureau and is expected to result in substantial cost savings to the Department and expedite reconciliation of the FTD cards with the taxpayers' returns.

The types of tax payments which are collected in this manner include withheld individual income and social security taxes, corporation income taxes, certain excise taxes, railroad retirement taxes, and Federal unemployment taxes. Collections received under this system during the period July 1, 1975, through June 30, 1976, totaled $239,004.9 million and required the processing of 45.3 million cards, compared with $233,847.5 million collected and 44.4 million cards processed in the previous year. In addition, collections received during the transition quarter totaled $23,900.5 million and required the processing of 11.4 million cards. The following table shows the volume of deposits processed by Federal Reserve banks for fiscal years 1960 through 1976.

Fiscal year	Individual income and social security taxes	Railroad retirement taxes	Federal excise taxes	Corporate income taxes	Unemployment taxes	Total
1960	9,469,057	10,625	598,881	....	....	10,078,563
1961	9,908,068	10,724	618,971	....	....	10,537,763
1962	10,477,119	10,262	610,026	....	....	11,097,407
1963	11,161,897	9,937	619,519	....	....	11,791,353
1964	11,729,243	9,911	633,437	....	....	12,372,591
1965	12,012,385	9,859	644,753	....	....	12,666,997
1966	12,518,436	9,986	259,952	....	....	12,788,374
1967	15,007,304	10,551	236,538	22,783	....	15,277,176
1968	17,412,921	14,596	233,083	394,792	....	18,055,392
1969	23,939,080	12,479	272,048	1,297,052	....	25,520,659
1970	26,612,484	11,622	296,487	1,235,452	192,905	28,348,950
1971	28,714,587	12,367	323,730	1,249,034	956,201	31,255,919
1972	32,336,751	15,080	364,556	1,309,668	1,409,527	35,435,582
1973	34,606,495	11,202	398,624	1,495,260	1,978,266	38,489,847
1974	37,755,332	10,360	452,796	1,803,689	2,340,052	42,362,229
1975	39,634,697	10,072	451,981	1,944,280	2,363,091	44,404,121
1976	40,464,446	10,444	469,681	1,856,430	2,500,974	45,301,975

NOTE.—Comparable data for 1944-59 will be found in the 1962 Annual Report, p. 141.

Paying grants through letters of credit.—Treasury Department Circular No. 1075, first published May 28, 1964, established a procedure to preclude withdrawals from the Treasury any sooner than necessary in cases where Federal programs are financed by grants or other payments to various organizations outside the Federal Government. Under this procedure, Government departments and agencies issue letters of credit which permit grantees to make withdrawals from the account of the Treasury of the United States when funds are needed for program purposes.

At the close of the 12-month period ended June 30, 1976, 95 Government agency accounting stations were financing with letters of credit under the Federal Reserve bank system. During the period, the Bureau of Government Financial Operations processed 79,690 withdrawal transactions aggregating $50,582 million, compared with 116,426 transactions totaling $46,685 million in fiscal 1975; 21,634 transactions, totaling $46,685 million, were processed during the transition quarter.

Further, the test of the letter of credit-Treasury RDO system implemented in fiscal 1974 with two participating agencies, and to date expanded to include eight agencies, has proven very successful. Accordingly, Treasury regulations governing advance financing under Federal grants and other programs are being revised to promulgate the system. Under this system, the letters of credit are maintained by the Treasury regional disbursing offices where payments are made by Treasury check upon receipt of requests from grantees. The payment requests contain brief status of funds reports which enable agencies to monitor the cash management practices of grantees on a more current basis.

At June 30, 1976, 34 Government agency accounting stations were financing with letters of credit under the Treasury RDO system. During the year, Treasury regional disbursing offices issued 48,693 checks, totaling $12,948 million, in response to grantee requests; 15,495 checks, totaling $3,829 million, were issued to grantees during the transition quarter.

Operations planning and research

The Operations Planning and Research Staff is continuing its systems developmental activities for a number of fiscal functions including the following major systems revisions:

(1) Implementation of the program for paying recipients of recurring Federal payments by credit to their accounts in financial organizations is well underway. Under the program, which is optional for the recipient, payments will be accomplished by means of electronic funds transfer to the financial organizations designated by the recipients. The option of having payments directed to a financial organization was offered to all social security recipients by October 1975. The electronic funds transfer system is being progressively implemented and will be completed by December 1976. This option will be offered to all civil service annuitants by November 1976 with payments made by electronic funds transfer by January 1977. Railroad retirement annuity payments are scheduled for implementation in this system nationwide in December 1976. Revenue sharing payments were included in October 1976 on a limited basis and will be made nationwide using this system in January 1977. Veterans compensation and pension payments will be included during 1977. It is estimated that approximately 74.8 million payments will be made by electronic funds transfer during fiscal 1977.

(2) The joint efforts of Operations Planning and Research Staff and Federal Reserve to develop a check truncation system have progressed to the point of implementation of a pilot operation. Under this system, the flow of paid Treasury checks will stop at the level of the Federal Reserve banks. Magnetic tape and microfilm records will be substituted for the hundreds of millions of checks now returned by the Federal Reserve banks to the Treasury for final payment and reconciliation. The pilot operation

was begun in June 1976. It will be expanded in February 1977 with full-scale implementation of the system by the end of 1977.

Miscellaneous fiscal activities

Auditing.—At June 30, the Audit Staff included 28 professional auditors and as of September 30, 1976, there were 31 auditors assigned to three branches—Headquarters, Insurance Company, and Field Office. Staff members are rotated among these branches to provide the broadest base of experience possible.

The Audit Staff as of September 30, 1976, issued a total of 57 audit reports on financial, compliance, and operational matters. There were 36 audit reports issued as of June 30 and 21 additional ones issued as of September 30, 1976. The audits ranged from small imprest funds to the accounting for several multibillion-dollar Federal trust funds and the audit of U.S. Government-owned gold. Onsite audits as well as management surveys and operational reviews were made at various disbursing centers of the Bureau throughout the United States. Also, onsite audits were made of the cancellation, verification, and destruction of unfit currency at virtually all of the Federal Reserve banks and branches.

In addition, the Audit Staff assigned personnel to the annual audit of the Exchange Stabilization Fund and to the Interagency Task Force for Indochina Refugees.

As the result of the annual examination of the financial statements and related supporting information of surety companies, Bureau auditors found 276 of these companies qualified for Certificates of Authority as acceptable sureties on bonds running in favor of the United States (6 U.S.C. 8). Certificates are renewable each July 1 and a list of approved companies (Department Circular 570, Revised) is published annually in the Federal Register for information of Federal bond-approving officers and persons required to give bonds to the United States.

Loans by the Treasury.—The Bureau administers loan agreements with those corporations and agencies that have authority to borrow from the Treasury. See the Statistical Appendix for tables showing the status of Treasury loans to Government corporations and agencies at June 30 and September 30, 1976.

Federal Financing Bank.—The loans outstanding balance at the end of fiscal 1976 was $22.4 billion, and at the end of the transition quarter, $25.9 billion (see table on p. 35). Interest of $1.2 billion was collected from borrowers during the fiscal year and $407 million during the transition quarter; $900 million during the year and $380 million during the quarter was paid on borrowings from the Secretary of the Treasury.

Liquidation of Reconstruction Finance Corporation assets.—The Secretary of the Treasury's responsibilities in the liquidation of RFC assets relate to completing the liquidation of business loans and securities with individual balances of $250,000 or more as of June 30, 1957, and securities of and loans to railroads and financial institutions. Net income and proceeds of liquidation amounting to $60 million have been paid into Treasury as miscellaneous receipts since July 1, 1957. Total unliquidated assets as of September 30, 1976, had a gross book value of $2.6 million.

Liquidation of Postal Savings System.—Effective July 1, 1967, pursuant to the Act of March 28, 1966 (39 U.S.C. 5225–5229), the unpaid deposits of the Postal Savings System were required to be transferred to the

Secretary of the Treasury for liquidation purposes. As of June 30, 1970, a total amount of $65.1 million, representing principal and accrued interest on deposits, had been transferred for payment of depositor accounts. All deposits are held in trust by the Secretary pending proper application for payment. Payments for the 15-month period totaled $429,037. Cumulative payments amount to $58.1 million plus pro rata payments to the States and other jurisdictions of $6 million. The undistributed fund balance as of September 30, 1976, was $1 million.

Government losses in shipment.—During the 15-month period, claims totaling $309,710 were paid from the fund established by the Government Losses in Shipment Act, as amended (40 U.S.C. 721–729). Details of operations under this act are shown in the Statistical Appendix.

Donations and contributions.—During the 15-month period, the Bureau received "conscience fund" contributions totaling $69,212 and other unconditional donations totaling $667,891. Other Government agencies received conscience fund contributions and unconditional donations amounting to $65,902 and $754,600, respectively. Conditional gifts to further the defense effort amounted to $23,584. Gifts of money and the proceeds of real or personal property donated in this period for reducing the public debt amounted to $265,369.

Foreign indebtedness

World War I.—The Governments of Greece and Finland made payments during fiscal 1976 of $328,898 and $3,068,487, respectively. The latter amount represents a final payment by the Government of Finland on their World War I indebtedness. For a complete status of World War I indebtedness to the United States, see the Statistical Appendix.

Credit to the United Kingdom.—The Government of the United Kingdom made a principal payment of $71.3 million and an interest payment of $58.9 million on December 31, 1975, under the Financial Aid Agreement of December 6, 1945, as amended March 6, 1957. The interest payment included $10.9 million representing interest on principal and interest installments previously deferred. Through June 30, 1976, cumulative payments totaled $2,510.4 million, of which $1,380.0 million was interest. A principal balance of $2,558.0 million remains outstanding; interest installments of $319.9 million which have been deferred by agreement also were outstanding at the end of the period.

Indonesia, consolidation of debts.—The Government of the Republic of Indonesia made payments in fiscal 1976 of $4,573,020 in principal and $701,948 in interest on deferred principal installments in accordance with the Indonesian Bilateral Agreement of March 16, 1971. The normal payment of interest on principal is not due until June 11, 1985.

Payments of claims against foreign governments.—The 16th installment of $2 million was received from the Polish Government under the agreement of July 16, 1960, and pro rata payments on each unpaid award were authorized.

The fourth installment of $2,082,000 was received from the Hungarian Government under the agreement of March 6, 1973. The fourth installment was greater than the minimum installment of $945,000 because 6 percent of the dollar proceeds of imports into the United States from Hungary for the 12 months ending December 31, 1975, exceeded the minimum installment by $1,137,000 thereby raising the annual installment from $945,000 to $2,082,000. Before any payment can be made on the previously certified Hungarian awards, the Foreign Claims Settlement Commission will have to complete the adjudication and certification of new awards. As the new awards are received from the Commission, an initial payment of $1,000 or the principal amount of the award, whichever is less is being made.

Administration

Personnel administration.—To meet the needs of the Bureau, 12 major personnel policies were developed or revised, including: appeals and grievances, upward mobility, troubled employee, time and leave, pay administration, labor-management-employee relations, position classification, merit promotion, and performance evaluation. All supervisors and employees were given the opportunity to attend a series of orientation sessions on these latter two programs.

Flexitime.—Consistent with effective completion of the Bureau mission, a flexible hours policy was developed and implemented for full-time employees in the headquarters offices. The policy has been effective in terms of increased employee morale, the elimination of tardiness problems, and reduction in the use of overtime work.

Labor-management relations.—Union activity remains centered in the Division of Disbursement with four regional disbursing centers (Austin, Birmingham, Philadelphia, and Washington, D.C.) dealing with certified exclusive representatives. All have ties with AFGE, AFL–CIO, except Austin which deals with NFFE. The Bureau enjoys stable and harmonious labor relations as a result of management training, affirmative employee relations policies, dedication and cooperation with its unions. The Bureau policy of good faith bilateralism is accepted by all levels of Bureau management.

Automated personnel reporting.—A system has been developed, using the "data base" concept, which greatly enhances the statistical reporting capabilities of the Personnel Administration Staff. The system contains pertinent personnel data for all currently active employees. Similar data are also maintained for employees who have separated since January 1975. The system has successfully generated personnel rosters, classification series and grade distributions, turnover and retirement statistics, employee profiles, average grade reports, and other valuable information used by Bureau management in its decisionmaking processes.

Training.—A "Personnel Management for Supervisors" course was developed and conducted for approximately 140 supervisors and managers during 6 training sessions. This course was also conducted in conjunction with personnel management evaluation surveys of the Austin and Birmingham Disbursing Centers. An in-depth summer aid program was developed and organized with great emphasis on assisting the students to think about their employment goals and ambitions in relation to their present and future plans for education. A comprehensive orientation and training program was also developed and conducted for the WIN II placements. This training was specifically designed to assist the participants in sharpening their skills in order to qualify for a Government job at the end of their training.

Position classification.—A trial application of the new factor evaluation system (FES) was conducted throughout the headquarters offices. Employees were interviewed and their work described in terms of the nine factors evaluated under FES. As intended and anticipated, there were few changes in grade reflected by the trial application. Whenever possible, all position descriptions are now being written in the FES format.

Extension of check-wrapping operations in disbursing centers led to establishing a new wage grade position structure in several centers, including new foreman positions and, in Philadelphia,the Bureau's first general foreman. New Bureau functions such as electronic funds transfer and accrual financial statements led to creation of new projected positions for those functions. Reductions in cash services and several reorganizations led to restructuring many positions and organizations. In addition, an improved system for establishing and recording competitive levels was implemented. Paraprofessional and upward mobility positions were structured as planned or as warranted.

Staffing.—The Personnel Administration Staff made significant accomplishments in placing employees affected by the phaseout of the Division of Cash Services. Avoiding a reduction in force, 58 Cash Services employees, or more than one-half of those affected, were successfully placed in vacant positions, thereby reducing outside recruitment costs and retaining valuable employees. Efforts in recruiting accountant trainees resulted in the appointment of 10 recent college graduates, 60 percent of whom represent females and minorities. Working within the constraints imposed by the Civil Service Commission, equal employment opportunities remain a priority in recruitment activities. To improve community service and involvement, two unpaid work experience programs for low-skilled clerical persons were introduced. The first program was with the United Planning Organization and involved the placement of seven persons from the local Opportunities Industrialization Center. Upon completion of the 12-week program, three trainees were offered positions within the Bureau. Through the second program (WIN), for a period of 13 weeks, unpaid work experiences and training were provided to 13 welfare mothers who were interested in developing skills necessary for entry into the job market. Additionally, 107 summer aids (needy youth), 3 Federal junior fellows, 13 summer exam students, and 46 stay-in-school students were employed by the Bureau. The first cooperative education program in the Bureau resulted in the appointments of two female and two male students majoring in accounting. This program will ultimately become the Bureau's prime recruitment source. Continuing efforts were made to enhance employment opportunities for Vietnam-era veterans, the handicapped, and disabled veterans.

Upward mobility.—With support and cooperation at all levels, accomplishments in this area remain conspicuous: 490 employees completed a skills survey, 796 candidates received career counseling with a total of 43 placements in upward mobility positions.

The troubled employee.—This program has been in effect for almost a year and covers not only alcoholism and drug abuse but all personal problems and concerns which may affect an employee's job performance. Inhouse training covering the program has been offered to all supervisors, and employees have been informed about the program. In addition, a "Community Services Guide" was prepared and distributed to all employees informing them where various types of personal and family services, including treatment for alcoholism and drugs, are available.

Bureau of the Public Debt

The Bureau of the Public Debt is charged with the administrative functions arising from the Treasury's debt management activities. These functions extend to transactions in the security issues of the United States, and of the Government agencies for which the Treasury acts as agent. The Bureau prepares the offering circulars and instructions relating to each offering of public debt securities, and directs the handling of subscriptions and making of allotments; prepares regulations governing public debt securities and conducts or directs all transactions thereof; supervises the public debt activities of fiscal agents and agencies authorized to issue and pay savings bonds; orders, stores, and distributes all public debt securities; audits and records retired securities and interest coupons; maintains individual accounts with owners of registered securities and authorizes the issuance of checks in payment of interest thereon; processes claims on account of lost, stolen, destroyed, or mutilated securities; maintains accounting control over public debt financial and security transactions, security accountability, and interest costs; and prepares public debt statements. The Bureau's principal office and headquarters is in Washington, D.C. An office is also maintained in Parkersburg, W. Va., where most Bureau operations related to U.S. savings bonds and U.S. savings notes are handled.

Management improvement

A Univac 1110 computer system was installed in the Parkersburg office. This computer will allow all of the Parkersburg systems to be processed on one computer in one language, replacing five older computers using three languages. In addition, telecommunication circuits were installed between Washington and Parkersburg. The use of these circuits and remote job entry terminals has made it possible for the Washington office to utilize the new computer facility. During the next several years, there will be a phase over of Washington office systems from the Office of the Secretary's Univac 1108 to the new Univac 1110. Approximately $700,000 annually is currently spent for processing on the Univac 1108.

A Treasury-Federal Reserve task force was formed to expand the book-entry program of issuing Government securities. The task force will develop an expanded book-entry system designed to eliminate the use of definitive securities in new Treasury offerings. Elimination of definitive securities will reduce the amount of paperwork created by the increasing volume of public debt transactions; protect against loss, theft, and counterfeiting; and substantially reduce costs. Expansion of the book-entry system will result in a more effective and efficient administration of the public debt.

The Bureau has initiated a project to develop a proposal for two new series of savings bonds to replace the series E and series H bonds. The series E bonds issued in the 1940's will begin to reach their third extended maturities in 1981. It was therefore decided to begin now to design a new bond that could be in place well in advance of 1981; that can be designed to take advantage of the latest data entry equipment; that will have more attractive terms and simplified regulations; and that can be offered in exchange for the maturing securities. The change was prompted also because the savings bonds that have already been issued exceed 4 billion and the recordkeeping problems are staggering; there are substantial amounts of accrued interest on the older bonds for which the taxes have been deferred; and it is increasingly difficult to determine legal ownership in many cases involving older bonds where the original owner is deceased.

Ten additional issuing agents began reporting series E savings bonds sales on magnetic tape in lieu of using registration stubs. A recurring annual savings of $191,741 should be realized based on the volume of issues handled each year by these agents. Fifty-four issuing agents are participating in this continuing program.

The procedure for interest payments to the Government National Mortgage Association (GNMA) was revised at the request of GNMA. Registered interest payments are now transferred from a Treasury symbol account directly to a GNMA symbol account, thereby eliminating the need to prepare and mail checks.

The Federal Reserve Bank of Boston and Federal Reserve Bank of Atlanta branches at New Orleans and Jacksonville have joined the Federal Reserve Bank of Atlanta in reporting daily activity of securities transactions to the Bureau on magnetic tape. This permits the immediate introduction of daily public debt activity into the processing cycle without data conversion.

In order to improve service to the public, the Issues Branch, Division of Transactions and Rulings was established in the Savings Bond Operations Office, Parkersburg. The establishment of this Branch resulted in a reduction of 3 weeks in the time required to issue bonds authorized as replacements for bonds lost, stolen, or destroyed, or involved in complex cases that the Federal Reserve banks could not handle.

Government-sponsored agencies were notified of Bureau plans to discontinue servicing their securities. The Bureau will assist the agencies in transferring functions to themselves or their agents.

Bureau operations

During the fiscal year and transition quarter, 177,000 individual accounts covering publicly held registered securities other than savings bonds, savings notes, individual retirement bonds, and retirement plan bonds were opened, and 85,000 were closed. This increased the number of open accounts to 472,000 covering registered securities in the principal amount of $13,924 million. There were 978,000 interest checks with a value of $878 million issued during the period.

Redeemed and canceled securities other than savings bonds, savings notes, and retirement plan bonds received for audit included 6,947,000 bearer securities and 506,000 registered securities. Coupons totaling 14,440,000 were received.

During the period, 70,000 registration stubs of retirement plan bonds, 52,000 registration stubs of individual retirement bonds, 17,000 retirement plan bonds, and 3,000 individual retirement bonds were received for audit.

A summary of the public debt operations handled by the Bureau appears on pages 12–29 of this report and in the Statistical Appendix.

U.S. savings bonds.—The issuance and retirement of savings bonds result in a heavy administrative burden for the Bureau of the Public Debt, including auditing and classifying all sales and redemptions; establishing and maintaining registration and status records for all bonds; servicing requests from bond owners and others for information; and adjudicating claims for lost, stolen, and destroyed bonds.

Detailed information on sales, accrued discount, and redemptions of savings bonds will be found in the Statistical Appendix.

There were 199 million stubs or records on magnetic tape and microfilm representing the issuance of series E savings bonds received for registration, making a grand total of 4,100 million, including reissues, received through September 30, 1976. All registration stubs of series E bonds are microfilmed, audited, and destroyed, after required permanent record data are prepared by an EDP system in the Parkersburg office.

Of the 152 million series A–E savings bonds and savings notes redeemed and charged to the Treasury during the period, 148 million (97.4 percent) were redeemed by authorized paying agents. For these redemptions the agents were reimbursed quarterly at the rate of 15 cents each for the first 1,000 bonds and notes paid and 10 cents each for all over the first 1,000 for a total of $19,292,000 and an average of 13.02 cents per bond and note.

Interest checks issued on current income-type savings bonds (series H) during the period totaled 5,267,000 with a value of $602 million. New accounts established for series H bonds totaled 153,000 while accounts closed totaled 149,000.

Applications received during the period for the issue of duplicates of savings bonds and savings notes lost, stolen, or destroyed after receipt by the registered owner or his agent totaled 85,000. In 49,000 of such cases the issuance of duplicate bonds was authorized. In addition, 25,000 applications for relief were received in cases where the original bonds were reported as not being received after having been mailed to the registered owner or his agent.

OFFICE OF FOREIGN ASSETS CONTROL

The Office of Foreign Assets Control administers five sets of regulations. The Foreign Assets Control Regulations and the Cuban Assets Control Regulations prohibit, unless licensed, all trade and financial transactions with North Korea, North Vietnam, South Vietnam, Cambodia, and Cuba, and their nationals. South Vietnam and Cambodia were added to the schedule of blocked countries under the Foreign Assets Control Regulations following the takeover of these countries by Communist forces in April 1975. These regulations also block assets in the United States of the above-named countries and their nationals.

Under a general license contained in the Foreign Assets Control Regulations, all transactions with the People's Republic of China are now authorized except transactions abroad by foreign firms, owned or controlled by Americans, involving shipment to the People's Republic of China of internationally controlled strategic merchandise unless the transaction is appropriately licensed under the Transaction Control Regulations (see below). Also, transactions in Chinese assets blocked in the United States as of May 6, 1971, remain prohibited.

The Transaction Control Regulations supplement the export controls exercised by the Department of Commerce over direct exports from the United States to Eastern Europe and the U.S.S.R. These regulations prohibit, unless licensed, the purchase or sale or the arranging of the purchase or sale of strategic merchandise located outside the United States for ultimate delivery to Communist countries of Eastern Europe, the U.S.S.R., the People's Republic of China, North Korea, North Vietnam, South Vietnam, and Cambodia. The prohibitions apply not only to domestic American companies, but also to foreign firms owned or controlled by persons within the United States. A general license permits sales of these commodities to the listed countries other than North Korea, North Vietnam, South Vietnam, and Cambodia, provided shipment is made from and licensed by a COCOM-member country. (COCOM, for Coordinating Committee, is a NATO entity which develops policy on sales of strategic items to Communist countries.)

The Office also administers controls on assets remaining blocked under the World War II Foreign Funds Control Regulations. These controls continue to apply to blocked assets of Czechoslovakia, Estonia, Latvia, Lithuania, and East Germany, and nationals thereof, who were, on December 7, 1945, in Czechoslovakia, Estonia, Latvia, or Lithuania or, on December 31, 1946, were in East Germany.

Finally, the Office administers the Rhodesian Sanctions Regulations, controlling transactions with Rhodesia and its nationals. The regulations implement United Nations Resolutions calling upon member countries to impose mandatory sanctions on Southern Rhodesia. An exception to the prohibition against imports of merchandise of Southern Rhodesian origin is authorized by general license for certain strategic and critical materials, pursuant to section 503 of the Military Procurement Act of 1971.

Under the Foreign Assets Control Regulations and the Transaction Control Regulations, the number of new license applications received during fiscal 1976 (including applications reopened) was 874, with 1,097 applications acted upon. During the transition quarter, the number of applications received was 90, with 78 applications acted upon.

New applications for licenses and requests for reconsideration under the Cuban Assets Control Regulations totaled 640 during fiscal 1976, and a total of 641 applications were acted upon. During the transition quarter, the number of new applications received was 96, with 95 applications acted upon.

During fiscal 1976, 856 new applications (including applications reopened) were received under the Rhodesian Sanctions Regulations and 864 applications were acted upon. During the transition quarter, the number of new applications received was 115, with 110 applications acted upon.

During fiscal 1976, 19 new applications (including applications reopened) were received under the Foreign Funds Control Regulations and 21 applications were acted upon. During the transition quarter, no new applications were received and one application was acted upon.

Certain broad categories of transactions are authorized by general licenses set forth in the regulations, and such transactions may be engaged in by interested parties without the need for securing specific licenses.

During fiscal 1976, there was one criminal case action by the Department of Justice involving violations of the regulations administered by this Office. Criminal court fines totaling $15,000 were collected as a result of criminal convictions reported in fiscal 1975. Civil penalties amounted to $4,974 and the total value of merchandise under seizure at the end of the fiscal year and transition quarter amounted to $2,650. There were no forfeitures of merchandise.

INTERNAL REVENUE SERVICE [1]

The Internal Revenue Service administers the internal revenue laws embodied in the Internal Revenue Code (26 U.S.C.) and certain other statutes, including the Employee Retirement Income Security Act of 1974 (Public Law 93–406, 88 Stat. 829).

Receipts

Gross revenue collections in fiscal 1976 totaled $302.5 billion, an increase of $8.7 billion (3.0 percent) over fiscal 1975. Collections passed the $300 billion mark for the first time, just 4 years after the $200 billion level was achieved and 13 years after the $100 billion line was crossed. The growth in collections was the smallest in 5 years due, partly, to tax reductions for individuals and corporations under the 1975 Tax Reduction and Revenue Adjustment Acts.

Income taxes accounted for over two-thirds of all tax receipts. Individual income taxes amounted to $159.0 billion, up $2.6 billion (1.6 percent) over 1975. Corporate income taxes were $46.8 billion, an increase of $1.0 billion (2.3 percent).

Employment taxes of $74.2 billion registered the largest dollar increase for the year, rising $4.1 billion (5.8 percent). An increase in the social security wage base and higher wage and salary levels were major factors affecting this area.

Excise tax revenue of $17.3 billion rose $0.4 billion (2.4 percent). Receipts from this source reflected a general increase despite a reduction in manufacturers' tax on trucks and buses, the continued phasing out of the telephone excise tax, and repeal of the sugar tax.

Estate and gift tax collections of $5.3 billion recorded the largest rate of increase of any major tax category for the year, advancing 13.2 percent ($0.6 billion). Both the estate and gift tax components of this combined tax class were higher.

During fiscal 1976, the IRS paid refunds of $34.7 billion to 68.0 million taxpayers whose payments and credits exceeded their tax liabilities. In fiscal 1975 a total of 122.5 million refunds totaling $40.1 billion were paid. In both fiscal years the number and amount of individual refunds were affected by the Tax Reduction Act of 1975. Included in 1976 data are 4.2 million checks totaling $0.9 billion for the new earned income credit (EIC). In fiscal 1975, the Service paid $7.9 billion in 1974 tax rebates and generated 54.7 million extra checks for rebate refunds alone. This accounted for the unusually high volume of individual checks issued in fiscal 1975.

IRS service centers received 127.1 million tax returns in 1976, compared with more than 126 million in 1975. Individual and fiduciary returns totaled 84.1 million compared with 85.5 million in 1975. The decrease is attributed to economic conditions and the increase in the standard deduction which changed the filing requirements and thus decreased the filing population. Nearly 28 million individual taxpayers, 34 percent of all individual filers, used the short form 1040A in 1976 as compared with more than 22 million in 1975, an increase of 24 percent in the number of forms 1040A filed. The Service received 54.5 million

[1]Additional information will be found in the separate Annual Report of the Commissioner of Internal Revenue. Transition quarter data will appear in an appendix to that report.

forms 1040, an 11-percent decrease from the 61.4 million in 1975. The reduction in form 1040 filers and the increase in form 1040A filers was primarily attributable to a form 1040A mailout to some 13.8 million individuals who had previously filed form 1040, but whose income indicated that they could use the short form.

Assisting taxpayers

The American tax system depends upon self-assessment and voluntary compliance. Every year taxpayers must determine their correct tax and file returns reporting it. Recognizing that taxpayers do not find this task easy, the IRS tries to help them to be in a better position to prepare their own returns.

During 1976, the IRS continued to expand assistance to taxpayers through a program designed to offer quality service, and to make taxpayer assistance readily available to taxpayers. Special training in basic tax law requirements was given to increase the effectiveness of taxpayer service personnel.

Before the 1976 filing period, a standard quality review system was implemented nationwide. The methods for providing taxpayer assistance were systematically monitored and measured to ensure the assistance was accurate, courteous, and timely. In over 600,000 contacts randomly sampled during the 1976 filing period (reviewing service returns, prepared observing walk-in inquiries, monitoring responses to taxpayer telephone inquiries, and reviewing referrals and correspondence), taxpayer assistors achieved an accurate rate of about 90 percent.

Specific criteria were issued for locating Taxpayer Service offices, emphasizing convenience to public transportation and first-floor locations. Low noise level and taxpayer privacy considerations were factors in the criteria. During the 1976 filing period, walk-in service was offered in about 740 permanent offices and in over 220 temporary filing-period-only offices. More offices were located in the inner city (133 in 1976, 112 in 1975), and in suburban and rural locations (185 in 1976, 92 in 1975), for taxpayer convenience. Extended-hours service was offered in most IRS offices for taxpayers unable to call or visit during normal business hours.

The Service again provided special assistance to taxpayers speaking foreign languages, with 117 offices (and over 390 employees) offering tax assistance in Spanish and 148 offices (and over 500 employees) providing help in other foreign languages.

Under the volunteer income tax assistance program (VITA), the Service trained over 20,000 volunteers who provided free tax assistance to elderly, Spanish-speaking, low-income, and other taxpayers in their communities. Over 150,000 individuals attended approximately 3,000 IRS-sponsored classes on taxes.

A major effort to raise the level of public awareness about the earned income credit, which benefited low-income taxpayers, was emphasized in Taxpayer Service contacts and through liaison with other Service activities. This program included notices sent with the cooperation of other Government agencies (Health, Education, and Welfare, Agriculture, Labor) to taxpayers who were eligible for the EIC. Notices were also sent by IRS to taxpayers who filed tax returns without claiming the EIC, but who apparently qualified based on tax return information. The EIC was allowed to about 6 million taxpayers for a total of approximately $1.2 billion, averaging out to some $203 per taxpayer who claimed the credit.

During 1976, the Service received about 38 million written, telephone, and walk-in inquiries. The total consisted of over 28 million telephone calls, more than 9 million walk-in inquiries, and over 150,000 written inquiries. More than 60 percent of these inquiries occurred during the filing period from January 1 through April 30, 1976. In that period, the IRS received almost 17 million telephone calls, over 6 million walk-in inquiries, and over 60,000 written inquiries, for a total of over 23 million requests for assistance.

Toll-free telephone service was offered for the third straight year nationwide. While the number of answering sites was reduced from 85 in 1975 to 82 this year, the reduction did not interfere with the quality and depth of assistance available to taxpayers at each location.

Under this system, any taxpayer in the United States may call the IRS for assistance without having to pay a long-distance telephone charge. Toll-free numbers are listed in the income tax return packages provided to taxpayers. Taxpayers may also use the toll-free network to call for information or clarification of the bills and notices they receive relating to their accounts. These notices are accompanied by an enclosure which lists a toll-free telephone number and suggests that the taxpayer use the number to obtain assistance or further explanation.

The toll-free telephone system has provided taxpayers with greater telephone access to IRS offices and has made an IRS office as close to taxpayers as their own telephones.

Communications with taxpayers.—During 1976, the Service's program to improve form letters, computer notices, and other similar taxpayer communications continued to be a major objective. A special unit of writer-editors continues to review all such standard communications to ensure they are personalized and understandable to the average taxpayer. National Office units and field offices reviewed a total of 1,800 form letters and notices during the year and were able to eliminate 479 of them as duplicative or unnecessary.

The Service continues to inform taxpayers of their rights under the tax laws and to provide complete, courteous responses to taxpayer inquiries.

Tax publications.—To reinforce information provided taxpayers during direct contact, and to assure nationwide consistency in the application of the tax laws, the Service also distributes, free of charge, a number of publications.

The major IRS publications are Publication 17, Your Federal Income Tax; Publication 334, Tax Guide for Small Business; and Publication 225, Farmer's Tax Guide. Also, the Service has issued publications dealing with special tax problems such as reporting the sale of a personal residence or computing the value of donated property.

New tax publications developed in 1976 included Publication 591, Tax Credit for the New Home Buyer; Publication 592, The Federal Gift Tax; Publication 593, Income Tax Benefits for U.S. Citizens Who Go Overseas; Publication 595, Tax Guide for Commercial Fishermen; Publication 596, Tax Benefit for Low-Income Individuals; Publication 597, Information on the United States-Canada Income Tax Treaty; Publication 598, Tax on Unrelated Business Income of Exempt Organizations.

The mass media.—The Service continued to use the Nation's mass media to furnish tax information to the public. In 1976, over 17,900 radio and TV stations, daily and weekly newspapers, and magazines received material prepared by the IRS to inform and assist taxpayers. Service personnel participated in 6,432 interviews, answered 19,243 media inquiries, and made 5,642 talks to citizen groups.

Nearly 8,200 news releases were issued to the media. These releases covered such topics as services available to taxpayers, appeal rights, correct filing of returns, the Presidential campaign fund checkoff, tax advice for disaster victims, earned income credit, pension benefit plans, the real estate allowance, the personal exemption allowance, as well as numerous releases relating to rulings, procedures, regulations, and other legal interpretations, positions, and announcements.

Some of the releases, as well as radio and TV scripts, were translated into Spanish for use in areas where it is widely spoken as a second language. Tax question-and-answer columns were written for nationwide distribution to weekly newspapers and magazines.

The Service also produced and distributed to field offices two color films, one covering audit and appeals procedures, and the other providing tax information to assist small businessmen. These IRS films were shown on 152 occasions by TV outlets and 2,430 occasions by civic associations, service, professional, and educational groups from January through June of 1976.

Electronic tax service.—The integrated data retrieval system (IDRS), which links all district and area offices and Puerto Rico through video terminals to computer files at the IRS service centers, processed 282.2 million inquiries during 1976.

The installation of large computers and related components with faster processing capabilities has enabled the Service to be more responsive to taxpayer requests and has caused rapid growth in the use of the equipment. The IRS service centers processed an average of 2.4 million inquiries per service center each month during the last half of fiscal 1976 compared with 1.8 million in the same period in 1975, an increase of 33 percent.

Tax forms improvements

The Service continues in its efforts to ensure that the number and content of reports it requires of the public are kept to the absolute minimum needed to meet the requirements of the law and to permit efficient administration of the tax system. The IRS continued to resist outside efforts to add nontax data to forms.

This year the simplification effort was stepped up with a line-by-line review of the major return forms in an attempt to delete unnecessary items and to insure that the forms did not place an undue burden on the public. Larger numbers of forms and questions were deleted than in previous years.

The Service, in addition to its own review, solicits suggestions from taxpayers, practitioners, organizations, industry groups, and other interested parties for improving tax forms and instructions and reducing reporting requirements. This year for the first time a public hearing was held on forms 1040 and 1040A. Announcements were published in the Federal Register and in the Internal Revenue Bulletin. Local newspapers ran articles inviting all interested persons to present their comments, and public interest groups were encouraged to participate. Nonetheless, only two speakers participated.

Among the changes made on this year's return was the addition of address information boxes requested by the Census Bureau for revenue sharing purposes. A line was added for the new earned income credit for certain individuals with less than $8,000 adjusted gross income, and for the new deduction of $30 for each personal exemption other than exemptions for age and blindness. Also, optional tax tables were expanded to cover adjusted gross income of up to $15,000.

Revenue Adjustment Act.—Because the Revenue Adjustment Act of 1975 was enacted on December 22, 1975, after the tax forms were sent to print, and because the new law contained various, and in some cases retroactive, effective dates, the provisions of the act had to be communicated to taxpayers who had already filed fiscal year returns as well as those who were about to file their calendar year returns. The IRS revised or developed forms, special instructions, tax computation worksheets and issued press releases to notify taxpayers of the tax law changes. Among the forms developed were Form 1040FY (1975–76), Fiscal Year Tax Computation Schedule; Form 1040ES, Estimated Tax Worksheet; and Corporation Estimated Tax, Form 1120–W (FY 1975–76), Form 1120–W (1976), Form 1120–W (1976–77).

During 1976, new pension forms were developed to implement the Employee Retirement Income Security Act of 1974. Of major importance were three forms requiring the joint efforts of the Department of Labor and IRS: Form 5500, Annual Return—Report of Employee Benefit Plan (with 100 or more participants); Form 5500–C, Annual Return—Report of Employee Benefit Plan (with fewer than 100 participants none of whom is an owner-employee); and Form 5500–K, Annual Return—Report of Employee Pension Benefit Plan for Sole Proprietorship and Partnerships (with fewer than 100 participants and at least 1 owner-employee). The final version of the forms reflected IRS and Labor response to over 1,600 public comments received as a result of publishing for comment the proposed forms in the Federal Register. The new pension law also required the development of annual information return Form 5329, Return for Individual Retirement Savings Arrangement, required to be filed by individuals who have established individual retirement accounts.

Privacy Act impact.—September 27, 1975, was the effective date of the Privacy Act of 1974 provisions that affected many forms, letters, and notices which request information from individuals. The Privacy Act specifies, in part, that the taxpayer must be informed of the authority for the request, of whether compliance is mandatory or voluntary, of the principal purpose for which the information is intended, of the routine uses which may be made of the information, and of the effects on the taxpayer of not providing all or part of the information.

To comply with the provisions of the act which affected over 200 major tax forms, the Service provided detailed information about the act on form 1040 and 1040A instructions to cover all forms, schedules, and supporting statements taxpayers use in connection with their individual tax returns. For filers in need of this information, new Publication 876, Privacy Act Notification, was developed between the effective date of the Privacy Act and the date filers received their form 1040/1040A packages. In August 1975, Notice 403, the Privacy Act of 1974, was developed for distribution to taxpayers who must furnish additional information concerning incorrect social security numbers for tax administration purposes.

Tax rulings and technical advice

The Service's tax ruling program consists of letter rulings and published revenue rulings.

A letter ruling is a written statement issued to a taxpayer by the National Office interpreting and applying the tax laws to a specific set of facts. Such a ruling provides advice concerning the tax effects of a proposed transaction so that the taxpayer may structure the transaction to comply with the tax laws, thus resolving issues in advance and avoiding future controversy. Letter rulings are not precedents and may not be relied upon by other taxpayers.

Technical advice is counsel or guidance as to the interpretation and proper application of the tax laws to a specific set of facts. It is furnished by the National Office at the request of a district office in connection with the audit of a taxpayer's return or claim for refund or credit. Frequently, the district director's request is made in response to the suggestion of the taxpayer that technical advice be sought.

A revenue ruling is an interpretation of the tax laws issued by the National Office and published in the Internal Revenue Bulletin for the information and guidance of taxpayers, practitioners, and IRS personnel. Most revenue rulings are based on letter rulings or technical advice which have the potential of setting precedents or have such broad applicability that general guidance should be offered to people in similar situations.

Test program for processing ruling requests.—On July 1, 1974, the Service initiated a test program in the Reorganization and Excise Tax Branches, Office of the Assistant Commissioner (Technical), to change the processing of ruling requests. Under the test program, a representative of the Branch would contact, within 7 workdays after receipt of the request, the taxpayer or the taxpayer's representative to discuss informally the procedural and substantive issues involved in the ruling request.

The test program proved to be feasible in the two branches and was very favorably received by taxpayers, taxpayer representatives, and the American Bar Association. Due to the success of the program, it was expanded on July 1, 1975, to include (with only a few exceptions) ruling requests received by all the ruling branches in Technical. Under this expanded test program, the taxpayer or the representative was contacted within 15 workdays after receipt of the ruling request to discuss the procedural and substantive issues involved in the ruling request. On July 19, 1976, the Service announced in Rev. Proc. 76–29 that the test program had been adopted as a permanent change. The 15-day rule is now an ongoing part of Technical's procedures for handling ruling requests.

Accounting methods rulings.—During fiscal 1976, receipts increased 14 percent over fiscal 1975 in requests for rulings regarding accounting methods. The increase occurred principally in two areas.

First, a significant portion of this increase was attributable to the large number of requests by manufacturers to change to the full absorption method for inventory valuation. This activity was primarily a result of the promulgation in 1973 of section 1.471–11 of the Income Tax Regulations, which provided a transition period for manufacturers to change to the full absorption method for inventory valuation.

Second, many taxpayers requested permission to readopt the last-in first-out (LIFO) method of inventorying their goods, as well as many requests for changes from taxpayers already on the LIFO method. The LIFO method softens the impact of inflationary trends on prices paid for goods and, in effect, reduces or defers taxpayers' current profits and taxes. Requests for method changes in the LIFO area are expected to increase until the present inflationary spiral levels off or reverses.

Internal Revenue Bulletin.—The weekly Internal Revenue Bulletin is the authoritative publication of the Commissioner for announcing official rulings and procedures of the Service and for publishing Treasury decisions, Executive orders, tax conventions, legislation, court decisions, and other items of general interest. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins. Copies of the weekly and semiannual issues are distributed within the Service and are made available to the public by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402, on a single copy or subscription basis.

During 1976, items in the Bulletin included 559 revenue rulings, 51 revenue procedures, 16 public laws relating to Internal Revenue matters and 13 committee reports, 2 Executive orders, 65 Treasury decisions containing new or amended regulations, 14 delegation orders, 3 Treasury Department orders, 14 notices of suspension and disbarment from practice before the Service, 242 announcements of general interest, and 7 court decisions.

The Bulletin Index-Digest System, revised as of December 31, 1974, provides a rapid and comprehensible means of researching material published in the Internal Revenue Bulletin after 1952. The major part of the system consists of digests of Bulletin items arranged under headings that facilitate a topical approach to a search for items on a specific issue. With the aid of finding lists, the researcher can locate items by Code section or number.

Tax Reduction Act of 1975

The Tax Reduction Act of 1975, Public Law 94–12, provided for allowable credits for earned income, personal exemptions, and purchase of residence. The earned income credit is in effect a negative income tax; it is a 10-percent refundable credit with a maximum of $400 reduced by 10 percent of adjusted gross income over $4,000. The personal exemption credit is an additional $30 personal exemption tax credit. The house purchase or residence credit provides for a maximum of $2,000 tax credit on the purchase of a new principal residence, the construction of which was commenced prior to March 26, 1975, and purchased between March 21, 1975, and January 1, 1977.

Data on these several credits for tax year 1975 is shown in the following table (data through June 30, 1976):

	Number	Amount
Earned income credits	6.0 million	$1.2 billion
Personal exemption credits	190.5 million	$5.7 billion
Residence credits	472,000	$653 million

Presidential election campaign fund

During fiscal 1976, a total of 21.1 million individual income tax returns had designations for the Presidential election campaign fund (PECF); this was 25.5 percent of the returns processed by the IRS in that period. The total amount designated in fiscal 1976 was $33.5 million. In fiscal 1975 there were 19.9 million individual tax returns with PECF designations totaling $31.7 million.

The cumulative amount credited to the Presidential election campaign fund since the checkoff was initiated in 1972 is $95.2 million.

Wagering taxes

Responsibility for administering the civil aspects of the Federal wagering tax laws was returned to the Service by Treasury Order 221-3, Revision 1, effective February 21, 1976. The responsibility for enforcing the criminal aspects of the wagering tax laws, including the forfeiture provisions, remains with the Bureau of Alcohol, Tobacco and Firearms. The Wage, Excise, and Administrative Provisions Branch of the IRS Individual Tax Division is responsible for wagering tax matters involving the application of the laws.

Creditability of foreign taxes by oil-producing corporations

One issue actively considered during the year was the question of whether amounts received by foreign governments from the production of mineral resources may be treated as creditable taxes for U.S. purposes by domestic corporations. Three significant news releases were issued in fiscal 1976 which pertain to this issue.

In IR 1591, the Service announced that it had taken the position that the share of oil production retained by a foreign government under a production sharing agreement is in substance a royalty in its entirety, and is not eligible for the foreign tax credit.

Subsequently, the Service announced in IR 1608, Rev. Rul. 76-215, that amounts received by an Indonesian Government entity under a production sharing agreement are not income taxes for purposes of sections 901(b), 903, and 164(a)(3) of the Code. This position was applied prospectively.

The last release, IR 1638, specified the circumstances under which a foreign tax credit will be allowed when a levy is imposed by a foreign government which owns minerals extracted by U.S. taxpayers. The Service expects this issue to be one of continuing concern in the upcoming year.

Multicorporation "F" reorganizations

The publication of Rev. Rul. 75-561, 1975-2 C.B. 129, revoking Rev. Rul. 69-185, 1969-1 C.B. 108, marked a major change in Service position with respect to whether the merger of two or more commonly owned operating corporations could qualify as reorganizations within the meaning of section 368(a)(1)(F) of the Code. The earlier position contained in Rev. Rul. 69-185 was that the Service would not follow several court decisions which held that a transaction resulting in the combination of two or more operating corporations constituted an "F" reorganization. In Rev. Rul. 75-561, this position was revoked and the Service announced it would now follow those cases, as well as other court cases, which had held that a merger of a wholly owned subsidiary corporation into its parent which qualified as a liquidation under section 332 of the Code (to which section 334(b)(2) does not apply) could also qualify as a reorganization under section 368(a)(1)(F).

Employee plans and exempt organizations

The Office of Employee Plans and Exempt Organizations (EP/EO) administers the regulatory responsibilities assigned to the Service concerning employee benefit plans as well as tax-exempt organizations. In the National Office, the structure consists of Employee Plans, Exempt Organizations, and Actuarial Divisions. EP/EO field staff are located primarily in 7 regional offices and 19 key districts, and local service is provided in numerous other offices.

Employee plans.—The Employee Plans activity ensures that the Employee Retirement Income Security Act of 1974 (ERISA) is administered in accordance with the law. Major emphasis has been placed on developing those regulations most urgently needed by taxpayers.

The Special Reliance Procedure and ERISA Guidelines issued in November of 1975 provided that, for employee plans which comply with the procedure, the ERISA Guidelines will be treated as fixed for a certain period so that they can be relied upon for drafting employee plans and amendments without regard to changes in the ERISA Guidelines during such period. A new procedure was established whereby law firms may obtain approval from a district director that the form of their pattern plan satisfies the qualification requirements of the Code.

The IRS has continued to coordinate implementation of ERISA with the Department of Labor and the Pension Benefit Guaranty Corporation in order to issue regulations, procedures, and rulings compatible with those issued by such other agencies and to reduce duplication of reporting by taxpayers.

The employee plans master file is being redesigned to provide for the processing of applications used for plan qualification determinations and the new form 5500 series returns and is expected to be operational in July 1977.

In January 1976 a case inventory control and management information reports system was implemented with computer terminals in all key districts. It has proved to be an effective system for controlling applications for approval of plans and plan amendments.

Exempt organizations.—During 1976, the Service received 44,377 applications and reapplications from organizations seeking a determination of their tax-exempt status or seeking a determination of the effect of organizational or operational change on their status. The Service issued 43,668 determinations and ruling letters. In addition, 309 technical advice memoranda were issued. The Service devoted an average of 530 field professional positions to the examination of 16,635 exempt organization returns and to other exempt organization activities. Also, 5 regulations, 70 revenue rulings and revenue procedures, 4 delegation orders, 12 forms, 9 news releases, and 3 publications were issued in 1976. Question-and-answer sheets were also prepared for taxpayer service use on exempt organizations.

A taxpayer compliance measurement program (TCMP) covering the examination of private foundations, public charities, and social welfare organizations was initiated in 1975. The first phase of the program was completed April 30, 1976; the second phase continues until December 31, 1976. The program is designed to identify patterns and characteristics of compliance and noncompliance of the exempt organizations being studied.

The number of active entities recorded on the exempt organizations master file increased from 692,000 in 1975 to 756,000 in 1976.

Exempt Organizations Division has revised its management reporting systems to maximize cost effectiveness. The revisions include the utilization of computer technology to identify, select, and control examination inventories; to control applications for exemption; and to provide to management and other interested parties information essential to carry out the mission of Exempt Organizations.

Exempt Organizations Division is participating in testing the feasibility of decentralizing the processing of exempt organization returns. All processing is currently done by the Philadelphia Service Center. The test involves processing the returns at the Cincinnati Service Center that would be filed there if a decentralized system were in use.

A revenue procedure concerning guidelines and recordkeeping requirements for private schools was published. Extensive changes had been made to the revenue procedure in order to reflect public comments received.

Five revenue rulings were published concerning the treatment of exempt organization income from the rental of display space to exhibitors at convention trade shows.

Final regulations were published on December 12, 1975, regarding the computation of unrelated business tax on exempt organizations from the sale of advertising in periodicals.

On February 17, 1976, final regulations were published providing the definition of medical research organizations for purposes of foundation status determinations and limits on deductibility of charitable contributions.

Public hearings were held June 6, 1976, to consider the proposed regulation defining an "integrated auxiliary of a church." This definition is critical in determining whether a church-related organization is required to file an annual information return. The Service is reconsidering the proposed definition. Under the Commissioner's discretionary authority, church-related organizations covered by a group ruling issued to a parent church were excused from filing a 1975 information return.

During 1976, 38 regulations, 17 revenue rulings and procedures, 6 delegation orders, 25 forms, 19 news releases, 1 publication, and 27 technical information releases including questions and answers on plans, mergers and consolidations, employee stock ownership plans, the Special Reliance Procedure, and the ERISA Guidelines were issued in the employee plans area. In addition, the National Office issued 5,446 opinion letters on master and prototype plans.

ERISA requires the conformance of all new pension benefit plans, approximately 500,000 existing corporate plans, and an estimated 400,000 existing self-employed plans.

In 1976, the Service devoted an average of 790 field professional positions to carrying out its regulatory responsibility in the employee benefit plans area.

This responsibility is met by issuing advance determination letters regarding the qualification of pension, profit-sharing, and other employee benefit plans and by conducting an examination program to determine whether plans continue to qualify in operation and to verify the appropriateness of deductions for plan contributions. The number of determination letters issued with respect to corporate and self-employed plans during 1976 was 47,313, a decrease of 33.2 percent from 1975. The decrease is attributed to the passage of ERISA and the fact that the IRS was in the process of developing regulations under the new law.

Actuarial matters.—In 1976, the Service devoted 19 average positions to preparing actuarial determinations, interpreting and clarifying provisions of ERISA and regulations issued thereunder, and serving on joint committees and task forces with Labor and with the Pension Benefit Guaranty Corporation.

In addition, the Service contributed technical and administrative assistance to the Joint Board for the Enrollment of Actuaries, established by ERISA and under the joint direction of Treasury and Labor, in the screening and processing of over 4,000 applications for enrollment. By June 30, 1976, almost 2,400 applicants had been enrolled.

Audit of returns

The IRS audits tax returns in order to help ensure the highest possible degree of voluntary compliance with the tax laws. While audit activity is the primary method that the IRS uses to encourage voluntary compliance, every return is subject to scrutiny by IRS employees and computers. When a return is received in one of the 10 IRS service centers, it is first checked manually for completeness and accuracy and for certain obvious errors such as the claiming of a partial exemption or duplicate deductions. Then the service center's computers check the accuracy of the taxpayer's arithmetic and pick up other errors which may have escaped manual detection such as the failure to reduce medical deductions by 3 percent of adjusted gross income.

Returns selections.—The primary method used by the IRS in selecting returns for audit is a computer program of mathematical formulae—the discriminant function system (DIF)—which measures the probability of tax error in each return. Returns identified by the system as having the highest error potential are selected for audit. Since this system was introduced in 1969, the IRS has reduced the number of taxpayers contacted whose audit would result in no tax change (all taxes) from a peak of 43 percent in 1968 to a historic low of 22 percent in 1976. The Service is continuing its efforts to reduce the number of no-change examinations and repetitive audits that result in no changes. In 1976, procedures were implemented to dispense with an examination in certain circumstances when the taxpayer has been audited for the same issue in either of 2 prior years and the audit resulted in little or no change in tax.

Returns may also be chosen for audit under the taxpayer compliance measurement program, a computerized system which makes a random selection of returns within income classes for research purposes, such as updating DIF formulae on more current taxpayer filing and reporting characteristics. Audits conducted under TCMP must be more intensive than most in order to develop the information required by TCMP.

The computer selection of returns is complemented by manual selection in various instances. For example, if the IRS is auditing the return of a partnership (or of one business partner), the returns of the partners (or additional partners) may also be audited. Other returns may be manually selected as a result of information from other enforcement activities, news reports, or criminal investigations. The IRS also screens returns with adjusted gross income above certain limits, and some returns of taxpayers who submit claims for refund or credit after filing their returns.

Results of audit activity.—The IRS audited 2,546,419 tax returns of all types in 1976, 80,714 more than the 2,465,705 audited in 1975. The 1976 total was more than in any year since 1968, when 2,903,722 were examined. Of the total returns audited in 1976, 141,204 were examined in service centers, compared with 112,550 last year. The remainder were examined in district offices by revenue agents, tax auditors, and employee plans and exempt organization specialists. Examinations conducted by revenue agents and such specialists under field audit techniques totaled

779,770 returns, a decrease of 32,566 returns, or 4 percent, from last year. [Examinations of Employee Plans decreased about 36,000 returns (this decrease is largely due to a change in methodology used in reporting referrals from Audit Division) and Exempt Organizations decreased about 4,000 returns with an increase of about 7,000 examinations in other tax areas.] Examinations conducted by tax auditors under office audit procedures numbered 1,625,445 returns, an increase of 86,277 returns, or 6 percent, over last year. Audit coverage of income, estate and gift tax returns increased to 2.59 percent compared with 2.55 percent achieved in 1975.

The Service's examination program resulted in $5.2 billion of additional tax and penalties recommended. While recommendations exceeded $5 billion for the fourth straight year, the total was about $156 million below last year.

During 1976, assessments totaled $4.4 billion, including $3.7 billion in assessed tax and penalties and $717 million in interest. In 1975, assessments amounted to $4.5 billion, of which $3.8 billion represented tax and penalties and $695 million represented interest.

Examiners are required to determine a taxpayer's correct tax liability—no more, no less. This means that examiners look for indications that taxpayers have overstated, as well as understated, their tax liability. In 1976, Service examinations disclosed overassessments on 137,455 returns, accounting for refunds of $290.5 million.

Service center programs.—The IRS service center review program began in 1972. It is generally limited to the verification or resolution of issues which can be satisfactorily handled by service center personnel through correspondence with the taxpayer. More than 1,882,000 returns were checked in service centers in 1976, a 42-percent increase over 1975.

Most of these returns involved obviously unallowable items such as medical expenses not reduced by the 1-percent and 3-percent limitations. Approximately 1,474,000 returns were corrected in 1976, compared with 952,000 in 1975.

The service centers also conducted correspondence examinations of returns selected under district office criteria involving issues such as charitable contributions or interest payments, which generally can be resolved through correspondence with the taxpayer. A total of 141,204 returns in this category were examined during 1976, an increase of nearly 25 percent over the 112,550 examined in 1975.

Computer-assisted audits.—The Service has an ongoing program to use computers in audits of tax data in automated accounting systems. Both generalized computer programs and specifically developed programs are used to retrieve and analyze data essential to an examination. These computer programs permit an automated "eye-balling" of massive data files with the printout of only those items of possible audit interest. Both taxpayers and the IRS save time and expense since computer-assisted audits can be done in a fraction of the time needed to do the same job manually.

Over 8,000 applications of these computer audit techniques were performed in 1976, double that of 1975. These are done by computer audit specialists, experienced revenue agents who have received intensive training in computer hardware, programming languages, and audit techniques.

The Program Audit Library (PAL), a system of generalized computer programs developed by the Service and designed specifically for tax audits, was expanded in 1976 to include statistical sampling techniques. PAL also includes programs for data selection, stratification, and summarization.

Coordinated examination program.—All large-case taxpayers, except financial institutions and utilities, whose gross assets exceed $250 million are included in the coordinated examination program. Financial institutions and utilities are included in the program if gross assets exceed $1 billion.

Because large-case taxpayers have complex accounting operations and tax issues, the Service turned to the team audit or coordinated examination concept when examining the tax returns of these taxpayers. This approach combines the skills of the accountant-revenue agents with those of economists, computer audit specialists, international tax examiners, engineering agents, excise tax examiners, employee plans examiners, and employment tax examiners.

At the end of fiscal 1976, there were 1,240 large cases in this program which averaged 2.7 open years per case. This is the fourth consecutive year the average open years in the large-case program has been less than 3 per case.

During 1976, the IRS expanded its practice of conducting industrywide audits involving the contemporaneous examination of major companies in a given industry. Nine industries are currently being audited by this approach, four more than 1975.

Tax shelter program.—In 1974, the IRS established a nationwide tax shelter examination program coordinated by the National Office. Due to the multidistrict involvement of promoters and investors, these examinations were conducted under industrywide audit concepts. This approach insures a greater degree of consistency and uniformity in the Service's overall treatment of the tax aspects of shelter programs.

Examinations of tax shelters are conducted by field personnel analyzing the entire enterprise first to determine whether participants, barring unexpected problems, can reasonably be expected to earn a profit appropriate to the investment and degree of risk involved. The business is then studied to determine possible improper or excess allocation of deductions and also to make certain that individual items causing operating losses are properly claimed deductions.

Computer-assisted audit techniques are being used, when appropriate, to assist in the examination of large partnership tax shelters. These shelters generate many related tax returns and present a major clerical problem to the Service. To correct this, the Service has developed computer programs to expedite the manual processing workflow in these examinations.

During 1976, the Service conducted examinations of possible tax shelter abuses by investors in the oil and gas, real estate, farm operations, and motion picture industries. The program will be expanded in 1977 to include other widespread abusive shelters.

Joint Committee review.—The Internal Revenue Code provides that all income, estate and gift tax refunds and credits which exceed $100,000 must be reported to the Joint Committee on Internal Revenue Taxation. During 1976, 1,506 cases involving overassessments of $1 billion were reported to the Joint Committee, as compared with 1,356 cases and $969 million in 1975.

During 1976, some changes were adopted to permit more efficient handling of these cases. Until this year, final decisions had to be made in the National Office in the name of the Commissioner and reported to the

Joint Committee on these cases. Now, the Regional Commissioners are authorized to take these actions on cases within their regional jurisdiction. In addition, the Assistant Commissioner (Compliance) now has authority to take final action for the Commissioner on matters formally presented by the Joint Committee relating to reports submitted under this provision of the Internal Revenue Code.

Audit information management system.—The audit information management system (AIMS) is a video terminal-oriented management information and case control system replacing the current system for controlling returns in inventory and production. The new system is an expansion of the existing integrated data retrieval system currently located in the IRS service centers.

This new system was successfully pilot-tested in 1976 and will be implemented nationwide during 1977. AIMS will provide for more rapid responses to taxpayer inquiries and faster assessment and refund action resulting in improved taxpayer relations. Also, the system will provide for automated control and verification of assessments from the point of origin in the district office and service center.

The perpetual inventory feature of the new system provides prompt location of any return in the Audit Division. This feature combined with more timely produced management reports will permit increased efficiencies in staffing and better workload management and control.

Technical reference information system.—In 1976, the Service began nationwide use of the technical reference information system (TRI). This system involves computerized legal research. All or any portion of court decisions, revenue rulings, statutes, or portions of the Internal Revenue Manual can be retrieved through TRI. IRS personnel are able to research issues more quickly and thoroughly than by doing traditional manual research, with resulting monetary savings. The IRS is currently leasing 15 computer terminals and plans to install a number of additional terminals.

Computer production of reports on audit changes.—In 1976, the Service increased its use of automated report-writing equipment for the production of Form 1902–E, Report of Individual Income Tax Audit Changes, and accompanying Form 3547, Explanation of Adjustments, through the acquisition of 40 report-writing machines. Located in local district offices, the new equipment replaced older, antiquated equipment in several districts, and provided a facility for automated onsite preparation of audit change reports in many district offices which previously did not have such a capability. The new equipment will improve the ability of district offices to service the increasing office audit workload and will provide increased service to the public. Also, the increased capacity of this equipment enables the Service to greatly enhance the present 1902–E programs by incorporating additional schedules (income averaging, sick pay exclusion, retirement income credit, etc.) into the system.

The appeals process

Administrative appeals.—The Internal Revenue Service encourages the resolution of tax disputes through an administrative appeals system rather than through litigation. Taxpayers who disagree with a proposed change to their tax liability are entitled to a prompt, independent review of their cases. The appeals system is designed to minimize inconvenience, expense, and delay to the taxpayer in disposing of contested tax cases.

Within the system, there are two levels of appeal: The district conference staff in the Audit Division of the district director's office, and the Appellate Division in the Regional Commissioner's office. Each level of appeal is independent of the other, and each has different authority and jurisdiction. Their common and principal objective is the early disposition of disputed cases, with a fair and impartial application of the law.

For the initial appeal conference, a taxpayer may choose either the district conference staff or the regional appellate staff. Opportunities for such a hearing are offered at 58 district offices and 40 regional offices throughout the country. Conferences are also arranged, as needed, at other IRS locations by circuit-riding conferees at a place and time convenient to the taxpayer.

Proceedings are informal in both of these offices. Taxpayers may represent themselves or be represented by an attorney, accountant, or any other adviser enrolled to practice before the IRS. If the disputed tax liability, for each taxable year involved in the dispute, is $2,500 or less, the taxpayer may obtain a district conference and a subsequent regional conference without filing a written protest. At the conference taxpayers are given the opportunity to present their views and discuss the merits of the issues. If agreement cannot be reached during the district conference, the taxpayer is advised of his further appeal rights and may then request a regional appellate office conference.

In a majority of cases, the taxpayers and district or regional conferees reach a mutually acceptable basis for resolving their tax disputes. Consequently, very few cases go to trial. In the past 10 years, 97 percent of all disputed cases were closed without trial. In 1976, the appeals function disposed of 56,004 cases by agreement; the Tax Court tried 1,407 cases; and the U.S. district courts and Court of Claims tried 344 cases. Thus, in disputed tax matters, the administrative appeals system continues to serve the taxpayer well. The system provides for an expeditious, independent, and impartial review of tax cases, and one measure of its success is its ability to efficiently resolve the great majority of tax disputes without litigation.

District conference.—District conference staffs consider disputes involving factual questions regardless of size. They also consider whether proposed actions by a district director's office, with respect to issues disputed by a taxpayer, reflect the correct interpretation of the Internal Revenue Code, as clarified by the courts and by IRS regulations and revenue rulings. In addition, since April 1, 1974, district conference staffs have had the authority to settle cases where the amount of tax in dispute was $2,500 or less, by taking into account the hazards of litigation; that is, the possibility that the Service might lose the case if it were litigated due to factors such as weight accorded to evidence, lack of clear precedents, or questions pertaining to how the law applies to a given, unusual set of facts. Previously, only appellate conferees had this settlement authority, which meant that many taxpayers had to take their cases to the regional appellate office in order to settle unclear issues.

Since receiving this settlement authority, the percentage of agreed cases closed by district conference staffs has significantly increased. Where settlement authority could be exercised, about 30 percent of these cases have been settled on that basis. The results have been favorable to taxpayers in terms of time, convenience, and expense as well as to the IRS in terms of reducing the number of cases going to the regional appellate offices or to the courts.

District conference staffs reach agreement with the taxpayer in about 73 percent of the cases they considered in 1976.

Appellate Division.—Cases considered by the Appellate Division cover a wide range of issues from the most elementary to the most complex. They involve additional taxes or claims for refund ranging from small amounts to millions of dollars, including individual and corporation income tax, estate tax, gift tax, excise tax, employment tax, and offers in compromise.

Cases considered fall into two broad categories: Nondocketed cases involve cases in which the taxpayer is protesting a proposed action by the district director, involving additional taxes, a refund disallowance, or a rejection of an offer in compromise. These cases made up about 57 percent of Appellate's workload in 1976. The second category of cases are known as docketed, and these involve cases where taxpayers have filed for a hearing before the U.S. Tax Court.

In 1976, 71 percent of nondocketed cases and 73 percent of docketed cases closed by the Appellate Division were closed by agreement with the taxpayer.

Tax fraud investigations

The Intelligence Division is responsible for the enforcement of the criminal provisions of the tax laws. Special agents investigate evasion of income, estate, gift and excise taxes, failure to file returns, failure to remit trust fund taxes (withheld income and social security taxes), the filing of false withholding exemption statements, false claims for refunds, and the preparation of false returns for others. When evidence of tax evasion or tax fraud is identified, the Intelligence Division investigates and recommends prosecution when warranted.

Special projects are sometimes carried out to determine the extent of noncompliance in a given geographical area or occupational field, if a pattern of noncompliance is detected, or to increase the coordination of investigations covering an already identified area of noncompliance. One successful project completed this year involved an extortion and kickback scheme employed in the construction of a $700 million nuclear power plant. This project resulted in 16 prosecution recommendations and has generated tax assessments in excess of $1 million. Other recent and significant intelligence investigations have focused on tax evasion by large corporations; abuse of tax havens in foreign countries; corruption of public officials through payoffs and kickbacks; and preparation of fraudulent tax returns.

During 1976, the Intelligence Division completed 8,797 investigations and recommended prosecution of 3,147 taxpayers. Grand juries indicted or courts filed information on 1,331 taxpayers. Prosecution was successfully completed in 1,193 cases. In 839 cases taxpayers entered guilty pleas, 138 pleaded nolo contendere, and in 216 cases the taxpayers were convicted after trial. Acquittals and dismissals totaled 77 and 71, respectively. Of the 1,172 taxpayers sentenced during 1976, 486, or 41.5 percent, received jail sentences compared with 40.3 percent last year.

Organized crime and strike force activities.—The IRS cooperates in the Federal Government's fight against organized crime by participating in the Federal organized crime and strike forces program. Located in 17 major cities, strike force units are headed by attorneys from the Justice

Department. The objective of this program is to coordinate the combined forces of Federal law enforcement agencies against the criminal element in our society. The IRS is responsible for ensuring the income from illegal activities is correctly reported and taxed and for detecting criminal violations of the tax laws. During 1976, the IRS contributed 660 staff years of direct investigative and examination time to the strike force effort.

A total of 130 organized crime members and their associates were convicted or pleaded guilty to tax charges during the year and 721 prosecution cases were pending when the year ended.

Since the inception of the organized crime program in 1966, 669 organized crime members and associates have been convicted or have pleaded guilty to various tax charges.

Narcotics investigations.—As part of its special enforcement program, the Service continued to identify and investigate significant tax violations by middle and upper echelon narcotics financiers and traffickers. During 1976, the IRS completed 326 criminal tax investigations, obtained 56 indictments, and achieved 51 convictions of financiers and traffickers.

Delinquent taxes and compliance

In its mission to maintain the highest degree of voluntary compliance with the tax laws, the Service makes every reasonable effort to secure delinquent returns and to collect delinquent taxes. These activities are constantly monitored to ensure appropriate and uniform application of the laws, and to protect the rights of taxpayers.

During 1976, the Service reduced both the number of outstanding delinquent accounts assigned to district offices and the dollar value of those accounts. Compared with 1975, the number of delinquent accounts cases assigned to district offices declined by over 21 percent, while the total dollar value of these accounts was reduced by nearly 12 percent.

Since nonpayment of business taxes withheld from employees' wages continues as the foremost delinquency problem facing the collection activity, the following programs have been developed to deal with those violations: The delinquency prevention program, which identifies potential business delinquents at a time when the situation can be reviewed and the causes of the problem corrected; the new Federal tax deposit system, which reduces processing time by more than half, presently implemented in several service centers with full implementation scheduled before the end of calendar 1976; and the trust fund compliance program, which was revised to allow institution of civil measures as well as criminal prosecution of chronic noncompliance cases, to provide uniform criteria for selection of cases, and to expand those cases which can be monitored.

Program accomplishments.—In 1976, the collection activity disposed of over 2.7 million delinquent accounts receivable, including approximately 327,000 cases in which the taxpayer, when notified of a delinquency, contacted the IRS field offices to resolve the matter ("notice cases"). The remaining 2.4 million delinquent accounts required field contact by district employees. Approximately 59 percent of these field contacts involved business taxpayers.

Nearly $3.5 billion in delinquent taxes was collected during the year, an increase of approximately $700 million over 1975. District personnel also disposed of over 1.3 million failure to file investigations, including 300,000 categorized as returns compliance program leads. For 1976 approximately

785,000 delinquent returns were secured involving nearly $540 million in additional taxes.

Repeater taxpayers have always been a primary concern of the Service. During 1976, 21 percent of delinquent individual income taxpayers were repeaters, while the rate for business taxpayers was 55 percent.

Because of the high business repeater rate and the fact that these taxpayers are required to hold "in trust" the withheld taxes of their employees, the Service continues to stress the importance of bringing business repeaters into voluntary compliance, primarily through the trust fund compliance program. At the beginning of 1976, there were 224,000 taxpayers with delinquent trust fund accounts amounting to over $756 million. Of these accounts, 2,800 had a balance due of $25,000 or more. At the end of 1976, the number of taxpayers with delinquent trust fund accounts had been reduced to some 143,000 with an outstanding balance of approximately $630 million. The number of delinquent trust fund accounts over $25,000 also declined to slightly over 2,300.

Tax administration abroad

The Service maintains a system of permanent foreign posts to help coordinate its domestic and foreign tax programs. Revenue Service representatives (RSR's) at these stations are involved in compliance and taxpayer assistance activities and maintain cooperative contacts with foreign tax agencies. Foreign operations of the IRS are the responsibility of the Office of International Operations (OIO).

Since 1948, when OIO established an office in Paris, the number of foreign posts staffed by RSR's has increased to 14. At present, posts in Bonn, London, Paris, and Rome cover Western Europe and North Africa. Those in Mexico City, Caracas, and Sao Paulo are responsible for Mexico, Central America, and South America, while Canada is serviced from Ottawa. Offices in Tokyo, Manila, Kuala Lumpur, and Canberra administer OIO activities in Japan, Southeast Asia, Australia, and New Zealand. A post in Teheran covers the Middle East and one in Johannesburg services Africa south of the Sahara.

These foreign posts provide a vital tax administration link with more than 2 million Americans living abroad. In 1976, the RSR's continued their support of the international aspects of the compliance and enforcement functions of the Service. This included the audit of tax returns, collection of delinquent accounts, intelligence investigations, year-round taxpayer assistance, and overseas collateral investigations for district offices in the United States.

The RSR's also maintain a broad network of personal contacts with foreign tax authorities and other foreign government officials, the U.S. Department of State and other agencies, as well as the American communities abroad. These cooperative contacts are a key element in overseas compliance activities. In addition, the RSR's act as a liaison with foreign competent authorities in tax treaty matters and, on occasion, are called upon to represent the U.S. competent authority in conferences with foreign tax officials involving international tax issues.

Foreign language training for the OIO.—The OIO continues to strengthen the language capability of its overseas staff through intensive training courses in foreign languages.

Prior to RSR's entering assignments overseas, they are required to receive broad instruction in the language of the host country. During their tour of duty, this skill can be improved through language training offered by the State Department.

Revenue agents, tax auditors, revenue officers, and taxpayer service representatives, temporarily detailed overseas, also receive language training. To meet their needs, the OIO has established, at National Office headquarters, a language laboratory which presently offers basic conversation courses in French, German, and Spanish.

In addition to improving the language ability of its staff, the OIO is making every effort to employ, whenever possible, revenue agent, revenue officer, and tax auditor trainees with a dual language capability.

Compliance overseas.—The OIO's audit activity takes place primarily within the United States. This activity focuses on securing compliance with Federal tax laws from resident and visiting aliens, and foreign corporations conducting business in the United States. Personnel of the OIO, at National Office, also examine thousands of tax returns filed by Americans living abroad.

The more complex tax return examinations continue to be conducted at the foreign country site of origin, and during 1976 the number of these audits increased over previous years. Until 1972, these audits were generally conducted by foreign post personnel. Since then, revenue agents and tax auditors are assigned to the OIO on detail from stateside duty for short overseas tours. During these tours, the temporarily assigned audit personnel travel through foreign posts performing audits under the supervision of the RSR's. This arrangement has greatly increased the number of overseas audits, and is an important factor in encouraging an increase in voluntary compliance abroad.

During the past year, the Service gave increased attention to the proper tax reporting of bribes, illegal political contributions, and other illicit fiscal activities. In many cases, these fiscal irregularities have involved arrangements between foreign nationals and American companies. These situations have enlarged the scope of assistance that the OIO normally provides to the IRS stateside districts. At the request of a stateside district, the OIO will examine the accounts of a foreign subsidiary of a U.S. corporation to determine whether they properly account for all income and deductions which may have U.S. tax consequences. These OIO support audits also make a positive effort to determine whether American foreign subsidiary corporations are serving as conduits for bribes, prohibited contributions, or other illicit activities.

Although most IRS delinquent tax collections occur within the United States or its possessions, an increasing number are made in foreign countries either by the IRS personnel on temporary detail or by the permanent RSR's. This collection activity is generated by an increase in delinquent accounts abroad, with dollar amount per account averages more than twice the amount of similar domestic accounts. During 1976, the OIO continued an effective overseas collection program, with special attention to collections in the Dominion of Canada. Currently, the OIO plans to expand the collection program during 1977. Revenue officers, on temporary detail, are scheduled to provide support to RSR's at posts in Western Europe, the Far East, Central and South America, and Canada.

Tax treaties and the competent authority.—The numerous tax treaties with other countries are designed to eliminate double taxation, remove tax barriers to trade and investment, and help curb tax avoidance. The United States now has income tax treaties with 37 countries and estate tax treaties with 13 countries. These include income tax treaties with the Soviet Union, Poland, Romania, and Iceland, which became effective during the past year upon exchange of instruments of ratification. A new income tax treaty to replace the current treaty with the United Kingdom was signed in December 1975 and awaits ratification by both the U.S. Senate and the British House of Commons.

The Assistant Commissioner (Compliance) is the designated U.S. competent authority in administering tax treaties. As such, he is responsible for negotiating agreements with foreign competent authorities to provide relief from the double taxation which results when both the United States and another treaty country subject the same income of a taxpayer to their respective taxes without an offsetting credit.

The number of taxpayer requests for competent authority assistance and the number of cases under negotiation reached a new high in 1976, representing a 40-percent increase over the prior 4 years. The competent authority continues to resolve these cases with a high degree of success. Adjustments to taxpayer income under U.S.-foreign competent authority agreements to provide relief have totaled more than $131 million since issuance of a revenue procedure in 1970 to cover taxpayer requests for competent authority assistance. Competent authority cases currently in inventory involve tax treaties with Australia, Belgium, Canada, Denmark, Finland, France, Italy, Japan, Luxembourg, the Netherlands, Norway, South Africa, Sweden, Switzerland, the United Kingdom, and the Federal Republic of Germany.

In 1976 meetings were held with tax officials from several treaty countries to improve the administration of the treaties involved. As a result of these and earlier conferences, working arrangements have been reached for more effective exchanges of information and for resolution of recurring problems which arise from interaction of U.S. and foreign tax laws. Such dialogs will continue in the future with the aim of concluding further reciprocal arrangements with treaty partners.

Technical assistance to foreign countries.—The Tax Administration Advisory Services Division provides reimbursable technical advisory assistance in tax administration to requesting foreign governments in cooperation with the Department of State and the Agency for International Development. Continuing the program established in 1963, the Service provided onsite technical assistance during 1976 to seven countries—Bolivia, El Salvador, Guatemala, Liberia, Paraguay, Trinidad and Tobago, and Uruguay. In addition, short-term mobile instructor teams conducted audit techniques training in Liberia and the Republic of China, and ADP systems design training in Uruguay. The training was tailored to the needs of each country at low unit cost. A broad tax administration survey was conducted for the Government of Sierra Leone at the latter's request.

The Service was host to 313 tax officials from 66 countries. In the years since 1963, over 4,200 tax officials from 123 countries have participated in study-observation programs. These visits give the participants the opportunity to see actual work processes and operations in various IRS offices and divisions nationwide, and frequently provide the motivating factor in instituting change in the visitor's own tax administration.

In March 1976, a 7-week middle management seminar in tax administration brought together 21 participants from 9 countries, demonstrating once again that peoples of diverse cultures can work together with mutual good-will. The countries involved were Barbados, Egypt, Indonesia, Iraq, Japan, Nepal, Nigeria, Republic of China, and Trinidad and Tobago.

The Commissioner of Internal Revenue completed his term as third councilor for the Inter-American Center of Tax Administrators (CIAT), this hemisphere's multinational organization for promoting better tax administration among its 26 member countries. The Commissioner attended the CIAT Executive Council meeting in El Salvador in February and, accompanied by the Director, Tax Administration Advisory Services Division, represented the United States at CIAT's 10th general assembly held in El Salvador in May. A member of the Audit Division staff represented the IRS at CIAT's 15th technical seminar held in Haiti in January 1976.

In March, the Service hosted a CIAT-sponsored, 2-day meeting of representatives from Brazil, Canada, Mexico, and Venezuela to discuss ways tax administrators might deal more effectively with multinational corporations.

Federal-State exchange program.—The IRS has formal agreements to provide reciprocal exchange of tax information with 48 States, the District of Columbia, Puerto Rico, Guam, and American Samoa. New model agreements are planned to implement the more stringent disclosure provisions contained in the Tax Reform Act of 1976. These provisions will require all Federal-State tax agreements to be renegotiated.

Magnetic tape data containing tax information on approximately 66 million taxpayer records were extracted from the individual master file for tax year 1974, sorted by State, and furnished to tax authorities in 39 States, the District of Columbia, and Puerto Rico. The IRS is currently developing a new annual standardized business master file extract tape program to be furnished to participating States. This program will include Federal unemployment tax information and current business master file extract data. Presently, States are provided limited tape extracts of information from the business master file and other Service master files relating to gift taxes and exempt organizations.

Assistance to State and local governments

During 1976, the IRS responded to several requests from State governments for technical assistance under the Intergovernmental Personnel Act.

The Service provided the State of Tennessee with an adviser to assist in the development of an intelligence capability to investigate suspected tax fraud practices.

The IRS also provided over 120 weeks of training assistance for 74 employees of State and local governments, including a specially designed computer auditing course for 21 employees of the Department of Taxation, Hawaii; training in excise tax law for Treasury employees, Puerto Rico; basic revenue agent instruction for employees of the State of Vermont; and investigative techniques training for Department of Revenue employees, Pennsylvania.

In addition, employees of the State of New York and from two of its counties were provided special IRS assistance to enable them to design tax courses and to instruct their own employees.

Research and testing

Study of alternative filing procedures.—Approximately 12,000 individual taxpayers were sent questionnaires seeking information about current filing practices and opinions on two alternative filing procedures—a staggered filing system and the extension of the current 3 1/2-month filing period to 6 months. Results of the survey, together with input from State tax administrators and other interested groups, will be incorporated in the Service's study of alternatives to the current filing period.

Problem resolution tests.—In an effort to simplify the taxpayer's job of meeting tax obligations, the IRS, during 1976, conducted tests in four districts covering special problem resolution procedures. The tests were intended to provide solutions to problems taxpayers have in dealing with various IRS components, as well as to help Service management identify factors causing problem patterns. Test results will be analyzed to determine the need for any procedural or organizational changes which may facilitate the resolution of taxpayer problems.

Optical character recognition.—The IRS is exploring the feasibility of substituting optical character recognition (OCR) equipment for data transcription. Cost-benefit analyses are being conducted to determine if OCR equipment could prove to be a more economical means of converting data recorded on Federal tax deposit forms and other forms with print characteristics controlled by the Service.

High-speed printers.—Tests have been completed to determine potential IRS applications for high-speed, nonimpact printers. These printers represent a technological breakthrough over existing designs and can print up to 25 times as fast as conventional printers. Because nonimpact printers can produce high-quality output at greater rates of speed, they have the potential for cutting the costs associated with producing taxpayer notices, periodic service center reports, and one-time printing efforts. Indications are that substantial savings would accrue over the next several years if these printers were installed in each service center.

Remittance processing system.—Based on successful tests with a computerized system to expedite clearance and deposit of tax remittances, the IRS has asked manufacturers to submit proposals for remittance processing systems to be installed in each of the 10 service centers. When installed, these systems should reduce processing costs by combining remittance data input, numbering, and preparation of accounting documents in a single operation. The system should also accelerate remittance posting to account status and tax data bases, and provide a "fact of filing" indicator for account status operations.

Compliance ADP applications test.—Onsite tests are being conducted in field offices to determine the costs and benefits of ADP applications in support of district office audit functions. Applications are related to providing direct computational assistance to revenue agents in their examinations, mechanizing clerical tasks, and providing reports for local management purposes.

Tax Reform Act of 1976

A number of substantive tax law changes and major revisions to the Tax Code were considered by both sessions of the 94th Congress. During these sessions, the Revenue Adjustment Act of 1975 was enacted to continue certain antirecession tax reductions through the first half of 1976, pending enactment of comprehensive tax legislation. The IRS prepared necessary forms and instructions to implement the act and its subsequent extensions. A number of proposals to change the Code were analyzed. These ranged from energy conservation credits to the tax treatment for rental of vacation homes. Such proposals were reviewed for administrative feasibility and for their effect upon the tax revenues. The results of these analyses were provided to the Secretary of the Treasury and congressional committees.

Confidentiality of tax returns

Several bills, including the proposed Tax Reform Act, for safeguarding the confidentiality of Federal tax return information were introduced in the 94th Congress. Generally, these bills would amend the Internal Revenue Code to restrict the disclosure of information from a tax return. The provisions prescribe, by statute, the persons to whom, and the purpose for which, disclosure of such information may be made. These bills impose stronger penalties for unauthorized disclosure of tax return information. These provisions and penalties would apply to employees, former employees, or other individuals who are allowed statutory access to return information including State tax officials and officials of other Federal agencies.

Commonwealth status slated for Northern Mariana Islands

Congress has approved a covenant which paves the way for the Northern Mariana Islands to become a Commonwealth of the United States. When the Marianas become a Commonwealth, the covenant provides that the Commonwealth will apply the income tax laws of the United States for its territorial income tax, similar to the Government of Guam. The IRS is implementing an agreement to collect social security taxes on behalf of the Northern Mariana Islands Government. The funds collected will be transferred to the United States and will be operated as a separate trust fund until the Northern Mariana Islands achieve full Commonwealth status, or earlier, if mutually agreeable. At that time this trust fund will be fully integrated into the U.S. Social Security Administration.

Delinquent child support program

The Department of Health, Education, and Welfare has begun the operation of a parent locator service, authorized by law, to locate absent parents who have not been making court-ordered payments for child support and to collect those delinquent payments. The law also directs, if necessary, that IRS would provide certain tax return information such as the last known home address or most recent place of employment for absent parents. In addition, upon certification by a State that court-ordered support payments are delinquent and uncollectable through State collection efforts, the IRS is required to assess and collect these delinquent payments as though they were tax deficiencies. Amounts collected are to be remitted to the States. Plans for implementing this law have been completed.

Restricting access to tax returns

Fiscal 1976 saw the disclosure activities again subject to continual concern, study, and oversight. Congressional hearings were conducted on proposed legislation dealing with tax return and tax information disclosures. In addition, the Privacy Commission, the Administrative Conference of the United States, and the Senate Select Committee to Study Governmental Operations with Respect to Intelligence Gathering made recommendations to Congress for legislative actions concerning disclosure matters.

The Disclosure Operations Division was established in the National Office to provide program guidance to the newly created disclosure officer positions in all IRS field offices. Both actions reflect the Service's concern over the individual's right of privacy and its responsibility to respond expeditiously to requests for information and documents under the disclosure laws and regulations. Field officials now act on certain requests for testimony of Service employees and make initial determinations concerning Freedom of Information requests as well as process requests for information under the Privacy Act of 1974.

The Service's disclosure activities are oriented to limit access to tax information, assuring that only those persons entitled by law are properly permitted to inspect such data, and to require that those who have access to such information maintain safeguards for its protection. On the other hand, the Service strives to make available as much nonprotected information and documents under the Freedom of Information Act and the Privacy Act of 1974 as possible. Important strides were made in both regards as evidenced by the decline in the number of requests for tax information from Federal agencies and others, and the increase in the number of requests for information and documents under the Freedom of Information Act.

Returns-filed projections

Planning throughout the Service is based on projections of the number of returns to be filed. The planning requirements of the various units of the Service require that workload projections be prepared for the entire United States as well as for service center areas, regions, and districts. Specialized projections are also made for research purposes. The projections are updated each year to incorporate changes in the economic and demographic outlook as well as the effects of tax law changes and filing patterns. Statistical techniques are used to identify the relationships between tax returns filed and the economic and demographic changes.

The total number of primary returns and supplemental documents is expected to grow from 127.3 million in calendar year 1975 to 164.7 million in 1985. This is an increase of 29.4 percent and reflects the expected growth in economic activity over the next decade.

Tax models

Originally developed almost 15 years ago to meet Treasury's need for timely estimates of the revenue effects of proposed tax legislation, the tax models continue to be valuable tools for economic planning. Five basic models, representing the returns of individuals, corporations, sole proprietorships, partnerships, and estates, are now used. Each model consists of a set of generalized computer programs used with specially structured data files comprising records in the statistics of income files.

In addition to the basic tax model for individual returns, the Service has developed, in connection with the Federal-State Tax Collection Act of 1972, a special individual model set, "State Tax Models." These models are designed to permit reliable data estimates for each of the 50 States and the District of Columbia. Toward this end, the models are based on the full statistics of income sample (over 200,000 returns for 1974) instead of the subsample of about 100,000 returns used for the basic model.

Art advisory panel

Since 1968, a 12-member panel of art experts, including museum directors, scholars, and art dealers, has helped the Service determine the value of works of art donated to charity or included in taxable gifts or estates.

The Commissioner's art advisory panel held 3 meetings at the National Office during fiscal 1976, reviewing 541 items representing works of art with a claimed value of more than $40 million. Adjustments were recommended on approximately 63 percent of the items and amounted to more than $13 million. Assistance was provided to the panel by the inhouse art program which, in addition, provides support to field requests for valuing such works of art as antique furniture, ceramics, Oriental and African art, gemstones, and historical and political memorabilia. Almost half of the appraisal items received are now being referred to the inhouse art activities program for valuation recommendations.

In its 8 years of operation, the panel has reviewed estimates valued at more than $185 million and has recommended valuation adjustments of over $48 million.

Maintaining IRS integrity and efficiency

Internal audit and security programs of the Inspection Service aid IRS managers in their efforts to maintain the highest levels of integrity and efficiency.

Internal audit activities.—The Internal Audit Division independently reviews all IRS activities to ensure that policies, procedures, and controls protect taxpayer rights and the revenue, and that Service operations are carried out efficiently, effectively, and in accordance with laws and regulations. Varied auditing techniques, including computer analyses and statistical sampling, are used to detect operating problems and integrity breakdowns.

Improvements and savings.—During the year, Internal Audit emphasized reviews of controls for safeguarding tax information, assuring equitable treatment of taxpayers, and safeguarding of revenue receipts and other Service assets. The resulting Internal Audit reports enabled management to strengthen the controls in these key areas, improve service to taxpayers, and stimulate an attitude of integrity awareness within the Service. In addition, measurable savings and additional revenue resulting from Internal Audit activities were estimated to total nearly $12 million.

Corrective actions on some internal audit findings do not result in measurable savings or additional revenue, but instead accelerate the collection of taxes or otherwise increase the effectiveness or efficiency of the Service. Management actions of this type were taken on accounts and returns estimated to total $4 million.

Fraud, embezzlement, or misconduct.—One of the basic purposes of the internal audit program is to detect fraud, embezzlement, or other wrongdoing on the part of Service employees or others who attempt to corrupt employees.

Integrity reviews during 1976 resulted in the detection of 10 fraudulent refund schemes involving 258 returns with refunds totaling $477,000. Nearly $402,000 of these refunds were stopped before issuance to the claimants. Only one scheme involved a Service employee. In addition, the

Internal Audit Division participated with other Service components in the investigation of nine other refund schemes totaling in excess of $1.4 million. The Service has established a committee, which includes an Internal Audit representative, to appraise fraudulent tax and refund schemes and recommend improved controls for detecting and deterring such schemes.

The integrity reviews were also a contributing factor in the referral to the Internal Security Division of information indicating possible breaches of integrity by 401 employees and other individuals.

Internal security activities.—The Internal Security Division conducts background investigations of IRS job applicants and investigates complaints of criminal and noncriminal misconduct and irregularities concerning employees. It also investigates persons outside the IRS who attempt to bribe or otherwise corrupt Service employees or who threaten or assault employees.

The Division also investigates the unauthorized disclosure of Federal tax return information, disclosure or use of information by preparers of returns, and charges against tax practitioners. In addition, the Division conducts special investigations and inquiries as required by the Commissioner and the Office of the Secretary of the Treasury.

During 1976, the Internal Security Division was responsible for the arrest or indictment of 125 individuals, including 27 employees or former employees and 98 taxpayers, tax practitioners, or others. A total of 90 defendants were convicted during the year, including 71 defendants who pleaded guilty rather than go to trial. Forty-three of these convictions were for bribery, 27 were for assault, and the remainder involved such other criminal charges as embezzlement, conspiracy to defraud the Government, obstruction of justice, and subscribing to false returns.

Employees who engage in improper behavior or unlawful actions constitute a very small percentage of the IRS work force. The vast majority of investigations relating to alleged acts of impropriety by Service personnel result in exoneration of the employees.

The Internal Security Division completed 17,004 investigations during the year. In addition, singular and multiple police record searches were conducted on 19,861 persons considered for temporary, short-term appointments or for positions created for special economic and educational programs.

These searches or investigations resulted in the rejection of 199 job applicants and in disciplinary actions such as separations, suspensions, reprimands, warnings, or demotions against 957 employees.

Bribery attempts.—IRS employees continued to report those persons who challenged the integrity of the Service through attempted bribery. In 1976, 179 employees reported 204 possible bribery attempts resulting in 51 arrests or indictments. At the end of fiscal 1976, 42 persons were awaiting trial on bribery charges. Historically, approximately one of every four such attempts results in prosecution of the taxpayer.

Assaults and threats on IRS employees.—During 1976, 705 investigations were initiated and 27 persons were convicted or pleaded guilty. An additional 13 persons were placed in the pretrial diversion program, subject to revocation of probation, or referred to local authorities for prosecution. In instances where prosecution is not authorized—which is the situation in most cases involving threats—inspectors, with the approval of the U.S. attorney, contact the alleged assailant to inform him or her of the applicable Federal statutes concerning assaults or threats on Government employees. The individual is also advised that repetitive acts could result in serious consequences, including prosecution.

Investigative teamwork.—Breaches of integrity by individuals can be investigated jointly by Internal Audit and Internal Security with the assistance of the IRS Intelligence Division in some cases.

In one case, a former tax technician was arrested for filing 37 false income tax returns, claiming refunds of over $118,000. After her arrest, she offered the explanation that she was "conducting a test" of refund procedure but was unable to explain 15 savings accounts she had recently opened under fictitious names.

A refund scheme in Ohio, which did not involve an employee, led to the arrest of an individual who filed false income tax returns claiming refunds of over $588,000 at five different IRS service centers.

Violations of tax laws discovered during internal audits and integrity investigations are referred to the IRS Intelligence Division for investigation if no employees are involved. During the year, there were 54 such referrals.

In each region, joint Internal Audit-Internal Security integrity development projects were initiated to probe identified high-risk Service operations. For example, tests were made at service centers to determine that revenue receipts were accurately and timely accounted for. This included testing whether taxpayer payments were input to the computerized integrated data retrieval system in accordance with prescribed procedures. Also, controls over taxpayer delinquent accounts in office branches at district offices were reviewed, accountability records were verified, and the propriety of collection actions were determined, including abatement of penalties and writeoff of accounts as uncollectable. A third project involved tests to determine whether undelivered refund checks were effectively safeguarded at service centers against unauthorized reissuance.

Cost reduction and management improvement

With the support and involvement of managers and executives at all levels, IRS vigorously applied its best efforts to achieve efficiency and savings during 1976. Through a planned management by objectives approach and emphasis on productivity measurement, IRS accomplished a number of objectives and made progress toward others resulting in savings (some of a cost avoidance nature) of many millions of dollars.

During 1976, several major projects to reduce mailing and distribution costs were accomplished, resulting in savings in excess of $4 million. The mail classifications for quarterly mailouts, Package X, some tax forms orders, as well as Publications 17 and 334 were changed. Also, the IRS developed a wide commercial bill of lading program for commercial shipments of tax forms and other printed material. Each commercial bill of lading produced saves the Government $12.50 over the processing and postaudit price of a Government bill of lading. Savings in this area alone exceeded $100,000. Another similar effort involved diverting to commercial transportation all material that could not be economically moved by mail, and this created savings of $500,000 per year over the past 2 years.

In the telecommunications area the cost reduction program initiated last year was expanded, resulting in improved service at a substantially lower cost. By reducing Federal Telecommunications System (FTS) charges and local telephone equipment, a $3.3 million savings was achieved.

The Service's ongoing reports curtailment project canceled enough reports to result in a 1976 savings of approximately $300,000.

Records disposal during calendar year 1975 resulted in the release of space and equipment valued at approximately $2.1 million. A total of 155,098 cubic feet of records were destroyed in accordance with regular programs, and 365,436 cubic feet of records were retired to the Federal Records Center.

Special emphasis was placed on efficient and economical space and property management to encourage cost consciousness. The implementation of internal management systems provided a means for closer monitoring and control of space and property inventories. These management systems and the continued emphasis on cost reduction, particularly through implementation of open office planning and multiple occupancy work stations, will result in the release of additional space in the future. Also, furniture and machine rehabilitation and repair have prolonged equipment lifetime and improved utilization.

Employee participation in cost reduction efforts was successfully promoted through the incentive awards program. During 1976, 937 employee suggestions were adopted, resulting in tangible benefits of $2,008,666 (an increase of $1,298,466 over last year).

In addition, 345 awards were granted for special achievements which saved IRS $1,328,723 ($792,823 more than last year's savings). In both categories, many employees received letters signed by President Ford thanking them for their participation in improving economy. All award recipients had created tangible benefits of $5,000 or more.

The Service continues to rank as one of the top Federal agencies in the area of safety and health, although the rate of 2.8 disabling employee injuries per million staff hours worked in calendar year 1975 is an increase over the 1974 rate of 1.9.

Service personnel drove 135.3 million miles on official business in 1975 with 874 accidents, for a low accident frequency rate of 6.4 accidents per million miles driven.

Executive development.—The Service continued to maintain a competent and effective career executive corps by enrolling 20 employees in executive development training. Included in this training were 16 employees selected by nationwide competition and 4 incumbent executives.

Middle-management development.—The Service's course for new middle managers, reduced last year from 4 weeks to 2 1/2 weeks, was offered 15 times. This enabled the Service to substantially reduce the backlog of middle managers requiring this training. Training costs were further reduced by conducting the program at field locations as well as in the National Office.

Basic management training.—Increased responsibilities have made the position of the IRS first level manager more complex and critical. Thus, the basic management training course, attended by all new managers, provides the IRS with a means to prepare first-level supervisors for their responsibilities.

This year the basic management training course was redesigned to include more essential material in the same classroom time. Job aids were developed to instruct the manager in the basic mechanics of the position as well as to provide a ready reference when on the job. Subjects such as communications, motivation, labor relations, and performance appraisal are taught in a manner that integrates them into the manager's job.

Labor-management activities.—In July 1975 the IRS concluded negotiations for a 3-year collective bargaining agreement with the National Treasury Employees Union (NTEU), covering 30,000 employees in the Data Center, National Computer Center, and in 9 of 10 service centers. Overall, the National Office agreement, the multicenter agreement, and the multiregional and multidistrict agreements cover over 65,000 IRS employees.

This agreement renewed the need for training managers and supporting staff people on their supervisory responsibilities under its provisions. Briefings were held for management officials and first-level managers received formal training.

Presently the IRS and NTEU are involved in negotiating a new multidistrict agreement covering 30,000 employees in 57 of 58 districts. Upon completion of these negotiations, negotiations for a new multiregional agreement will commence.

Approximately 220 unfair labor practice cases and 330 collective bargaining agreement arbitration cases were filed during the past year, which represents a significant increase over the previous 12-month period.

During the year, the agency has conducted training on local negotiations, arbitration, and unfair labor practice procedures to increase the expertise of personnel specialists engaged in the administration of Executive Order 11491, as amended, and the provisions of the collective bargaining agreements.

Employment of the handicapped.—The IRS continued to increase its employment of the handicapped in all occupations. By the end of calendar year 1975, 1,642 handicapped persons were employed by the IRS. Over 100 blind individuals were working as taxpayer service representatives in IRS districts and as tax examiners in the service centers.

Each year, the IRS focuses attention on the valuable contributions of IRS handicapped employees and their ability to perform top-level work by presenting an IRS Outstanding Handicapped Employee of the Year Award. This year, for the first time, two employees received this honor: Robert Clayton, from the Phoenix District, and Breland Collier, from the Jackson District. Mr. Clayton received an additional honor in being selected as the Department of the Treasury's Outstanding Handicapped Employee of the Year.

Equal employment opportunity.—The IRS continued to increase equal employment opportunity and to insure upward mobility opportunities for all employees. There was minimum hiring during the period from yearend 1975 to yearend 1976, with a total onboard increase of only 4 percent. Increases in minority representation exceeded that figure, however, with a total minority increase of 4.8 percent, from 14,321 to 15,008. Blacks increased by 4.5 percent, from 11,101 to 11,596, and Hispanics by 13.6 percent, from 2,188 to 2,486. It is also notable that 21 percent of the total increase were minorities.

Revenue officer training.—The revenue officer training program (phase III) was changed from 2 weeks of classroom training to a self-taught program requiring about 40 hours of study. This produced an annual savings of over $250,000 in travel, per diem, and staff costs for training about 400 new revenue officers.

Also, the redesigned program eliminated the need for senior revenue officers to serve as classroom instructors. Instead, trainees are given individual instruction and guidance, as needed, by a revenue officer at their work location.

Taxpayer Service training.—Major efforts have been made to improve Taxpayer Service employees' training. Basic courses have been redesigned to emphasize technical accuracy in answering taxpayer questions. The training program for taxpayer service specialists has been significantly improved to provide greater tax information in more complex areas. Also, improvements have been instituted in the refresher tax law program given all employees furnishing taxpayer assistance during the filing period. The refresher program provides assistors with sufficient knowledge of tax law to answer a wide range of taxpayers' questions.

BUREAU OF THE MINT [1]

The Mint became an operating bureau of the Department of the Treasury in 1873, pursuant to the Coinage Act of 1873 (31 U.S.C. 251). All U.S. coins are manufactured at Mint installations. The Bureau of the Mint distributes coins to and among the Federal Reserve banks and branches, which in turn release them to commercial banks. In addition, the Mint maintains physical custody of Treasury stocks of gold and silver, handles various deposit transactions, including inter-Mint transfers of gold and silver bullion, and refines and processes gold and silver bullion.

During the 15-month period, functions performed by the Mint on a reimbursable basis included the manufacture and sale of proof coin sets and uncirculated coin sets, medals of a national character, the Bicentennial 40-percent silver proof and uncirculated coin sets, and medals commemorating the Bicentennial, including America's First Medals in pewter and the American Revolution Bicentennial Administration (ARBA) medals; and, as scheduling permitted, the manufacture of foreign coins.

The headquarters of the Bureau of the Mint is located in Washington, D.C. The operations necessary for the conduct of Mint business are performed at seven field facilities. Mints are situated in Philadelphia, Pa., and Denver, Colo.; assay offices in New York, N.Y., and San Francisco, Calif.;[2] and bullion depositories in Fort Knox, Ky. (for gold) and West Point, N.Y.[3] (for silver). The Old Mint, San Francisco, houses the Mint Data Center, the Mint Museum, and the Special Coinage and Medals Division (order processing facility).

The Mint Security Force, supported by extensive and sophisticated alarm systems, closed-circuit television coverage, special vaults or other controlled locking devices, and a personnel security clearance program, provided protection for all employees and assets under the jurisdiction of the Bureau of the Mint. A total of 56 Mint security officers completed the

[1] Additional information is contained in the separate Annual Report of the Director of the Mint.
[2] The U.S. Assay Office at San Francisco also operates as a mint.
[3] Coinage operations are also performed at the West Point Bullion Depository.

5-week course at Treasury's Federal Law Enforcement Training Center, Brunswick, Ga. A compact pistol range was installed within the Old Mint to allow for the development and maintenance of proficiency in the use of official weapons by security personnel.

The Fiscal Assistant Secretary established a three-member Continuing Committee for the Audit of U.S.-owned gold located at various depositories at appropriate intervals. The Committee consists of one representative each from the Bureau of the Mint, the Bureau of Government Financial Operations, and the Federal Reserve Bank of New York. The General Accounting Office was invited to have participants in these audits as observers. During the fiscal year, an audit was conducted of each of the four Mint depositories where gold is stored (Fort Knox, Ky.; U.S. Assay Office, New York; U.S. Assay Office, San Francisco; and the Denver Mint). By September 30, 1976, about 17.5 percent of the gold stored at Bureau of the Mint depositories had been audited and found intact. The Committee will perform a complete audit of all U.S.-owned gold over a 10-year cycle.

The Bureau of the Mint deposited a total of $923,212,610 into the general fund of the Treasury during this 15-month period, $811,188,513 during fiscal 1976 and $112,024,097 during the transition quarter. Seigniorage on U.S. coinage accounted for $747,406,877 during fiscal 1976 and $98,937,792 during the transition quarter.

Domestic coinage

During the 15-month period, U.S. mints produced, for general circulation, cupronickel-clad dollars, half dollars, quarters, and dimes, cupronickel 5-cent pieces, and 1-cent pieces composed of 95 percent copper, 5 percent zinc.

In fiscal 1976 the Philadelphia Mint manufactured, for general circulation, 4,912,622,000 coins; the Denver Mint 6,001,278,032 pieces; the West Point Depository 1,701,709,196 1-cent pieces; and the U.S. Assay Office, San Francisco, 2,251,312 dimes.

The Bicentennial-design coins in the dollar, half dollar, and quarter denominations were released for general circulation in the early months

Bureau of the Mint operations, fiscal years 1975 and 1976, and transition quarter

Selected items	Fiscal year 1975	Fiscal year 1976	T.Q.
Newly minted U.S. coins issued:[1]			
1 dollar	56,267,000	146,400,000	12,900,000
50 cents	308,164,000	239,900,000	42,800,000
25 cents	674,344,000	1,072,000,000	193,600,000
10 cents	913,980,000	874,400,000	232,000,000
5 cents	756,960,000	618,200,000	114,300,000
1 cent	9,886,662,200	7,711,700,000	2,030,200,000
Total	12,596,377,200	10,662,600,000	2,625,800,000
Inventories of coins in Mints, end of period	r 1,293,300,000	3,248,400,000	3,741,300,000
Electrolytic refinery production:			
Gold—fine ounces	(r)	....	....
Silver—fine ounces	4,643,895.42	5,004,140.42	....
Balances in Mint, end of period:			
Gold bullion—fine ounces	266,700,077	266,188,680	266,177,852
Silver bullion—fine ounces	43,819,864	40,197,341	39,849,021

[1] For general circulation only.
r Revised.

U.S. coins manufactured

Denomination	General circulation		Numismatic [1]		Total coinage	
	Number of pieces	Face value	Number of pieces	Face value	Number of pieces	Face value
FISCAL YEAR 1976						
1 dollar:						
Cupronickel	189,849,287	$189,849,287.00	4,626,623	$4,626,623.00	194,475,910	$194,475,910.00
Silver-clad			[2]6,688,332	6,688,332.00	6,688,332	6,688,332.00
50 cents:						
Cupronickel	292,109,349	146,054,674.50	4,626,623	2,313,311.50	296,735,972	148,367,986.00
Silver-clad			[2]6,688,332	3,344,166.00	6,688,332	3,344,166.00
25 cents:						
Cupronickel	1,244,171,349	311,042,837.25	4,626,623	1,156,655.75	1,248,797,972	312,199.493.00
Silver-clad			[2]6,688,332	1,672,083.00	6,688,332	1,672.083.00
10 cents	1,025,400,661	102,540,066.10	4,626,623	462,662.30	1,030,027,284	103,002,728.40
5 cents	656,131,349	32,806,567.45	4,626,623	231,331.15	660,757,972	33,037,898.60
1 cent	[3]9,210,198,545	92,101,985.45	4,626,623	46,266.23	9,214,825,168	92,148,251.68
Total	[4]12,617,860,540	874,395,417.75	47,824,734	20,541,430.93	12,665,685,274	894,936,848.68
TRANSITION QUARTER						
1 dollar:						
Cupronickel			850,183	$850,183.00	850,183	$850,183.00
Silver-clad			[5]590,454	590,454.00	590,454	590,454.00
50 cents:						
Cupronickel	51,200	$25,600.00	850,183	425,091.50	901,383	450,691.50
Silver-clad			[5]590,454	295,227.00	590,454	295,227.00
25 cents:						
Cupronickel	201,887,200	50,471,800.00	850,183	212,545.75	202,737,383	50,684,345.75
Silver-clad			[5]590,454	147,613.50	590,454	147,613.50
10 cents	434,941,200	43,494,120.00	850.183	85,018.30	435,791,383	43,579,138.30
5 cents	212,723,200	10,636,160.00	850,183	42,509.15	213,573,383	10,678,669.15
1 cent	[6]2,271,232,070	22,712,320.70	850,183	8,501.83	2,272,082,253	22,720,822.53
Total	[7]3,120,834,870	127,340,000.70	6,872,460	2,657,144.03	3,127,707,330	129,997,144.73

[1] All numismatic coins were manufactured at the U.S. Assay Office, San Francisco, and included 2,909,335 1975 proof sets (dollar, half dollar, and quarter dollar dated 1776-1976; all other denominations dated 1975), 2,567,471 1976 proof sets (dollar, half dollar, and quarter dollar dated 1776-1976; all other denominations dated 1976).

[2] Consists of 2,823,592 proof and 3,864,740 uncirculated coins for inclusion in Bicentennial coin sets.

[3] Includes 1,701,709,196 1-cent coins produced at the U.S. Bullion Depository at West Point.

[4] Includes 189,849,287 Bicentennial dollars, 292,074,049 Bicentennial half dollars, and 1,244,136,049 Bicentennial quarter dollars.

[5] Consists of 386,778 proof and 203,676 uncirculated coins for inclusion in Bicentennial coin sets.

[6] Includes 355,955,870 1-cent coins produced at the U.S. Bullion Depository at West Point.

[7] Includes 51,200 Bicentennial half dollars and 201,887,200 Bicentennial quarter dollars.

NOTE.—All dollars, half dollars, quarter dollars, and dimes for general circulation are three-layer composite coins—outer cladding 75 percent copper, 25 percent nickel bonded to a core of pure copper. Proof coins for inclusion in the 1975 and 1976 proof sets are of the same metallic composition as those for general circulation. Coins for inclusion in Bicentennial proof and uncirculated coin sets are three-layer composite coins with an outer cladding 800 parts silver, 200 parts copper, bonded to a core approximately 209 parts silver, 791 parts copper.

of fiscal 1976. The half dollar was released in Minneapolis on July 7, 1975, and the quarter in Chicago on August 18, 1975. The dollar was made available to the public on October 13, 1975.

During the transition quarter, a total of 3,120,834,870 domestic coins for general issue were produced.

Approximately 13.3 billion coins were shipped by the Bureau of the Mint to the Federal Reserve banks and branches and the Treasury during the 15-month period.

Coinage study

As part of the Mint's continuing effort to provide the United States with the best possible coinage system, a contract was awarded in May 1975 to conduct a comprehensive analysis of U.S. coinage requirements to 1990. The final report was completed in September 1976.

The purpose of the study was to review and recommend changes in Mint facilities and in coinage forecasting, production planning, and the distribution systems for the present U.S. coins and possible alternatives. The impacts of various alternatives on public and private interests were assessed to develop coinage system recommendations to 1990. Among the more noteworthy recommendations of the study were elimination of the 1-cent coin and the half dollar and substitution for the present dollar coin of a $1 coin sized between the present quarter and half dollar. The Department and the Bureau of the Mint did not have sufficient time by September 30 to review thoroughly the recommendations of the coinage study, and had not, therefore, endorsed or rejected its conclusions and recommendations.

Foreign coinage

The Bureau of the Mint produces coinage for foreign governments on a reimbursable basis, provided the manufacture of such coins does not interfere with U.S. coinage production. During the 15-month period, Mint installations produced 800,976,163 coins for Liberia, Panama, Peru, and the Philippines.

Production

Domestic coin production remained at approximately the same rate as during the previous reporting period.

The Mint developed, tested, and approved an ADP pallet control system during the first half of fiscal 1976. Beginning in the second half, shipments of minor coins from the Denver Mint to Federal Reserve banks were added to the system implemented earlier for shipments of all denominations from Philadelphia. Also, a simplified, cost-saving technique for scheduling coin shipments was instituted.

Technology

The Bureau of the Mint's Laboratory in Washington continued to provide technical expertise on the authenticity of U.S. coins, examining 2,309 questioned coins submitted by the U.S. Secret Service and other law enforcement agencies, involving 248 cases.

Coin demand

The Bureau of the Mint continued its close liaison with the Federal Reserve in determining coin requirements. Demand for coins, as measured by the net outflow from Federal Reserve banks to commercial banks, totaled 12.9 billion coins for the period. Coin balances at the Federal Reserve banks increased by approximately 375 million coins from the end of fiscal 1975. Closing inventories at the Mint were up 2.4 billion. The Mint, therefore, absorbed most of the increase in joint inventories, which closed at 7.0 billion coins, or 67 percent over June 1975.

Marketing and statistical services

Public Law 93–127 required the Mint to produce 45 million 40 percent silver Bicentennial-design coins in dollar, half dollar, and quarter dollar denominations. The Mint elected to produce 4 million three-coin proof sets and 11 million three-coin uncirculated sets. The Mint began accepting orders in November 1974; however, because of legislative restriction on releasing the coins prior to July 4, 1975, all shipping has been conducted during this reporting period. Approximately 3 million Bicentennial proof sets and 4 million Bicentennial uncirculated sets had been sold and shipped as of September 30, 1976. During September 1975, the Mint began making the uncirculated sets available in bulk quantities at a reduced price. These were sold primarily to banking institutions, which in turn offered them for sale to the public, affording a much wider distribution of the sets during the Bicentennial year. Over 2.2 million sets were sold in this way.

In addition to these Bicentennial programs, the Mint accepted orders for approximately 4.1 million regular 1976 proof sets and 1.9 million regular uncirculated sets. Shipment of these will continue through calendar year 1976.

As part of the Department of the Treasury's observance of the Bicentennial of the American Revolution, the Mint continued to reproduce in antique-finished pewter the first 10 medals authorized by the Continental Congress. Orders were accepted for the two final units, representing four pewter medals. Medals in the fourth unit honored Lt. Col. John E. Howard and Lt. Col. William Washington; approximately 200,000 of each were sold. The fifth and final unit of the series commemorated the action of Gen. Nathaniel Green and Capt. John Paul Jones. The public was also offered the opportunity to order the complete 10-piece series. During the entire America's First Medals program, approximately 2,400,000 medals were sold.

The bronze 1 5/16-inch medal honoring the customhouse at New York, the last of the 10-medal historic customhouse series, was released in conjunction with the dedication of the New York Customhouse on August 1, 1975.

In continuing cooperation with the American Revolution Bicentennial Administration the Mint produced the fifth of the series of ARBA national medals commemorating events of the American Revolution. In addition to the yearly medals, the National Bicentennial Medal was offered in January 1976 in seven different sizes and alloy combinations, including gold. Also during the reporting period, the 1976 ARBA Philatelic-Numismatic (stamp and medal) Commemorative was offered. The 1976 single medals in bronze and silver will be offered in October 1976, completing the ARBA series.

Administration

The Department of the Treasury selected the computer facilities at the Old Mint, San Francisco, to implement, operate, and maintain payroll and related personnel services for the Treasury payroll/personnel information system (TPPIS). The Mint will provide these services to all Treasury bureaus with the exception of the Internal Revenue Service. Implementation of TPPIS began in fiscal 1976, with all Treasury bureaus scheduled to be on-line in 15 months.

The Mint completed the centralization of its own payroll/personnel services at the Old Mint with the adaptation of the departmental integrated payroll/personnel system (DIPS) developed by the Department of the Interior, which system forms the basis for TPPIS.

OFFICE OF REVENUE SHARING [1]

The Office of Revenue Sharing is located within the Office of the Secretary for administrative purposes. The Revenue Sharing staff, consisting of approximately 95 professional and clerical positions, has offices at 2401 E Street, N.W., in Washington, D.C.

During fiscal 1976 and the transition quarter, $7.8 billion was distributed to more than 38,000 States, counties, cities, towns, townships, Indian tribes, and Alaskan native villages which are recipients of shared revenues. This brought to $26.7 billion the amount of money returned to States and local governments since the inception of the general revenue sharing program in 1972.

The State and Local Fiscal Assistance Act of 1972 (31 U.S.C. 1221–1263) authorized the distribution of $30.2 billion during the 5-year period that ends December 31, 1976. The money is allocated according to formulas contained in the law which use data based on population, per capita income, and general tax effort for each recipient unit of government.

Program renewal

In April 1975, President Ford requested that the Congress renew the general revenue sharing program past its presently scheduled termination date of December 31, 1976. In his request, the President proposed that the program be extended for an additional 5 3/4 years, through September 1982.

The Subcommittee on Intergovernmental Relations and Human Resources of the Committee on Government Operations of the House of Representatives held hearings on the President's and other renewal proposals from September 1975 through early December 1975. On June 10, 1976, the full House of Representatives passed a measure which would extend the program for 3 3/4 years.

Hearings were conducted in the Senate on August 25, 1976 by the Subcommittee on Revenue Sharing of the Senate Finance Committee; and, on September 14, 1976, the full Senate passed a bill to extend general revenue sharing for 5 3/4 years.

On September 30, 1976, the House and Senate adopted a conference report recommending extension of the program for 3 3/4 years, to October 1, 1980.

While considering renewal legislation, House and Senate committees investigated the effects of changes to the data factors and formulas used for allocations in the revenue sharing program. The Office of Revenue Sharing obtained the necessary data and produced more than 80 trial allocations to estimate the amounts which recipient governments might receive under revenue sharing formulas with different data elements. Suggested formula changes were proposed by various Members of Congress, the Office of Management and Budget, and others; however, renewal legislation has retained the data factors and formulas of the original act.

Data improvement

During the year, the Office made significant improvements in the data base used to allocate revenue sharing funds. For example, the Bureau of

[1] Additional information is contained in the Annual Report of the Office of Revenue Sharing, Mar. 1, 1976.

the Census revised 1973 population and 1972 per capita income data for revenue sharing purposes. These revised data were developed using the most recent information available from the Census Bureau's annual Boundary and Annexation Survey, special censuses, and other data series which indicate changes since 1970.

The Office used the revised 1973 population and 1972 per capita income estimates, and fiscal 1975 adjusted taxes and intergovernmental transfer data to compute allocations for the period July 1, 1976–December 31, 1976 (seventh entitlement period).

Revenue Sharing's annual data improvement program is an administrative procedure to identify and to correct data errors. As part of this program, in February 1976, each government was asked to examine the data used to compute its seventh entitlement period allocation and submit proposed corrections for any data elements considered to be in error. More than 1,600 governments questioned at least one data element. After careful study of these challenges, data corrections were made for 400 governments. Additional revisions resulted from ongoing data improvement efforts of the Bureau of the Census and the Office of Revenue Sharing. Altogether, about 3,000 revisions were made to the data elements prior to the initial allocation of funds for entitlement period seven.

The Office of Revenue Sharing and the Bureau of the Census maintain an ongoing program of data review and evaluation to make the data for each entitlement period the most accurate available. As a result, data for thousands of governments were revised after review by the governments themselves in February 1976. To give the recipient governments an opportunity to propose corrections to the revised figures, a supplemental data improvement program was conducted. In June 1976, data notices were mailed to all governments whose data had been revised since February 1976.

Electronic funds transfer and direct deposit

During the year, recipient governments were given the option of having their revenue sharing payments deposited directly into bank accounts. Of the 1,310 recipients of the largest revenue sharing payments offered the opportunity to participate in the initial conversion in July, 875 elected to do so.

More than half of the 38,000 revenue sharing recipients were to be paid using electronic funds transfer or direct deposit in October 1976; and the Office of Revenue Sharing expects that payments using these techniques will continue to increase.

Audit procedures

Significant improvements were made to procedures used to audit revenue sharing accounts of recipient governments during the period.

Revenue sharing law authorizes the Office of Revenue Sharing to work with State audit agencies to review expenditures of shared revenues by State and local governments, as appropriate to the State agency involved. By the end of Federal Fiscal Year 1976 and the transition quarter, the Office of Revenue Sharing had concluded audit agreements with 43 States and the District of Columbia. These agreements provide audit coverage of 40 States and more than 15,000 units of local government. In addition, the Audit Division of the Office of Revenue Sharing continued its efforts to encourage recipients whose accounts are audited by independent public accountants to include the audit of revenue sharing funds in their annual audits.

During fiscal 1976 and the transition quarter, 6,904 external audit reports were reviewed by the Audit Division, as compared with 2,815 during prior years. These external audits disclosed 409 violations of the revenue sharing Act and Regulations. In addition, 51 audits were made by Office of Revenue Sharing staff during 1976 and 14 reviews were made of the performance of state auditors in auditing revenue sharing funds.

With assistance from the U.S. Customs Service, 131 simplified (mini) audits were made of recipient governments which received less than $10,000 on an annual basis. This special procedure includes a review of internal control, compliance checks and a limited examination of vouchers.

During the year, considerable progress was achieved in reducing the backlog of noncompliance matters which had arisen during the course of audits of recipient governments. In Fiscal Year 1976, 213 cases were opened and 261 closed.

In addition, the Audit Division increased the number of confirmations of payment amounts requested by and for IPAs. During Fiscal Year 1976, the Office of Revenue Sharing issued 3,392 confirmations, as compared with the previous year's total of 2,260.

Civil rights compliance

A Civil Rights Division was organized within the Office of Revenue Sharing during the year to improve the administration of the steadily increasing civil rights compliance workload.

Section 122 of the Revenue Sharing Act provides that "no person in the United States shall on the ground of race, color, national origin, or sex be excluded from participation in, be denied the benefits of, or be subject to discrimination under any program or activity funded in whole or in part . . ." with shared revenues.

During the 15-month period the Office of Revenue Sharing received over 300 civil rights complaints, more than double the number of complaints filed during the first 2 1/2 years of the program. Total civil rights complaints exceed 500.

Although the civil rights staff of the Office of Revenue Sharing has been small—a total of 10 specialists was authorized for fiscal 1976—it has been effective. More than 100 cases already have been resolved, mainly through negotiation and efforts to achieve voluntary compliance.

To assist in conducting field investigations and to help resolve discrimination complaints, the Office has entered into 15 cooperative agreements with State human rights agencies, 12 of which were signed on or after July 1, 1975. These agencies also are recognized by the Equal Employment Opportunity Commission for purposes of investigating complaints involving States and local governments under the Civil Rights Act of 1972. Over 12,000 recipients are in States involved in such agreements, nearly a third of the total.

The Office signed a cooperative agreement with the Department of Justice during the period, bringing to four the number of Federal interagency cooperative working agreements it has completed to achieve a more coordinated enforcement of the nondiscrimination provision of the Revenue Sharing Act with compliance requirements of other Federal laws.

Legal issues

During the 15-month period, the Chief Counsel was involved in the initiation or defense of 18 legal actions. The legal issues in those suits involved civil rights, the applicability of the National Environmental Policy Act (NEPA), and the Uniform Relocation Assistance Act to the expenditure of revenue sharing funds, and the determination of data factors for use in the revenue sharing allocation formulas.

In October 1975, the Chief Counsel's office issued revised civil rights regulations. As now published, they are among the most comprehensive civil rights regulations of any agency of the Federal Government.

In the area of litigation, the court held in the case of *Goolsby* v. *Simon* (U.S.D.C., M.D., Georgia) that NEPA and the Uniform Relocation Assistance Act were not applicable to a capital project in which revenue sharing funds were used. The case is now on appeal in the fifth circuit by the plaintiffs. In another fifth circuit case, *Davidek et al.* v. *Hidalgo County Commissioners et al.* (U.S.D.C., S.D., Texas), unappealed, the court held that NEPA was inapplicable to a capital project in which revenue sharing funds were used.

In *United States* v. *Chicago* (U.S.D.C., N.D., Ill.), the court, on February 2, 1976, ordered the city of Chicago to adopt specific goals for hiring and promoting minorities and women in the Chicago Police Department. The Office of Revenue Sharing was required to monitor the employment practices of the police department to ensure compliance with the Revenue Sharing Act. On May 27, 1976, the court implemented a plan and timetable for the city's compliance with the court's decree of February 2, 1976, to enable the city to obtain the release of the revenue sharing entitlements which had been withheld.

On July 1, 1976, the court ordered payment of the city's revenue sharing payment for the fourth quarterly installment of the sixth entitlement period, due on July 5, 1976. In all other aspects, the decree of February 2, 1976, remains in full force and effect until further order of the court.

During the fiscal period, the Chief Counsel issued approximately 250 letter rulings to recipient governments seeking guidance for the use of revenue sharing funds. A current and revised edition of letter rulings is in preparation.

Antirecession fiscal assistance

During fiscal 1976, Congress enacted a measure directing the U.S. Treasury Department to distribute funds to States and local general governments based on certain unemployment data. These antirecession funds supplement the general revenue sharing payments authorized by the State and Local Fiscal Assistance Act of 1972.

Responsibility for the administration of the new antirecession program, authorized by Title II of the Public Works Employment Act of 1976 (P.L. 94–369), was assigned to the Office of Revenue Sharing. Appropriations of funds to be distributed and of money to be used to administer the new program were made available in fiscal 1977.

The Revenue Sharing organization

The staff is organized into nine functional units, as follows:

Administration.—Manages personnel, budget, central services and other internal administration of the Office.

Program Planning and Coordination.—Coordinates special research projects at the request of the Director; manages the program planning system.

Data and Demography Division.—Responsible for acquisition of current and accurate data used to compute allocations of funds; conducts data improvement program.

Systems and Operations Division.—Computes allocations of funds; writes payment vouchers; does all associated accounting; issues and processes required reports; produces computer-generated communications and publications.

Audit Division.—Conducts and coordinates audit of recipient governments; reviews audits made by State audit agencies, certified public accountants and independent public accountants.

Civil Rights Division.—Responsible for ensuring compliance with the civil rights provisions of revenue sharing and antirecession law; conducts investigations of allegations of noncompliance; cooperates with other Federal agencies, State governments, and civil rights, women's rights, and governmental organizations.

Intergovernmental Relations and Technical Assistance Division.—Provides technical advice and assistance to States and local governments; maintains liaison with public interest groups.

Public Affairs Division.—Provides information about general revenue sharing to the public, the media, citizens groups, other Federal agencies, research groups, and the Congress.

Chief Counsel.—Interprets the law; issues opinion letters, prepares regulations; represents the Office of Revenue Sharing in all legal matters concerning the general revenue sharing and antirecession programs.

UNITED STATES CUSTOMS SERVICE

The principal mission of the Customs Service is to enforce customs and related laws against the smuggling of contraband; to assess, collect, and protect the levying of import duties and taxes; and to control carriers, persons, and articles entering or departing the United States by enforcing the Tariff Act of 1930 and numerous other statutes and regulations which govern international traffic and trade.

To accomplish this mission, the Customs Service performs the following:

1. Examination and clearance of carriers, persons, and merchandise consistent with the requirements for the proper assessment and collection of customs duties, taxes, fees, fines and penalties and compliance with the customs laws and regulations applying to international commerce.
2. Detection and prevention of all forms of smuggling and other illegal practices designed to gain illicit entry into the United States of prohibited articles, narcotics, drugs, and all types of contraband.
3. Detection and investigation of illegal activities to apprehend violators and otherwise take effective action to reduce, prevent, and deter violations of laws and regulations enforced by Customs.

4. As the principal border enforcement agency, the administration and enforcement of over 500 other laws and regulations of approximately 60 Government agencies relative to international traffic and trade.

5. The most effective application of resources to carry out the total Customs mission, consistent with efficiency in Government and economy and service to the public.

During fiscal 1976 Customs cleared over 269 million persons arriving in the United States. More than 79 million cars, trucks, and buses crossed the country's borders; an additional 129,000 ships and 353,000 aircraft were also cleared. This involved making 78 million baggage examinations and processing 13 million customs declarations. In the transition quarter, Customs cleared more than 79 million persons. Cars, trucks, and buses in excess of 22 million crossed the U.S. borders, and 37,000 ships and 103,000 aircraft were cleared. During this period there were over 3 million declarations made and 23 million bags examined.

There were 42 million foreign mail parcels to be processed in fiscal 1976, requiring over 2 million informal mail entries. Customs collected a record $4.9 billion in duty and taxes and processed 113.6 billion dollars' worth of imported goods, which required over 3 million formal entries (those over $250 in value). During the transition quarter, there were approximately 10 million foreign mail parcels processed, resulting in over 600,000 informal mail entries. Customs collections of duties and taxes in the transition quarter exceeded $1.4 billion (more than $300 million over the same 3-month period last year).

The Customs enforcement mission also produced tangible results during fiscal 1976. Merchandise seized, including illicit drugs, prohibited articles, undeclared merchandise, etc., was valued at $821 million. There were about 23,000 drug seizures. These seizures included 1,030 pounds of cocaine, 21.4 million units of polydrugs, and 380 tons of marijuana. There were 368 pounds of heroin seized—an increase of 220 percent over fiscal 1975. In addition, neutrality violations—smuggling arms out of the United States to other countries—jumped from 674 cases to 1,517 cases in fiscal 1976.

The transition quarter yielded similar results of the enforcement mission. The same category of value of merchandise seized exceeded $31 million—more than 7,000 drug seizures resulted in 45 pounds of heroin, 236 pounds of cocaine, and 115,000 pounds of marijuana being kept off the market.

Enforcement

Interdiction

The major thrust of the enforcement effort is to intercept attempts to introduce contraband occurring daily along the borders of the continental United States. This contraband may consist of anything from narcotics and guns to airplanes and automobiles. To accomplish this mission, customs officers respond quickly and investigate vigorously all significant arrests and seizures. Despite this vigorous enforcement effort, smuggling attempts continue to increase.

During fiscal 1976, a major currency control program was launched to try to identify and prevent the transfer of funds destined to support smuggling activities. Since money is the recurring factor in all such transactions, strict enforcement of the Currency and Foreign Transactions

Reporting Act should have a marked effect on the flow of contraband, including narcotics and dangerous drugs. By expanding investigative energies in this area, considerable success is expected in the drive to restrict, as much as possible, the flow of illegal goods across the borders.

In fiscal 1976, the Customs currency enforcement effort extended the application of the law to include the entire spectrum of criminal activity. Increased emphasis was placed on detecting and developing intelligence information on outbound violators. Those violations which appear to result from willful intent to violate the law are given as much investigation as circumstances dictate to identify any relationship with other criminal activity. Thorough investigations will not only identify any relationship with other criminal activity, but may also provide the basis for felony prosecution for currency violations.

In late 1975, the Customs currency program was related to the neutrality program along our southern border. Various law enforcement agencies were made aware of an additional tool for penetrating criminal activity, and new sources of information were developed. In February 1976 a 90-day pilot currency enforcement program was initiated in the New York region. Its purpose was to develop sources of information within law enforcement and to provide a basis upon which can be developed sound enforcement and investigative techniques. There have been 36 seizures from 36 violators, $775,613 seized, and 5 persons arrested. During the same 3-month period in 1975, 15 seizures were made from 15 persons, $314,025 was seized, and 3 persons were arrested. More significant were two examples of interrelationship of an agency outside Treasury. Information provided by the Drug Enforcement Administration (DEA) was expanded through investigation by customs officers into sufficient probable cause to search two persons about to depart the United States. In the separate incidents, seizures were made of $7,000 and $54,000.

Air interdiction.—In response to the escalating level of smuggling by private aircraft across the Nation's border, especially the southern border, the Congress, in 1969, authorized the establishment of a Customs air support program.

Today, there are six air support branches located at military airbases near San Diego, Tucson, El Paso, San Antonio, New Orleans, and Miami. These locations were selected because of their proximity to major air smuggling routes along the border, but smugglers can, and do, cross the border almost anywhere. Since the southern border of the United States is more than 3,000 miles long, each air branch has the responsibility for protecting an air corridor that, on the average, is 700 miles wide.

Although the air interdiction program achieved several developmental milestones in the period, the most significant in terms of overall program impact was the successful utilization, for the first time, of the NORAD/FAA long-range radar and the installation of supporting mobile ground-based radars for smuggler detection and tracking. Using these resources, Customs demonstrated that the radar networks could be integrated into the total air interdiction system to provide Customs with the information and leadtime necessary to permit the aerial interception of the smuggler aircraft. The dominant example of successes in this regard is Operation Star Trek; during this 50-day operation, ground-based radars detected 262 aircraft and Customs made 43 intercepts.

Ground-based radars are only one facet of the approach Customs is taking to counteract smuggling through the use of private aircraft.

Customs multifaceted approach involves the following additional elements:

1. Intelligence information on suspect aircraft which is available in the Treasury enforcement communications system (TECS).
2. The private aircraft reporting system (PARS), which requires that all private aircraft crossing the Southwest border give at least a 15-minute advance penetration report before entering the U.S. airspace and land at one of 13 specially designated airports.
3. The private aircraft inspection reporting system (PAIRS), which automates the arrival records of all general aviation-type aircraft arriving from foreign countries and clearing U.S. Customs. Arrival information on all aircraft in PAIRS is immediately accessible to enforcement units through TECS.
4. Air tactical interdiction units to intercept suspect aircraft.

The combination of these elements enables Customs to concentrate on high-risk private aircraft by screening out legitimate private aircraft. The Customs air support program seized 130 aircraft in fiscal 1976, an increase of more than 91 percent over last year, and 453,000 pounds of marijuana.

Marine interdiction.—The objective of the marine interdiction program is the detection and interdiction of smuggled contraband in water boundary areas while insuring that reporting and entry requirements for conveyances, goods, and persons are met. The Customs Service presently has an inventory of 56 boats, located at 28 different locations throughout the United States.

The small boat reporting system was developed to close a potential avenue for illicit drug smugglers. Present Customs regulations do not require all small boats to make an immediate report to Customs when returning from a foreign port or international waters; however, under the President's recently proposed new legislation, the masters of boats, including pleasure vessels, will be required to report immediately. Customs regulations will then be amended to require that all small boats returning from foreign countries immediately report for inspection at designated locations at the entrances to inland waterways or harbors. Small boats and private yachts provide an ideal means for narcotics smugglers to elude customs inspection and bring illicit drugs into the United States with minimal risks.

In a localized enforcement effort over a 3-day holiday weekend in mid-1975, customs officers focused on 70 boats known to be in Bimini. Within a reasonable period following that weekend, 40 boats still had not reported to Customs. One of those was under charter to an individual under indictment for conspiracy to import narcotics. Subsequent investigations have resulted in 10 additional penalties being imposed.

The following are examples of marine cases:

On July 1, 1975, customs officers seized 30,000 pounds of marijuana in Dover, Del., in a case involving a 65-foot trawler and 14 vehicles. This case included 31 arrests and the confiscation of several weapons, 3 jungle cats, and $100,000 in cash.

On August 23, 1975, customs officers in Savannah, Ga., seized 36,000 pounds of marijuana in a case involving 3 marine vessels—a 65-foot trawler, a 23-foot cabin cruiser, and a houseboat. Eight vehicles were also seized along with several weapons, and 21 arrests were made.

On January 23, 1976, 4 pounds 8 ounces of cocaine were found in a container bolted onto a ship's hull in Seattle, Wash.

On January 19, 1976, a case involving 4 boats, 8 vehicles, and 3 boat trailers in Ventura, Calif., resulted in the seizure of 32,520 pounds of marijuana and 13 arrests.

Border interdiction.—With 96,000 miles of border to patrol, Customs concentrated on increasing the selectivity criteria for patrol and inspection forces, and in improving productivity-enhancing hardware for interdiction purposes. The border intrusion detector system was expanded and improved between ports of entry along the Mexican border. In addition, Customs used night vision and infrared devices to detect and interdict clandestine intrusions along the vast, desolate region of the Southwest border.

Mail interdiction.—In addition to collecting revenue, Customs mail facilities combated the smuggling of narcotics, weapons, explosives, stolen property, and other contraband, by making over 5,000 seizures of illicit narcotics in both military and nonmilitary mail. Illegal drugs were uncovered in a diversity of articles such as camel saddles, Bibles, and baby powder cans, as well as in letter class mail.

X-ray screening devices were introduced in major mail units. A "blitz" technique by Special Narcotics Identification Forces was utilized when significant shipments of contraband were arriving from specific countries, with packages from that particular country being opened and thoroughly examined.

Interdiction summary.—In addition to the interdiction efforts already mentioned, significant accomplishments were made during fiscal 1976 in seven other major areas: Detection and tracking systems; radar systems; observation and surveillance systems; contraband detection systems; ground sensor systems; aircraft and marine systems; and special projects. Specific major accomplishments within the above areas completed through fiscal 1976 include the following significant deployments: (a) Military aircraft modified to meet specific Customs Air Patrol use; (b) high-performance twin jet civilian aircraft equipped with radar and infrared sensors to complement the Air Patrol strength; (c) airborne forward looking infrared systems to track suspect aircraft in darkness and to maintain a safe distance without giving away one's position or being endangered by sudden maneuvers by the suspect aircraft; (d) mobile search radars with a 100-mile coverage to detect low-altitude smuggler flights over the border; (e) ground intrusion sensors, with associated repeaters and displays modified by Customs Laboratory, to detect and report covert intrusions of vehicles and persons in remote, desolate areas; (f) tagging devices for covert emplacement in suspect aircraft resources to detect and track suspect aircraft in dense traffic or vast, remote regions; (g) items of night vision equipment for observing and interdicting smuggling traffic in near total darkness; (h) fixed site X-ray contraband detection device; (i) closed-circuit television system installed at San Ysidro, Calif., to provide permanent legal record of primary and secondary interviews of personnel and vehicles; (j) unattended border area surveillance system to detect suspect aircraft carrying tagging beacons covertly emplaced on them; (k) scanning and monitoring the entire avionics communication bands.

Also, Customs technical support program has established an electronic laboratory fully equipped and instrumented to design, develop, fabricate, and test circuits, receivers, and digital processors; an optical laboratory fully instrumented to test and evaluate optical and infrared devices and systems; and mobile optical laboratory van to test, evaluate, and support critical maintenance of optical and infrared devices in the field.

Fraud, neutrality violations

Fraud.—Customs antifraud program continues to be highly successful in terms of losses of revenue (LOR) discovered through field investigations and cash collections returned to the Government resulting from recovered duties, fines, and penalties. During fiscal 1976, 103 agent man-years were expended on fraud investigations with the following results: (a) $17,396,450 LOR attributable to fraud investigations, (b) $172,922 LOR per fraud agent man-year, (c) $19,307,264 total revenue collections attributable to fraud investigations, and (d) $187,449 revenue collections per fraud agent man-year.

The following are several significant fraud cases of fiscal 1976:

As a result of the information provided from a confidential source, agents in California developed a fraud case concerning asparagus grown and processed in Mexico. Investigation showed that entered values had been grossly understated and, in addition, false contracts were submitted to Customs. On April 29, 1976, the Federal grand jury returned a 115-count indictment against the corporation and three of the corporate officers. LOR was approximately $364,208 with a forfeiture value of $13,346,544.

On April 19, 1976, the president of a major importer of sportswear appeared in U.S. district court, Portland, Oreg., and, in behalf of his firm, entered pleas of guilty to 150 separate counts of criminal fraud (18 U.S.C. 542). Sentencing has been postponed pending receipts of a final probation report. The maximum penalty that can be imposed for the criminal violations is $750,000 ($5,000 for each offense). The court action culminates an investigation which established that the false and incomplete value information furnished U.S. Customs by the importing firm has resulted in a $537,406 LOR on merchandise having a forfeiture value of $17,852,055.

An importer of semiconductors in the Florida area imported merchandise in violation of U.S. laws by commingling of foreign and U.S. parts and invoicing them as U.S.; understating unit values; failing to invoice a selling commission and representing items manufactured abroad as being merely assembled. LOR was $979,730 and forfeiture value was $60,470,322.

Neutrality violations and related matters.—In the area of neutrality violations and related acts, customs officers have been active in attempting to curtail the illegal shipment of arms to terrorist groups. A special program has been initiated whereby more attention will be focused on pilots and aircraft suspected of such illegal activity. Regulations already in effect require pilots to report their arrival at the first port of entry. By vigorously following up any failures to report arrivals, progress can be made to increase airplane seizures and assess additional penalties against the pilots.

On February 19, 1976, in one arms case, U.S. Customs agents arrested 2 suspects when they attempted to deliver to undercover officers approximately 20 Browning 9-mm pistols converted to fully automatic weapons. At the time of their arrest, one of the suspects had on his person a fully automatic Browning 9-mm pistol. Two additional pistols were discovered in the pickup truck that they were driving. Subsequent to the arrest, agents executed a search warrant on a warehouse and seized 480

MAC 10 Ingram 9-mm fully automatic machineguns with silencers and 988 magazines.

In addition to neutrality violations, customs officers have increased their enforcement of the currency program, having found that currency violators are frequently narcotics traffickers, also. In one such case, on August 16, 1976, municipal police in Tijuana, Mexico, searched a vehicle occupied by three Mexicans. A briefcase in the vehicle contained $102,000 to be used for the purchase of heroin. Interrogation and investigation by the federal judicial police led to the arrest of five additional persons alleged to be involved in the narcotics buy. On August 22, 1976, five of the violators, who were U.S. citizens, were released to U.S. Customs officers. Four were arrested, and the fifth suspect was questioned and released. One of those arrested was identified as a heroin dealer in Los Angeles. Investigations determined that the currency had been provided by a major heroin supplier in San Francisco; the supplier and his wife were also arrested and charged with violations of currency laws, narcotic laws, and conspiracy.

The special agent in charge, Los Angeles, received information from DEA that a suspect would be departing the United States with a large sum of U.S. currency. DEA information indicated that he was a currency courier for a cocaine smuggling operation, headquartered in Bogota, Colombia. On December 17, 1975, the suspect was placed under surveillance by customs officers, and the next day he was arrested as he prepared to depart via commercial aircraft to Bogota. A search conducted after the arrest resulted in the seizure of $91,899 in unreported currency.

Fraud and smuggling summary.—The following table summarizes Customs efforts in fraud and smuggling:

Established loss of revenue	$17.8 million	Penalties imposed	$1,044.5 million
Arrests	1,172	Cases opened	29,202
Number of seizures	1,967	Cases closed	27,145
Appraised value of seizures	$36.6 million	Case backlog	18,971
Number of penalty assessments	1,582		

During fiscal 1976, Customs was required to support the Secret Service in its task of providing security for Presidential candidates in recent campaigns. Some 40 man-years were diverted to this operation, hampering efforts in the fraud program. Fiscal 1977 should be more productive since more resources will again be devoted to the fraud program.

Enforcement support

Detector dogs.—Narcotic detector dogs have been utilized by Customs since 1970. This unique part of the enforcement program provides an efficient and effective means to detect marijuana, hashish, cocaine, heroin, and many of their derivatives. This effective search and detection method is used in screening arriving carriers, cargo, and mail for the presence of narcotics and dangerous drugs.

For example, in most cases it would take a customs officer 20 to 30 minutes to assure himself that a vehicle coming across the border is free of drugs, as compared with 4 or 5 minutes for a dog team. A dog can check 400 to 500 packages in 30 minutes; the same work would take an employee several days.

Customs detector dogs screen over 21 million units of mail, cargo, and vehicles arriving annually. Detector dog teams trained at the modern training center in Front Royal, Va., contributed directly to the seizure of more than 52,000 pounds of marijuana, 4,200 pounds of hashish, 93 pounds of cocaine, 71 pounds of heroin, and 3 million units of dangerous drugs.

Treasury enforcement communications system (TECS).—TECS is a focal program in enforcement support and is closely interrelated with the information and radio communications systems. This system provides customs inspectors, special agents, and patrol officers with up-to-date vital information so that they can effectively and efficiently assist in the Federal effort to suppress narcotics trafficking, terrorism, transnational white collar crime, dealing in stolen vehicles and other articles, and other crimes against the Federal revenue and the citizenry.

It provides the systemic technology for operating a series of information systems and subsystems of vital importance to Customs management and operations, as well as an index to all of Customs central files.

TECS has a data base of over 660,000 records and a network of 668 terminals. To improve upon this system and to enable it to expand its services to Customs and other Federal agencies, a number of changes to the system were implemented in fiscal 1976. A new B7700 computer was installed in the San Diego computer facility and all ongoing systems were converted from the old computer to the new; new terminals were installed at preclearance airports of Winnepeg and Vancouver and Kennedy International Airport; a telecommunications study was completed which, when implemented, will improve performance and will result in long-range reduction in telecommunications cost; and a terminal procurement contract was completed to allow for upgrading of international airport TECS facilities and to extend service to additional field offices. Also, a new file was established that contains an index of wanted persons in the FBI's National Crime Information Center (NCIC) data base, which has contributed substantially to apprehension of wanted persons. Interface with the California law enforcement and telecommunications system (CLETS) was completed, providing TECS users with quick access to drivers' licenses and license-tag information available in State and local law enforcement agencies. Plans are underway to install TECS terminals for use by the Coast Guard and the State Department in a joint Federal effort to combat international terrorism.

Communications support program.—The heart and major thrust of the Customs communications system is a series of regional communication centers which, when fully implemented, will provide complete radio coverage along the entire perimeter of the United States. These centers will contain sector radio and message center facilities, and will provide total communications and 24-hour duty officer support to the entire regional management team.

Additionally, zone or local radio coverage will be provided at all ports of entry and international airports. Local communications facilities have been initiated and are proving of considerable value in certain remote or highly active ports; however, primary emphasis is being accorded the perimeter system.

With the completion of two sectors in fiscal 1976, coverage now includes seven regions and extends along the perimeter of the United States from San Francisco south to the Mexican border, along the Mexican border around the Gulf Coast, up the Atlantic coast to the Canadian border, and west along the Canadian border to Buffalo, N.Y. In fiscal 1976, also, local zone communications were installed in Puerto Rico, the Virgin Islands, the Miami Airport and Seaport, the Los Angeles Airport and Seaport, Detroit, Chicago, and New York City.

In addition to the expansion of the radio communications system, in 1976, a nationwide administrative teletype system was activated, connecting headquarters with 61 key Customs locations throughout the country. Any station can send a message to any other station, or simultaneously to a number of other stations.

In fiscal 1976, the communications capability available to the Customs headquarters in Washington was significantly increased. The communications center was expanded, a command and control center was added, and the Baltimore region sector control center was established in this complex. With the completion of this complex, headquarters now has a total communications capability 24 hours a day for strategic direction of enforcement operations and administrative control over Service field offices.

Customs enforcement information system.—A number of enforcement information systems were introduced or perfected during 1976 which had significant impact on enforcement activities. One of the major improved systems is the vessel violation profile system (VVPS), which provides real-time information on the smuggling activities of commercial vessels. A sampling of less than 30 vessels in this system contributed to narcotics seizures with aggregate street value of $244 million in fiscal 1976, as well as seizures of 3 commercial ships with values ranging from $100,000 to $5 million.

A subsystem addressed in fiscal 1976 is the currency and monetary instrument reporting system (CMIR) to monitor the filing pattern of individuals carrying large amounts of currency or monetary instruments into and out of this country to establish whether there is any correlation between the movement of currency and monetary instruments and illegal activities.

In fiscal 1976, a significant accomplishment was the completion of a modernized search, arrest, seizure reporting system which now combines, into one integrated computer-processed form, several reports previously prepared and compiled by cumbersome manual methods. All enforcement-related management and statistical reports have been automated, and the combined savings in manpower and associated costs realized through this program amount to hundreds of thousands of dollars.

Another major information system perfected was the private aircraft reporting system, while considerable progress was made on the small boat reporting system.

Military predeparture inspection program.—The military customs advisory program was established in 1974 to train military personnel (military customs inspectors [Excepted]) to inspect personnel, cargo, baggage, and mail, thus enabling them to perform their own customs inspections at the point of departure overseas.

Originally, six permanent customs advisers were stationed in Guam, Philippines/Taiwan, Germany, Korea, Thailand, and Okinawa/Japan. With the conclusion of the Vietnam conflict and mass deployment of troops to the United States, two of the advisory positions (Guam and Thailand) were abolished during fiscal 1976. Special projects such as the preclearance of the returning personnel and equipment engaged in the annual "Reforger" military exercises in Germany were also undertaken in a cooperative effort to facilitate customs clearance. In addition to the military customs inspectors (Excepted) in the Pacific and European Commands, there are 1,248 military and 75 DOD civilian employees in the United States who have been designated as customs inspectors (Excepted). They perform customs clearances at 88 foreign bases (military airbases which receive aircraft from outside the Customs territory) in the United States.

International activities.—Customs played an important role in the full range of programs of the Customs Cooperation Council, an 80-member international organization with headquarters in Brussels, which highlighted customs enforcement and the facilitation of international trade. By chairing the Finance Committee and presenting a major paper on the role of the Council, as well as sending delegations to the plenary Council session and all committee and working party meetings, Customs not only contributed to individual programs but also continued to influence the overall direction of the Council.

Responding to initiatives by United States and Australian Customs, the Council accelerated work on customs enforcement, developing a working draft of a multilateral convention on mutual customs assistance and instructing the Permanent Technical Committee and its Working Party on Customs Enforcement to prepare a draft convention for consideration by the Council for adoption at its June 1977 plenary session. It is anticipated that the convention will consist of a main body of rules and a series of procedural annexes to be accepted separately, including a special annex on assistance in action against the smuggling of narcotic drugs. The Council's "Recommendation on the Pooling of Information Concerning Customs Fraud" entered into force, and the Council continued to cooperate with other international organizations dealing with enforcement, especially the International Criminal Police Organization (Interpol) and the U.N. Commission on Narcotic Drugs.

Final drafts of mutual customs assistance agreements were negotiated bilaterally with the Governments of Austria and Mexico. The agreements provide for an expanded range of cooperative effort in the enforcement of customs laws and regulations.

Cabinet Committee on International Narcotics Control (CCINC).—The Cabinet Committee on International Narcotics Control was formed in September 1971 to launch an accelerated attack on the international aspects of the drug abuse problem. The U.S. Customs CCINC training program has been designed to train foreign enforcement officials in border control activities, emphasizing interdiction techniques, border surveillance, antismuggling programs and methods, cargo control, and search-and-seizure methods. The program is aimed at foreign customs officials or other border control officials who exercise some form of customs function or responsibility.

To date, Customs has trained nearly 4,500 foreign officials from 65 different countries. Of these, middle-management training in narcotics interdiction has been provided to 336 foreign customs officials in the United States. The remainder have been trained in their own countries.

High-level officials of foreign customs services participate in the 3-week senior level observation program under the auspices of CCINC. As of July 1976, 40 representatives of 23 countries had visited the United States. In addition, during fiscal 1976, U.S. Customs hosted 32 foreign customs officials not sponsored by CCINC.

As a more recent departure within the scope of foreign assistance-funded international narcotics control training, the U.S. Customs Service has initiated a 3-week training program directed at narcotics detector dog trainers. Since its inception, 43 officers from 11 countries have participated in this program. There have also been six participants in a 14-week course geared to detector dog handlers.

Merchandise Processing and Duty Assessment

Cargo theft prevention

The Customs Service has assumed the responsibility for preventing theft from international cargo while in Customs custody. Customs has a unique capability of improving cargo security because of the daily presence of customs inspectors at all points at which international cargo is processed. This allows for the daily involvement of trained customs investigators in preventing and minimizing losses from revenue fraud and improper handling. Additional benefits are gained by the protection of the public's health and safety, and reductions in the cost of imported goods and services are thereby realized.

Cargo security awareness.—Customs emphasizes educating the importing community and carriers concerning the merits of cargo security. Customs has now conducted cargo security miniseminars for some 5,000 executives representing importers, freight forwarders, manufacturers, and insurance agents.

Customs has designed two types of antitheft posters and eight different antipilferage slogan signs, printed in English and Spanish. Posters and signs have been circulated to the field for display in warehouses, terminals, freight sheds, container and devanning stations, security cribs, offices, and on docks and piers.

The Customs Service has conducted surveys at 540 locations which have resulted in the expenditure of over $23.4 million by private industry for improvements in physical and procedural security.

An illustration of the proper use of the identification of theft-prone facilities and the significant results obtained from voluntary compliance with the "Standards for Cargo Security" is this randomly selected airport and seaport terminal experience. These two terminals are representative of the hundreds of such facilities which have been surveyed by Customs and which have adopted Customs recommendations to improve their security. They dramatically demonstrate the effectiveness of the Customs cargo security program.

Terminal "A" is operated by a large, international, foreign flag air carrier. From July 1972 through September 1974, this carrier reported 58 incidents of theft totaling $64,517 at this terminal. The Customs Service performed a cargo security survey at this location on June 20, 1974. From October 20, 1974, through November 1975, this same carrier reported 15 instances of theft and $1,891 in losses.

Terminal "B" is a publicly owned seaport facility. From July 1971 through December 1973, this operator reported 49 instances of theft with a value of $5,924. In October 1973 the Customs Service conducted its cargo security survey. By April 1974, all of Customs recommendations had been complied with. From April 1974 through November 1975, this same operator reported only six thefts valued at $891.

Imported merchandise quantity control (IMQC) program.—As an adjunct to the cargo security program, the IMQC program was established by Treasury Decision 71-22 with the purpose of promoting better manifesting of merchandise, developing a system for identifying trends in imported cargo handling, and obtaining reports of overages and thefts, achieved because of both local Customs and carrier interpretations and procedures. In January 1975, a revised edition of the IMQC instruction manual was published to achieve maximum uniformity in the administration and operation of the program. Customs headquarters representatives conducted 32 lectures on the manual throughout the United States. Over 3,000 representatives from Customs, carriers, the importing community, and insurers received instructions in the use of the new manual.

Under the IMQC program, there were 323 seizures for manifesting violations in fiscal 1976. These violations led to penalties being assessed against carriers in the amount of $8,888,656. Audits of carrier records to verify claims of nonimportation or to detect manifesting errors have resulted in discovery of 1,746 discrepancies and assessment of additional duties, damages and/or penalties assessed in the amount of $796,532.

Customs has collaborated with the Imports Branch, Bureau of Alcohol, Tobacco and Firearms (ATF), to conduct security surveys of Customs bonded warehouses to which shipments of imported nonsporting, surplus military or automatic firearms are to be consigned. Based upon Customs evaluation of the facility, ATF will approve or disapprove the importation permit. As of June 1976, four surveys had been conducted and only one warehouse had been found to possess adequate security.

Customs program against cargo crime (C-PACC).—C-PACC is a continuing program utilizing the expertise of the Customs enforcement arms to achieve a reduction in cargo crime through arrests, apprehensions, seizures, establishment of a deterrent, gathering of intelligence, and followup accountability. From March 1, 1975, the inception date, through June 30, 1976, C-PACC has been responsible for 574 instances of seizures and/or penalties valued at $9,466,935 and 105 arrests, including 30 recovered stolen vehicles, 8.7 lbs. of cocaine, 80 lbs. of liquid hashish, and 20 lbs. of marijuana.

A major innovation in the program included the updating of the seal used to secure cargo which was last improved in 1912. A new, high-security seal approved by Treasury last year is now mandatory on all port-to-port inbond carload and container lot movements of cargo which are still within Customs custody.

Theft information system (TIS).—In 1975, a Customs Theft Information Committee worked to establish a viable theft information system to ascertain the value, quantity, type of merchandise, and location of pilferages or thefts of cargo from Customs custody or control. The Miami and Los Angeles regions were chosen as TIS test sites.

On December 12, 1975, the TIS Committee judged the tests so successful that it recommended that Customs headquarters (1) process the test data for input into the computer; (2) generate reports regarding thefts, i.e., volume, location, description of merchandise, carrier, dates, etc.; (3) evaluate printouts; and (4) implement TIS nationally.

Containerization program.—It has been estimated that the U.S. Government is deprived of $40 million in revenue each year through the false manifesting (underreporting) of containerized cargo. To reduce this loss, a program was instituted at 48 ports in February 1975 to conduct full examinations of 2 percent of the containers shipped directly to importers' premises. The results of this increased enforcement showed a return of approximately $3.10 for every dollar spent. During the year, the program was credited with the recovery of $860,054 in extra duty and taxes, the discovery of $8,433,117 in unmanifested merchandise, and the assessment of fines and penalties in the amount of $2,054,014.

Merchandise processing

Processing commercial merchandise.—Key to the efficient movements of goods, 3.3 million formal entries of merchandise were processed in fiscal 1976. This was 8.3 percent more than in fiscal 1975. Almost $5 billion in revenues were collected on 113.6 billion dollars' worth of merchandise.

Since not all merchandise can be allowed into the country, it is Customs task to determine the classification of all merchandise for both statistical and revenue-producing purposes. The statistical information is turned over to the U.S. Tariff Commission, through the Census Bureau, for use in the negotiation of international trade agreements. As a result, many industries and jobs have been saved from unfair competition from overseas.

Customs mail operations.—All incoming foreign mail is processed by Customs for revenue and enforcement purposes. During fiscal 1976, Customs mail branches processed approximately 50 million mail parcels, prepared over 2.2 million mail entries, and collected over $20 million in duty, with a manpower allocation of 485 man-years. Over 80 percent of the foreign mail is processed by Customs mail branches at its locations in New York, San Francisco, Los Angeles, and Chicago. Customs mail specialists prepare mail entries on all international and military mail arriving in the United States from abroad.

Import statistics.—Collection of import statistics is an integral part of processing merchandise imported into the United States. In fiscal 1976 customs officers, located at some 100 ports of entry, verified 6 million line items on the 3.3 million entries filed. This represents verification of approximately 39 million individual items. The present high quality of import statistics flows from commodity expertise essential to the effective collection of revenue, and to the enforcement, and admissibility mission of Customs.

Customs also participates in the gathering of export data and transmits approximately 8.5 million documents to the Bureau of the Census annually. Customs is currently developing administrative procedures that will allow for the collection and verification of the export declarations, resulting in more reliable export data.

Quotas and international agreements.—One of the principal uses of these vital trade statistics is in the establishment of commodity quotas. Currently the Customs Service enforces more than 700 such quotas.

In addition to commodity quotas, meat and agricultural products are monitored by customs officers.

Separate monitoring of other commodities such as certain meats and speciality steels is performed to observe the commodities and determine the possible need for establishing quotas. Other imports such as coffee and textiles are subject to various other international agreements.

Textile agreements.—Currently, the United States has separate bilateral textile agreements with 31 other countries covering trade in cotton, wool, and manmade fiber textiles and apparel. Ten of these agreements include systems under which imports from the exporting country must be visaed prior to entry. During fiscal 1976, Customs administration and maintenance of these agreements, under the direction of the President's Committee for Implementation of Textile Agreements, involved an expenditure of approximately 165 man-years.

International Coffee Agreement.—In February 1976, the United States became a signatory to the International Coffee Agreement of 1976, which was subsequently submitted to the Senate for ratification. Enabling legislation will be sought but is not expected to be passed before the October 1976 implementation date. However, this legislation is not necessary for the first phase of the program, which involves only monitoring the movement of coffee. This monitoring or tracking system is designed to provide accurate statistical data on the quantities of coffee imported by consuming member nations and will serve as an allocation base to exporting member countries if and when quotas are subsequently established under the agreement.

Customs laboratories.—During fiscal 1976, Customs laboratories analyzed approximately 170,000 samples, resulting in over 15,000 changes in the tariff classification of imported commodities. Necessitated by the continuously changing technology which has multiplied the number of different kinds of items imported into the United States, as well as the increasing complexity of finished products submitted to the laboratories for analysis, efforts were initiated in fiscal 1976 to develop guidelines for more cost-effective sampling. Applying the guidelines developed, one field laboratory analyzed 697 samples of wood products identified as probable high-risk commodities, resulting in 113 classification changes and $123,000 in additional Federal revenues.

International activities

Customs participated actively in the continuing program for facilitating international trade, in the Customs Cooperation Council, a worldwide organization of customs services. Major initiatives included development of 5 new technical annexes to the International Convention on the Simplification and Harmonization of Customs Procedures, bringing the total number of annexes adopted by the Council to 17. Eventually the convention will cover all aspects of customs procedures, involving approximately 30 annexes. In addition, the Council stepped up work on the development of an international harmonized commodity description and coding system which can serve as an international commodity code for transportation and the collection of trade statistics as well as for customs purposes. This project is of major interest to U.S. Government agencies and private business sectors, and Customs has coordinated U.S. participation in developing the project.

Customs also participated in significant projects of other international organizations in the field of trade facilitation. Principal among these was the U.N. Economic Commission for Europe's Review Conference in November 1975 to revise the 1959 TIR Convention, culminating 4 years of preparatory work. This convention makes possible the expeditious transit of cargo across national borders and through customs territory by means of a carnet and an international guarantee system. The revision updates the convention in the light of technological advances during the past decade in the transportation of cargo.

Modernization

Customs Modernization and Simplification Act.—In August 1975, H.R. 9220, the Customs Modernization and Simplification Act, was introduced by Congressmen Green and Conable, ranking members of the Trade Subcommittee of the House Ways and Means Committee, and referred to that committee for consideration. The Customs Modernization and Simplification Act as drafted by the Customs Service would permit the Service to adapt modern business techniques to the collection of duties on commercial importations. H.R. 9220 contains provisions which would allow Customs to fully implement the automated merchandise processing system program now under development. In addition, the bill would strengthen the laws pertaining to the verification of entry information and permit the expansion of Customs regulatory audit program. The bill also contains long-needed administrative simplification amendments such as a flat rate of duty on purchases accompanying returning residents and an increase in the monetary limit applicable to informal entries. Finally, the bill contains a revision of the provision for the licensing and regulating of customhouse brokers. From August 3 to August 6, 1976, the Trade Subcommittee held hearings on H.R. 9220. No further action has been taken since that time. In the Senate, the proposed legislation was referred to the Senate Finance Committee.

Automated merchandise processing system (AMPS).—AMPS is an ongoing program designed to improve, nationwide, the Customs Service supervision and control over all merchandise entering the United States, collection of duties, and uniform enforcement of regulations governing importation.

The AMPS program is based on an operational concept approved by the Commissioner of Customs in the summer of 1974 called the Customs concept system. The concept, a nationwide computer-supported telecommunications and data processing system, is being implemented through a phased and cost-effective modular operational deployment plan. Functional system design and detailed functional specifications, encompassing full entry and revenue processing for Customs, were completed during fiscal 1976. Fiscal 1977 will be devoted to computer system design development and programming for the Customs concept system. Simultaneously, hardware specifications will be identified, resulting in the issuance of a request for proposal in fiscal 1977 for computer delivery in fiscal 1978.

Currently, individual AMPS capabilities are being developed and implemented at selected, geographically dispersed ports, providing field operations in Customs with urgently needed assistance, and improving the processing of imported merchandise. The first phase of the Customs concept system, the early implementation system, which provides immediate delivery control, entry screening, and collection processing, is now fully operational at Philadelphia, Chicago Seaport, Baltimore, Chicago's O'Hare Airport, and Miami. As a result, a total of 10 percent of all Customs entries and 13 percent of all collections are now on the automated system. A total of 30 percent of all Customs entries and collections will be supported by the system with completion of the implementations scheduled for other ports in the Chicago region and at Boston during fiscal 1977, and at New Orleans and Houston during early fiscal 1978.

At the same time that new ports are being added to the network, refinements are continuously being developed so that the system itself more exactly meets the needs of the importing community. For example, a recent change to the system has allowed the import specialist more latitude in designating bypass criteria for entry selection, and has markedly reduced his burden of routine work because 40 to 50 percent of the entries are being liquidated by computer. The import specialist can now concentrate more of his time and attention on new importers, complex entries, and intensified enforcement efforts. Another major improvement, now in development, permits field users to store erroneous entries on-line and make corrections to them at a later time. This will eliminate duplication of effort in Customs Entry Control Sections.

Local manifest clearance systems have also been installed at most major seaports, and expansion to major airports is planned. These systems allow centralized clerical units, assisted by local computer support when justified by the volume, to post entry documents, freeing valuable inspector man-hours. Inspector time can then be devoted to more productive activities.

Vessel entry and clearance bill.—The proposed entry and clearance legislation, which would amend many navigation laws to provide more flexibility in administration, received clearance from the Office of Management and Budget on February 9, 1976. It is anticipated that it will be introduced early in the first session of the 95th Congress. The bill would amend or repeal some 60 navigation laws, including those relating to reports of arrival and entry by vessels, and authorize the establishment of appropriate controls by regulations.

Revision of vessel manifest form.—The proposal to revise the Customs Regulations to provide for a modified vessel manifest form based on the standardized Cargo Declaration prepared by the Intergovernmental Maritime Consultative Organization was the subject of a notice of proposed rulemaking published in the Federal Register on August 6, 1975 (40 F.R. 33038). Comments received in response to the notice are being evaluated, and it is expected that publication of amendments to the Regulations to provide for the use of this modified manifest form will be before January 1, 1977.

Collocation.—Collocations of regional offices to promote improved communications and greater adherence to the team concept were accomplished in three of the nine Customs regions in fiscal 1976. Only three offices remain to be collocated, with San Francisco and Miami scheduled for completion in fiscal 1977. The Baltimore region is substantially collocated while final action awaits the restoration of its historic customhouse by the General Services Administration.

Collocations of District Directors with the special agents in charge were completed in 25 of 42 locations in fiscal 1976, the remainder being in various planning stages.

Border improvements.—The upgrading of Customs facilities resulted in the construction and operation of new border stations at Richford, Vt., and Monticello and Bridgewater, Maine. Construction on the border facility at Nogales, Ariz. ($2.7 million) has been completed with occupancy expected shortly. In addition, new inspection facilities were opened at

Lambert Field, St. Louis, Mo., and Patrick Henry Field, Newport News, Va., both provided at no cost to the Federal Government.

Two Customs border stations have received approval as solar heating demonstration projects by the Energy Research and Development Administration. The Hamlin, Maine, inspection station, completed in 1975, has been selected for solar heating retrofit, and the Sherwood, N. Dak., station, scheduled for opening in 1978, will be designed with a solar heating system. Both projects are funded under the Solar Heating and Cooling Demonstration Act of 1974.

Customs accelerated passenger inspection system (CAPIS).—The rapid growth of international air travel necessitated the development of an accelerated inspection for international air travelers. The resultant system, CAPIS, offers the advantages of full passenger-inspector contact whereupon a determination is made as to the degree of baggage inspection to be conducted.

The CAPIS module is designed to provide a pleasant, efficient, and versatile work station for inspectors. The number of inspection counters is reduced by 25 percent from the traditional configuration and provides for wider aisles which promotes smoother passenger movement.

A highlight of the CAPIS module is the free lane exits through which 75 percent of the passengers are released after initial processing. A traveler requiring additional inspection is routed to inspectors further down the conveyor belt where baggage can be more closely examined without delaying other travelers. After initial installation at Miami, Montreal, and Toronto, CAPIS has since been installed at Boston (Logan Airport); Washington, D.C. (Dulles); Philadelphia, Pa.; Bangor, Maine; Great Falls, Mont.; San Juan (Eastern); Nassau; Bermuda; Minneapolis, Minn.; Houston, Tex.; and St. Louis, Mo.

Trade Policy

Trade Act of 1974—generalized system of preferences (GSP).—The generalized system of preferences (part V of the Trade Act of 1974) went into effect on January 1, 1976. To fulfill Customs responsibility under the act, immediate actions were taken to implement GSP.

Headquarters teams were sent to all nine Customs regions to conduct seminars explaining GSP procedures to both Customs officials and the importing public. Materials for training customs officers were developed and distributed. This was followed by the issuance of GSP regulations and directives to guide Customs employees, importers and their representatives, and foreign producers and shippers in GSP matters. A brochure on GSP, providing the traveling public with the information necessary to expedite customs clearance, was prepared and made available.

Currently 137 countries/territories and 2,724 major item numbers in the Tariff Schedules of the United States are eligible for GSP. During the first month GSP was in effect, the number of GSP imports represented 2.5 percent of all importations reported. In June 1976, GSP imports were more than doubled, representing 5.2 percent of the total importations reported.

Antidumping and countervailing duties.—A major revision of part 153 of the Customs Regulations was published as Treasury Decision 76–176 on June 25, 1976. The publication effectuated changes made in the Antidumping Act of 1921 by the Trade Act of 1974.

Draft revisions of the countervailing duty regulations are now before Treasury and will be published shortly in proposed rulemaking form. Revision of part 175, Customs Regulations, pertaining to appeal and review procedures for American manufacturers, is underway.

Fiscal 1976 saw a marked jump in the number of dumping allegations made. Twenty-two antidumping and 10 countervailing duty cases were initiated; 14 antidumping and 23 countervailing duty determinations were published, requiring 148 antidumping master lists to be circulated to field offices for their use in assessing dumping duties. Presently 61 findings of dumping are in effect. Most prominent in fiscal 1976 workload was the antidumping investigation that involved automobiles exported to the United States from 28 automobile manufacturers located in 8 countries, resulting in the largest antidumping investigation ever to be conducted.

Regulatory Activities

Regulatory audit.—Included in Customs modernization and simplification changes is the regulatory audit which will provide the Customs Service with an ability to establish a firm basis for determining compliance with various laws and regulations through the use of audit procedures in lieu of more costly physical controls or other means of verification. While not all firms can be audited, the application of scientific sampling methods and information quantified through computer analysis permits selecting for audit those companies identified as most likely to provide Customs with high-payoff transactions.

During fiscal 1976, 925 audits of various types were performed which resulted in revenues in excess of $6 million. Of the audits performed, 14 were referred to the Office of Investigations for suspicion of fraud while 79 other audits were performed for the Office of Revenue Sharing. In another major assist, not included in the above figures, regulatory auditors were assigned to a Justice Department task force which investigated petroleum sales to an electric utility company. Task force findings disclosed fraudulent billings to the utility and unpaid taxes by the selling company in excess of $22 million. As all the details of this investigation have not been completed, the final amount of recovery cannot be stated at this time, but is expected to far exceed the initial $22 million amount.

Regulatory Audit has accepted the containerization challenge and during fiscal 1976 developed and field-tested a containerization miniaudit program. The test results of the miniaudit program have been so successful, the audit program will be implemented on a nationwide basis during the next fiscal year.

Other-agency requirements.—Besides enforcement of the Tariff Act of 1930 as amended, the Customs Service is charged with assuring importer and traveler compliance with the laws and regulations of other Federal agencies. Customs must administer over 500 statutory or regulatory requirements for about 60 other agencies and/or administrations with almost 40 percent of the 10,000 or more Tariff Schedule item numbers subject to the requirements of Federal agencies other than Customs.

During calendar year 1975, Customs processed 96.5 billion dollars' worth of imported merchandise involving 5.2 million transactions. Of this amount, 36 percent of the transactions and 64 percent of the value represent merchandise subject to other-agency requirements.

From effectively enforcing motor vehicle safety and emission standards to controlling food and drug importations, Customs is making a meaningful contribution to the safety and welfare of society while enhancing its image as a responsive and dynamic service organization.

Freedom of information.—In response to the requirements imposed upon Federal agencies by the Privacy Act of 1974, and the amendments to the Freedom of Information Act of 1974, the Customs Service has formalized procedures for the handling of requests for records.

Requests from the public for disclosure of records were received at the rate of approximately 125 per month. The number of pages of records heretofore disclosed from the files of the Customs Service is in the order of tens of thousands. A systematic review and implementation of the Privacy Act requirements concerning the maintenance, collection, dissemination, and safeguarding of information and records pertaining to individuals were undertaken and are still in process. Guidance and instructions concerning the requirements of the act have been provided to the various elements of the Customs Service, both at headquarters and in the field.

Internal security.—Working in coordination with other agencies including the Office of the United States Attorney, 77 criminal investigators in 9 regional offices closed and completed a total of 504 investigations. Of that total, 80 were either referred for criminal prosecution or resulted in indictments. Also undertaken in the same reporting period were 162 investigations involving either administrative discipline (adverse action) or procedural change. Over 120 investigations resulted in the allegations being refuted or a determination made that there was no misconduct on the part of an employee. Thus, in the majority of these allegations which resulted in administrative investigations, no action was taken against the employee since the allegation was false or inaccurate or it could not be substantiated.

Full field investigations.—As the Customs Service is the Nation's first line of defense against smuggling, the full field investigation is Customs safeguard mechanism to insure that employment of any individual is unquestionably in the interest of national security. The full field is an extensive preappointment investigation conducted on all sensitive positions, which in the past included the majority of the positions in the Customs Service and in the near future will be extended to cover all positions. An average of 1,215 full field investigations are conducted each year with each taking an average of 50 man-hours to complete.

Security clearances.—For the period of fiscal 1973 through the first part of fiscal 1976, Customs has granted an average of 405 security clearances a year. In fiscal 1976, there has been a marked increase in the number of security clearance requests, as the Customs Service enforcement program is becoming more involved with the use of military classified equipment in its surveillance activities and other programs which require access to military installations.

Internal audits.—The internal audit activity is much like the Customs counterpart of the GAO. When the Customs Service is charged with a new program, Customs management must have available an internal audit capacity to assure that Customs programs are being carried out, that those implementing the program are adhering to established policy and procedure, and that resources to support the programs are being judiciously spent.

In 1976, 212 audits, surveys, and special projects were completed by the headquarters and regional staffs, an increase of 118 over the 94 cases completed in 1975. A substantial portion of the increase is attributable to improved planning, management, and coordination. Some of the increase is due to a change in audit direction towards more specific reports which address fewer unrelated topics.

Two major ADP audit areas of the past year were: (1) automated merchandise processing systems (AMPS), and (2) administrative ADP support. The combined budget for these two areas for fiscal 1976 exceeded $10 million. The reports identified for management those areas in which increased efficiencies could be effected and improved managment is required. The impact of improved efficiency and accuracy of data processing is not limited to the two areas as improvements benefit nearly every organizational entity in Customs.

Other Activities

Operation Sail 1976.—The U.S. Customs Service, working in close cooperation with the American Revolution Bicentennial Administration, devised a simplified entry and clearance procedure to facilitate the movement between ports in the United States of the vessels participating in Operation Sail 1976.

Recordations.—Approximately 340 trademarks, service marks, and copyrights, or renewals, assignments, and name changes therefor were recorded for import infringement protection. Eight patent surveys and renewals were approved. Fees collected for these services totaled approximately $66,000.

Micromation.—The pilot test of this project was successfully completed in May 1975 and the potential for expansion was significantly enhanced with a procurement action for 143 microfiche readers and 18 reader/printers in late fiscal 1975. Subsequent to this procurement, micromation has been expanded into all regional headquarters, 33 districts, and 64 ports of entry. During fiscal 1976, nine additional reporting requirements were converted to microfiche output, consisting of approximately 16 million pages of printed material with a resultant savings to Customs of approximately $250,000. With the objectives of reducing computer time expended in producing hardcopy output and a significant reduction in costs, expansion of this project will continue in fiscal 1977 with the conversion of other reporting requirements to microfiche.

Acquisition of a National Data Center computer.—During fiscal 1976, a request for proposal action was submitted through Treasury to GSA for acquisition of the National Data Center computer equipment. This request resulted in the installation of an "interim ADPE" (IBM 370/155) at the headquarters Data Center. Subsequent to readiness review and acceptance, production of all current operational systems was converted from the IBM 360/50 and time-shared equipment to the IBM 370/155. OMB and GSA directives require the interim ADPE to be replaced by competitive procurement, and a request for proposal has been prepared and forwarded to Treasury for review during the transition quarter. The IBM 370/155 has provided Customs with short-term relief in allowing greater productive capacity, more throughput, and faster turnaround in meeting its production requirements, while the longer term solution available in the procurement action is being processed.

Excess property.—Customs again led Treasury agencies in utilization of excess property in fiscal 1976. This program provides substantial savings to the Government, allowing more cost-conscious use of available resources. Customs acquisitions include such items as 7 helicopters (acquired from Army and Air Force surplus), with an original value of over $1.6 million, to be used in the continuing antinarcotics program; 31 house trailers from Health, Education, and Welfare ($125,000) for use at border ports or marine facilities; radar and other electronic equipment from Justice (DEA) for law enforcement purposes, valued at $500,000; and numerous other acquisitions totaling $4 million for the year.

Administrative rulings.—Amendments to the Customs Regulations setting forth procedures for applying for rulings on the legal consequences of prospective transactions were published in the Federal Register July 30, 1975. Under the regulations, the conditions under which rulings are issued and published are set forth. Procedures are also included which apply to applications for internal advice rulings on pending transactions.

Interpretative regulations.—Amendments to the regulations incorporating policies reflecting previous administrative and court interpretations of the partial exemption from duty under item 807, Tariff Schedules of the United States, were published in the Federal Register on September 18, 1975. These regulations set forth in detail all the requirements necessary for eligibility for an exemption from duty of American-made components which have been assembled as parts of imported merchandise.

Minority-owned bank program.—As a result of continued efforts, 20 minority-owned banks located in 11 different States are now receiving customs collections. Deposits into these minority-owned banks are approximately $181 million monthly and represented 34 percent of the entire June 1976 collections of over $529 million. On a projected basis, Customs is currently depositing collections in these banks at an annual rate of over $2 billion.

Importer identification system.—U.S. Customs Service computer-prepared bills, notices of liquidation, and refunds are automatically sent to importers based on a match of name and address with an assigned number within the identification system. This identification file contained over 315,000 records prior to June 1976. Extensive review during the month of June permitted purging of approximately 115,000 inactive records. In addition to the cost savings recognized in reduced computer running time, much-needed computer capacity was made available through this action for other Customs applications.

Penalties assessed.—During fiscal 1976, Customs received, reviewed, and prepared legal decisions regarding violations of customs and related laws and regarding claims for liquidated damages assessed under Customs bonds. Of those cases which liability was under $100,000, there were 271 resulting in penalty and forfeiture and 23 resulting in liquidated damages. The total amount was over $12 million.

More than 200 cases had liability over $100,000, which brought the total cases to almost 500 with total dollars to nearly $449 million.

During fiscal 1976, there was almost $15 million imposed by penalty decisions.

UNITED STATES SAVINGS BONDS DIVISION

The U.S. Savings Bonds Division promotes the sale and retention of U.S. savings bonds and the encouragement of individual thrift. Because the average life of series E and H savings bonds is about twice that of the marketable debt, this form of savings constitutes a long-term underwriting of the Treasury's debt structure and makes possible the widespread distribution of the national debt through its ownership by a substantial number of small investors.

The program is carried out by a small staff of less than 450 people with the active assistance of thousands of volunteers who are leaders in business, labor, finance, and the media.

Sales of series E and H savings bonds totaled $7.3 billion in fiscal 1976, and $1.8 billion in the transition quarter. Participation in the payroll savings plan as of September 30, 1976, totaled close to 9 1/2 million people. There were a total of $71.1 billion in savings bonds and savings notes held at the close of fiscal 1976 and the transition quarter. During fiscal 1976, holders of these savings vehicles received over $3.9 billion in interest, while an additional $900 million was paid in interest during the transition quarter.

Office of the National Director

Some of the resulting changes of a management review of the Savings Bonds Division were: The Office of Executive Secretary, U.S. Industrial Savings Committee, and the Advertising and Promotion Branch of the Division were restructured; a new office, Program Planning and Market Analysis, was established; and a number of long-range projects and studies were set in motion that will be beneficial over the next few years.

Major U.S. savings bonds campaigns were launched among a number of new groups, including a drive in the U.S. Congress.

A new role and mission statement for the Division—the first new statement in over 6 years—was approved by the Secretary. The statement highlights the twin goals of increasing the sale and retention of savings bonds and of encouraging thrift and personal savings by Americans.

A newly designed series E bond was launched to mark the Bicentennial. During July 1976, all bonds sold over the counter could be stamped "July 4, 1976."

The National Director of the U.S. Savings Bonds Division, Mrs. Francine I. Neff, carried on an active speaking schedule on behalf of the bond program. She spoke to more than 100 different groups in 40 different States, obtaining wide exposure for the program. The Director's audiences included representative groups in the fields of business, banking, labor, academia, conservation-interest and women's groups.

U.S. Industrial Payroll Savings Committee

The leader of the 1976 nationwide payroll savings campaign in industry was George A. Stinson, chairman, National Steel Corp., and Chairman of the U.S. Industrial Payroll Savings Committee. The 1976 campaign was launched in Washington, D.C., on January 23, 1976. The annual meeting of the Committee was highlighted by a meeting with President Ford at the White House. Serving on the Committee with Mr. Stinson were 13 former chairmen and 50 top executives of the Nation's major corporations.

Committee members conduct top management meetings, urge the chief executives in their areas and industries to conduct payroll savings drives, and set strong examples by the campaigns they conduct in their own companies. Through September 30, 1976, 34 committee members had completed their company campaigns and had enrolled over 362,000 employees either as new savers or as employees with increased allotments.

Chairman Stinson contributed much time and effort to the campaign. He traveled to 22 cities to address 33 meetings of business and community leaders, and to help members of the Committee launch their area and industry campaigns.

On April 22, 1976, Mr. Stinson appeared on the NBC television network "Today" show. Sixty NBC stations also presented their local volunteer leaders to further publicize the campaign. Mr. Stinson provided sales tools for the volunteers and staff workers in the campaign, including a brochure for top executives and a color motion picture entitled "Take Stock in America." Mr. Stinson produced three newsletters for volunteers to publicize the campaign and also ran a full-page ad featuring the 1976 Committee members with a photo of each in all editions of the Wall Street Journal on January 29, 1976.

The U.S. Industrial Payroll Savings Committee has been the principal force in raising the sales of E Bonds in the $25 to $200 denominations to $4.9 billion annually, more than $2.3 billion higher than in 1962 before the Committee was formed.

Federal campaign

The annual savings bonds campaign for Federal employees was conducted between March and June 1976. This staggered campaign approach allowed field promotional staff more time to give personal attention to field installations while the headquarters staff had more time to organize and carry out a successful campaign.

The Interdepartmental Savings Bonds Committee was headed by Thomas S. Kleppe, Secretary of the Interior. President Ford and Secretary Kleppe met at the White House on January 8 and filmed a message to all Federal employees outlining the importance of U.S. savings bonds. The President stated, in part, "There is no better time than now, in our Bicentennial year, to renew our confidence in America and its promising future, and there is no better way to do it than buying United States savings bonds."

The Federal kickoff rally was held on February 12. Secretary Kleppe and National Director Neff acted as cochairmen. Approximately 1,600 people attended the rally at which television personality Ralph Edwards, the honorary chairman, was the main speaker. Mr. Edwards was a very appropriate choice for this Bicentennial year because he was honored by the Treasury Department in 1945 as the man who sold more savings bonds than anyone else during the Second World War.

The Federal establishment, with a work force of approximately 2 1/2 million civilian employees and about 2 million military personnel, produced sales for the first 9 months of 1976 totaling $740 million. Over 300,000 new savers or increased allotments were obtained. Sixty percent of Federal civilian employees are now buying savings bonds, compared with 58 percent at the beginning of the campaign.

Volunteer activities

Some 670,000 volunteers nationwide provided important leadership for the success of the savings bonds program. Traditionally, State Governors serve as honorary volunteer chairmen, while a volunteer State chairman and his committee members provide leadership through a wide range of activities. Volunteer county chairmen in the more than 3,000 counties throughout the country provided community leadership in support of each State's savings bonds program.

The volunteer chairmen of the State savings bonds committees met with Treasury officials during the National Sales Conference in Washington, D.C., in November 1975 to discuss the past year's activities and to plan the 1976 program. Sessions were presided over by Bland W. Worley, chairman of the State Chairmen's Council and chairman and president of the American Credit Corp.

Volunteers participated in special Bicentennial celebrations throughout the country. Many of these activities were connected with Washington's Birthday Week ceremonies. State Governors were presented with a ceremonial savings bonds flag and a unique Liberty Bell, mounted beside a piece of wood from the original structure of Independence Hall, giving recognition and appreciation to the citizens of each State for their savings bonds purchases.

On the local level, savings bonds volunteer county chairmen presented Treasury awards and savings bonds as prizes to 8,000 winners in Bicentennial youth debates. This was a national Bicentennial program involving high school and college students in the art of debate.

On July 4 many of the full-scale replica Liberty Bells, presented to the States in 1950 by the Treasury, were rung across the Nation to commemorate the Nation's 200th birthday. Savings bonds volunteer chairmen participated in these bell-ringing ceremonies arranged by State Bicentennial commissions.

During the year, Secretary Simon appointed three new volunteer State chairmen and reappointed three others. He also appointed one new honorary State chairman.

Banking support

Throughout 1976, banking volunteers encouraged and participated in a wide variety of activities to promote bond sales and service. They sent letters to fellow bankers urging their support of the savings bonds program. State banking chairmen made platform presentations and presented citations at State banking conventions. Resolutions endorsing the program were passed and banking volunteers sent press releases and announcements to the media on behalf of savings bonds.

Members of the American Bankers Association Savings Bonds Committee and Treasury officials discussed plans for 1976 savings bonds activities at the Savings Bonds National Sales Conference in November 1975. Hovey S. Dabney, chairman of the ABA Savings Bonds Committee and chairman and president of the National Bank and Trust Co., Charlottesville, Va., presided over the sessions.

A joint ABA and Treasury Bicentennial promotion encouraged bankers to offer customers special July 4, 1976, dating on bonds issued during the entire month of July. Some banks also promoted the sale of $25 bonds for $17.76 during July as a special Bicentennial activity.

Labor support

America's labor unions and their leaders reaffirmed their traditional support of savings bonds and the payroll savings plan.

Secretary Simon reappointed George Meany, president, AFL–CIO, as Chairman of the National Labor Committee. Members of Mr. Meany's committee were as follows: Glenn E. Watts, president, Communications Workers of America; Frank E. Fitzsimmons, president, International Brotherhood of Teamsters, Chauffers, Warehousemen and Helpers of America; Al H. Chesser, president, United Transportation Union; and Leonard Woodcock, president, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America.

To further recognize the importance of labor support in the savings bonds program, Secretary Simon hosted a luncheon meeting for members of the National Labor Committee on December 16, 1975. Treasury attendees included Deputy Secretary Stephen S. Gardner; Francine I. Neff, National Director, U.S. Savings Bonds; Jesse Adams, Deputy National Director; Walter R. Niles, Director of Sales; Winston L. McMullen, national labor representative; and Clarence Selin, special Treasury representative.

Deputy Secretary Gardner presented certificates of appointment to the committee members. He emphasized the importance of the program to the Treasury by saying: "Labor has been at the heart of the payroll savings plan, which is the very heart of the savings bonds program. If national unions, State federations and local labor organizations continue this wholehearted support, the savings bonds program is sure to be a success in 1976."

Committee Chairman George Meany reviewed labor's traditional support of the program and remarked that while the current record of achievement is impressive, he believed the program should be greatly expanded.

National Director Neff spoke at the United Steel Workers of America annual convention in August 1976 and presented USWA President I.W. Abel with a special award. Mr. Abel was a member of the National Labor Committee for 10 years.

On State and local levels, union officials continue to serve as volunteers for the program. The labor press has been of great help by their continuing use of savings bonds ads, editorials, and news stories.

Advertising

The public service advertising campaign for savings bonds, conducted in cooperation with the Advertising Council, enjoyed one of its best years in 1976. According to Council estimates the media contributed more than $75 million in space, time, and services. Included in the contributions during the 15-month period were more than 25,000 ads in newspapers and 240,000 lines in national magazines.

The advertising campaign was centered around the Nation's history, tracing the contribution of citizen financing to the Nation's growth. Created by the Leo Burnett Co., volunteer task-force agency of the Council, the theme was "Take Stock in America—200 Years at the Same Location."

In the annual savings bonds awards competition for company communicators—based on payroll savings promotion appearing in company publications in 1975—Brian Masterson of Grumman Aerospace Corp. was named "Communicator of the Year," and Martin Marietta received the grand award for a total corporate campaign. Members of the National Employee Communications Committee, which held its annual meeting in

Washington in April, judged the contest, and awards were announced May 24 at the conference of the International Association of Business Communicators in Denver.

National organizations

The National Organizations Committee, under the Chairmanship of Valerie F. Levitan of Soroptimist International, continued its strong support of the bond program. Through this group individual club units were asked by their national presidents to participate in the "Seven-Point Program" of cooperation, and results to date indicate widespread participation among the Nation's civic, fraternal, and patriotic organizations.

Public affairs

The Office of Public Affairs developed a comprehensive package of "Copy Themes" for use by media, and a special package of news releases, proclamations, and scripts for the "Minute Man Week" ceremonies in February. A new series of feature articles on the history of the bond program was launched.

Public Affairs personnel assisted with appropriate remarks and made informational arrangements for over 100 appearances of the National Director, U.S. Savings Bonds. Other Treasury officials, speaking in behalf of the bond program, were also assisted.

Articles on the savings bonds program were prepared for the American Legion Magazine, the Ethyl Digest and other magazines. Continuing close collaboration with leading financial writers and editors brought about increased coverage in a number of magazines, including U.S. News & World Report and Changing Times. In addition, information was supplied to columnists such as Don G. Campbell, John Cunniff, Merle E. Dowd, Leonard Groupe, Sam Shulsky, and others.

During the period covered by this report, some 5,500 pieces of correspondence were handled concerning the bond program.

Charles R. Buxton, editor/publisher, Denver Post, continues to serve as chairman of the National Committee of Newspaper Publishers.

EDP program

For the 11 years of its operation the EDP program has served as a valuable management tool. It enables the Division to measure progress in the payroll savings program and helps to indicate where major work effort must be expended by the field staff. The centralized collection and publication of payroll savings statistics relieves the State offices of many hundreds of hours of clerical time and provides a meaningful picture of the payroll savings program. This assists the National, regional, and State levels to formulate realistic sales plans each year and to establish payroll savings goals.

During fiscal 1976 the program was expanded to include the centralized collection of statistics from Federal departments and agencies, in addition to companies in the private sector and to State and local governmental entities. At the end of fiscal 1976 the total number of reporting units in the private sector and in State and local governments was 39,397. This represents 22,031 interstate units (including branches of companies) and 17,366 intrastate companies. Total employment in these companies is shown as 27.7 million; the number of employees signed up to buy savings bonds in these companies is 6.9 million, or 24.9 percent.

In the Federal sector, the number of reporting units is 2,997 including civilian and military headquarters and field units. Total employment is 4.4 million; participation, 2.1 million or 48.3 percent.

Training and staff development

The Division continues to recruit and move young persons up through the ranks. Through an American Management Association-prepared course, "Principles of Professional Salesmanship," and on-the-job training assignments, recent college graduates and persons promoted through the upward mobility program are trained for key sales promotion, managerial, and administrative positions. A program of sales instruction/training—"20-Point System for Guaranteed Sales Success" by Dartnell-Andersonn—is used as a refresher course for veteran promotional staff members.

A line management training program entitled "How to Improve Individual Manager Performance," prepared by the American Management Association, was continued in fiscal 1976. A management library, publicized quarterly, has been extensively used by all staff members. During fiscal 1976, 5 of 12 persons selected for the executive development program were involved in a planning conference to assist in the development of a national sales program while 3 of the 12 attended courses presented by the Civil Service Commission and Advance Management Research, Inc.

UNITED STATES SECRET SERVICE

Responsibilities

The major responsibilities of the U.S. Secret Service, defined in section 3056, title 18, United States Code, are protective and investigatory. The protective responsibilities include protection of the President of the United States; the members of his immediate family; the President-elect; the Vice President or other officer next in the order of succession to the office of President; the Vice President-elect; and the members of their immediate families; the person of a former President and his wife during his lifetime; the person of the widow of a former President until her death or remarriage; minor children of a former President until they reach 16 years of age, unless such protection is declined; the person of a visiting head of a foreign state or foreign government; and, at the direction of the President, other distinguished foreign visitors to the United States and official representatives of the United States performing special missions abroad.

In addition, Public Law 90–331 authorizes the U.S. Secret Service to protect major Presidential or Vice Presidential candidates. This law also provides that, upon request of a Presidential or Vice Presidential nominee of a major political party, as determined by the Secretary of the Treasury after consultation with the advisory committee, the Secretary may authorize the U.S. Secret Service to furnish protection to the spouse of such major Presidential or Vice Presidential nominee, beginning not more than 60 days prior to the general Presidential election.

The investigative responsibilities are to detect and arrest persons committing any offense against the laws of the United States relating to coins, obligations, and securities of the United States and of foreign governments; and to detect and arrest persons violating certain laws relating to the Federal Deposit Insurance Corporation, Federal land banks, joint-stock land banks, and Federal land bank associations.

Protective operations

During fiscal 1976 and the transition period, the Secret Service provided protection for President and Mrs. Gerald R. Ford and their four children; Vice President and Mrs. Nelson A. Rockefeller and their two sons; former President and Mrs. Richard M. Nixon; John Kennedy, Jr.; and former First Ladies, Mrs. Harry S. Truman, Mrs. Dwight D. Eisenhower, and Mrs. Lyndon B. Johnson.

In addition, the Secret Service provided protection for Secretary of State Henry A. Kissinger (on a reimbursable basis) and Secretary of the Treasury William E. Simon. Secretary Kissinger made 16 foreign trips during fiscal 1976 and 3 during the transition period; Secretary Simon made 8 foreign trips during fiscal 1976 and 3 foreign trips during the transition period. The majority of these trips were extensive and involved large-scale protective and logistical problems.

In fiscal 1976 the Service was subjected to an extraordinary increase in protective responsibilities by the unexpected early initiation of protection for 12 major Presidential candidates. During this period, the candidates made 3,975 trips which included 11,480 stops. During the transition period, the candidates/nominees made 528 additional trips (1,851 stops).

During the transition period, protection was afforded to one Vice Presidential candidate and two Vice Presidential nominees. During the same period, protective efforts at the two major political conventions required extensive manpower.

In September 1976, Congress authorized the Secret Service to protect the spouses of Presidential and Vice Presidential nominees. During the transition period, this included Mrs. Rosalynn Carter, Mrs. Joan Mondale, and Mrs. Elizabeth Dole.

Foreign dignitary protection remained a major effort with 106 foreign dignitaries receiving protection during fiscal 1976. These included 103 visits by heads of a foreign state or government and 3 other distinguished visitors to the United States. An additional 35 heads of foreign states or governments have been protected during the transition period. Large-scale protective endeavors included the visits of the Emperor of Japan and Queen Elizabeth of Great Britain, the International Conference in Puerto Rico, and the opening sessions of United Nations General Assemblies No. 30 and No. 31.

The Executive Protective Service provided protection for the White House Presidential offices, the official Vice Presidential residence, and the foreign diplomatic missions of 127 countries at more than 300 locations in the metropolitan area of the District of Columbia. Additionally, the EPS provided protection for the annual International Monetary Fund meeting in Washington, D.C., and the International Conference in Puerto Rico.

On December 31, 1975, Public Law 94–196, amending title 3 of the

United States Code, was signed by President Ford. It authorizes the Executive Protective Service to provide protection to foreign diplomatic missions outside of Washington, D.C., provided certain specifications are satisfied. Further, the law provides for reimbursement of State and local governments for their assistance in accordance with this law.

Protective research

In fiscal 1976 the Intelligence Division implemented an improved computerized name search system which provides a more thorough and flexible searching of the Master Name Index. On-line computer response time has been improved by 100 percent. A new information retrieval system was developed to permit speedier and more efficient file searching.

The Service has initiated studies to provide more comprehensive data for the evaluation of individuals suspected of threatening the life of the President and others protected by the Service.

Technical Development and Planning Division.—This Division, in cooperation with both the Data Systems and Communications Divisions, completed a system to provide current status information on the personnel in all field offices. This information facilitates the formation of special protective details and the notification of agents assigned.

This Division also completed work in conjunction with the National Park Service on four of the gates to the White House complex. The new high-strength steel gates will provide protection against anyone gaining access to the complex by ramming the gates. The design for the six remaining gates is in progress.

Design of personnel body armor to provide various levels of ballistic protection was completed. The new armor has been distributed to all Service personnel.

During the fiscal year, the Technical Development and Planning Division initiated action in the following areas:

1. A voice privacy system which will provide message security for both protective and investigative functions;
2. An expansion of the White House computerized security system;
3. New protective vehicles to both replace and enhance the number of vehicles presently utilized to transport the various protectees of the Service;
4. An automatic system for processing and identification of both latent fingerprints and palmprints; and
5. New perimeter protective systems.

In fiscal 1976 communications facilities and equipment were expanded to meet the requirements of the candidate/nominee protective activities. This included portable communications packages used in direct support of protective trip requirements.

A new system for clearing individuals for access to the political conventions and inaugural festivities was developed jointly by Intelligence Division and Data Systems Division and placed into service prior to the Democratic National Convention.

Data Systems Division.—The Data Systems Division provided technical support to ADP long-range study groups. Chaired by operating elements of the Secret Service, these groups were established to study and determine the automated data processing needs of the Service over the next 6 to 8 years.

During the transition quarter, the Data Systems Division continued to supply technical support to the ADP long-range study groups until the final reports are consolidated into a presentation to the ADP Steering Committee in October of 1976.

Liaison Division.—During the period, the Liaison Division was highly active at the U.S. Capitol, the Department of State, and numerous other agencies regarding visits of protectees abroad and the activities of numerous protectees traveling domestically.

In addition, the Division continued to provide liaison in various criminal cases and investigative referrals both to and from Federal agencies.

During fiscal 1976, the Technical Security Division shipped new alarm and lock equipment to approximately 95 percent of Secret Service field offices and resident agencies. These have been installed and are in operation in approximately 60 percent of the offices. All offices will be equipped by January 1, 1977.

The new redesigned White House lock and key system was approximately 95 percent completed during fiscal 1976.

Investigative operations

During fiscal 1976, $35.1 million in counterfeit U.S. currency was seized by the U.S. Secret Service, down 28 percent from the alltime high of $48.6 million established the previous year. Ninety percent of the counterfeiter's total output, $31.7 million, was seized before it was placed into circulation. Losses to the public dropped to $3.37 million, 7 percent under fiscal 1975 and about 5 percent under the average loss of $3.53 million experienced during the 5-year period fiscal 1971 through fiscal 1975.

Of the total counterfeit reported during fiscal 1976, $29.6 million can be directly traced to counterfeit operations initiated during the year. Ninety-six percent of the counterfeit currency attributed to these new operations was seized before entering circulation, and the counterfeit plant operations which produced 94 percent of this currency were successfully suppressed prior to the end of the fiscal year.

Counterfeiting activity increased sharply during the transition quarter. Losses to the public reached $1.1 million, an increase of 47 percent over the closing 3 months of fiscal 1976. Seizures during the transition quarter reached $4.4 million.

Counterfeiting investigations.—The following are summaries of three cases successfully concluded by the Secret Service during fiscal 1976.

The first case began in January of 1976 when the Newark office received information indicating that a resident of northern New Jersey was seeking a single buyer for $3.5 million in counterfeit $100 Federal Reserve notes. The suspect had been long known to the Secret Service as the probable source of a dozen different types of counterfeit issues, of which nearly $2.5 million were successfully passed, but the Service had been unable to develop sufficient evidence to make a case against him. Promptly after receipt of the new information, an undercover agent was introduced to the suspect. The suspect gave several sample notes to the agent and told the agent that only sample notes had been printed, but that he would be able to make full delivery within 5 weeks. A surveillance of the suspect's movements developed no information which disclosed the location of his plant.

In early February the suspect telephoned the agent that he was ready to make delivery. Two days later, the suspect and agent met at a Newark motel. Covering agents observed the suspect and undercover agent drive to the suspect's residence and emerge a few minutes later with a large suitcase. The suspect was arrested while driving back to the motel with the undercover agent. The $3.5 million in new counterfeit $100 bills was seized—they had been printed in the suspect's basement. He is now awaiting sentence.

The second case originated in the New Orleans area during December of 1975. The owners of 12 different businesses reported they had received anonymous letters enclosing 2 samples of a new and fairly deceptive counterfeit $20 bill. The letters, signed "Andrew," offered to sell large quantities of the counterfeit and outlined an elaborate payment scheme. An initial delivery to a merchant cooperating in the investigation was arranged but "Andrew" failed to appear.

In late February "Andrew" surfaced again in Jacksonville, using the same anonymous letter approach. A $25,000 delivery was arranged with a merchant cooperating in the investigation. The package was delivered on schedule, but by two young boys stopped and hired by "Andrew" on the street. The following day "Andrew" called to give payment instructions. By prearrangement the merchant was absent and "Andrew" was requested to call again in 30 minutes. The initial call was traced. A few minutes later "Andrew" and his son were arrested in a downtown motel room with $160,000 of $20 notes in their possession. An additional $1.7 million were seized at the counterfeiter's residence in Waco, Tex. The arrest of a New Orleans businessman and two of his employees followed. They had been "Andrew's" only other customers; all three received 1-year sentences. "Andrew" and his son received sentences of 7 and 5 years, respectively.

The third case originated in the Atlanta area with the appearance of a new counterfeit $20 bill. Two months later 23 other related new counterfeit issues appeared in scattered locations ranging in denomination from $1 to $100. All were associated by workmanship with the issue which originally appeared in Atlanta. Information obtained from arrested passers resulted in the identification of a Cleveland hoodlum as being a major distributor of the counterfeits. Examination of the suspect's telephone records linked him with a printer in the Atlanta area who had a previous counterfeiting record.

Simultaneously, undercover agents in the Atlanta area succeeded in gaining an introduction to a woman believed to be the local distributor of counterfeits. A small purchase of counterfeits was made from her. As she drove from the scene, the suspect printer's car was noted following. A second, larger deal with the female suspect was quickly arranged which resulted in her arrest and the seizure of $100,000 in counterfeits. The suspect printer, also on the scene, was taken into custody. Subsequently, over $1 million in counterfeits and equipment was recovered from the printer's residence. The Cleveland distributor was also arrested. None of the principals have as yet been sentenced. Over $1.3 million in counterfeit was seized during the investigation; less than $30,000 was successfully passed on the public.

Check forgery.—During fiscal 1976, the Service received 108,724 checks for investigation, a record in this activity for the third consecutive fiscal year, and a 39-percent increase over fiscal 1975. The Department paid approximately 823 million checks during fiscal 1976. The Service received 132 checks per million checks paid so that the Service received

1 check for investigation for every 7,575 checks the Department paid.

During the transition quarter, 33,679 checks were received for investigation; 24,660 checks were received during the same period last year.

After setting records during the previous 2 fiscal years, arrests for check-related offenses declined. During fiscal 1976, the Service made 5,171 check-related arrests as compared with 6,602 in fiscal 1975 and 5,465 in fiscal 1974.

During the transition quarter, 1,394 check-related arrests were made compared with 1,710 during the same period last year.

Additionally, for the second consecutive fiscal year, a significant number of the forged-check cases have been generated by the supplemental security income (SSI) program. During fiscal 1976, the Service received 12,750 forged SSI checks for investigation as opposed to 7,500 such checks in fiscal 1975, an increase of 70 percent. Although it is anticipated that the trend will continue, it is expected that the rate of increase will diminish.

The backlog of pending check cases at the end of fiscal 1976 increased to 82,528, as compared with 42,478 at the end of fiscal 1975. This backlog continued to increase during the transition quarter. Assuming even a minimal increase in the number of checks paid by the Department during fiscal 1977, the check workload will continue to be heavy for the near future.

Despite achievements over the past several fiscal years in the area of check investigations, Campaign '76 necessitated reordering of priorities in the investigative activities and temporarily curtailed efforts in the check area.

The increase in the number of checks received for investigation during fiscal 1976 and the number of check investigations pending are attributable in part to the decline in the number of check-related arrests and to the reduced availability of manpower for assignment to this activity.

The basic indicators of check forgery activity were all up significantly during fiscal 1976. Tactical countermeasures, although somewhat curtailed during fiscal 1976, did prove effective. Overall control of the situation has been maintained, despite the dramatic increase in the number of forged checks received.

In early April 1975, three persons negotiated several altered and forged U.S. Treasury checks in Grand Forks, N. Dak. As a result of the alertness of local authorities, agents from the Denver office traced the three to a commercial airline flight bound for Honolulu, Hawaii. On April 12, 1975, two of the persons, both Americans, were arrested in Honolulu when en route to Manila, Republic of the Philippines. On April 16, 1975, a Filipino alien was arrested in San Francisco after being identified as the third individual involved in the North Dakota case. All defendants were returned to the U.S. district court in Grand Forks for judicial action and on July 2, 1975, entered pleas of guilty. They were subsequently sentenced to 6 years. Three other members of this gang, one American and two Filipinos, were arrested by Philippine authorities on local charges. During the arrests, the authorities seized over $200,000 worth of counterfeit U.S. Treasury checks as well as plates used in making the checks. These three suspects remain in custody in the Republic of the Philippines.

In another check case, an individual was arrested in Boston, Mass., in May of 1975 after a lengthy investigation dating back to the early part of

1973. The individual fit the description of the forger responsible for stealing and negotiating a large number of U.S. Treasury checks in the northeastern part of the United States. The defendant appeared before the U.S. Magistrate at Hartford, Conn., where he was arraigned on a basis of a John Doe warrant issued in September of 1973 charging him with possession of stolen mail. He was held in lieu of $50,000 cash bail. At that time there was also a warrant outstanding for him for violation of Federal parole. In a written statement, the defendant advised that he stole, forged, and altered U.S. Treasury checks in the Hartford, Boston, and Philadelphia districts. His usual modus operandi was to steal not only Treasury checks but the bank statements of other people and use the statements as identification when he cashed the checks. The defendant was charged with five counts of forgery and six counts of possession of stolen mail. In September 1975 he was sentenced to a term of 10 years in prison.

Bond forgery.—Bond forgery investigations increased during fiscal 1976, with 14,356 bond investigations being opened as compared with 12,645 in fiscal 1975, 13,163 in fiscal 1974, and 13,849 in fiscal 1973.

Stolen bonds continually appear in the hands of known dealers of stolen securities in large metropolitan areas. House burglary is a popular means to obtain bonds; however, bank robbery, office burglary, and mail thefts are also major sources. Many of the dealers utilize part-time forgers, who either buy stolen bonds outright or operate on a consignment basis. They then travel across the country forging and redeeming the stolen bonds.

At the end of the fiscal year, there were 777,173 stolen bonds, representing a face value of $52,581,915, entered into the National Crime Information Center (NCIC) by the Secret Service. Each of these bonds represents a potential forgery case and a loss to the Government if presented for redemption.

The number of stolen bonds entered into the NCIC by the Secret Service increased during the transition quarter to 799,153, representing a face value of $54,467,340.

During fiscal 1976, 144 persons were arrested for bond forgery, as compared with 199 persons arrested in fiscal 1975. Known organized crime figures continue to be connected with many of those arrested.

For the transition quarter, 37 persons were arrested for bond forgery compared with 32 persons arrested during the same period last year.

During fiscal 1976, prior to forgery and redemption, the Secret Service recovered 5,757 stolen bonds with a face value of $487,575.

During the transition quarter, 1,809 stolen bonds, face value $312,905, were recovered.

In July 1974, an unknown male forged and redeemed six $1,000 bonds in Cincinnati, Ohio. These bonds were among $8,525 worth of bonds that had been stolen from the registered owner's residence in Chicopee Falls, Mass. A bank surveillance photograph was taken of the suspect in Cincinnati. In August 1974, in Miami, Fla., the same unknown male forged and redeemed additional bonds which were among $34,475 in bonds stolen from the registered owner's residence in Beverly, Mass. The descriptions of the suspect in the Cincinnati case and in the Miami case were similar and the handwriting was associated as being the same forger. Between September and December 1974, numerous bonds were forged and redeemed by the same suspect in different registered owners' names in eight different States. All the bonds were stolen in large thefts from registered owners' residences in Massachusetts.

In October 1974, the Portland, Oreg., office obtained an arrest warrant for the suspect based on positive identification of known photos of the forger. A concentrated investigative effort by four field offices led to the forger's arrest in December 1974 in Boston. A search of the forger at the time of his arrest disclosed a loaded six-shot .32-caliber revolver, concealed in the waistband of his trousers, and over $5,000 in cash. When interviewed, he stated he normally paid a dealer 10 percent for a package of bonds, and he worked alone forging bonds throughout the country. He would handle only large packages in the name of the same registered owner. In September 1975, this multiple interdistrict bond forger was sentenced to 10 years' imprisonment after pleading guilty to 11 counts of forgery. During 6 months of activity, he forged 549 bonds and redeemed them for over $110,000.

Identification Branch.—The Identification Branch of the Special Investigations and Security Division serves all field offices by conducting technical examinations of handwriting, handprinting, typewriting, fingerprints, palmprints, striations on counterfeit currency, altered documents, and other types of physical evidence.

During fiscal 1976, members of the Identification Branch conducted examinations in 7,133 cases involving 408,499 exhibits. This resulted in the identification of 2,262 suspects and a total of 261 court appearances to furnish expert testimony. During the transition quarter, an additional 1,800 cases involving approximately 103,000 exhibits were examined. Identifications were made in 565 instances, necessitating 75 court appearances.

Treasury Security Force

The Treasury Security Force, a uniformed branch of the U.S. Secret Service, protects the Main Treasury complex and participates in providing security to the White House. The Force also enforces Treasury's restricted access policy.

During fiscal 1976, the Force expended 7,142 hours in an intensive in-Service training program. During the transition quarter, 1,750 hours of training were expended. Thirty felony arrests, compared with 40 in fiscal 1975, were made by the Force; most of the arrests were effected in the Cash Room as individuals attempted to cash forged checks. The Cash Room operation was closed by the Treasury on July 1, 1976. However, the sale of Government securities will continue at the building.

Organized crime

The Secret Service provided special agents to 16 organized crime strike forces located throughout the United States. One intelligence research specialist assigned to headquarters coordinated and disseminated organized crime intelligence information to Secret Service field offices.

Because of the unusually large numbers of candidates and the early starting date of the 1976 Presidential campaign, agents have been more highly involved in protective assignments than ever before. Even so, the Secret Service continued its participation in the strike forces and its involvement in organized crime investigations.

Administration

Major revisions to the method of cost accumulation by the automated accounting system were developed during fiscal 1975 for implementation effective with the start of fiscal 1976. Essentially, these revisions alined the system of cost accumulation of the organizational structure and programs of the U.S. Secret Service.

These revisions were successfully implemented on schedule and have significantly improved the capacity of the automated accounting system to provide meaningful fiscal 1976 financial data in a timely fashion for both external reporting purposes and internal management needs.

An Employee Relations Branch was established in the Personnel Division to provide more effective, personal attention to both management and line employee needs.

As a test of the new factor evaluation system of classification, Secret Service clerk-typist and clerk dictating-machine transcriber positions were evaluated under FES standards. Appropriate FES training was secured for specialists and selected executives.

Two of the four Secret Service merit promotion plans were revised, with significant employee input. Internal regulations, Freedom of Information and Privacy Act considerations were also taken into account, resulting in improved procedures.

New initiatives were undertaken during fiscal 1976 to strengthen paperwork management programs in the Secret Service. Policies and procedures communicated in the directives system were revised and updated, comprehensive new records disposition schedules were developed, nonessential forms were canceled, and modern word-processing equipment was incorporated into offices having a high volume of paperwork.

The U.S. Secret Service has developed an occupational safety and health action plan based on the requirements of Executive Order 11807, dated September 28, 1974, and part 29 CFR 1960. The plan is the first to be developed using guidelines established by the Department of Labor. When implemented, it should significantly improve the safety and health of Service employees. The plan will be used by the departmental Safety Director as a guide to assist other Treasury bureaus in the development of their action plan.

As the functions and responsibilities of the Service continue to grow, the fragmentation of operations as well as the need for additional space has become more acute. The solution is a consolidated site for the Secret Service headquarters operation. Phase I of this project includes the appointment of a Consolidated Building Liaison Group, the development of a Space Utilization Survey to document requirements, and the acquisition of the services of a consulting firm to draw up specifications. This phase is near completion.

Inspection

The continued assignment of personnel from the Office of Inspection to protective details limited the number of office inspections conducted during fiscal 1976. Beginning October 1, 1975, and continuing through the end of the fiscal year, three Inspectors and two special agents were selected for full-time assignments to the Candidate/Nominee Protective Division. In addition, five Inspectors and four Assistant Inspectors were assigned, on a rotating basis, to various candidate/nominee details in administrative capacities.

Training

Man-hours of training conducted by the Office of Training for personnel engaged in investigative, protective, and administrative functions totaled 229,000. In addition, 11,400 man-hours of interagency training and 6,400 man-hours of nongovernment training were completed for a total of

246,800 man-hours. In the transition quarter, there were 18,400 man-hours of training conducted by the Office of Training for personnel engaged in investigative, protective, and administrative functions. In addition, 2,500 man-hours of interagency training and 2,900 man-hours of nongovernment training were completed for a total of 23,800 man-hours.

The Secret Service provided firearms training for students of the Federal Law Enforcement Training Center through September 1976 (181 students from the Criminal Investigator School and 1,250 students from the Police School). In addition, firearms training was provided to 1,484 employees of other agencies. The Secret Service provided firearms instructor training courses for 88 employees of other agencies. Firearms training was also provided for all the enforcement personnel of the Secret Service.

During the transition quarter, firearms training was provided for 20 IRS employees. Firearms training was also provided for all the enforcement personnel of the Secret Service during this period.

During fiscal 1976, the Secret Service's management training system became fully operational, providing a planned program of regularly scheduled management training for each of the Service's supervisors, managers, and executives. The system includes a balance of specialized Secret Service courses, interagency programs, and nongovernment training. During fiscal 1976, the Training Resource Center enrolled approximately 580 students with 207 completing course requirements. A training technician was hired to administer programs on a daily basis. A building supervisory skills program, consisting of 10 hours of slide-tape and workbook exercises on supervisory techniques, was added to the Center's curriculum. Next year, video-tape programs for individual use and new programs for use in field offices will be added.

During the transition quarter, 144 students enrolled in the Training Resource Center with 33 completing course requirements.

A catalog of training programs was published in fiscal 1976. It contained 43 courses offered by the Office of Training to Secret Service employees.

Twenty-three dignitary protection seminars were conducted for 460 command level police officers. This 2-week program was offered jointly by the Secret Service and the Federal Bureau of Investigation.

Training was provided for 544 agents from Alcohol, Tobacco and Firearms, Customs, and Internal Revenue Service in protective operations of the Secret Service in 25 classes. These courses were conducted in various districts throughout the United States and were designed to allow the use of these agents on temporary protective assignments to supplement Secret Service agents during Campaign '76.

Eleven candidate/nominee detail training courses were given with a total of 352 Secret Service agents trained. The purpose of this course was to refamiliarize the agents with current protective procedures and to participate in practical exercises before being assigned to a candidate.

Ten protective operations briefings were presented for 200 midlevel supervisory police personnel engaged in protective activities either in an operational or a training capacity.

Forty Secret Service agents qualified as first-aid instructors in two first-aid instructor courses.

Ten protective forces driving courses were presented to 60 special agents and special officers. This course is intended to improve protective driving techniques as well as normal driving skills.

Seven special agent training courses were conducted. A total of 250 new agents received this training in all aspects of the Secret Service protective and investigative responsibilities.

There were 70 "Attack on a Principal" exercises. These 1-day exercises simulated various types of attacks on protectees and tested the protective detail's ability to react to the attack and to respond within the total team.

There were numerous 1- and 2-day briefings presented to various police agencies throughout the country and to Federal agencies in the Washington, D.C., area. These briefings were primarily on protection but did include investigative responsibilities at times.

During the transition quarter, a special agent training course was conducted with 35 new special agents attending. Several briefings were given for local police in various parts of the country.

For the first time in history, the Office of Training conducted briefings for nominees and staffs. Presidential nominee Jimmy Carter and Vice Presidential nominees Walter Mondale and Robert Dole were briefed on the role of the Secret Service and the necessity of cooperating with each other.

Legal counsel

During fiscal 1976, the Secret Service resubmitted a legislative proposal to the Secretary of the Treasury that would amend title 18, United States Code, section 871, "Threats against the President and successors to the Presidency," to cover threats made against all protectees of the U.S. Secret Service.

The Secret Service also proposed title 18, United States Code, section 513, forgery of Government checks, bonds or other obligations, which would in effect eliminate the need to rely on title 18, United States Code, section 495, "Contracts, deeds, and powers of attorney" and other Federal statutes in the investigation of violations concerning Treasury checks, bonds or other obligations. In effect, this section would centralize all existing laws relating to Treasury checks, bonds or other obligations that now appear in various parts of the United States Code and apply to contracts, deeds, and powers of attorney as well as checks, bonds or other obligations.

Lastly, the Secret Service submitted a legislative proposal to amend its basic authorization by altering its protective responsibilities, in some cases eliminating categories presently authorized protection and adding others.

There are presently 75 lawsuits pending in which the Secret Service is a party. These cases involve, among others, the Federal Tort Claims Act and alleged violations of civil rights stemming from the protective and investigative responsibilities of the Service.

In addition, the Office of Legal Counsel drafted memoranda, reports, and legal opinions on the following: Reproductions of obligations of the United States—955; administrative claims involving employees of the Secret Service—174; Training Division projects—54; general litigation matters—80; inquiries from other agencies—30; Secret Service personnel matters—20; petitions for remission of forfeiture of seized equipment—55; interpretation of protection laws—28; interpretation of counterfeit laws—23; interpretation of forgery laws—6; comments on proposed legislation—32; Freedom of Information and Privacy Act matters—112; legal research projects—3; pending major lawsuits—7; pending lawsuits—49.

During the transition quarter, 224 such documents were drafted.

EXHIBITS

Public Debt Operations, Regulations, and Legislation

Exhibit 1.—Treasury notes

Two Treasury circulars—one containing a subscription offering and one covering an auction for cash with prices established through competitive bidding—are reproduced in this exhibit. Circulars pertaining to the other note offerings during fiscal 1976 and the transition quarter are similar in form and therefore are not reproduced in this report. However, essential details for each offering are summarized in the table in this exhibit, and allotment data for the new notes will be shown in table 37 in the Statistical Appendix. During the period there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new notes.

DEPARTMENT CIRCULAR NO. 11-76. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, April 29, 1976.

I. OFFERING OF NOTES

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, offers $3,500,000,000 of notes of the United States, designated 7 7/8 percent Treasury Notes of Series A-1986, at par. The amount of the offering may be increased by a reasonable amount to the extent that the total amount of subscriptions warrants. Additional amounts of these notes may be issued to Government accounts and to Federal Reserve Banks. The 6 1/2 percent Treasury Notes of Series B-1976, and 5 3/4 percent Treasury Notes of Series E-1976, maturing May 15, 1976, will be accepted at par in payment, in whole or in part, to the extent subscriptions are allotted by the Treasury. The books will be open through Wednesday, May 5, 1976, for the receipt of subscriptions.

II. DESCRIPTION OF NOTES

1. The notes will be dated May 17, 1976, and will bear interest from that date, payable on a semiannual basis on November 15, 1976, and thereafter on May 15 and November 15 in each year until the principal amount becomes payable. They will mature May 15, 1986, and will not be subject to call for redemption prior to maturity.
2. The income derived from the notes is subject to all taxes imposed under the Internal Revenue Code of 1954. The notes are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.
3. The notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.
4. Bearer notes with interest coupons attached, and notes registered as to principal and interest, will be issued in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. Book-entry notes will be available to eligible subscribers in multiples of those amounts. Interchanges of notes of different denominations and of coupon and registered notes, and the transfer of registered notes will be permitted.
5. The notes will be subject to the general regulations of the Department of the Treasury, now or hereafter prescribed, governing United States notes.

III. TENDERS AND ALLOTMENTS

1. Subscriptions accepting the offer made by this circular will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, through Wednesday, May 5, 1976. Each subscription must state the face amount of notes subscribed for, which must be $1,000 or a multiple thereof.
2. All subscribers are required to agree not to purchase or to sell, or to make any agreements with respect to the purchase or sale or other disposition of any notes of this issue at a specific rate or price, until after midnight, May 5, 1976.
3. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and dealers who make primary markets in Government securities and report daily

to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, may submit subscriptions for account of customers provided the names of the customers are set forth in such subscriptions. Others will not be permitted to submit subscriptions except for their own account.

4. Under the Second Liberty Bond Act, as amended, the Secretary of the Treasury has the authority to reject or reduce any subscription, to allot more or less than the amount of notes applied for, and to make different percentage allotments to various classes of subscribers when he deems it to be in the public interest; and any action he may take in these respects shall be final. Subject to the exercise of that authority, subscriptions for $500,000, or less, will be allotted in full provided that 20% of the face value of the securities for each subscriber is submitted as a deposit (in cash or the notes referred to in Section I which will be accepted at par). Such deposits must be submitted to the Federal Reserve Bank or Branch, or to the Bureau of the Public Debt, with the subscription; this will apply even if the subscription is for the account of a commercial bank or securities dealer, or for one of their customers. Guarantees in lieu of deposits will not be accepted. Allotment notices will not be sent to subscribers submitting subscriptions in accordance with this paragraph.

5. Subscriptions not accompanied by the 20% deposit will be received subject to a percentage allotment. On such subscriptions a 5% deposit (in cash or the notes referred to in Section I which will be accepted at par) will be required from all subscribers except commercial and other banks for their own account, Federally-insured savings and loan associations, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, Federal Reserve Banks, and Government accounts. Commercial banks and securities dealers authorized to enter subscriptions for customers will be required to certify that they have received the 5% deposit from their customers or guarantee payment of the deposits. Allotment notices will be sent out promptly upon allotment to subscribers submitting subscriptions in accordance with this paragraph. Following allotment, any portion of the 5 percent payment in excess of 5 percent of the amount of notes allotted may be released upon the request of the subscriber.

6. Subscribers may submit subscriptions under the provisions of each of the two foregoing paragraphs, i.e., up to $500,000, with a 20% deposit and in any amount with a 5% deposit. Each of the two types of subscriptions will be treated as separate subscriptions.

IV. PAYMENT

1. Payment at par for notes allotted hereunder must be made or completed on or before May 17, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt. Payment must be in cash, notes referred to in Section I (interest coupons dated May 15, 1976, should be detached), in other funds immediately available to the Treasury by May 17, 1976, or by check drawn to the order of the Federal Reserve Bank to which the tender is submitted, or the United States Treasury if the subscription is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Wednesday, May 12, 1976, if the check is drawn on a bank in the Federal Reserve District of the Bank to which the check is submitted, or the Fifth Federal Reserve District in case of the Treasury, or (2) Monday, May 10, 1976, if the check is drawn on a bank in another district. Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at a Federal Reserve Bank. Payment will not be deemed to have been completed where registered notes are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. In every case where full payment is not completed, the payment with the tender up to 5 percent of the amount of notes allotted shall, upon declaration made by the Secretary of the Treasury in his discretion, be forfeited to the United States.

2. Delivery of notes in bearer form will be made on May 17, 1976, except that if adequate stocks of the notes are not available on that date, the Department of the Treasury reserves the right to issue interim certificates on that date which will be exchangeable for the notes when available at any Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. If a subscriber elects to receive an interim certificate, the certificate must be returned at his own risk and expense.

V. ASSIGNMENT OF REGISTERED NOTES

1. Registered notes tendered as deposits and in payment for notes allotted hereunder are not required to be assigned if the notes are to be registered in the same names and forms

as appear in the registrations or assignments of the notes surrendered. Specific instructions for the issuance and delivery of the notes, signed by the owner or his authorized representative, must accompany the notes presented. Otherwise, the notes should be assigned by the registered payees or assignees thereof in accordance with the general regulations governing United States securities, as hereinafter set forth. When the new notes to be registered in names and forms different from those in the inscriptions or assignments of the notes presented the assignment should be to "The Secretary of the Treasury for 7 7/8 percent Treasury Notes of Series A–1986 in the name of (name and taxpayer identifying number)." If notes in coupon form are desired, the assignment should be to "The Secretary of the Treasury for 7 7/8 percent coupon Treasury Notes of Series A–1986 to be delivered to ________________." Notes tendered in payment should be surrendered to the Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. The notes must be delivered at the expense and risk of the holder.

VI. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive subscriptions, to make such allotments as may be prescribed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of notes on full-paid subscriptions allotted, and they may issue interim receipts pending delivery of the definitive notes.
2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

GEORGE H. DIXON,
Acting Secretary of the Treasury.

DEPARTMENT CIRCULAR NO. 17–76. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, July 15, 1976.

I. INVITATION FOR TENDERS

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, invites tenders on a yield basis for $2,750,000,000, or thereabouts, of notes of the United States, designated Treasury Notes of Series P–1978. The interest rate for the notes will be determined as set forth in Section III, paragraph 3, hereof. Additional amounts of these notes may be issued at the average price of accepted tenders to Government accounts and to Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Tenders will be received up to 1:30 p.m., Eastern Daylight Saving time, Tuesday, July 20, 1976, under competitive and noncompetitive bidding, as set forth in Section III hereof.

II. DESCRIPTION OF NOTES

1. The notes will be dated July 30, 1976, and will bear interest from that date, payable on a semiannual basis on January 31, 1977, July 31, 1977, January 31, 1978, and July 31, 1978. They will mature July 31, 1978, and will not be subject to call for redemption prior to maturity.
2. The income derived from the notes is subject to all taxes imposed under the Internal Revenue Code of 1954. The notes are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.
3. The notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.
4. Bearer notes with interest coupons attached, and notes registered as to principal and interest, will be issued in denominations of $5,000, $10,000, $100,000 and $1,000,000. Book-entry notes will be available to eligible bidders in multiples of those amounts. Interchanges of notes of different denominations and of coupon and registered notes, and the transfer of registered notes will be permitted.
5. The notes will be subject to the general regulations of the Department of the Treasury, now or hereafter prescribed, governing United States notes.

III. TENDERS AND ALLOTMENTS

1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to the closing hour, 1:30 p.m., Eastern Daylight Saving time, Tuesday, July 20, 1976. Each tender must state the face amount of notes bid for, which must be $5,000 or a multiple thereof, and the yield desired, except that in the case of noncompetitive tenders the term "noncompetitive" should be used in lieu of a yield. In the case of competitive tenders, the yield must be expressed in terms of an annual yield, with two decimals, e.g., 7.11. Fractions may not be used. Noncompetitive tenders from any one bidder may not exceed $500,000.

2. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from banking institutions for their own account, Federally-insured savings and loan associations, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, and Government accounts. Tenders from others must be accompanied by payment of 5 percent of the face amount of notes applied for.

3. Immediately after the closing hour tenders will be opened, following which public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Those submitting competitive tenders will be advised of the acceptance or rejection thereof. In considering the acceptance of tenders, those with the lowest yields will be accepted to the extent required to attain the amount offered. Tenders at the highest accepted yield will be prorated if necessary. After the determination is made as to which tenders are accepted, a coupon rate will be determined at a 1/8 of one percent increment that translates into an average accepted price close to 100.000 and a lowest accepted price above 99.500. That rate of interest will be paid on all of the notes. Based on such interest rate, the price on each competitive tender allotted will be determined and each successful competitive bidder will be required to pay the price corresponding to the yield bid. Price calculations will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, including the right to accept tenders for more or less than the $2,750,000,000 of notes offered, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for $500,000 or less without stated yield from any one bidder will be accepted in full at the average price[1] (in three decimals) of accepted competitive tenders.

IV. PAYMENT

1. Settlement for accepted tenders in accordance with the bids must be made or completed on or before July 30, 1976, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. Payment must be in cash, in other funds immediately available to the Treasury by July 30, 1976, or by check drawn to the order of the Federal Reserve Bank to which the tender is submitted, or the United States Treasury if the tender is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Tuesday, July 27, 1976, if the check is drawn on a bank in the Federal Reserve District of the Bank to which the check is submitted, or the Fifth Federal Reserve District in the case of the Treasury, or (2) Friday, July 23, 1976, if the check is drawn on a bank in another district. Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at a Federal Reserve Bank. Payment will not be deemed to have been completed where registered notes are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. In every case where full payment is not completed, the payment with the tender up to 5 percent of the amount of notes allotted shall, upon declaration made by the Secretary of the Treasury in his discretion, be forfeited to the United States.

[1]Average price may be at, or more or less than 100,000.

V. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make such allotments as may be prescribed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of notes on full-paid tenders allotted, and they may issue interim receipts pending delivery of the definitive notes.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

GEORGE H. DIXON,
Acting Secretary of the Treasury.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 17-76. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, July 21, 1976.

The Secretary of the Treasury announced on July 20, 1976, that the interest rate on the notes described in Department Circular—Public Debt Series—No. 17-76 dated July 15, 1976, will be 6 7/8 percent per annum. Accordingly, the notes are hereby redesignated 6 7/8 percent Treasury Notes of Series P-1978. Interest on the notes will be payable at the rate of 6 7/8 percent per annum.

DAVID MOSSO,
Fiscal Assistant Secretary.

Summary of information pertaining to Treasury notes issued during fiscal 1976 and transition quarter

Date of preliminary announcement	Department circular		Concurrent offering circular No.	Treasury notes issued (all offered for cash)	Type of auction[1]	Accepted tenders			Minimum denomination	Issue date	Maturity date	Date tenders received	Payment date[2]
	No.	Date				Average price	High price	Low price					
1975		*1975*								*1975*		*1975*	*1975*
June 18	19-75	June 19	....	7 3/4 percent Series E-1979	Yield	99.731	[3]100.034	99.664	$5,000	July 9	June 30, 1979	June 25	July 9
July 10	20-75	July 11	....	7 1/2 percent Series K-1977	do	99.963	[3]100.018	99.945	5,000	July 31	July 31, 1977	July 17	July 31
July 23	23-75	July 24	24-75, 25-75	7 7/8 percent Series F-1978	do	99.768	[3]100.233	99.695	5,000	Aug. 15	May 15, 1978	July 29	Aug. 15
July 23	24-75	July 24	23-75, 25-75	8 1/8 percent Series B-1982	do	99.921	[3]100.343	99.711	1,000	Aug. 15	Aug. 15, 1982	July 30	Aug. 15
Aug. 6	26-75	Aug. 7	27-75	8 1/4 percent Series L-1977	do	99.998	[3]100.180	99.926	5,000	Aug. 29	Aug. 31, 1977	Aug. 14	Aug. 29
Aug. 6	27-75	Aug. 7	26-75	8 1/2 percent Series F-1979	do	99.840	[3]100.145	99.773	1,000	Sept. 4	Sept. 30, 1979	Aug. 21	Sept. 4
Sept. 10	28-75	Sept. 11	29-75	8 3/8 percent Series M-1977	do	99.883	[3]99.955	99.847	5,000	Sept. 30	Sept. 30, 1977	Sept. 16	Sept. 30
Sept. 10	29-75	Sept. 11	28-75	8 percent Series G-1978	do	99.786	[3]99.893	99.722	5,000	Oct. 7	Feb. 28, 1978	Sept. 24	Oct. 7
Oct. 1	30-75	Oct. 2	....	8 1/8 percent Series H-1978	do	99.899	[3]100.121	99.761	5,000	Oct. 22	Dec. 31, 1978	Oct. 7	Oct. 22
Oct. 9	31-75	Oct. 10	....	7 1/2 percent Series N-1977	do	99.909	[3]100.055	99.836	5,000	Oct. 31	Oct. 31, 1977	Oct. 16	Oct. 31
Oct. 22	32-75	Oct. 23	33-75	7 7/8 percent Series C-1982	do	99.762	[3]100.027	99.603	1,000	Nov. 17	Nov. 15, 1982	Oct. 29	Nov. 17
Dec. 9	34-75	Dec. 10	35-75	7 1/4 percent Series P-1977	do	99.945	[3]100.018	99.890	5,000	Dec. 31	Dec. 31, 1977	Dec. 16	Dec. 31
										1976			*1976*
Dec. 9	35-75	Dec. 10	34-75	7 1/2 percent Series G-1979	do	100.000	[3]100.238	99.898	1,000	Jan. 6	Dec. 31, 1979	Dec. 22	Jan. 6
1976		*1976*										*1976*	
Jan. 7	1-76	Jan. 7	2-76	7 3/8 percent Series D-1981	do	99.892	[3]100.108	99.806	1,000	Jan. 26	May 15, 1981	Jan. 13	Jan. 26
Jan. 7	2-76	Jan. 7	1-76	6 3/8 percent Series J-1978	do	99.788	99.935	99.751	5,000	Feb. 2	Jan. 31, 1978	Jan. 14	Feb. 2
Jan. 27	3-76	Jan. 28	4-76, 5-76	7 percent Series H-1979	do	99.867	[3]100.000	99.761	5,000	Feb. 17	Feb. 15, 1979	Feb. 5	Feb. 17
Jan 27	4-76	Jan. 28	3-76, 5-76	8 percent Series A-1983	Subscription[4]	....	....	....	1,000	Feb. 17	Feb. 15, 1983	Feb. 3	Feb. 17
Feb. 13	6-76	Feb. 13	....	6 5/8 percent Series Q-1977	Yield	99.957	[3]100.039	99.925	5,000	Mar. 3	Nov. 30, 1977	Feb. 20	Mar. 3
Feb. 27	7-76	Feb. 27	....	7 1/2 percent Series C-1980	do	99.853	[3]99.990	99.818	1,000	Mar. 17	Mar. 31, 1980	Mar. 5	Mar. 17
Mar. 11	8-76	Mar. 12	....	6 3/4 percent Series K-1978	do	99.982	[3]100.074	99.908	5,000	Mar. 31	Mar. 31, 1978	Mar. 18	Mar. 31
Mar. 16	9-76	Mar. 17	....	7 3/8 percent Series E-1981	do	99.980	[3]100.101	99.940	1,000	Apr. 5	Feb. 15, 1981	Mar. 24	Apr. 5
Apr. 28	10-76	Apr. 29	11-76, 12-76	6 1/2 percent Series L-1978	do	99.801	[3]99.837	99.765	5,000	May 17	Apr. 30, 1978	May 4	May 17
Apr. 28	11-76	Apr. 29	10-76, 12-76	7 7/8 percent Series A-1986	Subscription[4]	....	....	....	1,000	May 17	May 15, 1986	May 5	May 17
May 13	13-76	May 14	....	7 1/8 percent Series M-1978	Yield	99.936	[3]100.082	99.881	5,000	June 1	May 31, 1978	May 19	June 1
May 18	14-76	May 19	....	7 5/8 percent Series D-1980	do	99.693	[3]99.796	99.625	1,000	June 10	June 30, 1980	June 3	June 10
June 15	15-76	June 16	....	6 7/8 percent Series N-1978	do	99.789	[3]99.844	99.752	5,000	June 30	June 30, 1978	June 21	June 30
June 18	16-76	June 21	....	7 5/8 percent Series F-1981	do	99.951	[3]100.076	99.909	1,000	July 9	Aug. 15, 1981	June 29	July 9
July 14	17-76	July 15	....	6 7/8 percent Series P-1978	do	99.861	[3]99.953	99.843	5,000	July 30	July 31, 1978	July 20	July 30
July 28	18-76	July 29	19-76, 20-76	6 7/8 percent Series J-1979	do	99.907	[3]99.987	99.880	5,000	Aug. 16	Aug. 15, 1979	Aug. 3	Aug. 16
July 28	19-76	July 29	18-76, 20-76	8 percent Series B-1986	Subscription[4]	....	....	....	1,000	Aug. 16	Aug. 15, 1986	Aug. 4	Aug. 16
Aug. 13	21-76	Aug. 13	....	6 5/8 percent Series Q-1978	Yield	99.917	[3]100.065	99.880	5,000	Aug. 31	Aug. 31, 1978	Aug. 19	Aug. 31
Aug. 25	22-76	Aug. 25	....	6 7/8 percent Series E-1980	do	99.799	[3]99.903	99.764	1,000	Sept. 14	Sept. 30, 1980	Aug. 31	Sept. 14
Sept. 13	23-76	Sept. 14	....	6 1/4 percent Series R-1978	do	99.907	[3]99.963	99.870	5,000	Sept. 30	Sept. 30, 1978	Sept. 21	Sept. 30

[1] All auctions for issues of notes were by the "yield" method in which bidders were required to bid on the basis of an annual yield; after tenders were allotted an interest rate for the notes was established at the nearest 1/8 of 1 percent increment that translated into an average accepted price close to 100.000.

[2] Payment could not be made through Treasury tax and loan accounts for any of the issues.

[3] Relatively small amounts of bids were accepted at a price or prices above the high shown. However, the higher price or prices are not shown in order to prevent an appreciable discontinuity in the range of prices, which would make it misrepresentative.

[4] Sold at par with the interest rate fixed prior to the sale, and subscriptions received subject to allotment.

Exhibit 2.—Treasury bonds

A Treasury circular covering an auction of Treasury bonds for cash is reproduced in this exhibit. Circulars pertaining to other bond offerings during fiscal 1976 and the transition quarter are similar in form and therefore are not reproduced in this report. However, essential details for each offering are summarized in the table in this exhibit, and allotment data for the bonds will be shown in table 38 in the Statistical Appendix. During the period there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new bonds.

DEPARTMENT CIRCULAR NO. 25-75. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, July 24, 1975.

I. INVITATION FOR TENDERS

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, as amended, invites tenders on a yield basis for $800,000,000, or thereabouts, of bonds of the United States, designated Treasury Bonds of 1995-2000. The interest rate for the bonds will be determined as set forth in Section III, paragraph 3, hereof. Additional amounts of these bonds may be issued at the average price of accepted tenders to Government accounts and to Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Tenders will be received up to 1:30 p.m., Eastern Daylight Saving time, Thursday, July 31, 1975, under competitive and noncompetitive bidding, as set forth in Section III hereof. The 5 7/8 percent Treasury Notes of Series C-1975, maturing August 15, 1975, will be accepted at par in payment, in whole or in part, to the extent tenders are allotted by the Treasury.

II. DESCRIPTION OF BONDS

1. The bonds will be dated August 15, 1975, and will bear interest from that date, payable semiannually on February 15 and August 15 in each year until the principal amount becomes payable. They will mature August 15, 2000, but may be redeemed at the option of the United States on and after August 15, 1995, in whole or in part, at par and accrued interest on any interest day or days, on 4 months' notice of redemption given in such manner as the Secretary of the Treasury shall prescribe. In case of partial redemption, the bonds to be redeemed will be determined by such method as may be prescribed by the Secretary of the Treasury. From the date of redemption designated in any such notice, interest on the bonds called for redemption shall cease.
2. The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority.
3. The bonds will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.
4. Bearer bonds with interest coupons attached, and bonds registered as to principal and interest, will be issued in denominations of $1,000, $5,000, $10,000, $100,000 and $1,000,000. Book-entry bonds will be available to eligible bidders in multiples of those amounts. Interchanges of bonds of different denominations and of coupon and registered bonds, and the transfer of registered bonds will be permitted.
5. The bonds will be subject to the general regulations of the Department of the Treasury, now or hereafter prescribed, governing United States bonds.

III. TENDERS AND ALLOTMENTS

1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to the closing hour, 1:30 p.m., Eastern Daylight Saving time, Thursday, July 31, 1975. Each tender must state the face amount of bonds bid for, which must be $1,000 or a multiple thereof, and the yield desired, except that in the case of noncompetitive tenders the term "noncompetitive" should be used in lieu of a yield. In the case of competitive tenders, the yield must be expressed in terms of an annual yield with two decimals, e.g., 7.11. Fractions may not be used. Noncompetitive tenders from any one bidder may not exceed $500,000.

2. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from banking institutions for their own account, Federally-insured savings and loan associations, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, foreign central banks and foreign States, dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon, and Government accounts. Tenders from others must be accompanied by payment (in cash or the notes referred to in Section I which will be accepted at par) of 5 percent of the face amount of bonds applied for.

3. Immediately after the closing hour tenders will be opened, following which public announcement will be made by the Department of the Treasury of the amount and yield range of accepted bids. Those submitting competitive tenders will be advised of the acceptance or rejection thereof. In considering the acceptance of tenders, those with the lowest yields will be accepted to the extent required to attain the amount offered. Tenders at the highest accepted yield will be prorated if necessary. After the determination is made as to which tenders are accepted, an interest rate will be established at the nearest 1/8 of one percent necessary to make the average accepted price 100.000 or less. That will be the rate of interest that will be paid on all of the bonds. Based on such interest rate, the price on each competitive tender allotted will be determined and each successful competitive bidder will be required to pay the price corresponding to the yield bid. Price calculations will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, including the right to accept tenders for more or less than the $800,000,000 of bonds offered to the public, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for $500,000 or less without stated yield from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive tenders.

IV. PAYMENT

1. Settlement for accepted tenders in accordance with the bids must be made or completed on or before August 15, 1975, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt. Payment must be in cash, notes referred to in Section I (interest coupons dated August 15, 1975, should be detached), in other funds immediately available to the Treasury by August 15, 1975, or by check drawn to the order of the Federal Reserve Bank to which the tender is submitted, or the United States Treasury if the tender is submitted to it, which must be received at such Bank or at the Treasury no later than: (1) Tuesday, August 12, 1975, if the check is drawn on a bank in the Federal Reserve District of the Bank to which the check is submitted, or the Fifth Federal Reserve District in the case of the Treasury, or (2) Friday, August 8, 1975, if the check is drawn on a bank in another district. Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at a Federal Reserve Bank. Payment will not be deemed to have been completed where registered bonds are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. In every case where full payment is not completed the payment with the tender up to 5 percent of the amount of bonds allotted shall, upon declaration made by the Secretary of the Treasury in his discretion, be forfeited to the United States. When payment is made with notes, a cash adjustment will be made to or required of the bidder for any difference between the face amount of notes submitted and the amount payable on the bonds allotted.

V. ASSIGNMENT OF REGISTERED NOTES

1. Registered notes tendered as deposits and in payment for bonds allotted hereunder are not required to be assigned if the bonds are to be registered in the same names and forms as appear in the registrations or assignments of the notes surrendered. Specific instructions for the issuance and delivery of the bonds, signed by the owner or his authorized representative, must accompany the notes presented. Otherwise, the notes should be assigned by the registered payees or assignees thereof in accordance with the general regulation governing United States securities, as hereinafter set forth. Bonds to be registered in names and forms different from those in the inscriptions or assignments of the notes

presented should be assigned to "The Secretary of the Treasury for Treasury Bonds of 1995–2000 in the name of (name and taxpayer identifying number)." If bonds in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon Treasury Bonds of 1995–2000 to be delivered to ________________." Notes tendered in payment should be surrendered to the Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. The notes must be delivered at the expense and risk of the holder.

VI. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make such allotments as may be prescribed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of bonds on full-paid tenders allotted, and they may issue interim receipts pending delivery of the definitive bonds.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve Banks.

WILLIAM E. SIMON,
Secretary of the Treasury.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 25–75. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, August 1, 1975.

The Secretary of the Treasury announced on July 31, 1975, that the interest rate on the bonds described in Department Circular—Public Debt Series—No. 25–75, dated July 24, 1975, will be 8 3/8 percent per annum. Accordingly, the bonds are hereby redesignated 8 3/8 percent Treasury Bonds of 1995–2000. Interest on the bonds will be payable at the rate of 8 3/8 percent per annum.

DAVID MOSSO,
Fiscal Assistant Secretary.

Summary of information pertaining to Treasury bonds issued during fiscal 1976 and transition quarter

Date of preliminary announcement	Department circular		Concurrent offering circular No.	Treasury bonds issued (all auctioned for cash)	Type of auction[1]	Accepted tenders			Issue date	Maturity date	Date tenders received	Payment date[2]
	No.	Date				Average price	High price	Low price				
1975		*1975*							*1975*		*1975*	*1975*
July 23	25-75	July 24	23-75, 24-75	8 3/8 percent of 1995-2000	Yield	99.327	[3] 99.948	98.917	Aug. 15	Aug. 15, 2000	July 31	Aug. 15
Oct. 22	33-75	Oct. 23	32-75	8 3/8 percent of 1995-2000	Price	101.50	101.73	101.34	Aug. 15[4]	Aug. 15, 2000	Oct. 30	Nov. 17
1976		*1976*									*1976*	*1976*
Jan. 27	5-76	Jan. 28	3-76, 4-76	8 1/4 percent of 2000-05	do	101.75	102.14	101.42	May 15[5]	May 15, 2005	Feb. 5	Feb. 17
Apr. 28	12-76	Apr. 29	10-76, 11-76	7 7/8 percent of 1995-2000	do	96.73	[3] 97.50	96.36	Feb. 18[6]	Feb. 15, 2000	May 7	May 17
									1976			
July 28	20-76	July 29	18-76, 19-76	8 percent of 1996-2001	Yield	99.893	100.215	99.679	Aug. 16	Aug. 15, 2001	Aug 6	Aug. 16

[1] Some issues of bonds were auctioned by the "price" method, with the interest rate being announced prior to the auction, and bidders were required to bid a price. Other auctions were held by the "yield" method in which case bidders were required to bid a yield; after tenders were allotted an interest rate for the bonds was established at the nearest 1/8 of 1 percent necessary to make the average accepted price 100.000 or less.

[2] Payment could not be made through Treasury tax and loan accounts for any of the issues.

[3] Relatively small amounts of bids were allotted at a price or prices above the high shown. However, the higher price or prices are not shown in order to prevent an appreciable discontinuity in the range of prices, which would make it misrepresentative.

[4] Interest was payable from Nov. 17, 1975.

[5] Interest was payable from Feb. 17, 1976.

[6] Interest was payable from May 17, 1976.

NOTE.—The maximum amount that could be bid for a noncompetitive basis for each issue was $500,000. All issues had a minimum denomination of $1,000.

Exhibit 3.—Treasury bills

During the fiscal year and transition quarter there were 66 weekly issues of 13-week and 26-week bills (the 13-week bills represent additional amounts of bills with an original maturity of 26 weeks), 17 52-week issues, 1 issue of 139 days and 7 issues of short-dated ("Federal Funds") bills. A press release inviting tenders for 13-week and 26-week bills is reproduced in this exhibit and is representative of all releases except those for short-dated bills. The press release of September 3, 1975, announcing the initiation of this type of short-term offering is also included in this exhibit, as well as the detailed offering press release of the same date, which is representative of all such releases. Also reproduced is a press release which is representative of releases announcing the results of offerings. Data for each issue during the period appears in table 39 in the Statistical Appendix.

PRESS RELEASE OF SEPTEMBER 14, 1976

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $5,200 million, or thereabouts, to be issued September 23, 1976, as follows:

91-day bills (to maturity date) in the amount of $2,100 million, or thereabouts, representing an additional amount of bills dated June 24, 1976, and to mature December 23, 1976 (CUSIP No. 912793 C7 9), originally issued in the amount of $3,103 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,100 million, or thereabouts, to be dated September 23, 1976, and to mature March 24, 1977 (CUSIP No. 912793 F3 5).

The bills will be issued for cash and in exchange for Treasury bills maturing September 23, 1976, outstanding in the amount of $5,208 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,876 million. These accounts may exchange bills they hold for the bills now being offered at the average prices of accepted tenders.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their face amount will be payable without interest. They will be issued in bearer form in denominations of $10,000, $15,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value), and in book-entry form to designated bidders.

Tenders will be received at Federal Reserve Banks and Branches up to one-thirty p.m., Eastern Daylight Saving time, Monday, September 20, 1976. Tenders will not be received at the Department of the Treasury, Washington. Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting competitive tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the average price (in three decimals) of accepted competitive bids for the respective issues. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch on September 23, 1976, in cash or other immediately available funds or in a like face amount of Treasury bills maturing September 23, 1976. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of bills (other than life insurance companies) issued hereunder must include in his Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

PRESS RELEASES OF SEPTEMBER 3, 1975

In order to meet its financing needs through the low point of its operating cash balance in mid-September, the Treasury will sell up to $0.8 billion of an additional amount of the bills maturing September 18, 1975, and up to $0.7 billion of an additional amount of the bills maturing September 25, 1975. These 13- and 20-day bills will be auctioned only through the Federal Reserve Bank of New York on September 4 for payment on September 5. The minimum acceptable tender for each of these issues will be $10 million, with increments of $1 million above that minimum.

The need for a short-term cash management instrument of this type has substantially increased over the past several years and is a result of the growing concentration of large payments in the first several working days of each month. This in turn has led to the substantial increase in the variability of the Treasury's cash balance, thereby requiring that the Treasury either maintain abnormally high balances to accommodate the intra-monthly low point in the balance or to borrow directly from the Federal Reserve. The resulting variability of the Treasury's balance at the Federal Reserve Bank affects the reserves of the banking system in a manner that often requires the Federal Reserve to undertake large open market operations to offset this reserve impact. These operations have at times been unsettling to the market. Use of short-dated bills of this type, first offered by the Treasury in August of this year, represents a new means for the maintenance of orderly markets. As such, this offering serves much the same purpose as Tax Anticipation Bills which have been offered from time to time in the past to provide financing over a low point in the Treasury's cash balance prior to a major tax date. Unlike the use of Tax Anticipation Bills, however, the sale of these bills carries no implication of a future paydown. However, depending upon cash requirements, the Treasury may choose to either increase or decrease the amounts to be offered when these bills mature.

These short-dated bills have been referred to as "Federal Funds Bills." The minimum $10 million tender size and the offering solely through the Federal Reserve Bank of New York simplify the auction and permits these bills to be sold on much shorter notice than is the case with regular bill auctions. Investors outside of New York may subscribe through correspondent banks or dealers in New York or directly with the Federal Reserve Bank of New York by wire.

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills to the aggregate amount of $1,500,000,000, or thereabouts, to be issued September 5, 1975, as follows:

13-day bills (to maturity date) in the amount of $800,000,000, or thereabouts, representing an additional amount of bills dated March 20, 1975, maturing September 18, 1975 (CUSIP No. 912793 XP6), and

20-day bills (to maturity date) in the amount of $700,000,000, or thereabouts, representing an additional amount of bills dated March 27, 1975, maturing September 25, 1975 (CUSIP No. 912793 XQ4).

The bills will be issued on a discount basis under competitive bidding, and at maturity their face amount will be payable without interest. They will be issued in bearer form in denominations of $10,000, $15,000, $50,000, $100,000, $500,000 and $1,000,000 (maturity value), and in book-entry form to designated bidders.

Tenders will be received for each issue only at the Federal Reserve Bank of New York up to noon, Eastern Daylight Saving time, Thursday, September 4, 1975. Wire and telephone tenders may be received at the discretion of the Federal Reserve Bank of New York. Each tender for each issue must be for a minimum of $10,000,000. Tenders over $10,000,000 must be in multiples of $1,000,000. The price on tenders offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions with respect to Government securities and borrowings thereon may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others will not be permitted to submit tenders except for their own account. Tenders will be received without deposit from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. Tenders from others must be accompanied by payment of 2 percent of the face amount of bills applied for, unless the tenders are accompanied by an express guaranty of payment by an incorporated bank or trust company.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection thereof. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and his action in any such respect shall be final. Settlement for accepted tenders in accordance with the bids must be made at the Federal Reserve Bank of New York on September 5, 1975, in immediately available funds.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which bills issued hereunder are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of bills (other than life insurance companies) issued hereunder must include in his Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circular No. 418 (current revision) and this notice prescribe the terms of the Treasury bills and govern the conditions of their issue. Copies of the circular may be obtained from any Federal Reserve Bank or Branch.

PRESS RELEASE OF SEPTEMBER 20, 1976

Tenders for $2,100 million of 13-week Treasury bills and for $3,100 million of 26-week Treasury bills, both series to be issued on September 23, 1976, were opened at the Federal Reserve Banks today. The details are as follows:

Range of accepted competitive bids	13-week bills maturing Dec. 23, 1976			26-week bills maturing Mar. 24, 1977		
	Price	Discount rate	Investment rate[1]	Price	Discount rate	Investment rate[1]
		Percent			Percent	
High	98.736	5.000	5.13	[3]97.364	5.214	5.43
Low	[2]98.728	5.032	5.17	[4]97.348	5.246	5.46
Average	98.729	5.028	5.16	97.353	5.236	5.45

[1] Equivalent coupon-issue yield.
[2] Tenders at the low price for the 13-week bills were allotted 94 percent.
[3] Excepting one tender of $3,500,000.
[4] Tenders at the low price for the 26-week bills were allotted 38 percent.

Total tenders received and accepted by Federal Reserve districts

District	13-week bills		26-week bills	
	Received	Accepted	Received	Accepted
Boston	$ 31,530,000	$ 16,530,000	$ 26,450,000	$ 11,450,000
New York	3,700,235,000	1,870,950,000	4,453,050,000	2,802,050,000
Philadelphia	21,315,000	20,765,000	8,800,000	8,800,000
Cleveland	31,435,000	30,310,000	63,940,000	13,940,000
Richmond	20,995,000	15,845,000	17,975,000	7,475,000
Atlanta	23,090,000	19,320,000	15,215,000	15,030,000
Chicago	256,420,000	31,475,000	298,915,000	103,855,000
St. Louis	54,135,000	27,720,000	42,545,000	20,545,000
Minneapolis	24,855,000	6,855,000	37,310,000	21,810,000
Kansas City	26,575,000	23,050,000	18,145,000	18,145,000
Dallas	29,045,000	16,045,000	25,150,000	14,910,000
San Francisco	183,215,000	22,190,000	222,265,000	64,165,000
Total	$4,402,845,000	[1]$2,101,055,000	$5,229,760,000	[2]$3,102,175,000

[1] Includes $325,175,000 noncompetitive tenders from the public.
[2] Includes $162,675,000 noncompetitive tenders from the public.

Exhibit 4.—Department Circular, Public Debt Series No. 21–75, July 10, 1975, regulations governing 2 percent depositary bonds

DEPARTMENT OF THE TREASURY,
Washington, July 10, 1975.

AUTHORITY: 31 U.S.C. 752, 754b; 5 U.S.C. 301.

§ 348.0 Offering of bonds.

The Secretary of the Treasury under authority of the Second Liberty Bond Act, as amended, offers, at par, 2 percent Depositary Bonds to depositaries and financial agents designated under the provisions of section 5153 of the Revised Statutes of 1873, as amended (12 U.S.C. 90); the Act of May 7, 1928, 45 Stat. 492 (12 U.S.C. 332); the Act of June 19, 1922, 42 Stat. 662 (31 U.S.C. 473); and section 10 of the Act of June 11, 1942, 56 Stat. 356 (12 U.S.C. 265), which have executed a depositary, financial agency and collateral agreement satisfactory to the Secretary of the Treasury. The bonds will be sold to such depositaries and financial agents in an amount not to exceed in any case the amount for which the depositary and financial agent is qualified. This offering will continue until terminated by the Secretary of the Treasury.

§ 348.1 Description of bonds.

(a) *General.*—The bonds will be issued in book-entry form on the books of the Department of the Treasury, Bureau of the Public Debt, Washington, D.C. 20226.

(b) *Terms and rate of interest.*—The bonds, bearing interest at the rate of 2 percent per annum, payable by Treasury check on a semiannual basis on June 1 and December 1 in each year, will be issued in multiples of $1,000, and will mature twelve years from issue date.

(c) *Nontransferability.*—2 percent Depositary Bonds are not transferable, but they will be acceptable to secure deposits of Federal funds with, and the faithful performance of duties by, depositaries and financial agents designated under the statutory provisions shown in § 348.0, and may not be obtained or used for any other purpose.

§ 348.2 Subscription for purchase and issue date.

Eligible investors may subscribe for bonds under this offering through submission of a subscription to the Department of the Treasury, Domestic Banking Staff, Bureau of Government Financial Operations, Washington, D.C. 20226, which office will determine the appropriate amount and issue date of bonds to be issued. A confirmation of the issuance, in the form of a written advice, which shall specify the amount and describe the bonds by title and maturity date, shall be sent to the subscriber.

§ 348.3 Redemption/reinvestment.

(a) *Before maturity.*—A bond may be redeemed either at the option of the United States or the owner, in whole or in multiple $1,000 amounts, at par and accrued interest, at any time, upon not less than 30 days' notice in writing given by either party to the other. From the date of redemption designated in such notice, interest on the bonds to be redeemed shall cease, and the unredeemed portion, if any, shall continue to be held in book-entry form with the original issue date. Any such notice of redemption given by an owner shall be addressed to the Department of the Treasury, Domestic Banking Staff, Bureau of Governmental Financial Operations, Washington, D.C. 20226.

(b) *At maturity.*—Unless the Department of the Treasury, Bureau of the Public Debt, Division of Public Debt Accounts, Washington, D.C. 20226, or the office specified in (a) above, has received from the owner, at least two weeks prior to the maturity date of a bond, a written request for payment at maturity, the bond shall be automatically redeemed at maturity and the principal amount reinvested in the owner's name in a new bond having the same description in all material respects as the one redeemed. In all such instances, interest will not be paid on the redemption date but on the next regular interest payment date, unless the redemption date coincides with the interest payment date.

§ 348.4 Taxation.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954, but the bonds are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State or any of the possessions of the United States, or by any local taxing authority.

§ 348.5 Reservations.

The Secretary of the Treasury reserves the right to reject any application for the purchase of bonds hereunder, in whole or in part, and to refuse to issue or permit to be issued any such bonds in any case or any class or classes of cases if he deems such action to be in the public interest, and his action in any such respect shall be final. The Secretary of the Treasury may also at any time, or from time to time, supplement or amend the terms of these regulations, or of any amendments or supplements thereto.

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

Exhibit 5.—Department Circular, Public Debt Series No. 22-75, July 10, 1975, regulations governing 2 percent Treasury bonds—REA series

DEPARTMENT OF THE TREASURY,
Washington, July 10, 1975.

AUTHORITY: 31 U.S.C. 752-754b; 5 U.S.C. 301.

§ 347.0 Offering of bonds.

The Secretary of the Treasury under authority of the Second Liberty Bond Act, as amended, offers to borrowers from the Rural Electrification Administration, U.S. Department of Agriculture, 2 percent Treasury Bonds—R.E.A. Series. The bonds will be sold to such borrowers with the specific approval of the Rural Electrification Administration for each transaction. This offering will continue until terminated by the Secretary of the Treasury.

§ 347.1 Description of bonds.

(a) *General.*—The bonds will be issued in book-entry form on the books of the Department of the Treasury, Bureau of the Public Debt, Washington, D.C. 20226.

(b) *Terms and rate of interest.*—The bonds, bearing interest at the rate of 2 percent per annum, payable on a semiannual basis on January 1 and July 1 in each year, will be issued in multiples of $1,000, and will mature twelve years from issue date. Interest will be paid by Treasury check.

(c) *Nontransferability.*—2 percent Treasury Bonds—R.E.A. Series are not transferable nor entitled to any privilege of conversion, and they may not be sold, discounted or pledged as collateral for a loan or as security for the performance of an obligation, or for any other purpose.

§ 347.2 Procedure for purchase.

Subscriptions for approved borrowers shall be submitted by the Rural Electrification Administration, together with the remittances, to the Bureau of the Public Debt, Securities Transactions Branch, Washington, D.C. 20226.

§ 347.3 Issue date.

The issue date of a bond shall be the date on which funds in full payment therefor are received by the office described in § 347.2.

§ 347.4 Redemption/reinvestment.

(a) *Before maturity.*—A bond may be redeemed either at the option of the United States or the owner, in whole or in multiple $1,000 amounts, at par and accrued interest, at any time, upon not less than 30 nor more than 60 days' notice in writing given by either party to the other. From the date of redemption designated in any such notice, interest on the bonds to be redeemed shall cease, and the unredeemed portion, if any, shall continue to be held in book-entry form with the original issue date. Any such notice of redemption given by an owner shall be addressed to the Department of the Treasury, Bureau of the Public Debt, Washington, D.C. 20226.

(b) *At maturity.*—Unless the Department of the Treasury, Bureau of the Public Debt, has received from the owner, at least one week prior to the maturity date of a bond, a written request for payment at maturity, it shall automatically redeem the same at maturity, and reinvest in the owner's name the principal amount in a new bond having the same description in all material respects as the one redeemed. In all such instances, interest will not be paid on the redemption date but on the next regular interest payment date, unless the redemption date coincides with the interest payment date.

§ 347.5 Taxation.

The income derived from the bonds is subject to all taxes imposed under the Internal Revenue Code of 1954. The bonds are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State or any of the possessions of the United States, or by any local taxing authority.

§ 347.6 General provisions.

(a) *Regulations.*—2 percent Treasury Bonds—R.E.A. Series shall be subject to the general regulations with respect to United States securities, which are set forth in the Department of the Treasury Circular No. 300, current revision (31 CFR, Part 306), to the extent applicable. Copies of the circular may be obtained from the Bureau of the Public Debt, Department of the Treasury, Washington, D.C. 20226, or a Federal Reserve Bank or Branch.

(b) *Reservations.*—The Secretary of the Treasury reserves the right to reject any application for the purchase of bonds hereunder, in whole or in part, and to refuse to issue or permit to be issued any such bonds in any case or any class or classes of cases if he deems such action to be in the public interest, and his action in any such respect shall be final. The Secretary of the Treasury may also at any time, or from time to time, supplement or amend the terms of these regulations, or of any amendments or supplements thereto.

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

Exhibit 6.—Department Circular, Public Debt Series No. 11-73, December 19, 1973, amended, regulations governing 5 percent Treasury certificates of indebtedness– REA series

DEPARTMENT OF THE TREASURY,
Washington, July 10, 1975.

Department of the Treasury Circular, Public Debt Series No. 11-73, dated December 19, 1973 (31 CFR, Part 345), is hereby amended to provide for the payment of interest on the 5 percent Treasury Certificates of Indebtedness- R.E.A. Series, by credit through a Federal Reserve Bank or Branch; to authorize the submission of subscriptions to such facility; and, to redesignate § 345.5 as § 345.6 and to insert a new § 345.5 that provides customary tax information, as shown below:

Section 345.1(b) is revised as follows:

§ 345.1 Description of certificates.

* * * * * * *

(b) *Terms and rates of interest.*—The certificates, bearing interest at the rate of 5 percent per annum, will be issued in multiples of $1,000 and will mature one year from issue date. Interest on the certificates will be computed on an annual basis and, unless redeemed prior to maturity, will be payable six months from issue date and at maturity. Interest may be paid to an owner by having the amount thereof credited by a Federal Reserve Bank or Branch, acting as fiscal agent of the United States, to the reserve account of a member bank servicing such owner and for the latter's account. Such action will be taken at the owner's option. If not exercised, payment of interest will be made by Treasury check.

Section 345.2 is revised as follows:

§ 345.2 Subscription for purchase.

The recipient of a 5 percent loan from the Rural Electrification Administration or Rural Telephone Bank may subscribe for certificates under this offering, up to the amount of the unexpended portion of the loan, by submitting a subscription, together with the remittance, to the Federal Reserve Bank or Branch of the district in which the subscriber is located. The subscription form must show the amount of certificates desired, and give the title of the designated official of the subscriber authorized to redeem them.

The present § 345.5 is redesignated as § 345.6 and a new § 345.5 is added as follows:

§ 345.5 Taxation.

The income derived from the certificates is subject to all taxes imposed under the Internal Revenue Code of 1954. The certificates are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State or any of the possessions of the United States, or by any local taxing authority.

The foregoing amendments were effected under authority of 31 U.S.C. 754, 754b and 5 U.S.C. 301 for the purpose of facilitating the payment of interest and the submission of subscriptions for 5 percent Treasury Certificates of Indebtedness—R.E.A. Series. Notice and public procedures thereon are unnecessary as the fiscal policy of the United States is involved.

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

Exhibit 7.—Department Circular No. 653, Ninth Revision, April 23, 1974, First Amendment, offering of United States savings bonds, series E

DEPARTMENT OF THE TREASURY,
Washington, December 9, 1975.

§ 316.8 Extended terms and improved yields for outstanding bonds.

(a) *Extended maturity periods.* * * *

(3) *Bonds with issue dates May 1, 1952, through November 1, 1965.* Owners of Series E bonds with issue dates of May 1, 1952, through November 1, 1965, may retain their bonds for a second extended maturity period of 10 years.

(4) *Bonds with issue dates of December 1, 1965, or thereafter.* Owners of Series E bonds with issue dates of December 1, 1965, or thereafter, may retain their bonds for an extended maturity period of 10 years.

* * * * * * *

The foregoing revisions and amendments were effected under authority of Section 22 of the Second Liberty Bond Act, as amended (49 Stat. 21, as amended; 31 U.S.C. 757c), and 5 U.S.C. 301. Notice and public procedures thereof are unnecessary as the fiscal policy of the United States is involved.

DAVID MOSSO,
Fiscal Assistant Secretary.

TABLE 13-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1945, THROUGH MAY 1, 1946

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1000.00			
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)* THIRD EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 ... 1/(12/1/75)	$22.96	$57.41	$114.82	$229.64	$459.28	$1148.20	$2296.40	----	5.99	6.00
0-6 to 1-0 .... (6/1/76)	23.65	59.13	118.26	236.52	473.04	1182.60	2365.20	5.99	6.02	6.00
1-0 to 1-6 .... (12/1/76)	24.36	60.91	121.82	243.64	487.28	1218.20	2436.40	6.01	5.98	6.00
1-6 to 2-0 .... (6/1/77)	25.09	62.73	125.46	250.92	501.84	1254.60	2509.20	6.00	6.03	6.00
2-0 to 2-6 .... (12/1/77)	25.85	64.62	129.24	258.48	516.96	1292.40	2584.80	6.00	5.97	6.00
2-6 to 3-0 .... (6/1/78)	26.62	66.55	133.10	266.20	532.40	1331.00	2662.00	6.00	6.01	6.00
3-0 to 3-6 .... (12/1/78)	27.42	68.55	137.10	274.20	548.40	1371.00	2742.00	6.00	6.01	6.00
3-6 to 4-0 .... (6/1/79)	28.24	70.61	141.22	282.44	564.88	1412.20	2824.40	6.00	6.00	6.00
4-0 to 4-6 .... (12/1/79)	29.09	72.73	145.46	290.92	581.84	1454.60	2909.20	6.00	5.99	6.00
4-6 to 5-0 .... (6/1/80)	29.96	74.91	149.82	299.64	599.28	1498.20	2996.40	6.00	5.98	6.00
5-0 to 5-6 .... (12/1/80)	30.86	77.15	154.30	308.60	617.20	1543.00	3086.00	6.00	6.01	6.00
5-6 to 6-0 .... (6/1/81)	31.79	79.47	158.94	317.88	635.76	1589.40	3178.80	6.00	5.99	6.00
6-0 to 6-6 .... (12/1/81)	32.74	81.85	163.70	327.40	654.80	1637.00	3274.00	6.00	6.01	6.00
6-6 to 7-0 .... (6/1/82)	33.72	84.31	168.62	337.24	674.48	1686.20	3372.40	6.00	6.00	6.00
7-0 to 7-6 .... (12/1/82)	34.74	86.84	173.68	347.36	694.72	1736.80	3473.60	6.00	5.99	6.00
7-6 to 8-0 .... (6/1/83)	35.78	89.44	178.88	357.76	715.52	1788.80	3577.60	6.00	6.02	6.00
8-0 to 8-6 .... (12/1/83)	36.85	92.13	184.26	368.52	737.04	1842.60	3685.20	6.00	5.99	6.00
8-6 to 9-0 .... (6/1/84)	37.96	94.89	189.78	379.56	759.12	1897.80	3795.60	6.00	6.01	6.00
9-0 to 9-6 .... (12/1/84)	39.10	97.74	195.48	390.96	781.92	1954.80	3909.60	6.00	6.00	6.00
9-6 to10-0 .... (6/1/85)	40.27	100.67	201.34	402.68	805.36	2013.40	4026.80	6.00	6.00	6.00
10-0 2/ ..... (12/1/85)	41.48	103.69	207.38	414.76	829.52	2073.80	4147.60	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1945, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.32 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 14-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1946

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1000.00			
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — THIRD EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/76)	$23.26	$58.16	$116.32	$232.64	$465.28	$1163.20	$2326.40	----	5.98	6.00
0-6 to 1-0 . . . . (12/1/76)	23.96	59.90	119.80	239.60	479.20	1198.00	2396.00	5.98	6.01	6.00
1-0 to 1-6 . . . . (6/1/77)	24.68	61.70	123.40	246.80	493.60	1234.00	2468.00	6.00	6.00	6.00
1-6 to 2-0 . . . . (12/1/77)	25.42	63.55	127.10	254.20	508.40	1271.00	2542.00	6.00	6.01	6.00
2-0 to 2-6 . . . . (6/1/78)	26.18	65.46	130.92	261.84	523.68	1309.20	2618.40	6.00	5.99	6.00
2-6 to 3-0 . . . . (12/1/78)	26.97	67.42	134.84	269.68	539.36	1348.40	2696.80	6.00	6.02	6.00
3-0 to 3-6 . . . . (6/1/79)	27.78	69.45	138.90	277.80	555.60	1389.00	2778.00	6.00	5.99	6.00
3-6 to 4-0 . . . . (12/1/79)	28.61	71.53	143.06	286.12	572.24	1430.60	2861.20	6.00	6.01	6.00
4-0 to 4-6 . . . . (6/1/80)	29.47	73.68	147.36	294.72	589.44	1473.60	2947.20	6.00	6.00	6.00
4-6 to 5-0 . . . . (12/1/80)	30.36	75.89	151.78	303.56	607.12	1517.80	3035.60	6.00	5.98	6.00
5-0 to 5-6 . . . . (6/1/81)	31.26	78.16	156.32	312.64	625.28	1563.20	3126.40	6.00	6.01	6.00
5-6 to 6-0 . . . . (12/1/81)	32.20	80.51	161.02	322.04	644.08	1610.20	3220.40	6.00	5.99	6.00
6-0 to 6-6 . . . . (6/1/82)	33.17	82.92	165.84	331.68	663.36	1658.40	3316.80	6.00	6.01	6.00
6-6 to 7-0 . . . . (12/1/82)	34.16	85.41	170.82	341.64	683.28	1708.20	3416.40	6.00	5.99	6.00
7-0 to 7-6 . . . . (6/1/83)	35.19	87.97	175.94	351.88	703.76	1759.40	3518.80	6.00	6.00	6.00
7-6 to 8-0 . . . . (12/1/83)	36.24	90.61	181.22	362.44	724.88	1812.20	3624.40	6.00	6.00	6.00
8-0 to 8-6 . . . . (6/1/84)	37.33	93.33	186.66	373.32	746.64	1866.60	3733.20	6.00	6.00	6.00
8-6 to 9-0 . . . . (12/1/84)	38.45	96.13	192.26	384.52	769.04	1922.60	3845.20	6.00	5.99	6.00
9-0 to 9-6 . . . . (6/1/85)	39.60	99.01	198.02	396.04	792.08	1980.20	3960.40	6.00	6.00	6.00
9-6 to10-0 . . . . (12/1/85)	40.79	101.98	203.96	407.92	815.84	2039.60	4079.20	6.00	6.00	6.00
10-0 2/ . . . . . (6/1/86)	42.02	105.04	210.08	420.16	840.32	2100.80	4201.60	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1946, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.35 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 41-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1955, THROUGH MARCH 1, 1956

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 19 years 8 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(8/1/75)	$41.48	$82.96	$165.92	$331.84	$829.60	$1659.20	$16592	----	5.98	6.00
0-6 to 1-0 . . . . (2/1/76)	42.72	85.44	170.88	341.76	854.40	1708.80	17088	5.98	6.04	6.00
1-0 to 1-6 . . . . (8/1/76)	44.01	88.02	176.04	352.08	880.20	1760.40	17604	6.01	6.00	6.00
1-6 to 2-0 . . . . (2/1/77)	45.33	90.66	181.32	362.64	906.60	1813.20	18132	6.01	6.00	6.00
2-0 to 2-6 . . . . (8/1/77)	46.69	93.38	186.76	373.52	933.80	1867.60	18676	6.00	6.00	6.00
2-6 to 3-0 . . . . (2/1/78)	48.09	96.18	192.36	384.72	961.80	1923.60	19236	6.00	5.99	6.00
3-0 to 3-6 . . . . (8/1/78)	49.53	99.06	198.12	396.24	990.60	1981.20	19812	6.00	6.02	6.00
3-6 to 4-0 . . . . (2/1/79)	51.02	102.04	204.08	408.16	1020.40	2040.80	20408	6.00	6.00	6.00
4-0 to 4-6 . . . . (8/1/79)	52.55	105.10	210.20	420.40	1051.00	2102.00	21020	6.00	5.98	6.00
4-6 to 5-0 . . . . (2/1/80)	54.12	108.24	216.48	432.96	1082.40	2164.80	21648	6.00	6.02	6.00
5-0 to 5-6 . . . . (8/1/80)	55.75	111.50	223.00	446.00	1115.00	2230.00	22300	6.00	5.99	6.00
5-6 to 6-0 . . . . (2/1/81)	57.42	114.84	229.68	459.36	1148.40	2296.80	22968	6.00	5.99	6.00
6-0 to 6-6 . . . . (8/1/81)	59.14	118.28	236.56	473.12	1182.80	2365.60	23656	6.00	5.99	6.00
6-6 to 7-0 . . . . (2/1/82)	60.91	121.82	243.64	487.28	1218.20	2436.40	24364	6.00	6.01	6.00
7-0 to 7-6 . . . . (8/1/82)	62.74	125.48	250.96	501.92	1254.80	2509.60	25096	6.00	5.99	6.00
7-6 to 8-0 . . . . (2/1/83)	64.62	129.24	258.48	516.96	1292.40	2584.80	25848	6.00	6.00	6.00
8-0 to 8-6 . . . . (8/1/83)	66.56	133.12	266.24	532.48	1331.20	2662.40	26624	6.00	6.01	6.00
8-6 to 9-0 . . . . (2/1/84)	68.56	137.12	274.24	548.48	1371.20	2742.40	27424	6.00	6.01	6.00
9-0 to 9-6 . . . . (8/1/84)	70.62	141.24	282.48	564.96	1412.40	2824.80	28248	6.00	6.00	6.00
9-6 to 10-0 . . . . (2/1/85)	72.74	145.48	290.96	581.92	1454.80	2909.60	29096	6.00	5.99	5.99
10-0 2/ . . . . . (8/1/85)	74.92	149.84	299.68	599.36	1498.40	2996.80	29968	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1955, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 29 years 8 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.72 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 42-A

BONDS BEARING ISSUE DATE APRIL 1 OR MAY 1, 1956

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000	(annual percentage rate)		
Period (years and months after first extended maturity at 19 years 8 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/75)	$42.54	$85.08	$170.16	$340.32	$850.80	$1701.60	$17016	----	6.02	6.00
0-6 to 1-0 . . . . (6/1/76)	43.82	87.64	175.28	350.56	876.40	1752.80	17528	6.02	5.98	6.00
1-0 to 1-6 . . . . (12/1/76)	45.13	90.26	180.52	361.04	902.60	1805.20	18052	6.00	5.98	6.00
1-6 to 2-0 . . . . (6/1/77)	46.48	92.96	185.92	371.84	929.60	1859.20	18592	5.99	6.02	6.00
2-0 to 2-6 . . . . (12/1/77)	47.88	95.76	191.52	383.04	957.60	1915.20	19152	6.00	6.02	6.00
2-6 to 3-0 . . . . (6/1/78)	49.32	98.64	197.28	394.56	986.40	1972.80	19728	6.00	5.96	6.00
3-0 to 3-6 . . . . (12/1/78)	50.79	101.58	203.16	406.32	1015.80	2031.60	20316	6.00	6.02	6.00
3-6 to 4-0 . . . . (6/1/79)	52.32	104.64	209.28	418.56	1046.40	2092.80	20928	6.00	6.00	6.00
4-0 to 4-6 . . . . (12/1/79)	53.89	107.78	215.56	431.12	1077.80	2155.60	21556	6.00	6.01	6.00
4-6 to 5-0 . . . . (6/1/80)	55.51	111.02	222.04	444.08	1110.20	2220.40	22204	6.00	5.98	6.00
5-0 to 5-6 . . . . (12/1/80)	57.17	114.34	228.68	457.36	1143.40	2286.80	22868	6.00	6.02	6.00
5-6 to 6-0 . . . . (6/1/81)	58.89	117.78	235.56	471.12	1177.80	2355.60	23556	6.00	5.98	6.00
6-0 to 6-6 . . . . (12/1/81)	60.65	121.30	242.60	485.20	1213.00	2426.00	24260	6.00	6.00	6.00
6-6 to 7-0 . . . . (6/1/82)	62.47	124.94	249.88	499.76	1249.40	2498.80	24988	6.00	6.02	6.00
7-0 to 7-6 . . . . (12/1/82)	64.35	128.70	257.40	514.80	1287.00	2574.00	25740	6.00	6.00	6.00
7-6 to 8-0 . . . . (6/1/83)	66.28	132.56	265.12	530.24	1325.60	2651.20	26512	6.00	5.97	6.00
8-0 to 8-6 . . . . (12/1/83)	68.26	136.52	273.04	546.08	1365.20	2730.40	27304	6.00	6.01	6.00
8-6 to 9-0 . . . . (6/1/84)	70.31	140.62	281.24	562.48	1406.20	2812.40	28124	6.00	6.00	6.00
9-0 to 9-6 . . . . (12/1/84)	72.42	144.84	289.68	579.36	1448.40	2896.80	28968	6.00	5.99	6.00
9-6 to10-0 . . . . (6/1/85)	74.59	149.18	298.36	596.72	1491.80	2983.60	29836	6.00	6.01	6.01
10-0 2/ . . . . . (12/1/85)	76.83	153.66	307.32	614.64	1536.60	3073.20	30732	6.00 3/	----	----

1/ Month, day, and year on which issues of April 1, 1956, enter each period. For issues of May 1, 1956, add 1 month.
2/ Second extended maturity reached at 29 years 8 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.81 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 43-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH SEPT. 1, 1956

Issue price		$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination		25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 19 years 8 months)		(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/	(2/1/76)	$42.64	$85.28	$170.56	$341.12	$852.80	$1705.60	$17056	----	6.00	6.00
0-6 to 1-0	(8/1/76)	43.92	87.84	175.68	351.36	878.40	1756.80	17568	6.00	6.01	6.00
1-0 to 1-6	(2/1/77)	45.24	90.48	180.96	361.92	904.80	1809.60	18096	6.01	5.97	6.00
1-6 to 2-0	(8/1/77)	46.59	93.18	186.36	372.72	931.80	1863.60	18636	5.99	6.01	6.00
2-0 to 2-6	(2/1/78)	47.99	95.98	191.96	383.92	959.80	1919.60	19196	6.00	6.00	6.00
2-6 to 3-0	(8/1/78)	49.43	98.86	197.72	395.44	988.60	1977.20	19772	6.00	5.99	6.00
3-0 to 3-6	(2/1/79)	50.91	101.82	203.64	407.28	1018.20	2036.40	20364	6.00	6.01	6.00
3-6 to 4-0	(8/1/79)	52.44	104.88	209.76	419.52	1048.80	2097.60	20976	6.00	6.03	6.00
4-0 to 4-6	(2/1/80)	54.02	108.04	216.08	432.16	1080.40	2160.80	21608	6.00	6.00	6.00
4-6 to 5-0	(8/1/80)	55.64	111.28	222.56	445.12	1112.80	2225.60	22256	6.00	5.97	6.00
5-0 to 5-6	(2/1/81)	57.30	114.60	229.20	458.40	1146.00	2292.00	22920	6.00	6.00	6.00
5-6 to 6-0	(8/1/81)	59.02	118.04	236.08	472.16	1180.40	2360.80	23608	6.00	6.00	6.00
6-0 to 6-6	(2/1/82)	60.79	121.58	243.16	486.32	1215.80	2431.60	24316	6.00	6.02	6.00
6-6 to 7-0	(8/1/82)	62.62	125.24	250.48	500.96	1252.40	2504.80	25048	6.00	6.00	6.00
7-0 to 7-6	(2/1/83)	64.50	129.00	258.00	516.00	1290.00	2580.00	25800	6.00	5.98	6.00
7-6 to 8-0	(8/1/83)	66.43	132.86	265.72	531.44	1328.60	2657.20	26572	6.00	5.99	6.00
8-0 to 8-6	(2/1/84)	68.42	136.84	273.68	547.36	1368.40	2736.80	27368	6.00	6.02	6.00
8-6 to 9-0	(8/1/84)	70.48	140.96	281.92	563.84	1409.60	2819.20	28192	6.00	5.99	6.00
9-0 to 9-6	(2/1/85)	72.59	145.18	290.36	580.72	1451.80	2903.60	29036	6.00	6.01	6.00
9-6 to10-0	(8/1/85)	74.77	149.54	299.08	598.16	1495.40	2990.80	29908	6.00	5.99	5.99
10-0 2/	(2/1/86)	77.01	154.02	308.04	616.08	1540.20	3080.40	30804	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1956, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 29 years 8 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.82 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 44-A

BONDS BEARING ISSUE DATE OCT. 1 OR NOV. 1, 1956

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 19 years 8 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/76)	$43.03	$86.06	$172.12	$344.24	$860.60	$1721.20	$17212	----	6.00	6.00
0-6 to 1-0 . . . . (12/1/76)	44.32	88.64	177.28	354.56	886.40	1772.80	17728	6.00	6.00	6.00
1-0 to 1-6 . . . . (6/1/77)	45.65	91.30	182.60	365.20	913.00	1826.00	18260	6.00	6.00	6.00
1-6 to 2-0 . . . . (12/1/77)	47.02	94.04	188.08	376.16	940.40	1880.80	18808	6.00	6.00	6.00
2-0 to 2-6 . . . . (6/1/78)	48.43	96.86	193.72	387.44	968.60	1937.20	19372	6.00	5.99	6.00
2-6 to 3-0 . . . . (12/1/78)	49.88	99.76	199.52	399.04	997.60	1995.20	19952	6.00	6.01	6.00
3-0 to 3-6 . . . . (6/1/79)	51.38	102.76	205.52	411.04	1027.60	2055.20	20552	6.00	5.99	6.00
3-6 to 4-0 . . . . (12/1/79)	52.92	105.84	211.68	423.36	1058.40	2116.80	21168	6.00	6.01	6.00
4-0 to 4-6 . . . . (6/1/80)	54.51	109.02	218.04	436.08	1090.20	2180.40	21804	6.00	5.98	6.00
4-6 to 5-0 . . . . (12/1/80)	56.14	112.28	224.56	449.12	1122.80	2245.60	22456	6.00	6.02	6.00
5-0 to 5-6 . . . . (6/1/81)	57.83	115.66	231.32	462.64	1156.60	2313.20	23132	6.00	5.98	6.00
5-6 to 6-0 . . . . (12/1/81)	59.56	119.12	238.24	476.48	1191.20	2382.40	23824	6.00	6.01	6.00
6-0 to 6-6 . . . . (6/1/82)	61.35	122.70	245.40	490.80	1227.00	2454.00	24540	6.00	6.00	6.00
6-6 to 7-0 . . . . (12/1/82)	63.19	126.38	252.76	505.52	1263.80	2527.60	25276	6.00	6.01	6.00
7-0 to 7-6 . . . . (6/1/83)	65.09	130.18	260.36	520.72	1301.80	2603.60	26036	6.00	5.99	6.00
7-6 to 8-0 . . . . (12/1/83)	67.04	134.08	268.16	536.32	1340.80	2681.60	26816	6.00	6.00	6.00
8-0 to 8-6 . . . . (6/1/84)	69.05	138.10	276.20	552.40	1381.00	2762.00	27620	6.00	6.00	6.00
8-6 to 9-0 . . . . (12/1/84)	71.12	142.24	284.48	568.96	1422.40	2844.80	28448	6.00	6.02	6.00
9-0 to 9-6 . . . . (6/1/85)	73.26	146.52	293.04	586.08	1465.20	2930.40	29304	6.00	5.98	6.00
9-6 to10-0 . . . . (12/1/85)	75.45	150.90	301.80	603.60	1509.00	3018.00	30180	6.00	6.02	6.02
10-0 2/ . . . . . (6/1/86)	77.72	155.44	310.88	621.76	1554.40	3108.80	31088	6.00 3/	----	----

1/ Month, day, and year on which issues of Oct. 1, 1956, enter each period. For issues of Nov. 1, 1956, add 1 month.
2/ Second extended maturity reached at 29 years 8 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.85 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 46-A

BONDS BEARING ISSUE DATES FROM FEB. 1 THROUGH MAY 1, 1957

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(1/1/76)	$42.59	$85.18	$170.36	$340.72	$851.80	$1703.60	$17036	----	6.01	6.00
0-6 to 1-0 . . . . (7/1/76)	43.87	87.74	175.48	350.96	877.40	1754.80	17548	6.01	5.97	6.00
1-0 to 1-6 . . . . (1/1/77)	45.18	90.36	180.72	361.44	903.60	1807.20	18072	5.99	6.02	6.00
1-6 to 2-0 . . . . (7/1/77)	46.54	93.08	186.16	372.32	930.80	1861.60	18616	6.00	6.02	6.00
2-0 to 2-6 . . . . (1/1/78)	47.94	95.88	191.76	383.52	958.80	1917.60	19176	6.00	5.97	6.00
2-6 to 3-0 . . . . (7/1/78)	49.37	98.74	197.48	394.96	987.40	1974.80	19748	6.00	6.00	6.00
3-0 to 3-6 . . . . (1/1/79)	50.85	101.70	203.40	406.80	1017.00	2034.00	20340	6.00	6.02	6.00
3-6 to 4-0 . . . . (7/1/79)	52.38	104.76	209.52	419.04	1047.60	2095.20	20952	6.00	5.99	6.00
4-0 to 4-6 . . . . (1/1/80)	53.95	107.90	215.80	431.60	1079.00	2158.00	21580	6.00	6.01	6.00
4-6 to 5-0 . . . . (7/1/80)	55.57	111.14	222.28	444.56	1111.40	2222.80	22228	6.00	6.01	6.00
5-0 to 5-6 . . . . (1/1/81)	57.24	114.48	228.96	457.92	1144.80	2289.60	22896	6.00	5.97	6.00
5-6 to 6-0 . . . . (7/1/81)	58.95	117.90	235.80	471.60	1179.00	2358.00	23580	6.00	6.01	6.00
6-0 to 6-6 . . . . (1/1/82)	60.72	121.44	242.88	485.76	1214.40	2428.80	24288	6.00	5.99	6.00
6-6 to 7-0 . . . . (7/1/82)	62.54	125.08	250.16	500.32	1250.80	2501.60	25016	6.00	6.01	6.00
7-0 to 7-6 . . . . (1/1/83)	64.42	128.84	257.68	515.36	1288.40	2576.80	25768	6.00	5.99	6.00
7-6 to 8-0 . . . . (7/1/83)	66.35	132.70	265.40	530.80	1327.00	2654.00	26540	6.00	6.00	6.00
8-0 to 8-6 . . . . (1/1/84)	68.34	136.68	273.36	546.72	1366.80	2733.60	27336	6.00	6.00	6.00
8-6 to 9-0 . . . . (7/1/84)	70.39	140.78	281.56	563.12	1407.80	2815.60	28156	6.00	6.02	6.00
9-0 to 9-6 . . . . (1/1/85)	72.51	145.02	290.04	580.08	1450.20	2900.40	29004	6.00	5.99	5.99
9-6 to10-0 . . . . (7/1/85)	74.68	149.36	298.72	597.44	1493.60	2987.20	29872	6.00	6.00	6.00
10-0 2/ . . . . . (1/1/86)	76.92	153.84	307.68	615.36	1538.40	3076.80	30768	6.00 3/	----	----

1/ Month, day, and year on which issues of Feb. 1, 1957, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.94 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 47-A

BONDS BEARING ISSUE DATE JUNE 1, 1957

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(5/1/76)	$42.78	$85.56	$171.12	$342.24	$855.60	$1711.20	$17112	----	5.98	6.00
0-6 to 1-0 . . . . (11/1/76)	44.06	88.12	176.24	352.48	881.20	1762.40	17624	5.98	6.04	6.00
1-0 to 1-6 . . . . (5/1/77)	45.39	90.78	181.56	363.12	907.80	1815.60	18156	6.01	5.99	6.00
1-6 to 2-0 . . . . (11/1/77)	46.75	93.50	187.00	374.00	935.00	1870.00	18700	6.00	5.99	6.00
2-0 to 2-6 . . . . (5/1/78)	48.15	96.30	192.60	385.20	963.00	1926.00	19260	6.00	5.98	6.00
2-6 to 3-0 . . . . (11/1/78)	49.59	99.18	198.36	396.72	991.80	1983.60	19836	6.00	6.01	6.00
3-0 to 3-6 . . . . (5/1/79)	51.08	102.16	204.32	408.64	1021.60	2043.20	20432	6.00	5.99	6.00
3-6 to 4-0 . . . . (11/1/79)	52.61	105.22	210.44	420.88	1052.20	2104.40	21044	6.00	6.01	6.00
4-0 to 4-6 . . . . (5/1/80)	54.19	108.38	216.76	433.52	1083.80	2167.60	21676	6.00	6.02	6.00
4-6 to 5-0 . . . . (11/1/80)	55.82	111.64	223.28	446.56	1116.40	2232.80	22328	6.00	5.98	6.00
5-0 to 5-6 . . . . (5/1/81)	57.49	114.98	229.96	459.92	1149.80	2299.60	22996	6.00	6.02	6.00
5-6 to 6-0 . . . . (11/1/81)	59.22	118.44	236.88	473.76	1184.40	2368.80	23688	6.00	5.98	6.00
6-0 to 6-6 . . . . (5/1/82)	60.99	121.98	243.96	487.92	1219.80	2439.60	24396	6.00	6.00	6.00
6-6 to 7-0 . . . . (11/1/82)	62.82	125.64	251.28	502.56	1256.40	2512.80	25128	6.00	6.02	6.00
7-0 to 7-6 . . . . (5/1/83)	64.71	129.42	258.84	517.68	1294.20	2588.40	25884	6.00	6.00	6.00
7-6 to 8-0 . . . . (11/1/83)	66.65	133.30	266.60	533.20	1333.00	2666.00	26660	6.00	6.00	6.00
8-0 to 8-6 . . . . (5/1/84)	68.65	137.30	274.60	549.20	1373.00	2746.00	27460	6.00	6.00	6.00
8-6 to 9-0 . . . . (11/1/84)	70.71	141.42	282.84	565.68	1414.20	2828.40	28284	6.00	6.00	6.00
9-0 to 9-6 . . . . (5/1/85)	72.83	145.66	291.32	582.64	1456.60	2913.20	29132	6.00	5.99	6.01
9-6 to10-0 . . . . (11/1/85)	75.01	150.02	300.04	600.08	1500.20	3000.40	30004	6.00	6.03	6.03
10-0 2/ . . . . . (5/1/86)	77.27	154.54	309.08	618.16	1545.40	3090.80	30908	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1957, enter each period.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.96 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 48-A

BONDS BEARING ISSUE DATES FROM JULY 1 THROUGH NOV. 1, 1957

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/76)	$43.16	$86.32	$172.64	$345.28	$863.20	$1726.40	$17264	----	5.98	6.00
0-6 to 1-0 . . . . (12/1/76)	44.45	88.90	177.80	355.60	889.00	1778.00	17780	5.98	6.03	6.00
1-0 to 1-6 . . . . (6/1/77)	45.79	91.58	183.16	366.32	915.80	1831.60	18316	6.00	5.98	6.00
1-6 to 2-0 . . . . (12/1/77)	47.16	94.32	188.64	377.28	943.20	1886.40	18864	6.00	6.02	6.00
2-0 to 2-6 . . . . (6/1/78)	48.58	97.16	194.32	388.64	971.60	1943.20	19432	6.00	5.97	6.00
2-6 to 3-0 . . . . (12/1/78)	50.03	100.06	200.12	400.24	1000.60	2001.20	20012	6.00	6.04	6.00
3-0 to 3-6 . . . . (6/1/79)	51.54	103.08	206.16	412.32	1030.80	2061.60	20616	6.00	5.98	6.00
3-6 to 4-0 . . . . (12/1/79)	53.08	106.16	212.32	424.64	1061.60	2123.20	21232	6.00	5.99	6.00
4-0 to 4-6 . . . . (6/1/80)	54.67	109.34	218.68	437.36	1093.40	2186.80	21868	6.00	6.00	6.00
4-6 to 5-0 . . . . (12/1/80)	56.31	112.62	225.24	450.48	1126.20	2252.40	22524	6.00	6.00	6.00
5-0 to 5-6 . . . . (6/1/81)	58.00	116.00	232.00	464.00	1160.00	2320.00	23200	6.00	6.00	6.00
5-6 to 6-0 . . . . (12/1/81)	59.74	119.48	238.96	477.92	1194.80	2389.60	23896	6.00	6.03	6.00
6-0 to 6-6 . . . . (6/1/82)	61.54	123.08	246.16	492.32	1230.80	2461.60	24616	6.00	5.98	6.00
6-6 to 7-0 . . . . (12/1/82)	63.38	126.76	253.52	507.04	1267.60	2535.20	25352	6.00	6.00	6.00
7-0 to 7-6 . . . . (6/1/83)	65.28	130.56	261.12	522.24	1305.60	2611.20	26112	6.00	6.00	6.00
7-6 to 8-0 . . . . (12/1/83)	67.24	134.48	268.96	537.92	1344.80	2689.60	26896	6.00	6.01	6.00
8-0 to 8-6 . . . . (6/1/84)	69.26	138.52	277.04	554.08	1385.20	2770.40	27704	6.00	6.01	6.00
8-6 to 9-0 . . . . (12/1/84)	71.34	142.68	285.36	570.72	1426.80	2853.60	28536	6.00	6.00	6.00
9-0 to 9-6 . . . . (6/1/85)	73.48	146.96	293.92	587.84	1469.60	2939.20	29392	6.00	5.99	5.99
9-6 to10-0 . . . . (12/1/85)	75.68	151.36	302.72	605.44	1513.60	3027.20	30272	6.00	6.00	6.00
10-0 2/ . . . . . (6/1/86)	77.95	155.90	311.80	623.60	1559.00	3118.00	31180	6.00 3/	----	----

1/ Month, day, and year on which issues of July 1, 1957, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.99 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 87-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1968, THROUGH MAY 1, 1969

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 7 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/75)	$27.11	$54.22	$81.33	$108.44	$216.88	$542.20	$1084.40	$10844	----	5.98	6.00
0-6 to 1-0 . . . . (6/1/76)	27.92	55.84	83.76	111.68	223.36	558.40	1116.80	11168	5.98	6.02	6.00
1-0 to 1-6 . . . . (12/1/76)	28.76	57.52	86.28	115.04	230.08	575.20	1150.40	11504	6.00	5.98	6.00
1-6 to 2-0 . . . . (6/1/77)	29.62	59.24	88.86	118.48	236.96	592.40	1184.80	11848	5.99	6.01	6.00
2-0 to 2-6 . . . . (12/1/77)	30.51	61.02	91.53	122.04	244.08	610.20	1220.40	12204	6.00	6.03	6.00
2-6 to 3-0 . . . . (6/1/78)	31.43	62.86	94.29	125.72	251.44	628.60	1257.20	12572	6.00	5.98	6.00
3-0 to 3-6 . . . . (12/1/78)	32.37	64.74	97.11	129.48	258.96	647.40	1294.80	12948	6.00	5.99	6.00
3-6 to 4-0 . . . . (6/1/79)	33.34	66.68	100.02	133.36	266.72	666.80	1333.60	13336	6.00	6.00	6.00
4-0 to 4-6 . . . . (12/1/79)	34.34	68.68	103.02	137.36	274.72	686.80	1373.60	13736	6.00	6.00	6.00
4-6 to 5-0 . . . . (6/1/80)	35.37	70.74	106.11	141.48	282.96	707.40	1414.80	14148	6.00	5.99	6.00
5-0 to 5-6 . . . . (12/1/80)	36.43	72.86	109.29	145.72	291.44	728.60	1457.20	14572	6.00	6.04	6.00
5-6 to 6-0 . . . . (6/1/81)	37.53	75.06	112.59	150.12	300.24	750.60	1501.20	15012	6.00	5.97	6.00
6-0 to 6-6 . . . . (12/1/81)	38.65	77.30	115.95	154.60	309.20	773.00	1546.00	15460	6.00	6.00	6.00
6-6 to 7-0 . . . . (6/1/82)	39.81	79.62	119.43	159.24	318.48	796.20	1592.40	15924	6.00	6.03	6.00
7-0 to 7-6 . . . . (12/1/82)	41.01	82.02	123.03	164.04	328.08	820.20	1640.40	16404	6.00	6.00	5.99
7-6 to 8-0 . . . . (6/1/83)	42.24	84.48	126.72	168.96	337.92	844.80	1689.60	16896	6.00	5.97	5.99
8-0 to 8-6 . . . . (12/1/83)	43.50	87.00	130.50	174.00	348.00	870.00	1740.00	17400	6.00	6.02	6.00
8-6 to 9-0 . . . . (6/1/84)	44.81	89.62	134.43	179.24	358.48	896.20	1792.40	17924	6.00	5.98	5.99
9-0 to 9-6 . . . . (12/1/84)	46.15	92.30	138.45	184.60	369.20	923.00	1846.00	18460	6.00	6.02	6.00
9-6 to10-0 . . . . (6/1/85)	47.54	95.08	142.62	190.16	380.32	950.80	1901.60	19016	6.00	5.97	5.97
10-0 2/ . . . . . (12/1/85)	48.96	97.92	146.88	195.84	391.68	979.20	1958.40	19584	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1968, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 17 years 0 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.73 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 89-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1969, THROUGH MAY 1, 1970.

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 5 years 10 months)	(1) Redemption values during each half-year period (values increase on first day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(10/1/75)	$25.90	$51.80	$77.70	$103.60	$207.20	$518.00	$1036.00	$10360	----	6.02	6.00
0-6 to 1-0 . . . . (4/1/76)	26.68	53.36	80.04	106.72	213.44	533.60	1067.20	10672	6.02	6.00	6.00
1-0 to 1-6 . . . . (10/1/76)	27.48	54.96	82.44	109.92	219.84	549.60	1099.20	10992	6.01	5.97	6.00
1-6 to 2-0 . . . . (4/1/77)	28.30	56.60	84.90	113.20	226.40	566.00	1132.00	11320	6.00	6.01	6.00
2-0 to 2-6 . . . . (10/1/77)	29.15	58.30	87.45	116.60	233.20	583.00	1166.00	11660	6.00	6.04	6.00
2-6 to 3-0 . . . . (4/1/78)	30.03	60.06	90.09	120.12	240.24	600.60	1201.20	12012	6.01	5.99	6.00
3-0 to 3-6 . . . . (10/1/78)	30.93	61.86	92.79	123.72	247.44	618.60	1237.20	12372	6.00	5.95	6.00
3-6 to 4-0 . . . . (4/1/79)	31.85	63.70	95.55	127.40	254.80	637.00	1274.00	12740	6.00	6.03	6.00
4-0 to 4-6 . . . . (10/1/79)	32.81	65.62	98.43	131.24	262.48	656.20	1312.40	13124	6.00	5.97	6.00
4-6 to 5-0 . . . . (4/1/80)	33.79	67.58	101.37	135.16	270.32	675.80	1351.60	13516	6.00	6.04	6.00
5-0 to 5-6 . . . . (10/1/80)	34.81	69.62	104.43	139.24	278.48	696.20	1392.40	13924	6.00	5.98	6.00
5-6 to 6-0 . . . . (4/1/81)	35.85	71.70	107.55	143.40	286.80	717.00	1434.00	14340	6.00	6.03	6.00
6-0 to 6-6 . . . . (10/1/81)	36.93	73.86	110.79	147.72	295.44	738.60	1477.20	14772	6.00	6.01	6.00
6-6 to 7-0 . . . . (4/1/82)	38.04	76.08	114.12	152.16	304.32	760.80	1521.60	15216	6.00	5.99	6.00
7-0 to 7-6 . . . . (10/1/82)	39.18	78.36	117.54	156.72	313.44	783.60	1567.20	15672	6.00	5.97	6.00
7-6 to 8-0 . . . . (4/1/83)	40.35	80.70	121.05	161.40	322.80	807.00	1614.00	16140	6.00	6.00	6.00
8-0 to 8-6 . . . . (10/1/83)	41.56	83.12	124.68	166.24	332.48	831.20	1662.40	16624	6.00	6.02	6.00
8-6 to 9-0 . . . . (4/1/84)	42.81	85.62	128.43	171.24	342.48	856.20	1712.40	17124	6.00	5.98	6.00
9-0 to 9-6 . . . . (10/1/84)	44.09	88.18	132.27	176.36	352.72	881.80	1763.60	17636	6.00	6.03	6.01
9-6 to 10-0 . . . . (4/1/85)	45.42	90.84	136.26	181.68	363.36	908.40	1816.80	18168	6.00	5.99	5.99
10-0 2/ . . . . . (10/1/85)	46.78	93.56	140.34	187.12	374.24	935.60	1871.20	18712	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1969, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 10 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.86 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 90-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1970

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 5 years 10 months)	(1) Redemption values during each half-year period (values increase on first day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(4/1/76)	$26.02	$52.04	$78.06	$104.08	$208.16	$520.40	$1040.80	$10403	----	6.00	6.00
0-6 to 1-0 . . . . (10/1/76)	26.80	53.60	80.40	107.20	214.40	536.00	1072.00	10720	6.00	5.97	6.00
1-0 to 1-6 . . . . (4/1/77)	27.60	55.20	82.80	110.40	220.80	552.00	1104.00	11040	5.98	6.01	6.00
1-6 to 2-0 . . . . (10/1/77)	28.43	56.86	85.29	113.72	227.44	568.60	1137.20	11372	5.99	6.05	6.00
2-0 to 2-6 . . . . (4/1/78)	29.29	58.58	87.87	117.16	234.32	585.80	1171.60	11716	6.01	5.94	6.00
2-6 to 3-0 . . . . (10/1/78)	30.16	60.32	90.48	120.64	241.28	603.20	1206.40	12064	5.99	6.03	6.00
3-0 to 3-6 . . . . (4/1/79)	31.07	62.14	93.21	124.28	248.56	621.40	1242.80	12428	6.00	5.99	6.00
3-6 to 4-0 . . . . (10/1/79)	32.00	64.00	96.00	128.00	256.00	640.00	1280.00	12800	6.00	6.00	6.00
4-0 to 4-6 . . . . (4/1/80)	32.96	65.92	98.88	131.84	263.68	659.20	1318.40	13184	6.00	6.01	6.00
4-6 to 5-0 . . . . (10/1/80)	33.95	67.90	101.85	135.80	271.60	679.00	1358.00	13580	6.00	6.01	6.00
5-0 to 5-6 . . . . (4/1/81)	34.97	69.94	104.91	139.88	279.76	699.40	1398.80	13988	6.00	6.01	6.00
5-6 to 6-0 . . . . (10/1/81)	36.02	72.04	108.06	144.08	288.16	720.40	1440.80	14408	6.00	6.00	6.00
6-0 to 6-6 . . . . (4/1/82)	37.10	74.20	111.30	148.40	296.80	742.00	1484.00	14840	6.00	5.98	6.00
6-6 to 7-0 . . . . (10/1/82)	38.21	76.42	114.63	152.84	305.68	764.20	1528.40	15284	6.00	6.02	6.00
7-0 to 7-6 . . . . (4/1/83)	39.36	78.72	118.08	157.44	314.88	787.20	1574.40	15744	6.00	6.00	6.00
7-6 to 8-0 . . . . (10/1/83)	40.54	81.08	121.62	162.16	324.32	810.80	1621.60	16216	6.00	5.97	6.00
8-0 to 8-6 . . . . (4/1/84)	41.75	83.50	125.25	167.00	334.00	835.00	1670.00	16700	6.00	6.04	6.01
8-6 to 9-0 . . . . (10/1/84)	43.01	86.02	129.03	172.04	344.08	860.20	1720.40	17204	6.00	6.00	6.00
9-0 to 9-6 . . . . (4/1/85)	44.30	88.60	132.90	177.20	354.40	886.00	1772.00	17720	6.00	6.00	6.00
9-6 to10-0 . . . . (10/1/85)	45.63	91.26	136.89	182.52	365.04	912.60	1825.20	18252	6.00	6.00	6.00
10-0 2/ . . . . . (4/1/86)	47.00	94.00	141.00	188.00	376.00	940.00	1880.00	18800	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1970, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 10 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.89 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

Exhibit 8.—Department Circular No. 905, Sixth Revision, March 18, 1974, First Amendment, offering of United States savings bonds, series H

DEPARTMENT OF THE TREASURY,
Washington, December 9, 1975.

§ 332.8 Extended terms and improved yields for outstanding bonds.

(a) *Extended maturity periods.* * * *

(2) *Bonds with issue dates June 1, 1952, through May 1, 1959.* Owners of Series H bonds with issue dates of June 1, 1952, through May 1, 1959, may retain their bonds for a second extended maturity period of 10 years.

(3) *Bonds with issue dates of June 1, 1959, or thereafter.* Owners of Series H bonds with issue dates of June 1, 1959, or thereafter, may retain their bonds for an extended maturity period of 10 years.

* * * * * * *

The foregoing revisions and amendment were effected under authority of section 22 of the Second Liberty Bond Act, as amended (49 Stat. 21, as amended; 31 U.S.C. 757c), and 5 U.S.C. 301. Notice and public procedures thereon are unnecessary as the fiscal policy of the United States is involved.

DAVID MOSSO,
Fiscal Assistant Secretary.

TABLE 9-A

BONDS BEARING ISSUE DATES FROM OCT. 1, 1955 THROUGH MAR. 1, 1956

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 19 YEARS, 8 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . . 1/ (12/1/75)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (6/1/76)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (12/1/76)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (6/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (6/1/85)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF OCT. 1, 1955. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ SECOND EXTENDED MATURITY REACHED AT 29 YEARS AND 8 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY DATE ON BONDS DATED: OCT. 1 AND NOV. 1, 1955 IS 4.31%; DEC. 1, 1955 THROUGH MAR. 1, 1956 IS 4.32%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 10-A

BONDS BEARING ISSUE DATES FROM APR. 1 THROUGH SEP. 1, 1956

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 19 YEARS, 8 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (6/1/76)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/76)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/85)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF APR. 1, 1956. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.
2/ SECOND EXTENDED MATURITY REACHED AT 29 YEARS AND 8 MONTHS AFTER ISSUE DATE.
3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY DATE ON BONDS DATED: APR. 1 AND MAY 1, 1956 IS 4.39%; JUNE 1 THROUGH SEP. 1, 1956 IS 4.40%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 11-A

BONDS BEARING ISSUE DATES FROM OCT. 1, 1956 THROUGH JAN. 1, 1957

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 19 YEARS, 8 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . . 1/ (12/1/76)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (6/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (6/1/86)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF OCT. 1, 1956. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ SECOND EXTENDED MATURITY REACHED AT 29 YEARS AND 8 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY DATE ON BONDS DATED: OCT. 1 AND NOV. 1, 1956 IS 4.43%; DEC. 1, 1956 THROUGH JAN. 1, 1957 IS 4.45%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 29-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1965

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION *				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
	EXTENDED MATURITY PERIOD**						
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (12/1/75)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (6/1/76)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (12/1/76)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (6/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (6/1/85)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF JUNE 1, 1965. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.
2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.
3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.13%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 30-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1965 THROUGH MAY 1, 1966

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000	

PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . . 1/ (6/1/76)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/76)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/85)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF DEC. 1, 1965. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.29%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 31-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1966

						APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
ISSUE PRICE		$500	$1,000	$5,000	$10,000			
REDEMPTION AND MATURITY VALUE		500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS		(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION *				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
		EXTENDED MATURITY PERIOD**						
						PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/	(12/1/76)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS	(6/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS	(12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS	(6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS	(12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS	(6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS	(12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS	(6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS	(12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS	(6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS	(12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS	(6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS	(12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS	(6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS	(12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS	(6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS	(12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS	(6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS	(12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . .	(6/1/86)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF JUNE 1, 1966. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.35%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

Exhibit 9.—Department Circular No. 653, Ninth Revision, April 23, 1974, Second Amendment, offering of United States savings bonds, series E

DEPARTMENT OF THE TREASURY,
Washington, August 10, 1976.

The Department of the Treasury is adopting a new schedule of interest accruals for United States Savings Bonds, Series E, bearing the issue date of September 1, 1976, or thereafter, to provide therefor the minimum investment yield required by section 4 of Public Law 94–232, approved March 15, 1976. Supplemental tables of redemption values and investment yields are also being published for bonds of various earlier issue dates which will be entering their next extended maturity period.

Accordingly, Department of the Treasury Circular No. 653, Ninth Revision, dated April 23, 1974, and the tables incorporated therein, as amended, (31 CFR, Part 316), are hereby further amended to prescribe interest accruals for bonds bearing issue dates of September 1, 1976, or thereafter; to provide the table of redemption values and investment yields therefor; and, to provide tables of redemption values and investment yields for the next extended maturity period for bonds bearing issue dates of December 1, 1946, through May 1, 1948; December 1, 1956, through January 1, 1957; December 1, 1957, through May 1, 1960; and December 1, 1970, through May 1, 1972. Section 316.2(e) and Table 1 are revised, and Tables 15–A, 16–A, 17–A, 45–A, 49–A, 50–A, 51–A, 52–A, 53–A, 54–A, 55–A, 56–A, 57–A, 58–A, 91–A, 92–A, 93–A and 97 are added, as follows:

Section 316.2 *Description of bonds.* * * *

(e) *Investment yield (interest).* The investment yield (interest) on a Series E bond will be approximately 6 percent per annum, compounded semiannually, if the bond is held to maturity, but the yield will be less if the bond is redeemed prior thereto. A bond bearing the issue date of September 1, 1976, or thereafter, beginning in the third month from such issue date, will increase in redemption value on the first day of each month up to and including the thirtieth month from issue date so as to provide for such period an investment yield of no less than 4 per centum per annum, compounded semiannually. Thereafter, its redemption value will increase at the beginning of each successive half-year period. The interest will be paid as part of the redemption value. See Table I.

*　　*　　*　　*　　*　　*　　*

The foregoing revisions and amendments were effected under authority of section 22 of the Second Liberty Bond Act, as amended (49 Stat. 21, as amended; 31 U.S.C. 757c), and 5 U.S.C. 301. Notice and public procedures thereon are unnecessary as the fiscal policy of the United States is involved.

DAVID MOSSO,
Fiscal Assistant Secretary.

TABLE 1

BONDS BEARING ISSUE DATES BEGINNING SEPTEMBER 1, 1976

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after issue)	(1) Redemption values during each period (values increase on first day of period) 1/								(2) From issue date to beginning of each period	(3) From beginning of each period to beginning of next period	(4) From beginning of each period to maturity
									Percent	Percent	Percent
0- 0 to 0- 2	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	----	4.19	6.00
0- 2 to 0- 3	18.88	37.76	56.64	75.52	151.04	377.60	755.20	7552	4.19	3.84	6.06
0- 3 to 0- 4	18.94	37.88	56.82	75.76	151.52	378.80	757.60	7576	4.07	3.83	6.10
0- 4 to 0- 5	19.00	38.00	57.00	76.00	152.00	380.00	760.00	7600	4.01	4.46	6.14
0- 5 to 0- 6	19.07	38.14	57.21	76.28	152.56	381.40	762.80	7628	4.10	3.81	6.17
0- 6 to 0- 7	19.13	38.26	57.39	76.52	153.04	382.60	765.20	7652	4.05	4.43	6.22
0- 7 to 0- 8	19.20	38.40	57.60	76.80	153.60	384.00	768.00	7680	4.11	5.05	6.25
0- 8 to 0- 9	19.28	38.56	57.84	77.12	154.24	385.60	771.20	7712	4.23	5.03	6.28
0- 9 to 0-10	19.36	38.72	58.08	77.44	154.88	387.20	774.40	7744	4.31	5.64	6.30
0-10 to 0-11	19.45	38.90	58.35	77.80	155.60	389.00	778.00	7780	4.45	4.99	6.31
0-11 to 1- 0	19.53	39.06	58.59	78.12	156.24	390.60	781.20	7812	4.50	4.97	6.34
1- 0 to 1- 1	19.61	39.22	58.83	78.44	156.88	392.20	784.40	7844	4.54	4.95	6.37
1- 1 to 1- 2	19.69	39.38	59.07	78.76	157.52	393.80	787.60	7876	4.57	4.93	6.40
1- 2 to 1- 3	19.77	39.54	59.31	79.08	158.16	395.40	790.80	7908	4.59	4.91	6.43
1- 3 to 1- 4	19.85	39.70	59.55	79.40	158.80	397.00	794.00	7940	4.61	5.50	6.47
1- 4 to 1- 5	19.94	39.88	59.82	79.76	159.52	398.80	797.60	7976	4.67	4.86	6.49
1- 5 to 1- 6	20.02	40.04	60.06	80.08	160.16	400.40	800.80	8008	4.68	4.84	6.53
1- 6 to 1- 7	20.10	40.20	60.30	80.40	160.80	402.00	804.00	8040	4.69	4.82	6.57
1- 7 to 1- 8	20.18	40.36	60.54	80.72	161.44	403.60	807.20	8072	4.70	5.41	6.61
1- 8 to 1- 9	20.27	40.54	60.81	81.08	162.16	405.40	810.80	8108	4.73	4.78	6.64
1- 9 to 1-10	20.35	40.70	61.05	81.40	162.80	407.00	814.00	8140	4.73	4.76	6.69
1-10 to 1-11	20.43	40.86	61.29	81.72	163.44	408.60	817.20	8172	4.74	5.34	6.74
1-11 to 2- 0	20.52	41.04	61.56	82.08	164.16	410.40	820.80	8208	4.76	4.72	6.78
2- 0 to 2- 1	20.60	41.20	61.80	82.40	164.80	412.00	824.00	8240	4.76	5.30	6.83
2- 1 to 2- 2	20.69	41.38	62.07	82.76	165.52	413.80	827.60	8276	4.78	5.28	6.88
2- 2 to 2- 3	20.78	41.56	62.34	83.12	166.24	415.60	831.20	8312	4.80	5.25	6.92
2- 3 to 2- 4	20.87	41.74	62.61	83.48	166.96	417.40	834.80	8348	4.82	5.23	6.97
2- 4 to 2- 5	20.96	41.92	62.88	83.84	167.68	419.20	838.40	8384	4.83	5.21	7.03
2- 5 to 2- 6	21.05	42.10	63.15	84.20	168.40	421.00	842.00	8420	4.85	5.19	7.09
2- 6 to 3- 0	21.14	42.28	63.42	84.56	169.12	422.80	845.60	8456	4.86	5.39	7.15
3- 0 to 3- 6	21.71	43.42	65.13	86.84	173.68	434.20	868.40	8684	4.95	5.53	7.59
3- 6 to 4- 0	22.31	44.62	66.93	89.24	178.48	446.20	892.40	8924	5.03	5.92	8.29
4- 0 to 4- 6	22.97	45.94	68.91	91.88	183.76	459.40	918.80	9188	5.14	6.09	9.48
4- 6 to 5- 0	23.67	47.34	71.01	94.68	189.36	473.40	946.80	9468	5.25	12.93	12.93
5- 0 2/	25.20	50.40	75.60	100.80	201.60	504.00	1008.00	10080	6.00	----	----

1/ Not redeemable during first 2 months after issue.
2/ Maturity value reached at 5 years and 0 months after issue.

TABLE 15-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1946, THROUGH MAY 1, 1947

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1000.00			
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)* THIRD EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/76)	$23.58	$58.96	$117.92	$235.84	$471.68	$1179.20	$2358.40	----	6.00	6.00
0-6 to 1-0 . . . . (6/1/77)	24.29	60.73	121.46	242.92	485.84	1214.60	2429.20	6.00	5.99	6.00
1-0 to 1-6 . . . . (12/1/77)	25.02	62.55	125.10	250.20	500.40	1251.00	2502.00	6.00	6.01	6.00
1-6 to 2-0 . . . . .(6/1/78)	25.77	64.43	128.86	257.72	515.44	1288.60	2577.20	6.00	5.99	6.00
2-0 to 2-6 . . . . (12/1/78)	26.54	66.36	132.72	265.44	530.88	1327.20	2654.40	6.00	6.00	6.00
2-6 to 3-0 . . . . (6/1/79)	27.34	68.35	136.70	273.40	546.80	1367.00	2734.00	6.00	6.00	6.00
3-0 to 3-6 . . . . (12/1/79)	28.16	70.40	140.80	281.60	563.20	1408.00	2816.00	6.00	5.99	6.00
3-6 to 4-0 . . . . (6/1/80)	29.00	72.51	145.02	290.04	580.08	1450.20	2900.40	6.00	6.01	6.00
4-0 to 4-6 . . . . (12/1/80)	29.88	74.69	149.38	298.76	597.52	1493.80	2987.60	6.00	6.00	6.00
4-6 to 5-0 . . . . (6/1/81)	30.77	76.93	153.86	307.72	615.44	1538.60	3077.20	6.00	6.01	6.00
5-0 to 5-6 . . . . (12/1/81)	31.70	79.24	158.48	316.96	633.92	1584.80	3169.60	6.00	5.98	6.00
5-6 to 6-0 . . . . (6/1/82)	32.64	81.61	163.22	326.44	652.88	1632.20	3264.40	6.00	6.00	6.00
6-0 to 6-6 . . . . (12/1/82)	33.62	84.06	168.12	336.24	672.48	1681.20	3362.40	6.00	6.00	6.00
6-6 to 7-0 . . . . (6/1/83)	34.63	86.58	173.16	346.32	692.64	1731.60	3463.20	6.00	6.01	6.00
7-0 to 7-6 . . . . (12/1/83)	35.67	89.18	178.36	356.72	713.44	1783.60	3567.20	6.00	6.01	6.00
7-6 to 8-0 . . . . (6/1/84)	36.74	91.86	183.72	367.44	734.88	1837.20	3674.40	6.00	5.99	6.00
8-0 to 8-6 . . . . (12/1/84)	37.84	94.61	189.22	378.44	756.88	1892.20	3784.40	6.00	6.00	6.00
8-6 to 9-0 . . . . (6/1/85)	38.98	97.45	194.90	389.80	779.60	1949.00	3898.00	6.00	6.01	6.00
9-0 to 9-6 . . . . (12/1/85)	40.15	100.38	200.76	401.52	803.04	2007.60	4015.20	6.00	6.00	6.00
9-6 to10-0 . . . . (6/1/86)	41.36	103.39	206.78	413.56	827.12	2067.80	4135.60	6.00	6.00	6.00
10-0 2/ . . . . . . (12/1/86)	42.60	106.49	212.98	425.96	851.92	2129.80	4259.60	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1946, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.39 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 16-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1947

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1000.00			
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)*							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
	THIRD EXTENDED MATURITY PERIOD**									
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/77)	$23.90	$59.76	$119.52	$239.04	$478.08	$1195.20	$2390.40	----	5.99	6.00
0-6 to 1-0 . . . . (12/1/77)	24.62	61.55	123.10	246.20	492.40	1231.00	2462.00	5.99	6.01	6.00
1-0 to 1-6 . . . . (6/1/78)	25.36	63.40	126.80	253.60	507.20	1268.00	2536.00	6.00	5.99	6.00
1-6 to 2-0 . . . . (12/1/78)	26.12	65.30	130.60	261.20	522.40	1306.00	2612.00	6.00	6.00	6.00
2-0 to 2-6 . . . . (6/1/79)	26.90	67.26	134.52	269.04	538.08	1345.20	2690.40	6.00	6.01	6.00
2-6 to 3-0 . . . . (12/1/79)	27.71	69.28	138.56	277.12	554.24	1385.60	2771.20	6.00	6.00	6.00
3-0 to 3-6 . . . . (6/1/80)	28.54	71.34	142.72	285.44	570.88	1427.20	2854.40	6.00	6.00	6.00
3-6 to 4-0 . . . . (12/1/80)	29.40	73.50	147.00	294.00	588.00	1470.00	2940.00	6.00	5.99	6.00
4-0 to 4-6 . . . . (6/1/81)	30.28	75.70	151.40	302.80	605.60	1514.00	3028.00	6.00	6.00	6.00
4-6 to 5-0 . . . . (12/1/81)	31.19	77.97	155.94	311.88	623.76	1559.40	3118.80	6.00	6.00	6.00
5-0 to 5-6 . . . . (6/1/82)	32.12	80.31	160.62	321.24	642.48	1606.20	3212.40	6.00	6.00	6.00
5-6 to 6-0 . . . . (12/1/82)	33.09	82.72	165.44	330.88	661.76	1654.40	3308.80	6.00	6.00	6.00
6-0 to 6-6 . . . . (6/1/83)	34.08	85.20	170.40	340.80	681.60	1704.00	3408.00	6.00	6.01	6.00
6-6 to 7-0 . . . . (12/1/83)	35.1[illegible]	87.76	175.52	351.04	702.08	1755.20	3510.40	6.00	5.99	6.00
7-0 to 7-6 . . . . (6/1/84)	36.16	90.39	180.78	361.56	723.12	1807.80	3615.60	6.00	6.00	6.00
7-6 to 8-0 . . . . (12/1/84)	37.24	93.10	186.20	372.40	744.80	1862.00	3724.00	6.00	6.02	6.00
8-0 to 8-6 . . . . (6/1/85)	38.36	95.90	191.80	383.60	767.20	1918.00	3836.00	6.00	5.99	6.00
8-6 to 9-0 . . . . (12/1/85)	39.51	98.77	197.54	395.08	790.16	1975.40	3950.80	6.00	6.01	6.00
9-0 to 9-6 . . . . (6/1/86)	40.70	101.74	203.48	406.96	813.92	2034.80	4069.60	6.00	6.00	5.99
9-6 to10-0 . . . . (12/1/86)	41.92	104.79	209.58	419.16	838.32	2095.80	4191.60	6.00	5.99	5.99
10-0 2/ . . . . . (6/1/87)	43.17	107.93	215.86	431.72	863.44	2158.60	4317.20	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1947, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.42 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 17-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1947, THROUGH MAY 1, 1948

Issue price . . . . Denomination	$7.50 10.00	$18.75 25.00	$37.50 50.00	$75.00 100.00	$150.00 200.00	$375.00 500.00	$750.00 1000.00	Approximate investment yield (annual percentage rate)		
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)* THIRD EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/77)	$24.22	$60.56	$121.12	$242.24	$484.48	$1211.20	$2422.40	----	6.01	6.00
0-6 to 1-0 . . . . (6/1/78)	24.95	62.38	124.76	249.52	499.04	1247.60	2495.20	6.01	6.00	6.00
1-0 to 1-6 . . . . (12/1/78)	25.70	64.25	128.50	257.00	514.00	1285.00	2570.00	6.00	6.01	6.00
1-6 to 2-0 . . . . (6/1/79)	26.47	66.18	132.36	264.72	529.44	1323.60	2647.20	6.00	5.98	6.00
2-0 to 2-6 . . . . (12/1/79)	27.26	68.16	136.32	272.64	545.28	1363.20	2726.40	6.00	6.02	6.00
2-6 to 3-0 . . . . (6/1/80)	28.08	70.21	140.42	280.84	561.68	1404.20	2808.40	6.00	5.98	6.00
3-0 to 3-6 . . . . (12/1/80)	28.92	72.31	144.62	289.24	578.48	1446.20	2892.40	6.00	6.00	6.00
3-6 to 4-0 . . . . (6/1/81)	29.79	74.48	148.96	297.92	595.84	1489.60	2979.20	6.00	6.02	6.00
4-0 to 4-6 . . . . (12/1/81)	30.69	76.72	153.44	306.88	613.76	1534.40	3068.80	6.00	6.00	6.00
4-6 to 5-0 . . . . (6/1/82)	31.61	79.02	158.04	316.08	632.16	1580.40	3160.80	6.00	6.00	6.00
5-0 to 5-6 . . . . (12/1/82)	32.56	81.39	162.78	325.56	651.12	1627.80	3255.60	6.00	6.00	6.00
5-6 to 6-0 . . . . (6/1/83)	33.53	83.83	167.66	335.32	670.64	1676.60	3353.20	6.00	5.99	6.00
6-0 to 6-6 . . . . (12/1/83)	34.54	86.34	172.68	345.36	690.72	1726.80	3453.60	6.00	6.00	6.00
6-6 to 7-0 . . . . (6/1/84)	35.57	88.93	177.86	355.72	711.44	1778.60	3557.20	6.00	6.00	6.00
7-0 to 7-6 . . . . (12/1/84)	36.64	91.60	183.20	366.40	732.80	1832.00	3664.00	6.00	6.00	6.00
7-6 to 8-0 . . . . (6/1/85)	37.74	94.35	188.70	377.40	754.80	1887.00	3774.00	6.00	6.00	6.00
8-0 to 8-6 . . . . (12/1/85)	38.87	97.18	194.36	388.72	777.44	1943.60	3887.20	6.00	6.01	6.00
8-6 to 9-0 . . . . (6/1/86)	40.04	100.10	200.20	400.40	800.80	2002.00	4004.00	6.00	5.99	6.00
9-0 to 9-6 . . . . (12/1/86)	41.24	103.10	206.20	412.40	824.80	2062.00	4124.00	6.00	5.99	6.00
9-6 to10-0 . . . . (6/1/87)	42.48	106.19	212.38	424.76	849.52	2123.80	4247.60	6.00	6.01	6.01
10-0 2/ . . . . . (12/1/87)	43.75	109.38	218.76	437.52	875.04	2187.60	4375.20	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1947, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.46 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 45-A

BONDS BEARING ISSUE DATE DEC. 1, 1956, or JAN. 1, 1957

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 19 years 8 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(8/1/76)	$43.27	$86.54	$173.08	$346.16	$865.40	$1730.80	$17308	----	6.01	6.00
0-6 to 1-0 . . . . (2/1/77)	44.57	89.14	178.28	356.56	891.40	1782.80	17828	6.01	6.01	6.00
1-0 to 1-6 . . . . (8/1/77)	45.91	91.82	183.64	367.28	918.20	1836.40	18364	6.01	5.97	6.00
1-6 to 2-0 . . . . (2/1/78)	47.28	94.56	189.12	378.24	945.60	1891.20	18912	6.00	6.01	6.00
2-0 to 2-6 . . . . (8/1/78)	48.70	97.40	194.80	389.60	974.00	1948.00	19480	6.00	6.00	6.00
2-6 to 3-0 . . . . (2/1/79)	50.16	100.32	200.64	401.28	1003.20	2006.40	20064	6.00	6.02	6.00
3-0 to 3-6 . . . . (8/1/79)	51.67	103.34	206.68	413.36	1033.40	2066.80	20668	6.00	6.00	6.00
3-6 to 4-0 . . . . (2/1/80)	53.22	106.44	212.88	425.76	1064.40	2128.80	21288	6.00	5.98	6.00
4-0 to 4-6 . . . . (8/1/80)	54.81	109.62	219.24	438.48	1096.20	2192.40	21924	6.00	6.02	6.00
4-6 to 5-0 . . . . (2/1/81)	56.46	112.92	225.84	451.68	1129.20	2258.40	22584	6.00	5.99	6.00
5-0 to 5-6 . . . . (8/1/81)	58.15	116.30	232.60	465.20	1163.00	2326.00	23260	6.00	6.02	6.00
5-6 to 6-0 . . . . (2/1/82)	59.90	119.80	239.60	479.20	1198.00	2396.00	23960	6.00	5.98	6.00
6-0 to 6-6 . . . . (8/1/82)	61.69	123.38	246.76	493.52	1233.80	2467.60	24676	6.00	6.00	6.00
6-6 to 7-0 . . . . (2/1/83)	63.54	127.08	254.16	508.32	1270.80	2541.60	25416	6.00	6.01	6.00
7-0 to 7-6 . . . . (8/1/83)	65.45	130.90	261.80	523.60	1309.00	2618.00	26180	6.00	5.99	6.00
7-6 to 8-0 . . . . (2/1/84)	67.41	134.82	269.64	539.28	1348.20	2696.40	26964	6.00	6.02	6.00
8-0 to 8-6 . . . . (8/1/84)	69.44	138.88	277.76	555.52	1388.80	2777.60	27776	6.00	5.99	6.00
8-6 to 9-0 . . . . (2/1/85)	71.52	143.04	286.08	572.16	1430.40	2860.80	28608	6.00	5.98	6.00
9-0 to 9-6 . . . . (8/1/85)	73.66	147.32	294.64	589.28	1473.20	2946.40	29464	6.00	6.00	6.01
9-6 to10-0 . . . . (2/1/86)	75.87	151.74	303.48	606.96	1517.40	3034.80	30348	6.00	6.01	6.01
10-0 2/ . . . . . (8/1/86)	78.15	156.30	312.60	625.20	1563.00	3126.00	31260	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1956, enter each period. For issues of Jan. 1, 1957, add 1 month.
2/ Second extended maturity reached at 29 years 8 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 4.37 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 49-A

BONDS BEARING ISSUE DATE DEC. 1, 1957

Issue price / Denomination								Approximate investment yield (annual percentage rate)		
Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500			
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(11/1/76)	$43.35	$86.70	$173.40	$346.80	$867.00	$1734.00	$17340	----	6.00	6.00
0-6 to 1-0 . . . . (5/1/77)	44.65	89.30	178.60	357.20	893.00	1786.00	17860	6.00	6.00	6.00
1-0 to 1-6 . . . . (11/1/77)	45.99	91.98	183.96	367.92	919.80	1839.60	18396	6.00	6.00	6.00
1-6 to 2-0 . . . . (5/1/78)	47.37	94.74	189.48	378.96	947.40	1894.80	18948	6.00	6.00	6.00
2-0 to 2-6 . . . . (11/1/78)	48.79	97.58	195.16	390.32	975.80	1951.60	19516	6.00	5.98	6.00
2-6 to 3-0 . . . . (5/1/79)	50.25	100.50	201.00	402.00	1005.00	2010.00	20100	6.00	6.01	6.00
3-0 to 3-6 . . . . (11/1/79)	51.76	103.52	207.04	414.08	1035.20	2070.40	20704	6.00	6.03	6.00
3-6 to 4-0 . . . . (5/1/80)	53.32	106.64	213.28	426.56	1066.40	2132.80	21328	6.00	5.96	6.00
4-0 to 4-6 . . . . (11/1/80)	54.91	109.82	219.64	439.28	1098.20	2196.40	21964	6.00	6.01	6.00
4-6 to 5-0 . . . . (5/1/81)	56.56	113.12	226.24	452.48	1131.20	2262.40	22624	6.00	6.01	6.00
5-0 to 5-6 . . . . (11/1/81)	58.26	116.52	233.04	466.08	1165.20	2330.40	23304	6.00	6.01	6.00
5-6 to 6-0 . . . . (5/1/82)	60.01	120.02	240.04	480.08	1200.20	2400.40	24004	6.00	6.00	6.00
6-0 to 6-6 . . . . (11/1/82)	61.81	123.62	247.24	494.48	1236.20	2472.40	24724	6.00	5.99	6.00
6-6 to 7-0 . . . . (5/1/83)	63.66	127.32	254.64	509.28	1273.20	2546.40	25464	6.00	6.00	6.00
7-0 to 7-6 . . . . (11/1/83)	65.57	131.14	262.28	524.56	1311.40	2622.80	26228	6.00	6.01	6.00
7-6 to 8-0 . . . . (5/1/84)	67.54	135.08	270.16	540.32	1350.80	2701.60	27016	6.00	5.98	6.00
8-0 to 8-6 . . . . (11/1/84)	69.56	139.12	278.24	556.48	1391.20	2782.40	27824	6.00	6.01	6.00
8-6 to 9-0 . . . . (5/1/85)	71.65	143.30	286.60	573.20	1433.00	2866.00	28660	6.00	6.00	6.00
9-0 to 9-6 . . . . (11/1/85)	73.80	147.60	295.20	590.40	1476.00	2952.00	29520	6.00	5.99	5.99
9-6 to10-0 . . . . (5/1/86)	76.01	152.02	304.04	608.08	1520.20	3040.40	30404	6.00	6.00	6.00
10-0 2/ . . . . . (11/1/86)	78.29	156.58	313.16	626.32	1565.80	3131.60	31316	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1957, enter each period.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.00 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 50-A

BONDS BEARING ISSUE DATES FROM JAN. 1 THROUGH MAY 1, 1958

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/76)	$43.75	$87.50	$175.00	$350.00	$875.00	$1750.00	$17500	----	5.99	6.00
0-6 to 1-0 . . . . (6/1/77)	45.06	90.12	180.24	360.48	901.20	1802.40	18024	5.99	5.99	6.00
1-0 to 1-6 . . . . (12/1/77)	46.41	92.82	185.64	371.28	928.20	1856.40	18564	5.99	6.03	6.00
1-6 to 2-0 . . . . (6/1/78)	47.81	95.62	191.24	382.48	956.20	1912.40	19124	6.00	5.98	6.00
2-0 to 2-6 . . . . (12/1/78)	49.24	98.48	196.96	393.92	984.80	1969.60	19696	6.00	6.01	6.00
2-6 to 3-0 . . . . (6/1/79)	50.72	101.44	202.88	405.76	1014.40	2028.80	20288	6.00	5.99	6.00
3-0 to 3-6 . . . . (12/1/79)	52.24	104.48	208.96	417.92	1044.80	2089.60	20896	6.00	6.01	6.00
3-6 to 4-0 . . . . (6/1/80)	53.81	107.62	215.24	430.48	1076.20	2152.40	21524	6.00	5.98	6.00
4-0 to 4-6 . . . . (12/1/80)	55.42	110.84	221.68	443.36	1108.40	2216.80	22168	6.00	5.99	6.00
4-6 to 5-0 . . . . (6/1/81)	57.08	114.16	228.32	456.64	1141.60	2283.20	22832	6.00	6.03	6.00
5-0 to 5-6 . . . . (12/1/81)	58.80	117.60	235.20	470.40	1176.00	2352.00	23520	6.00	5.99	6.00
5-6 to 6-0 . . . . (6/1/82)	60.56	121.12	242.24	484.48	1211.20	2422.40	24224	6.00	6.01	6.00
6-0 to 6-6 . . . . (12/1/82)	62.38	124.76	249.52	499.04	1247.60	2495.20	24952	6.00	6.00	6.00
6-6 to 7-0 . . . . (6/1/83)	64.25	128.50	257.00	514.00	1285.00	2570.00	25700	6.00	6.01	6.00
7-0 to 7-6 . . . . (12/1/83)	66.18	132.36	264.72	529.44	1323.60	2647.20	26472	6.00	5.98	6.00
7-6 to 8-0 . . . . (6/1/84)	68.16	136.32	272.64	545.28	1363.20	2726.40	27264	6.00	6.02	6.00
8-0 to 8-6 . . . . (12/1/84)	70.21	140.42	280.84	561.68	1404.20	2808.40	28084	6.00	5.98	6.00
8-6 to 9-0 . . . . (6/1/85)	72.31	144.62	289.24	578.48	1446.20	2892.40	28924	6.00	6.00	6.00
9-0 to 9-6 . . . . (12/1/85)	74.48	148.96	297.92	595.84	1489.60	2979.20	29792	6.00	6.02	6.01
9-6 to 10-0 . . . . (6/1/86)	76.72	153.44	306.88	613.76	1534.40	3068.80	30688	6.00	6.00	6.00
10-0 2/ . . . . . (12/1/86)	79.02	158.04	316.08	632.16	1580.40	3160.80	31608	6.00 3/	----	----

1/ Month, day, and year on which issues of Jan. 1, 1958, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.04 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 51-A

BONDS BEARING ISSUE DATE JUNE 1, 1958

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(5/1/77)	$43.94	$87.88	$175.76	$351.52	$878.80	$1757.60	$17576	----	6.01	6.00
0-6 to 1-0 . . . . (11/1/77)	45.26	90.52	181.04	362.08	905.20	1810.40	18104	6.01	6.01	6.00
1-0 to 1-6 . . . . (5/1/78)	46.62	93.24	186.48	372.96	932.40	1864.80	18648	6.01	5.96	6.00
1-6 to 2-0 . . . . (11/1/78)	48.01	96.02	192.04	384.08	960.20	1920.40	19204	5.99	6.00	6.00
2-0 to 2-6 . . . . (5/1/79)	49.45	98.90	197.80	395.60	989.00	1978.00	19780	5.99	6.03	6.00
2-6 to 3-0 . . . . (11/1/79)	50.94	101.88	203.76	407.52	1018.80	2037.60	20376	6.00	6.01	6.00
3-0 to 3-6 . . . . (5/1/80)	52.47	104.94	209.88	419.76	1049.40	2098.80	20988	6.00	5.98	6.00
3-6 to 4-0 . . . . (11/1/80)	54.04	108.08	216.16	432.32	1080.80	2161.60	21616	6.00	6.00	6.00
4-0 to 4-6 . . . . (5/1/81)	55.66	111.32	222.64	445.28	1113.20	2226.40	22264	6.00	6.00	6.00
4-6 to 5-0 . . . . (11/1/81)	57.33	114.66	229.32	458.64	1146.60	2293.20	22932	6.00	6.00	6.00
5-0 to 5-6 . . . . (5/1/82)	59.05	118.10	236.20	472.40	1181.00	2362.00	23620	6.00	5.99	6.00
5-6 to 6-0 . . . . (11/1/82)	60.82	121.64	243.28	486.56	1216.40	2432.80	24328	6.00	6.02	6.00
6-0 to 6-6 . . . . (5/1/83)	62.65	125.30	250.60	501.20	1253.00	2506.00	25060	6.00	6.00	6.00
6-6 to 7-0 . . . . (11/1/83)	64.53	129.06	258.12	516.24	1290.60	2581.20	25812	6.00	5.98	6.00
7-0 to 7-6 . . . . (5/1/84)	66.46	132.92	265.84	531.68	1329.20	2658.40	26584	6.00	6.02	6.00
7-6 to 8-0 . . . . (11/1/84)	68.46	136.92	273.84	547.68	1369.20	2738.40	27384	6.00	5.99	6.00
8-0 to 8-6 . . . . (5/1/85)	70.51	141.02	282.04	564.08	1410.20	2820.40	28204	6.00	6.01	6.00
8-6 to 9-0 . . . . (11/1/85)	72.63	145.26	290.52	581.04	1452.60	2905.20	29052	6.00	5.98	6.00
9-0 to 9-6 . . . . (5/1/86)	74.80	149.60	299.20	598.40	1496.00	2992.00	29920	6.00	6.02	6.01
9-6 to10-0 . . . . (11/1/86)	77.05	154.10	308.20	616.40	1541.00	3082.00	30820	6.00	6.00	6.00
10-0 2/ . . . . . (5/1/87)	79.36	158.72	317.44	634.88	1587.20	3174.40	31744	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1958, enter each period.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.05 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 52-A

BONDS BEARING ISSUE DATES FROM JULY 1 THROUGH NOV. 1, 1958

Issue price . . . . Denomination	$18.75 25.00	$37.50 50.00	$75.00 100.00	$150.00 200.00	$375.00 500.00	$750.00 1000.00	$7500 10000	Approximate investment yield (annual percentage rate)		
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/77)	$44.34	$88.68	$177.36	$354.72	$886.80	$1773.60	$17736	----	6.00	6.00
0-6 to 1-0 . . . . (12/1/77)	45.67	91.34	182.68	365.36	913.40	1826.80	18268	6.00	6.00	6.00
1-0 to 1-6 . . . . (6/1/78)	47.04	94.08	188.16	376.32	940.80	1881.60	18816	6.00	5.99	6.00
1-6 to 2-0 . . . . (12/1/78)	48.45	96.90	193.80	387.60	969.00	1938.00	19380	6.00	6.03	6.00
2-0 to 2-6 . . . . (6/1/79)	49.91	99.82	199.64	399.28	998.20	1996.40	19964	6.01	5.97	6.00
2-6 to 3-0 . . . . (12/1/79)	51.40	102.80	205.60	411.20	1028.00	2056.00	20560	6.00	5.99	6.00
3-0 to 3-6 . . . . (6/1/80)	52.94	105.88	211.76	423.52	1058.80	2117.60	21176	6.00	6.01	6.00
3-6 to 4-0 . . . . (12/1/80)	54.53	109.06	218.12	436.24	1090.60	2181.20	21812	6.00	6.02	6.00
4-0 to 4-6 . . . . (6/1/81)	56.17	112.34	224.68	449.36	1123.40	2246.80	22468	6.00	5.98	6.00
4-6 to 5-0 . . . . (12/1/81)	57.85	115.70	231.40	462.80	1157.00	2314.00	23140	6.00	6.02	6.00
5-0 to 5-6 . . . . (6/1/82)	59.59	119.18	238.36	476.72	1191.80	2383.60	23836	6.00	6.01	6.00
5-6 to 6-0 . . . . (12/1/82)	61.38	122.76	245.52	491.04	1227.60	2455.20	24552	6.00	6.00	6.00
6-0 to 6-6 . . . . (6/1/83)	63.22	126.44	252.88	505.76	1264.40	2528.80	25288	6.00	5.98	6.00
6-6 to 7-0 . . . . (12/1/83)	65.11	130.22	260.44	520.88	1302.20	2604.40	26044	6.00	6.02	6.00
7-0 to 7-6 . . . . (6/1/84)	67.07	134.14	268.28	536.56	1341.40	2682.80	26828	6.00	5.99	6.00
7-6 to 8-0 . . . . (12/1/84)	69.08	138.16	276.32	552.64	1381.60	2763.20	27632	6.00	5.99	6.00
8-0 to 8-6 . . . . (6/1/85)	71.15	142.30	284.60	569.20	1423.00	2846.00	28460	6.00	6.02	6.00
8-6 to 9-0 . . . . (12/1/85)	73.29	146.58	293.16	586.32	1465.80	2931.60	29316	6.00	6.00	5.99
9-0 to 9-6 . . . . (6/1/86)	75.49	150.98	301.96	603.92	1509.80	3019.60	30196	6.00	5.99	5.99
9-6 to10-0 . . . . (12/1/86)	77.75	155.50	311.00	622.00	1555.00	3110.00	31100	6.00	5.99	5.99
10-0 2/ . . . . . (6/1/87)	80.08	160.16	320.32	640.64	1601.60	3203.20	32032	6.00 3/	----	----

1/ Month, day, and year on which issues of July 1, 1958, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.08 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 53-A

BONDS BEARING ISSUE DATE DEC. 1, 1958

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 18 years 11 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(11/1/77)	$44.54	$89.08	$178.16	$356.32	$890.80	$1781.60	$17816	----	6.02	6.00
0-6 to 1-0 . . . . (5/1/78)	45.88	91.76	183.52	367.04	917.60	1835.20	18352	6.02	5.97	6.00
1-0 to 1-6 . . . . (11/1/78)	47.25	94.50	189.00	378.00	945.00	1890.00	18900	5.99	6.01	6.00
1-6 to 2-0 . . . . (5/1/79)	48.67	97.34	194.68	389.36	973.40	1946.80	19468	6.00	6.00	6.00
2-0 to 2-6 . . . . (11/1/79)	50.13	100.26	200.52	401.04	1002.60	2005.20	20052	6.00	5.98	6.00
2-6 to 3-0 . . . . (5/1/80)	51.63	103.26	206.52	413.04	1032.60	2065.20	20652	6.00	6.00	6.00
3-0 to 3-6 . . . . (11/1/80)	53.18	106.36	212.72	425.44	1063.60	2127.20	21272	6.00	6.02	6.00
3-6 to 4-0 . . . . (5/1/81)	54.78	109.56	219.12	438.24	1095.60	2191.20	21912	6.00	5.99	6.00
4-0 to 4-6 . . . . (11/1/81)	56.42	112.84	225.68	451.36	1128.40	2256.80	22568	6.00	5.99	6.00
4-6 to 5-0 . . . . (5/1/82)	58.11	116.22	232.44	464.88	1162.20	2324.40	23244	6.00	6.02	6.00
5-0 to 5-6 . . . . (11/1/82)	59.86	119.72	239.44	478.88	1197.20	2394.40	23944	6.00	5.98	6.00
5-6 to 6-0 . . . . (5/1/83)	61.65	123.30	246.60	493.20	1233.00	2466.00	24660	6.00	6.00	6.00
6-0 to 6-6 . . . . (11/1/83)	63.50	127.00	254.00	508.00	1270.00	2540.00	25400	6.00	6.02	6.00
6-6 to 7-0 . . . . (5/1/84)	65.41	130.82	261.64	523.28	1308.20	2616.40	26164	6.00	5.99	6.00
7-0 to 7-6 . . . . (11/1/84)	67.37	134.74	269.48	538.96	1347.40	2694.80	26948	6.00	6.00	6.00
7-6 to 8-0 . . . . (5/1/85)	69.39	138.78	277.56	555.12	1387.80	2775.60	27756	6.00	6.00	6.00
8-0 to 8-6 . . . . (11/1/85)	71.47	142.94	285.88	571.76	1429.40	2858.80	28588	6.00	6.02	6.00
8-6 to 9-0 . . . . (5/1/86)	73.62	147.24	294.48	588.96	1472.40	2944.80	29448	6.00	6.00	5.99
9-0 to 9-6 . . . . (11/1/86)	75.83	151.66	303.32	606.64	1516.60	3033.20	30332	6.00	5.99	5.99
9-6 to10-0 . . . . (5/1/87)	78.10	156.20	312.40	624.80	1562.00	3124.00	31240	6.00	5.99	5.99
10-0 2/ . . . . . (11/1/87)	80.44	160.88	321.76	643.52	1608.80	3217.60	32176	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1958, enter each period.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.10 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 54-A

BONDS BEARING ISSUE DATES FROM JAN. 1 THROUGH MAY 1, 1959

Issue price / Denomination		$18.75 / 25.00	$37.50 / 50.00	$75.00 / 100.00	$150.00 / 200.00	$375.00 / 500.00	$750.00 / 1000.00	$7500 / 10000	Approximate investment yield (annual percentage rate)		
Period (years and months after first extended maturity at 18 years 11 months)		(1) Redemption values during each half-year period (values increase on first day of period)* — SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
									Percent	Percent	Percent
0-0 to 0-6	1/(12/1/77)	$44.95	$89.90	$179.80	$359.60	$899.00	$1798.00	$17980	----	6.01	6.00
0-6 to 1-0	(6/1/78)	46.30	92.60	185.20	370.40	926.00	1852.00	18520	6.01	6.00	6.00
1-0 to 1-6	(12/1/78)	47.69	95.38	190.76	381.52	953.80	1907.60	19076	6.01	6.00	6.00
1-6 to 2-0	(6/1/79)	49.12	98.24	196.48	392.96	982.40	1964.80	19648	6.00	5.99	6.00
2-0 to 2-6	(12/1/79)	50.59	101.18	202.36	404.72	1011.80	2023.60	20236	6.00	6.01	6.00
2-6 to 3-0	(6/1/80)	52.11	104.22	208.44	416.88	1042.20	2084.40	20844	6.00	5.99	6.00
3-0 to 3-6	(12/1/80)	53.67	107.34	214.68	429.36	1073.40	2146.80	21468	6.00	6.00	6.00
3-6 to 4-0	(6/1/81)	55.28	110.56	221.12	442.24	1105.60	2211.20	22112	6.00	6.01	6.00
4-0 to 4-6	(12/1/81)	56.94	113.88	227.76	455.52	1138.80	2277.60	22776	6.00	6.01	6.00
4-6 to 5-0	(6/1/82)	58.65	117.30	234.60	469.20	1173.00	2346.00	23460	6.00	6.00	6.00
5-0 to 5-6	(12/1/82)	60.41	120.82	241.64	483.28	1208.20	2416.40	24164	6.00	5.99	6.00
5-6 to 6-0	(6/1/83)	62.22	124.44	248.88	497.76	1244.40	2488.80	24888	6.00	6.01	6.00
6-0 to 6-6	(12/1/83)	64.09	128.18	256.36	512.72	1281.80	2563.60	25636	6.00	5.99	6.00
6-6 to 7-0	(6/1/84)	66.01	132.02	264.04	528.08	1320.20	2640.40	26404	6.00	6.00	6.00
7-0 to 7-6	(12/1/84)	67.99	135.98	271.96	543.92	1359.80	2719.60	27196	6.00	6.00	6.00
7-6 to 8-0	(6/1/85)	70.03	140.06	280.12	560.24	1400.60	2801.20	28012	6.00	6.00	6.00
8-0 to 8-6	(12/1/85)	72.13	144.26	288.52	577.04	1442.60	2885.20	28852	6.00	6.02	6.00
8-6 to 9-0	(6/1/86)	74.30	148.60	297.20	594.40	1486.00	2972.00	29720	6.00	5.98	5.99
9-0 to 9-6	(12/1/86)	76.52	153.04	306.08	612.16	1530.40	3060.80	30608	6.00	6.01	6.00
9-6 to 10-0	(6/1/87)	78.82	157.64	315.28	630.56	1576.40	3152.80	31528	6.00	5.99	5.99
10-0 2/	(12/1/87)	81.18	162.36	324.72	649.44	1623.60	3247.20	32472	6.00 3/	----	----

1/ Month, day, and year on which issues of Jan. 1, 1959, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 28 years 11 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.13 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 55-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH AUG. 1, 1959

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(3/1/77)	$42.25	$84.50	$169.00	$338.00	$845.00	$1690.00	$16900	----	6.01	6.00
0-6 to 1-0 . . . . (9/1/77)	43.52	87.04	174.08	348.16	870.40	1740.80	17408	6.01	5.97	6.00
1-0 to 1-6 . . . . (3/1/78)	44.82	89.64	179.28	358.56	896.40	1792.80	17928	5.99	6.02	6.00
1-6 to 2-0 . . . . (9/1/78)	46.17	92.34	184.68	369.36	923.40	1846.80	18468	6.00	5.98	6.00
2-0 to 2-6 . . . . (3/1/79)	47.55	95.10	190.20	380.40	951.00	1902.00	19020	6.00	6.01	6.00
2-6 to 3-0 . . . . (9/1/79)	48.98	97.96	195.92	391.84	979.60	1959.20	19592	6.00	6.00	6.00
3-0 to 3-6 . . . . (3/1/80)	50.45	100.90	201.80	403.60	1009.00	2018.00	20180	6.00	5.99	6.00
3-6 to 4-0 . . . . (9/1/80)	51.96	103.92	207.84	415.68	1039.20	2078.40	20784	6.00	6.00	6.00
4-0 to 4-6 . . . . (3/1/81)	53.52	107.04	214.08	428.16	1070.40	2140.80	21408	6.00	6.02	6.00
4-6 to 5-0 . . . . (9/1/81)	55.13	110.26	220.52	441.04	1102.60	2205.20	22052	6.00	5.99	6.00
5-0 to 5-6 . . . . (3/1/82)	56.78	113.56	227.12	454.24	1135.60	2271.20	22712	6.00	5.99	6.00
5-6 to 6-0 . . . . (9/1/82)	58.48	116.96	233.92	467.84	1169.60	2339.20	23392	6.00	6.02	6.00
6-0 to 6-6 . . . . (3/1/83)	60.24	120.48	240.96	481.92	1204.80	2409.60	24096	6.00	6.01	6.00
6-6 to 7-0 . . . . (9/1/83)	62.05	124.10	248.20	496.40	1241.00	2482.00	24820	6.00	6.00	6.00
7-0 to 7-6 . . . . (3/1/84)	63.91	127.82	255.64	511.28	1278.20	2556.40	25564	6.00	5.98	6.00
7-6 to 8-0 . . . . (9/1/84)	65.82	131.64	263.28	526.56	1316.40	2632.80	26328	6.00	6.02	6.00
8-0 to 8-6 . . . . (3/1/85)	67.80	135.60	271.20	542.40	1356.00	2712.00	27120	6.00	5.99	6.00
8-6 to 9-0 . . . . (9/1/85)	69.83	139.66	279.32	558.64	1396.60	2793.20	27932	6.00	6.01	6.00
9-0 to 9-6 . . . . (3/1/86)	71.93	143.86	287.72	575.44	1438.60	2877.20	28772	6.00	6.01	6.00
9-6 to 10-0 . . . . (9/1/86)	74.09	148.18	296.36	592.72	1481.80	2963.60	29636	6.00	5.99	5.99
10-0 2/ . . . . . .(3/1/87)	76.31	152.62	305.24	610.48	1526.20	3052.40	30524	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1959, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.12 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 56-A

BONDS BEARING ISSUE DATES FROM SEPT. 1 THROUGH NOV. 1, 1959

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 ... 1/(6/1/77)	$42.62	$85.24	$170.48	$340.96	$852.40	$1704.80	$17048	----	6.01	6.00
0-6 to 1-0 .... (12/1/77)	43.90	87.80	175.60	351.20	878.00	1756.00	17560	6.01	6.01	6.00
1-0 to 1-6 .... (6/1/78)	45.22	90.44	180.88	361.76	904.40	1808.80	18088	6.01	5.97	6.00
1-6 to 2-0 .... (12/1/78)	46.57	93.14	186.28	372.56	931.40	1862.80	18628	6.00	6.01	6.00
2-0 to 2-6 .... (6/1/79)	47.97	95.94	191.88	383.76	959.40	1918.80	19188	6.00	6.00	6.00
2-6 to 3-0 .... (12/1/79)	49.41	98.82	197.64	395.28	988.20	1976.40	19764	6.00	5.99	6.00
3-0 to 3-6 .... (6/1/80)	50.89	101.78	203.56	407.12	1017.80	2035.60	20356	6.00	6.01	6.00
3-6 to 4-0 .... (12/1/80)	52.42	104.84	209.68	419.36	1048.40	2096.80	20968	6.00	5.99	6.00
4-0 to 4-6 .... (6/1/81)	53.99	107.98	215.96	431.92	1079.80	2159.60	21596	6.00	6.00	6.00
4-6 to 5-0 .... (12/1/81)	55.61	111.22	222.44	444.88	1112.20	2224.40	22244	6.00	6.01	6.00
5-0 to 5-6 .... (6/1/82)	57.28	114.56	229.12	458.24	1145.60	2291.20	22912	6.00	6.01	6.00
5-6 to 6-0 .... (12/1/82)	59.00	118.00	236.00	472.00	1180.00	2360.00	23600	6.00	6.00	6.00
6-0 to 6-6 .... (6/1/83)	60.77	121.54	243.08	486.16	1215.40	2430.80	24308	6.00	5.99	6.00
6-6 to 7-0 .... (12/1/83)	62.59	125.18	250.36	500.72	1251.80	2503.60	25036	6.00	6.01	6.00
7-0 to 7-6 .... (6/1/84)	64.47	128.94	257.88	515.76	1289.40	2578.80	25788	6.00	5.99	6.00
7-6 to 8-0 .... (12/1/84)	66.40	132.80	265.60	531.20	1328.00	2656.00	26560	6.00	5.99	6.00
8-0 to 8-6 .... (6/1/85)	68.39	136.78	273.56	547.12	1367.80	2735.60	27356	6.00	6.00	6.00
8-6 to 9-0 .... (12/1/85)	70.44	140.88	281.76	563.52	1408.80	2817.60	28176	6.00	6.02	6.01
9-0 to 9-6 .... (6/1/86)	72.56	145.12	290.24	580.48	1451.20	2902.40	29024	6.00	5.98	6.00
9-6 to10-0 .... (12/1/86)	74.73	149.46	298.92	597.84	1494.60	2989.20	29892	6.00	6.02	6.02
10-0 2/ ..... (6/1/87)	76.98	153.96	307.92	615.84	1539.60	3079.20	30792	6.00 3/	----	----

1/ Month, day, and year on which issues of Sept. 1, 1959, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.15 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 57-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1959, THROUGH FEB. 1, 1960

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(9/1/77)	$42.72	$85.44	$170.88	$341.76	$854.40	$1708.80	$17088	----	5.99	6.00
0-6 to 1-0 . . . . (3/1/78)	44.00	88.00	176.00	352.00	880.00	1760.00	17600	5.99	6.00	6.00
1-0 to 1-6 . . . . (9/1/78)	45.32	90.64	181.28	362.56	906.40	1812.80	18128	6.00	6.00	6.00
1-6 to 2-0 . . . . (3/1/79)	46.68	93.36	186.72	373.44	933.60	1867.20	18672	6.00	6.00	6.00
2-0 to 2-6 . . . . (9/1/79)	48.08	96.16	192.32	384.64	961.60	1923.20	19232	6.00	5.99	6.00
2-6 to 3-0 . . . . (3/1/80)	49.52	99.04	198.08	396.16	990.40	1980.80	19808	6.00	6.02	6.00
3-0 to 3-6 . . . . (9/1/80)	51.01	102.02	204.04	408.08	1020.20	2040.40	20404	6.00	6.00	6.00
3-6 to 4-0 . . . . (3/1/81)	52.54	105.08	210.16	420.32	1050.80	2101.60	21016	6.00	6.01	6.00
4-0 to 4-6 . . . . (9/1/81)	54.12	108.24	216.48	432.96	1082.40	2164.80	21648	6.00	5.99	6.00
4-6 to 5-0 . . . . (3/1/82)	55.74	111.48	222.96	445.92	1114.80	2229.60	22296	6.00	5.99	6.00
5-0 to 5-6 . . . . (9/1/82)	57.41	114.82	229.64	459.28	1148.20	2296.40	22964	6.00	5.99	6.00
5-6 to 6-0 . . . . (3/1/83)	59.13	118.26	236.52	473.04	1182.60	2365.20	23652	6.00	6.02	6.00
6-0 to 6-6 . . . . (9/1/83)	60.91	121.82	243.64	487.28	1218.20	2436.40	24364	6.00	6.01	6.00
6-6 to 7-0 . . . . (3/1/84)	62.74	125.48	250.96	501.92	1254.80	2509.60	25096	6.00	5.99	6.00
7-0 to 7-6 . . . . (9/1/84)	64.62	129.24	258.48	516.96	1292.40	2584.80	25848	6.00	6.00	6.00
7-6 to 8-0 . . . . (3/1/85)	66.56	133.12	266.24	532.48	1331.20	2662.40	26624	6.00	5.98	6.00
8-0 to 8-6 . . . . (9/1/85)	68.55	137.10	274.20	548.40	1371.00	2742.00	27420	6.00	6.01	6.00
8-6 to 9-0 . . . . (3/1/86)	70.61	141.22	282.44	564.88	1412.20	2824.40	28244	6.00	6.00	6.00
9-0 to 9-6 . . . . (9/1/86)	72.73	145.46	290.92	581.84	1454.60	2909.20	29092	6.00	5.99	6.00
9-6 to10-0 . . . . (3/1/87)	74.91	149.82	299.64	599.28	1498.20	2996.40	29964	6.00	6.01	6.01
10-0 2/ . . . . . (9/1/87)	77.16	154.32	308.64	617.28	1543.20	3086.40	30864	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1959, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.16 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 58-A

BONDS BEARING ISSUE DATES FROM MARCH 1 THROUGH MAY 1, 1960

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD**							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/77)	$43.10	$86.20	$172.40	$344.80	$862.00	$1724.00	$17240	----	5.99	6.00
0-6 to 1-0 . . . . (6/1/78)	44.39	88.78	177.56	355.12	887.80	1775.60	17756	5.99	5.99	6.00
1-0 to 1-6 . . . . (12/1/78)	45.72	91.44	182.88	365.76	914.40	1828.80	18288	5.99	6.04	6.00
1-6 to 2-0 . . . . (6/1/79)	47.10	94.20	188.40	376.80	942.00	1884.00	18840	6.01	5.99	6.00
2-0 to 2-6 . . . . (12/1/79)	48.51	97.02	194.04	388.08	970.20	1940.40	19404	6.00	5.98	6.00
2-6 to 3-0 . . . . (6/1/80)	49.96	99.92	199.84	399.68	999.20	1998.40	19984	6.00	6.00	6.00
3-0 to 3-6 . . . . (12/1/80)	51.46	102.92	205.84	411.68	1029.20	2058.40	20584	6.00	6.02	6.00
3-6 to 4-0 . . . . (6/1/81)	53.01	106.02	212.04	424.08	1060.20	2120.40	21204	6.00	6.00	6.00
4-0 to 4-6 . . . . (12/1/81)	54.60	109.20	218.40	436.80	1092.00	2184.00	21840	6.00	6.01	6.00
4-6 to 5-0 . . . . (6/1/82)	56.24	112.48	224.96	449.92	1124.80	2249.60	22496	6.00	5.97	6.00
5-0 to 5-6 . . . . (12/1/82)	57.92	115.84	231.68	463.36	1158.40	2316.80	23168	6.00	6.01	6.00
5-6 to 6-0 . . . . (6/1/83)	59.66	119.32	238.64	477.28	1193.20	2386.40	23864	6.00	6.00	6.00
6-0 to 6-6 . . . . (12/1/83)	61.45	122.90	245.80	491.60	1229.00	2458.00	24580	6.00	5.99	6.00
6-6 to 7-0 . . . . (6/1/84)	63.29	126.58	253.16	506.32	1265.80	2531.60	25316	6.00	6.00	6.00
7-0 to 7-6 . . . . (12/1/84)	65.19	130.38	260.76	521.52	1303.80	2607.60	26076	6.00	6.01	6.00
7-6 to 8-0 . . . . (6/1/85)	67.15	134.30	268.60	537.20	1343.00	2686.00	26860	6.00	5.99	6.00
8-0 to 8-6 . . . . (12/1/85)	69.16	138.32	276.64	553.28	1383.20	2766.40	27664	6.00	6.02	6.00
8-6 to 9-0 . . . . (6/1/86)	71.24	142.48	284.96	569.92	1424.80	2849.60	28496	6.00	5.98	5.99
9-0 to 9-6 . . . . (12/1/86)	73.37	146.74	293.48	586.96	1467.40	2934.80	29348	6.00	6.02	6.00
9-6 to10-0 . . . . (6/1/87)	75.58	151.16	302.32	604.64	1511.60	3023.20	30232	6.00	5.98	5.98
10-0 2/ . . . . . (12/1/87)	77.84	155.68	311.36	622.72	1556.80	3113.60	31136	6.00 3/	----	----

1/ Month, day, and year on which issues of March 1, 1960, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.20 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 91-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1970, THROUGH MAY 1, 1971

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 5 years 10 months)	(1) Redemption values during each half-year period (values increase on first day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(10/1/76)	$26.08	$52.16	$78.24	$104.32	$208.64	$521.60	$1043.20	$10432	----	5.98	6.00
0-6 to 1-0 . . . . (4/1/77)	26.86	53.72	80.58	107.44	214.88	537.20	1074.40	10744	5.98	6.03	6.00
1-0 to 1-6 . . . . (10/1/77)	27.67	55.34	83.01	110.68	221.36	553.40	1106.80	11068	6.01	6.00	6.00
1-6 to 2-0 . . . . (4/1/78)	28.50	57.00	85.50	114.00	228.00	570.00	1140.00	11400	6.00	5.96	6.00
2-0 to 2-6 . . . . (10/1/78)	29.35	58.70	88.05	117.40	234.80	587.00	1174.00	11740	5.99	6.00	6.00
2-6 to 3-0 . . . . (4/1/79)	30.23	60.46	90.69	120.92	241.84	604.60	1209.20	12092	5.99	6.02	6.00
3-0 to 3-6 . . . . (10/1/79)	31.14	62.28	93.42	124.56	249.12	622.80	1245.60	12456	6.00	6.04	6.00
3-6 to 4-0 . . . . (4/1/80)	32.08	64.16	96.24	128.32	256.64	641.60	1283.20	12832	6.00	5.99	6.00
4-0 to 4-6 . . . . (10/1/80)	33.04	66.08	99.12	132.16	264.32	660.80	1321.60	13216	6.00	5.99	6.00
4-6 to 5-0 . . . . (4/1/81)	34.03	68.06	102.09	136.12	272.24	680.60	1361.20	13612	6.00	5.99	6.00
5-0 to 5-6 . . . . (10/1/81)	35.05	70.10	105.15	140.20	280.40	701.00	1402.00	14020	6.00	5.99	6.00
5-6 to 6-0 . . . . (4/1/82)	36.10	72.20	108.30	144.40	288.80	722.00	1444.00	14440	6.00	5.98	6.00
6-0 to 6-6 . . . . (10/1/82)	37.18	74.36	111.54	148.72	297.44	743.60	1487.20	14872	6.00	6.02	6.00
6-6 to 7-0 . . . . (4/1/83)	38.30	76.60	114.90	153.20	306.40	766.00	1532.00	15320	6.00	6.01	6.00
7-0 to 7-6 . . . . (10/1/83)	39.45	78.90	118.35	157.80	315.60	789.00	1578.00	15780	6.00	5.98	6.00
7-6 to 8-0 . . . . (4/1/84)	40.63	81.26	121.89	162.52	325.04	812.60	1625.20	16252	6.00	6.01	6.00
8-0 to 8-6 . . . . (10/1/84)	41.85	83.70	125.55	167.40	334.80	837.00	1674.00	16740	6.00	6.02	6.00
8-6 to 9-0 . . . . (4/1/85)	43.11	86.22	129.33	172.44	344.88	862.20	1724.40	17244	6.00	5.98	5.99
9-0 to 9-6 . . . . (10/1/85)	44.40	88.80	133.20	177.60	355.20	888.00	1776.00	17760	6.00	5.99	5.99
9-6 to 10-0 . . . . (4/1/86)	45.73	91.46	137.19	182.92	365.84	914.60	1829.20	18292	6.00	5.99	5.99
10-0 2/ . . . . . (10/1/86)	47.10	94.20	141.30	188.40	376.80	942.00	1884.00	18840	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1970, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 10 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.90 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 92-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1971

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000	(annual percentage rate)		
Period (years and months after original maturity at 5 years 10 months)	(1) Redemption values during each half-year period (values increase on first day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(4/1/77)	$26.15	$52.30	$78.45	$104.60	$209.20	$523.00	$1046.00	$10460	----	5.97	6.00
0-6 to 1-0 . . . . (10/1/77)	26.93	53.86	80.79	107.72	215.44	538.60	1077.20	10772	5.97	6.02	6.00
1-0 to 1-6 . . . . (4/1/78)	27.74	55.48	83.22	110.96	221.92	554.80	1109.60	11096	5.99	5.98	6.00
1-6 to 2-0 . . . . (10/1/78)	28.57	57.14	85.71	114.28	228.56	571.40	1142.80	11428	5.99	6.02	6.00
2-0 to 2-6 . . . . (4/1/79)	29.43	58.86	88.29	117.72	235.44	588.60	1177.20	11772	6.00	6.05	6.00
2-6 to 3-0 . . . . (10/1/79)	30.32	60.64	90.96	121.28	242.56	606.40	1212.80	12128	6.01	5.94	6.00
3-0 to 3-6 . . . . (4/1/80)	31.22	62.44	93.66	124.88	249.76	624.40	1248.80	12488	6.00	6.02	6.00
3-6 to 4-0 . . . . (10/1/80)	32.16	64.32	96.48	128.64	257.28	643.20	1286.40	12864	6.00	6.03	6.00
4-0 to 4-6 . . . . (4/1/81)	33.13	66.26	99.39	132.52	265.04	662.60	1325.20	13252	6.00	5.98	6.00
4-6 to 5-0 . . . . (10/1/81)	34.12	68.24	102.36	136.48	272.96	682.40	1364.80	13648	6.00	5.98	6.00
5-0 to 5-6 . . . . (4/1/82)	35.14	70.28	105.42	140.56	281.12	702.80	1405.60	14056	6.00	6.03	6.00
5-6 to 6-0 . . . . (10/1/82)	36.20	72.40	108.60	144.80	289.60	724.00	1448.00	14480	6.00	5.97	6.00
6-0 to 6-6 . . . . (4/1/83)	37.28	74.56	111.84	149.12	298.24	745.60	1491.20	14912	6.00	6.01	6.00
6-6 to 7-0 . . . . (10/1/83)	38.40	76.80	115.20	153.60	307.20	768.00	1536.00	15360	6.00	5.99	6.00
7-0 to 7-6 . . . . (4/1/84)	39.55	79.10	118.65	158.20	316.40	791.00	1582.00	15820	6.00	6.02	6.00
7-6 to 8-0 . . . . (10/1/84)	40.74	81.48	122.22	162.96	325.92	814.80	1629.60	16296	6.00	5.99	6.00
8-0 to 8-6 . . . . (4/1/85)	41.96	83.92	125.88	167.84	335.68	839.20	1678.40	16784	6.00	6.01	6.00
8-6 to 9-0 . . . . (10/1/85)	43.22	86.44	129.66	172.88	345.76	864.40	1728.80	17288	6.00	6.02	6.00
9-0 to 9-6 . . . . (4/1/86)	44.52	89.04	133.56	178.08	356.16	890.40	1780.80	17808	6.00	5.97	6.00
9-6 to10-0 . . . . (10/1/86)	45.85	91.70	137.55	183.40	366.80	917.00	1834.00	18340	6.00	6.02	6.02
10-0 2/ . . . . . (4/1/87)	47.23	94.46	141.69	188.92	377.84	944.60	1889.20	18892	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1971, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 10 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.92 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 93-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1971, THROUGH MAY 1, 1972

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 5 years 10 months)	(1) Redemption values during each half-year period (values increase on first day of period)* EXTENDED MATURITY PERIOD**								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(10/1/77)	$26.21	$52.42	$78.63	$104.84	$209.68	$524.20	$1048.40	$10484	----	6.03	6.00
0-6 to 1-0 . . . . (4/1/78)	27.00	54.00	81.00	108.00	216.00	540.00	1080.00	10800	6.03	6.00	6.00
1-0 to 1-6 . . . . (10/1/78)	27.81	55.62	83.43	111.24	222.48	556.20	1112.40	11124	6.01	5.97	6.00
1-6 to 2-0 . . . . (4/1/79)	28.64	57.28	85.92	114.56	229.12	572.80	1145.60	11456	6.00	6.01	6.00
2-0 to 2-6 . . . . (10/1/79)	29.50	59.00	88.50	118.00	236.00	590.00	1180.00	11800	6.00	5.97	6.00
2-6 to 3-0 . . . . (4/1/80)	30.38	60.76	91.14	121.52	243.04	607.60	1215.20	12152	5.99	6.06	6.00
3-0 to 3-6 . . . . (10/1/80)	31.30	62.60	93.90	125.20	250.40	626.00	1252.00	12520	6.00	5.94	6.00
3-6 to 4-0 . . . . (4/1/81)	32.23	64.46	96.69	128.92	257.84	644.60	1289.20	12892	6.00	6.02	6.00
4-0 to 4-6 . . . . (10/1/81)	33.20	66.40	99.60	132.80	265.60	664.00	1328.00	13280	6.00	6.02	6.00
4-6 to 5-0 . . . . (4/1/82)	34.20	68.40	102.60	136.80	273.60	684.00	1368.00	13680	6.00	5.96	6.00
5-0 to 5-6 . . . . (10/1/82)	35.22	70.44	105.66	140.88	281.76	704.40	1408.80	14088	6.00	6.02	6.00
5-6 to 6-0 . . . . (4/1/83)	36.28	72.56	108.84	145.12	290.24	725.60	1451.20	14512	6.00	6.01	6.00
6-0 to 6-6 . . . . (10/1/83)	37.37	74.74	112.11	149.48	298.96	747.40	1494.80	14948	6.00	5.99	6.00
6-6 to 7-0 . . . . (4/1/84)	38.49	76.98	115.47	153.96	307.92	769.80	1539.60	15396	6.00	5.98	6.00
7-0 to 7-6 . . . . (10/1/84)	39.64	79.28	118.92	158.56	317.12	792.80	1585.60	15856	6.00	6.00	6.01
7-6 to 8-0 . . . . (4/1/85)	40.83	81.66	122.49	163.32	326.64	816.60	1633.20	16332	6.00	6.02	6.01
8-0 to 8-6 . . . . (10/1/85)	42.06	84.12	126.18	168.24	336.48	841.20	1682.40	16824	6.00	5.99	6.00
8-6 to 9-0 . . . . (4/1/86)	43.32	86.64	129.96	173.28	346.56	866.40	1732.80	17328	6.00	6.00	6.00
9-0 to 9-6 . . . . (10/1/86)	44.62	89.24	133.86	178.48	356.96	892.40	1784.80	17848	6.00	6.01	6.01
9-6 to10-0 . . . . (4/1/87)	45.96	91.92	137.88	183.84	367.68	919.20	1838.40	18384	6.00	6.01	6.01
10-0 2/ . . . . . (10/1/87)	47.34	94.68	142.02	189.36	378.72	946.80	1893.60	18936	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1971, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 10 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.94 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

TABLE 97

BONDS BEARING ISSUE DATES FROM DEC. 1, 1973, THROUGH AUG. 1, 1976

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$ 7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after issue)	(1) Redemption values during each half-year period (values increase on first day of period)								(2) From issue date to beginning of each ½-yr. period	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to maturity
									Percent	Percent	Percent
0-0 to 0-6 ... 1/(12/1/73)	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$ 7500	----	3.73	6.00
0-6 to 1-0 .... (6/1/74)	19.10	38.20	57.30	76.40	152.80	382.00	764.00	7640	3.73	5.34	6.25
1-0 to 1-6 .... (12/1/74)	19.61	39.22	58.83	78.44	156.88	392.20	784.40	7844	4.54	5.00	6.37
1-6 to 2-0 .... (6/1/75)	20.10	40.20	60.30	80.40	160.80	402.00	804.00	8040	4.69	4.98	6.57
2-0 to 2-6 .... (12/1/75)	20.60	41.20	61.80	82.40	164.80	412.00	824.00	8240	4.76	5.24	6.83
2-6 to 3-0 .... (6/1/76)	21.14	42.28	63.42	84.56	169.12	422.80	845.60	8456	4.86	5.39	7.15
3-0 to 3-6 .... (12/1/76)	21.71	43.42	65.13	86.84	173.68	434.20	868.40	8684	4.95	5.53	7.59
3-6 to 4-0 .... (6/1/77)	22.31	44.62	66.93	89.24	178.48	446.20	892.40	8924	5.03	5.92	8.29
4-0 to 4-6 .... (12/1/77)	22.97	45.94	68.91	91.88	183.76	459.40	918.80	9188	5.14	6.09	9.48
4-6 to 5-0 .... (6/1/78)	23.67	47.34	71.01	94.68	189.36	473.40	946.80	9468	5.25	12.93	12.93
5-0 2/ ..... (12/1/78)	25.20	50.40	75.60	100.80	201.60	504.00	1008.00	10080	6.00	----	----

1/ Month, day and year on which issues of December 1, 1973, enter each period. These are representative dates. For subsequent issue dates, substitute the month, day and year of issue on the first line, and the appropriate six-month accrual date on each succeeding line. For example: if the issue date of the bond is October 1, 1974, the entries on succeeding lines in this column would be 10/1/74, 4/1/75, 10/1/75, 4/1/76, 10/1/76, etc., to the maturity date of 10/1/79; if the issue date of the bond is July 1, 1976, the line entries would be 7/1/76, 1/1/77, 7/1/77, 1/1/78, 7/1/78, etc., to the maturity date of 7/1/81.

2/ Maturity value reached at 5 years and 0 months after issue.

Exhibit 10.—Department Circular No. 905, Sixth Revision, March 18, 1974, First Amendment, First Supplement, offering of United States savings bonds, series H

DEPARTMENT OF THE TREASURY,
Washington, August 10, 1976.

The Department of the Treasury is announcing the interest payments and investment yields for United States Savings Bonds, Series H, of various issue dates which are entering their next extended maturity periods.

Accordingly, Department of the Treasury Circular No. 905, Sixth Revision, dated March 18, 1974, and the tables incorporated therein, as amended (31 CFR, Part 332), are hereby supplemented for the purpose of providing tables showing the schedule of interest payments and investment yields for the next extended maturity period for bonds bearing issue dates of February 1, 1957, through May 1, 1958; and December 1, 1966, through May 1, 1968. Accordingly, Tables 12–A, 13–A, 14–A, 32–A, 33–A and 34–A are added as set forth below.

The foregoing supplement was effected under authority of section 22 of the Second Liberty Bond Act, as amended (49 Stat. 21, as amended; 31 U.S.C. 757c), and 5 U.S.C. 301. Notice and public procedures thereon are unnecessary as the fiscal policy of the United States is involved.

DAVID MOSSO,
Fiscal Assistant Secretary.

TABLE 12-A

BONDS BEARING ISSUE DATES FROM FEB. 1 THROUGH MAY 1, 1957

ISSUE PRICE . . . . REDEMPTION AND MATURITY VALUE	$500 500	$1,000 1,000	$5,000 5,000	$10,000 10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 20 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . . 1/ (8/1/77)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (2/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (8/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (2/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (8/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (2/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (8/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (2/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (8/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (2/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (8/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (2/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (8/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (2/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (8/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (2/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (8/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (2/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (8/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (2/1/87)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	****

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF FEB. 1, 1957. FOR SUBSEQUENT ISSUE MONTHS ADD APPPROPRIATE NUMBER OF MONTHS.

2/ SECOND EXTENDED MATURITY REACHED AT 30 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY IS 4.58%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 13-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1957

ISSUE PRICE . . . . / REDEMPTION AND MATURITY VALUE		$500 / 500	$1,000 / 1,000	$5,000 / 5,000	$10,000 / 10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 20 YEARS, 0 MONTHS		(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
						PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/	(12/1/77)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS	(6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS	(12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS	(6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS	(12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS	(6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS	(12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS	(6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS	(12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS	(6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS	(12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS	(6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS	(12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS	(6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS	(12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS	(6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS	(12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS	(6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS	(12/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . .	(6/1/87)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF JUNE 1, 1957. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.
2/ SECOND EXTENDED MATURITY REACHED AT 30 YEARS AND 0 MONTHS AFTER ISSUE DATE.
3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY IS 4.63%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.
** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 14-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1957 THROUGH MAY 1, 1958

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000	(ANNUAL PERCENTAGE RATE)		
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 20 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (6/1/78)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/87)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/87)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF DEC. 1, 1957. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ SECOND EXTENDED MATURITY REACHED AT 30 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY IS 4.68%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 32-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1966 THROUGH MAY 1, 1967

ISSUE PRICE . . . . REDEMPTION AND MATURITY VALUE	$500 500	$1,000 1,000	$5,000 5,000	$10,000 10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (6/1/77)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/77)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/86)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF DEC. 1, 1966. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.40%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 33-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1967

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . . 1/ (12/1/77)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (6/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (12/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (6/1/87)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF JUNE 1, 1967. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.46%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

TABLE 34-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1967 THROUGH MAY 1, 1968

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (6/1/78)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/78)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/79)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/87)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/87)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF DEC. 1, 1967. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.51%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

Exhibit 11.—Department Circular No. 418, Second Revision, September 29, 1976, issue and sale of Treasury bills

DEPARTMENT OF THE TREASURY,
Washington, September 29, 1976.

The Department of the Treasury announces the revision of Department Circular No. 418, revised, as amended. This revision effects two additions to the current circular, as amended. The additions are: first, the provision that Treasury Bills will be issued in denominations (maturity value) of $10,000, $15,000, $50,000, $100,000, $500,000 and $1,000,000 and second, that tenders for such Treasury Bills will also be accepted at, and the Treasury Bills issued directly from, the Department of the Treasury, Bureau of the Public Debt, Washington, D.C. 20226. The new regulations are set forth at the end of this notice. Because the fiscal policy of the United States is involved, it is found unnecessary to issue these regulations with notice and public procedure thereon under 5 U.S.C. 553(b) or subject to the effective date limitation of 5 U.S.C. 553(d).

This second revision is effected under the following authority: 80 Stat. 379; sec. 8, 50 Stat. 481, as amended; sec. 5, 40 Stat. 290, as amended; 5 U.S.C. 301; 31 U.S.C. 738a, 754.

DAVID MOSSO,
Fiscal Assistant Secretary.

This revision of Department Circular No. 418 becomes effective on October 1, 1976.

Sec. 309.1 *Authority for issue and sale.*—The Secretary of the Treasury is authorized by the Second Liberty Bond Act, as amended, to issue Treasury bills of the United States on an interest-bearing basis, on a discount basis, or on a combination interest-bearing and discount basis, at such price or prices and with interest computed in such manner and payable at such time or times as he may prescribe; and to fix the form, terms, and conditions thereof, and to offer them for sale on a competitive or other basis, under such regulations and upon such terms and conditions as he may prescribe. Pursuant to said authorization, the Secretary of the Treasury may, from time to time, by public notice, offer Treasury bills for sale, and invite tenders therefor, through the Federal Reserve Banks and Branches and through the Department of the Treasury, Bureau of the Public Debt. The Treasury bills so offered, and the tenders made, will be subject to the terms and conditions and to the general rules and regulations herein set forth, except as they may be modified in the public notices issued by the Secretary of the Treasury in connection with particular offerings.[1]

309.2 *Description of Treasury bills (General).*—Treasury bills are bearer obligations of the United States promising to pay a specified amount on a specified date. They will be payable at maturity upon presentation to the Bureau of the Public Debt, Washington, D.C. 20226, or to any Federal Reserve Bank or Branch. Treasury bills are issued only by Federal Reserve Banks and Branches and the Bureau of the Public Debt pursuant to tenders accepted by the Secretary of the Treasury, and shall not be valid unless the issue date and the maturity date are entered thereon. Treasury bills bearing the same issue date and the same maturity date shall constitute a series.

309.3 *Denominations and exchange.*—Treasury bills will be issued in denominations (maturity value) of $10,000, $15,000, $50,000, $100,000, $500,000 and $1,000,000. Exchanges from higher to lower and lower to higher denominations of the same series (bearing the same issue and maturity dates) will be permitted at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226. Insofar as applicable, the general regulations of the Treasury Department governing transactions in bonds and notes will govern transactions in Treasury bills.

309.4 *Taxation.*—The income derived from Treasury bills, whether interest or gain from the sale or other disposition of the bills, shall not have any exemption, as such, and loss from the sale or other disposition of Treasury bills shall not have any special treatment, as such, under the Internal Revenue Code, or laws amendatory or supplementary thereto. The bills shall be subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but shall be exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, or any of the possessions of the United States, or by any local taxing authority. For purposes of taxation the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest.

309.5 *Acceptance of Treasury bills for various purposes.*

(a) *Acceptable as security for public deposits.*—Treasury bills will be acceptable at maturity value to secure deposits of public monies.

[1]Accordingly, these regulations do not constitute a specific offering of Treasury bills.

(b) *Acceptable in payment of taxes.*—The Secretary of the Treasury, in his discretion, when inviting tenders for Treasury bills, may provide that Treasury bills of any series will be acceptable at maturity value, whether at or before maturity, under such rules and regulations as he shall prescribe or approve, in payment of income taxes payable under the provisions of the Internal Revenue Code. Treasury bills which by the terms of their issue are acceptable in payment of income taxes may be surrendered to any Federal Reserve Bank or Branch, acting as fiscal agent of the United States, or to the Bureau of the Public Debt, Washington, D.C. 20226, fifteen days or less before the date on which the taxes become due.

(1) In the case of payments of corporation income taxes (including payments of estimates) for taxable years ending on or after December 31, 1967, the bills shall be accompanied by a pre-inscribed Form 503, Federal Tax Deposit, Corporation Income Taxes, on which the face amount of the bills being surrendered should be entered in the space provided for the amount of the tax deposit. The office receiving the bills and Form 503 will acknowledge receipt of the bills to the owner corporation and effect the tax deposit on the date on which the taxes become due. Accordingly, in these cases, it will no longer be necessary to submit receipts for Treasury bills to the Internal Revenue Service with the corporation's declaration or tax return.

(2) In the case of payments of all other income taxes the office receiving the bills will issue receipts (in duplicate) to the owners. The original of the receipt *shall be* submitted, by the owner, in lieu of the bills, together with the tax return, to the District Director, Internal Revenue Service.

(c) *Discounting by Federal Reserve Bank of notes secured by Treasury bills.*—Notes secured by Treasury bills are eligible for discount or rediscount at Federal Reserve Banks as provided under the provisions of section 13 of the Federal Reserve Act, as are notes secured by bonds and notes of the United States.

(d) *Acceptable in connection with foreign obligations held by United States.*—Treasury bills will be acceptable at maturity, but not before, in payment of interest or of principal on account of obligations of foreign governments held by the United States.

309.6 *Public notice of offering.*—When Treasury bills are to be offered, tenders therefor will be invited through public notice given by the Secretary of the Treasury. Such public notices may be issued by the Secretary of the Treasury in the name of "the Treasury Department" with the same force and effect as if issued in the name of the Secretary of the Treasury. In such notice there will be set forth the amount of Treasury bills for which tenders are then invited, the date of issue, the date or dates when such bills will become due and payable, the date and closing hour for the receipt of tenders at the Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, and the date on which payment for accepted tenders must be made or completed.

309.7 *Tenders; submission through Federal Reserve Banks and Branches and to the Bureau of the Public Debt.*—Tenders in response to any such public notice will be received at the Federal Reserve Banks, or Branches thereof and at the Bureau of the Public Debt, Washington, D.C. 20226, and unless received before the time fixed for closing will be disregarded. Each tender must be for a minimum amount of $10,000. Tenders over $10,000 must be in multiples of $5,000 (maturity value). In the case of competitive tenders the price or prices offered by the bidder for the amount or amounts (at maturity value) applied for must be stated, and must be expressed on the basis of 100, with not more than three decimals, *e.g.*, 99.925. Fractions may not be used.

309.8 *Tenders; when cash deposit is required.*—Tenders should be submitted on the printed forms and forwarded in the special envelopes which will be supplied on application to any Federal Reserve Bank, or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. If a special envelope is not available, the inscription "*Tender for Treasury Bills*" should be placed on the envelope used. The instructions set forth in the public notice announcing the offering should be observed with respect to the submission of tenders. Banking institutions generally may submit tenders for account of customers provided the names of the customers are set forth in such tenders. Others, than banking institutions, will not be permitted to submit tenders except for their own account. Tenders from incorporated banks and trust companies, and from responsible and recognized dealers in investment securities will be received without deposit. Tenders from all others must be accompanied by a payment of such percent of the face amount of the Treasury bills applied for as the Secretary of the Treasury may from time to time prescribe: *Provided, however*, that such deposit will not be required if the tender is accompanied by an express guaranty of payment in full by an incorporated bank or trust company. Forfeiture of the prescribed payment may be declared by the Secretary of the Treasury, if payment is not completed, in the case of accepted tenders, on the prescribed date.

309.9 *Tenders; acceptance by the Secretary of the Treasury.*—At the time fixed for closing, as specified in the public notice, all tenders received by the Federal Reserve Banks and Branches and by the Bureau of the Public Debt will be opened. The Secretary of the Treasury will determine the acceptable prices offered and will make public announcement thereof.

Those submitting tenders will be advised of the acceptance or rejection thereof, and payment on accepted tenders must be made or completed on the date specified in the public notice.

309.10 *Tenders; reservation of right to reject.*—In considering the acceptance of tenders, the highest prices offered will be accepted in full down to the amount required, and if the same price appears in two or more tenders and it is necessary to accept only a part of the amount offered at such price, the amount accepted at such price will be prorated in accordance with the respective amounts applied for. However, the Secretary of the Treasury expressly reserves the right on any occasion to accept non-competitive tenders entered in accordance with specific offerings, to reject any or all tenders or parts of tenders, and to award less than the amount applied for; and any action he may take in any such respect or respects shall be final.

309.11 *Tenders; payment of accepted tenders.*—Settlement for accepted tenders in accordance with the bids must be made or completed at the appropriate Federal Reserve Bank or Branch or at the Bureau of the Public Debt in cash or other immediately available funds on or before the date specified, except that the Secretary of the Treasury, in his discretion, when inviting tenders for Treasury bills, may provide: (a) that any qualified depositary may make such settlement by credit, on behalf of itself and its customers, up to any amount for which it shall be qualified in excess of existing deposits, when so notified by the Federal Reserve Bank of its District or (b) that such settlement may be made in maturing Treasury bills accepted in exchange. Whenever the Secretary provides for settlement in maturing Treasury bills, cash adjustments will be made for differences between the par value of the maturing bills and the issue price of the new bills.

309.12 *Relief on account of loss, theft or destruction, etc.*—(a) Relief on account of the loss, theft, destruction, mutilation or defacement of Treasury bills may be given only under the authority of, and subject to the conditions set forth in section 8 of the Act of July 8, 1937 (50 Stat. 481), as amended (31 U.S.C. 738a) and the regulations pursuant thereto in Treasury Department Circular No. 300 insofar as applicable.

(b) In case of the loss, theft, destruction, mutilation or defacement of Treasury bills, immediate advice, with a full description of the bill or bills involved, should be sent to the Bureau of the Public Debt, Division of Securities Operations, Department of the Treasury, Washington, D.C. 20226, either direct or through any Federal Reserve Bank or Branch, and, if relief under the statutes may be given, instructions and necessary blank forms will be furnished.

309.13 *Functions of Federal Reserve Banks.*—Federal Reserve Banks and Branches, as fiscal agents of the United States, are authorized to perform all such acts as may be necessary to carry out the provisions of this circular and of any public notice or notices issued in connection with any offering of Treasury bills.

309.14 *Reservation as to terms of circular.*—The Secretary of the Treasury reserves the right further to amend, supplement, revise or withdraw all or any of the provisions of this circular at any time, or from time to time.

Exhibit 12.—An act to increase the temporary debt limitation until March 15, 1976

[Public Law 94—132, 94th Congress, H.R. 10585, November 14, 1975]

Public debt limit. Temporary increase. 31 U.S.C. 757b note.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That during the period beginning on the date of the enactment of this Act and ending on March 15, 1976, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased by $195,000,000,000.

Repeal; effective date. 31 U.S.C. 757b note. *Ante*, p. 246.

SEC. 2. Effective on the date of the enactment of this Act, the first section of the Act of June 30, 1975, entitled "An Act to increase the temporary debt limitation until November 15, 1975" (Public Law 94–47), is hereby repealed.

Exhibit 13.—An act to increase the temporary debt limit, and for other purposes

[Public Law 94–232, 94th Congress, H.R. 11893, March 15, 1976]

Public debt limit. Temporary increase.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That during the period beginning on the date of the enactment of this Act and ending on June 30, 1976, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased by $227,000,000,000.

31 U.S.C. 757b note.

Repeal: effective date. 31 U.S.C. 757b note.

SEC. 2. Effective on the date of the enactment of this Act, the first section of the Act of November 14, 1975, entitled "An Act to increase the temporary debt limitation until March 15, 1976" (Public Law 94–132), is hereby repealed.

89 Stat. 693.

SEC. 3. (a) The last sentence of the second paragraph of the first section of the Second Liberty Bond Act (31 U.S.C. 752) is amended by striking out "$10,000,000,000" and inserting in lieu thereof "$12,000,000,000".

(b) Section 18(a) of the Second Liberty Bond Act (31 U.S.C. 753) is amended by striking out "seven years" and inserting in lieu thereof "ten years".

U.S. savings bonds, interest rate.

SEC. 4. Section 22(b)(1) of the Second Liberty Bond Act (31 U.S.C. 757c(b)) is amended by adding at the end thereof the following new sentence: "The investment yield on series E savings bonds shall in no case be less than 4 per centum per annum compounded semiannually for the period beginning on the first day of the calendar month following the date of issuance (or, beginning on October 1, 1976, if later) and ending on the last day of the calendar month preceding the date of redemption".

Exhibit 14.—An act to increase the temporary debt limit, and for other purposes

[Public Law 94—334,94th Congress, H.R. 14114, June 30, 1976]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased as follows:

Public debt limit. Temporary increase. 31 U.S.C. 757b note.

(1) for the period beginning on July 1, 1976, and ending on September 30, 1976, by $236,000,000,000,

(2) for the period beginning on October 1, 1976, and ending on March 31, 1977, by $282,000,000,000, and

(3) for the period beginning on April 1, 1977, and ending on September 30, 1977, by $300,000,000,000.

SEC. 2. The last sentence of the second paragraph of the first section of the Second Liberty Bond Act (31 U.S.C. 752) is amended by striking out "$12,000,000,000" and inserting in lieu thereof "$17,000,000,000".

Capital Markets and Debt Management

Exhibit 15.—Statement of Secretary Simon, October 30, 1975, before the Subcommittee on Economic Stabilization of the House Committee on Banking, Currency and Housing, on the financial plight of New York City

I appreciate the opportunity to appear before you on this subject of utmost importance. I must commend the members of the subcommittee for the extremely responsible way in which you have conducted these proceedings. In my 3 years in Washington I cannot recall a more extensive exploration of issues. You have wisely provided the opportunity for presentation of a wide variety of points of view on these difficult and exceedingly important matters.

As the committee is aware, these proceedings parallel proceedings now taking place in your counterpart committee in the Senate. They too have been conducting their proceedings with due regard for the importance of the issues involved. In that connection, I have been particularly struck by the comments, on separate occasions, of two members of the Senate Banking Committee, Senator Edward Brooke of Massachusetts and Senator Joseph Biden of Delaware. In urging that the Senate act with well-considered prudence, both of them aptly characterized this decision as perhaps the most important one facing the U.S. Congress since the Gulf of Tonkin resolution in 1965. I agree.

The issue facing the Congress today is not simply whether to avert default of New York City. To be sure, if Congress enacts legislation providing Federal financial assistance in amounts sufficient to meet debt service on the city's outstanding obligations, default will be averted. But in the final analysis, the issue presented has far broader implications: Namely, whether our system of financing State and local government credit needs—a system which has served this country well for more than a century—will be replaced by a system of Federal financing and by Federal control of fiscal and financial decisionmaking at the State and local level.

We can talk all we want about strict guidelines, about narrow drafted legislation, about the importance of meeting an immediate need. But the fact remains that Congress, as representative of the American people, is imbued with an overriding sense of fairness. And what Congress is prepared to do for one city it must be and will be prepared to do for all other units of government in the United States.

There are things that must be done and that can be done at all levels of government with respect to New York City's financial crisis. I have outlined such a program in the past and I will reiterate it in my testimony before the committee today. Before turning to that, however, I want to highlight a point which I believe to be of paramount importance. I have often said that there are two risks presented by a default: The financial and the psychological. I have often expressed the view that the financial risk can be managed, and recent events support that position. But at the same time, I have been equally candid about our inability to measure the psychological impact and about our concerns that dire predictions and vigorous rhetoric may compound whatever psychological risks do in fact exist.

Let's look at some of the language which has dominated the debate in both Houses of Congress: "Federal money or Federal troops"; "Catastrophe"; "New York City will go down the drain"; "Too horrible to imagine"; "Major banks will be insolvent." Is there any justification for this phraseology? Can Congress make a decision of this importance, of such far-reaching implications, largely in reliance on this type of analysis? Of course not. Congress and the American people are entitled to the facts, if any, underlying such reasoning. We must consider these issues on the basis of facts and not on the basis of buzz words and rhetoric.

At the same time, it is clear to all that the issue must be resolved promptly; that this crisis has already persisted too long. As I have said before, continued delay and uncertainty increases the psychological risk and may cause the consequences to be more severe. Certainly the potential impact today, or in 6 weeks, will be greater than if the matter had been resolved 3 months ago. If New York City had provided for an orderly restructuring of its debt at that time, we would not be facing the same concerns we face today.

A recent experience provides a factual basis for evaluating our judgments—and I must emphasize that they are judgments—concerning the impact of a default by New York City. On Friday, October 17, at 9 a.m., $453 million of New York City's short-term notes became due and payable. At that time, New York City had insufficient funds to satisfy these obligations. Moreover, many observers believed that it was quite unlikely that New York City would obtain such funds by the time the banks closed that afternoon. Indeed, even New York officials advised the President of the imminence of default. While New York City ultimately did obtain the funds, what happened that day is a good measure of how our financial markets respond to financial reversals and how the people of the city of New York function under such circumstances.

Let's look at some professional surveys of the marketplace on that fateful Friday:

Moody's Bond Survey: "The possibility of a New York City note default last Friday led to brief unsettlement in tax-exempts. Other market sectors, however, showed little reaction."

Chase Manhattan Bank Money Market Report: "On Friday, doubt over the timely payment of maturing New York City notes led to some price erosion, but there is still substantial improvements over the week."

Business Week: "New York barely escaped default today, but the municipal bond market held essentially firm. This casts some light on the favorite question of bond market analysts: To what extent do the current levels of municipal bond prices already discount default? Alan H. Meltzer of Carnegie-Mellon University thinks that Friday's bond market supports the view that Federal assistance is unnecessary, if the concern is the financial market."

John Nuveen & Co.: "It is refreshing to note that the market was not totally mesmerized by New York City's problems, but in fact, reacting to events within the money market."

Smith Barney & Co.: "The key element near term is certainly the New York City situation. One view assumes financial catastrophe; the other that the market has discounted most of the problems. We lean toward the latter view."

These are the views of professionals. But what were the people told? The following day, Saturday, October 18, banner headlines in the New York Times reported "Financial Markets Disrupted" and a front-page story characterized market behavior as "alternately sluggish and chaotic * * * a taste of what default by New York City might mean."

For those who turned to the financial pages, a very different picture emerged. In light trading, the stock market declined some 10 points during the period of uncertainty in the morning, recovered on the news that default had been averted, and then fell back 6 points for the day. Hardly disruption. But the damage had been done. Although the Wall Street Journal and others later took the Times to task, a further erosion of public confidence had taken place. When will our leaders recognize that extreme and unsupportable rhetoric can only increase the risks?

I don't believe there is sufficient recognition of the extraordinary performance of the municipal market over the past 9 months. In the third quarter alone, State and local governments raised $13.7 billion in bonds and notes to bring the 9-month total to $45 billion. By contrast, only 5 years ago, in the third quarter of 1970, $8.6 billion was raised. And last week the municipal market continued its vigorous rally. States and cities from throughout the country raised substantial amounts of money at lower interest rates, in some cases significantly lower, than those which have prevailed over the last 2 months.

Three months to the day after it paid nearly 6 percent for a loan, Maryland borrowed $85 million at 5.3 percent. Is New York City dragging the municipal bond market down? I hardly think so. If I may draw an analogy to Gresham's law, bad bonds don't make good bonds bad; they make good bonds better, as Maryland and other well-run communities have recently found out.

For the record I shall submit detailed evaluations of activity in the municipal bond market. These evaluations clearly belie the contention so often heard in this committee and elsewhere in the Halls of Congress that somehow the New York City financial crisis is responsible for devastating the municipal bond market. Nothing could be more incorrect. But I must point out again, the psychological risks cannot be dismissed. Uncertainty can have a very disruptive effect on markets: An early resolution of this matter remains of utmost importance.

In order for this committee to evaluate the need for legislation, I would urge that you concentrate on several basic questions. What would be the impact on our financial markets if the city is unable to pay its noteholders on time? What impact would it have on the ability of the city to provide essential services?

At the same time, the committee must ask itself what the price will be for Federal assistance. What is the price the American people will have to pay in terms of higher borrowing costs for all borrowers? What is the price our economy will pay if more marginal borrowers are crowded out of our capital markets? And what is the price our society will pay if the Federal Government takes over the fiscal and financial decisionmaking process at the State and local level?

In asking if the Federal Government should act to prevent default through financial assistance, all these questions must be addressed.

Condition of New York State and its agencies

Many times in recent days this committee has been told that Congress must act to prevent default by New York City because if it fails to act, New York State and its agencies will also default. But to my knowledge, none of the witnesses who have testified in this matter have advised the Congress or anyone else as to why such an event will in fact occur. Each of the agencies of the State are separate and distinct and, ultimately, each will be judged on its own merits.

It is clear to all of us that the State must act and must act promptly to improve the credit of certain of its agencies. With respect to the New York State Housing Finance Agency, the financial community has acted most responsibly in analyzing this agency's financing and in presenting a proposal designed to remedy some of its difficulties. We urge the State to act promptly on these proposals.

With respect to the State itself, the current official estimate of the State's deficit for the fiscal year ending March 31, 1976, is $611 million. New York State should act to reduce that deficit.

The financial difficulties of New York State and its agencies cannot be attributed entirely to New York City. More importantly, a resolution of the financial situation in New York City through congressional action or otherwise will not cure those financial difficulties. Responsible action must be taken at the State level to prevent an extension of the financial crisis to the State and its agencies.

Again, I must emphasize that we must not be misled by dire predictions and vigorous rhetoric. Our views as to the financial risk notwithstanding, the psychological risk remains a serious concern. The only meaningful solution to the financial crisis which now exists is responsible action at appropriate governmental levels.

Building a bridge to the capital markets

All levels of government, and the private sector as well, share the responsibility for developing a workable program that will restore New York City's access, and that of the State as well, to the capital markets. What must be done is to build a solid bridge, span by span, over which New York City can return to the private capital markets. In my view, such a program should involve the following elements:

First, and foremost, New York City must implement a *credible balanced budget plan* which provides for the prompt elimination of budget deficits. The institutional framework is now in place, and the Emergency Financial Control Board and the new deputy mayor appear to be operating in concert, devoting all of their resources to implement the fiscal policies necessary to return the city to the market. The plan adopted October 15 represents a very constructive step. It attacks many of the major concerns: Payroll levels will be cut, operating expenses are being removed from the capital budget, capital expenditures are being reduced. At this point, however, there is no clear guidance in other important areas: Levels of health services, employee benefit and retirement programs, the City University. All of these areas must be dealt with if New York City is to be on a sound financial footing.

Expenditure reductions must be accompanied by a continued realinement of the city's management to insure that the tough decisions which have to be made will continue to be made. Until investors are convinced that New York City's management is in control of the city's financial future, there can be no market.

Second, during the period of transition to balanced budget operations, the State should provide New York City with a *temporary source of additional revenues* to meet cash-flow requirements in the interim period. It appears that through the end of this fiscal year, New York City's expenditures not including debt service will exceed its revenues by approximately $700 million, according to figures supplied by the city. In addition, New York City will have a peak seasonal cash need amounting to $1.3 billion during the December–March period.

Resources are available to meet these needs. For example, New York State could impose an emergency and temporary tax, perhaps a 3-year increase in the State sales tax on a sliding-scale 3-percent, 2-percent, 1-percent basis. As the situation improves, these funds can be repaid by New York City. At that point all the people of the State could benefit as repayment by the city would allow a reduction in tax rates to below existing levels.

Alternatively, the city could borrow such funds, with the loans collateralized by assets in employee pension funds.

Let me be clear, I am not suggesting that such methods are the only possibilities. New York State has vast financial resources and there are many potential sources of the necessary funds. But to those who would say that all resources have been exhausted, these are only two examples of what could be done.

Third, there must be an *orderly proceeding for the restructuring of New York City's debt.* As the President announced yesterday, the administration is sending up legislation establishing procedures under which large cities could seek the assistance of a Federal court in restructuring their financial obligations. The legislation provides that cities with populations exceeding 1 million, having the express approval of the State, may petition for court enforcement of a plan to reschedule payments to creditors. Such a petition must be accompanied by an expenditure reduction plan to return the city to a sound fiscal basis.

Within the context of such a proceeding, holders of short-term securities will be required to extend maturities for a reasonable period. In addition, only if necessary, the city's bondholders may be asked to agree to a moratorium on debt service payments for a period of time.

The legislation announced by the President also authorizes the city to issue new certificates of indebtedness if—and this is important—the court approves. These certificates could be granted priority rights to the city's revenue stream and may provide an alternative means of dealing with the cash-flow problem I discussed a few moments ago.

Once the threshold of budgetary control has been crossed, these actions can provide the bridge to return New York City to the capital markets. But any comprehensive program of reform must deal with longer range concerns as well. We in the Federal Government have a clear responsibility with respect to this part of the process.

As a fourth part of the program, the Federal Government must accelerate a *comprehensive reexamination of all Federal, State, and local relationships*. We must determine whether the priorities, practices, and procedures of the past in all areas—welfare, housing, food stamps, medical assistance, and the like—are consistent with the needs of the last quarter of the 20th century.

Specifically, we should review once again our administrative machinery and make whatever changes are necessary to provide State and local governments the full benefits they are entitled to under existing law.

But a comprehensive response requires more action as well. If we determine that large cities and populous States are unfairly disadvantaged under existing formulae or programs, we should consider corrective legislation, if necessary, to remedy whatever imbalances exist.

We must ask whether our assistance programs fulfill their intended purpose, or whether they help people they were not designed to help. Have our programs grown so cumbersome, so abuse-prone, that they are fast losing their base of public support? If so, and if fewer funds are therefore available to help the really needy, the ones who get hurt are the poor themselves.

Fifth, we must propose *structural improvements* in the municipal bond market. In proposing these changes, we will not have lost sight of the fact that even in these unsettled times the municipal market has served State and local government well.

During September alone, for example, State and local government raised nearly $4.5 billion in tax-exempt bonds and notes, a truly extraordinary performance. And, as shown in a recent Salomon Bros. study, which I shall submit for the record, such funds were raised at a cost not disproportionate to historical levels.

Traditionally, yields on tax-exempt securities have been, on the average, 30 percent lower than taxable yields. Yield spreads will vary according to quality, maturity, call protection, monetary conditions, and similar factors. Moreover, yields will also vary within rating categories. For example, largely because of the substantial volume of debt outstanding, yields on New York City securities were significantly higher than yields on comparably rated securities of other issuers. The Salomon Bros. study shows that in September, the spread between prime municipals and comparable quality utility issues was squarely on the 30-percent figure.

While the market has performed well, improvements can be made. In recent years an imbalance between supply and demand has developed. Tax-exempt borrowing is at unprecedented levels: Nearly $45 billion of bonds and notes in the first 9 months of this year alone. But the growth in demand, especially from institutions, has not kept pace. Casualty companies, always large buyers, have had their need for tax-exempt income reduced. And commercial banks, traditionally the largest purchasers of tax-exempts, have cut back their participation substantially, reflecting reduced taxable income as a result of loan losses, leasing activities, and foreign tax credits. In 1969, commercial banks were net purchasers of municipals in an amount equal to 97 percent of new issue volume. For the first 6 months of this year, their net purchases dropped to 12 percent of new issue volume.

In addition, also as a consequence of these specialized sources of demand, yields in the tax-exempt market tend to rise disproportionately during periods of tight money as banks are forced to commit their limited credit resources to their commercial customers.

Accordingly, to broaden the market, and to effect a reduction in the volume of tax-exempt debt, State and local governments should be afforded the option of issuing debt on a taxable basis, with an appropriate interest subsidy from the Federal Government. Also, tax-exempt debt now issued for nongovernmental purposes—pollution control and industrial development bonds—should be issued only on a fully taxable basis, again with appropriate interest subsidies. According to our calculations, these changes should result in a substantial benefit to State and local governments in the form of a broader market for their securities, which could result in lower borrowing costs at little, if any, expense to the Federal Treasury.

Lastly, partially in recognition of the growing participation of the smaller investor in the State and local bond market, we believe the time has come for a *federally imposed uniform system of financial accounting and reporting* by State and local issuers which sell a substantial amount of securities in our capital markets.

Precipitated by major financial reversals such as the Penn Central bankruptcy, there has been a marked increase in the tendency of investors to restrict themselves to higher grade instruments—a "flight to quality" to use the terminology of the market. We must satisfy this legitimate interest of the investing public in detailed, accurate, and comparable data by requiring complete and accurate disclosure. Such a system of disclosure has helped make our corporate markets the finest in the world. The time has come to extend it to the municipal market as well.

In my view, it is these steps which Congress and the Nation must focus upon in dealing with New York City's financial crisis:

- A sound fiscal policy administered by a realined management, and including a credible balanced budget;
- A temporary increase in State assistance;
- An orderly mechanism for debt restructuring, with the financial community and investors participating in the bridge back to the capital markets;
- A comprehensive reexamination of Federal, State, and local relationships;
- A broader market for municipal securities; and
- A uniform financial disclosure system for State and local government.

This is a program designed to attack the causes of the problem at their roots. Unlike the legislative proposals before us today, it is far more likely to return our greatest city to a totally sound fiscal basis.

Proposed legislation

The legislative approaches before us have a single overriding objective: To prevent default by providing Federal financial assistance in amounts equal to the city's cash needs for operations, capital expenditures, and debt service. And each is subject to the same general concerns.

First, any such assistance would involve further expansion of already enormous Federal credit demands, driving up Federal borrowing costs even higher. Because the borrowing costs of all other issuers would rise as well, all Americans would pay the price in the form of higher interest rates, more expensive mortgages, and higher prices for goods and services.

Second, the discipline of the market would be lost. Spending would be constrained not by the desire to avoid higher borrowing costs or the loss of credit, but through pervasive Federal fiscal and financial control of local government. As for the principle of home rule that is so fundamental to our system of government in the United States, I would only note that any entity that gives up its ability to make its own financial decisions has basically lost its power to rule.

Guarantees and insurance

There is absolutely no difference between a guarantee program and an insurance program. Either would involve a commitment by the Federal Government to meet debt service requirements in the event the issuer is unable or unwilling to make such payments out of its own revenue sources. And once provided, a guarantee could not be withdrawn if, for example, the issuer failed to meet the fiscal conditions of the program. The Government's obligation under a guarantee program would be to the investor, not to the issuer.

Impact on capital markets

It has been stated altogether too often before this committee that New York City is not asking for a bailout, that it is not even asking for a loan, but it is asking merely for a Federal guarantee and that such a guarantee would not cost the American taxpayers one cent. Nothing could be more incorrect.

No aspect of this debate troubles me more than the continuous suggestions that the solution is free. Too often, the "free lunch syndrome" dominates decisionmaking at all levels of society and government. Well, ladies and gentlemen, let me say again—as I have many times—there is no such thing as a free lunch.

I don't care how ingenious the disguise may be—call it a guarantee, insurance, reinsurance, or what you will—the fact of the matter is that it is borrowing. And we will pay the price, not only in the future, but right away.

Any expansion of Federal credit—including a federally guaranteed municipal bond—would further strain our overburdened capital markets. Federal borrowing costs would rise and, since our borrowing rate establishes a benchmark in the marketplace, the borrowing costs of all other issues would rise as well. And if guaranteed bonds retained the tax-exempt feature, the impact on unguaranteed municipal issuers would be especially direct and could be severe.

Such inflationary forces would also enhance the flight to quality. Yield differentials between the stronger and the weaker credits are at record highs: Recently the spread between

A and Baa industrial bonds has been as high as 200 basis points, double the 1974 figures and 4 times greater than the 1971–73 average. Additional Federal credit in the market could cause these spreads to widen further.

To repeat, for the American people these are the real costs that would be incurred with a guarantee program: The cost of higher interest rates, higher mortgages, more expensive products, and the like. Very high costs indeed.

Too often, when we concern ourselves with the problems of the municipal bond market we tend to forget that this market is not entirely distinct, but is instead an integral part of our capital market structure as a whole. And the same things that are happening in our capital markets as a whole are happening in the municipal market. Higher rates, shorter maturities: These are the concerns the Nation's mayors brought to the President and to the Joint Economic Committee 2 weeks ago. But they misplaced the blame. The blame primarily lies not with New York City, but with inflation, caused by massive continuing Federal deficits and the substantial new Federal borrowing required to finance them. The proposals before us today would only exacerbate these problems.

Fiscal restraint

Equally great are the potential costs imposed by these programs on fiscal and financial decisionmaking at the State and local level. Like all borrowers, a State or local government's access to credit depends upon its ability to persuade potential lenders that its financial affairs are such that the lender can reasonably expect to be repaid. A Federal guarantee would have the effect of removing this element of concern on the part of the lender and thus have the corresponding effect of removing the market-imposed restraints on the borrower.

The only effective substitute for the restraints of the marketplace would be direct Federal control over the budgets of those local governments that participated in Federal guarantee programs. While some have suggested the interposition of State control, I seriously doubt whether it would provide a viable alternative. There would be little reason for a State agency not to yield to the same pressures as a local government in the absence of discipline from the market or from the Federal managers.

Federal control of fiscal and financial affairs at the local level presents grave practical and philosophical difficulties. This is not a dispute between liberals and conservatives, but rather simply a question of the right of citizens to be governed by their duly elected local leaders rather than by Federal bureaucrats.

We would have to create a new bureaucracy simply to concoct and enforce the guidelines as to local priorities we here in Washington would be imposing on the governments of the Nation. We would be confronted with the sorry spectacle of duly elected local officials lining up outside my door, attempting to persuade me that they were carrying out their responsibilities in a satisfactory fashion. We would, in short, be contravening constitutionally imposed principles of federalism—principles which lie at the heart of the structure of government in this Nation.

Thousands, perhaps tens of thousands, of governments would resist this intrusion into local affairs. And they would be absolutely right. But in the final analysis, theirs would be a Hobson's choice: Submit to Federal control or pay the price of independence in the bond markets.

Finally, there are those who say that New York City is a special case; that New York has unique problems not faced by other cities. But let's look at the facts:

- Median family income in New York City is just about at the national average;
- The median income of minority families is nearly $2,000 higher than the national average;
- The percentage of the population on welfare is lower than that of Newark, Philadelphia, Washington, Baltimore, or St. Louis.

New York's burden has come, not from caring for the poor, but from subsidizing the middle class through massive municipal payrolls and fringe benefits, through free tuition at the City University and similar programs.

Accordingly, to those who would say that New York is unique, that helping New York will not obligate us to help other cities, I say we are already obligated. We are obligated to local officials throughout the country who have risked their careers by insisting on fiscal restraint. Would financing the deficits of New York City be consistent with our obligation to them? And can we really draw the line at New York City? I doubt it. Assistance to one city would create an intolerable precedent for the future.

None of us can assess with any degree of precision the contribution the division of governmental authority called for by the Constitution has made to the quality of life in this country. But I doubt our society would be as heterogeneous, as tolerant of diversity, as responsive to local needs if all basic decisions were made here in Washington.

Comparison with existing programs

It is such considerations which plainly distinguish the pending bills from programs such as FDIC or FHA insurance. It is altogether appropriate to require that all of the Nation's banks be subject to the same operating standards and be subject to consistent and detailed Federal supervision and regulation. It is equally appropriate that a citizen seeking the assistance of the Federal Government in obtaining a mortgage disclose fully his financial situation and open the property he or she desires to purchase to extensive Federal scrutiny.

Imposing uniform standards on State and local governments is plainly an entirely different matter. Each political subdivision in this Nation has unique needs. And each is led by people selected for the job by an electorate which believed that such people could best translate the needs of the community into effective governmental decisions. Yet any program of financial assistance would require bureaucrats in Washington to supervise these decisions and reverse them if necessary, irrespective of the wishes of the local electorate. It is one thing to regulate a corporation. Under our democratic system, it is quite another to supervise and control the affairs of local governments.

In short, State and local government have a special status in our Federal system. The proposals for Federal financial assistance now pending before this committee would, of necessity, require that such special status be ended.

Unguaranteed participation

Chairman Reuss in this House and Chairman Proxmire in the Senate have proposed legislation which would condition Federal assistance on private sector agreement to provide a specified percentage of the aggregate financial need on an unguaranteed basis. In addition, Senator Proxmire's measure would require the State to provide the city with substantial additional revenues, through new taxes or other means. These proposals correctly recognize that the prime beneficiaries of Federal action to prevent default are not the people of New York City, but investors and politicians. Although the burden on the Federal Treasury would be lessened somewhat under these proposals, all of the concerns I have just expressed apply equally to these proposals.

Guarantees, insurance, loans—each of these proposals has serious implications for the condition of our capital markets, would eliminate market restraints on spending at the State and local level, and could erode the traditional autonomy of these levels of government over their fiscal and financial affairs.

Impact of default

I have concentrated today on a variety of approaches to the financial situation in New York City and New York State. I believe the approach I have suggested is desirable and workable. I cannot support the approaches—guarantees and similar forms of assistance—suggested to this committee. To complete the analysis, however, it is necessary to discuss the consequences if none of the approaches is adopted.

Necessary concepts

To set the framework for my analysis of the impact of default, it is important to define some relevant terms and concepts. I sense that the dialog concerning the issue has been hampered by confusion over the meaning and import of certain key words. First, there is "insolvency" which, simply stated, means that a person or a city has current obligations which exceed its available funds. "Default" is a technical legal term describing a debtor's refusal or inability to pay a creditor who has demanded payment. "Bankruptcy" describes a legal proceeding—provided for in the Constitution—under which an insolvent party in default turns over to a court the job of deciding how his financial resources will be apportioned among creditors.

In looking at default and bankruptcy, we should also draw a distinction between the options available in the event of a corporate default and those available with respect to a municipal default. If a corporation defaults and is subsequently brought under the jurisdiction of a Federal bankruptcy court, one option—albeit often not the most desirable one—is liquidation: The sale of assets to satisfy the claims of creditors and the subsequent disappearance of the corporation as a continuing entity. Both common sense and constitutional principles preclude such an option with respect to municipal defaults.

In this respect, a default by a State or local government is closely analogous to a default by an individual person. In either case, if a bankruptcy proceeding ensues, resources essential to the maintenance of life in the one case and essential services in the other are protected from the demands of creditors.

It is important to reemphasize this point: If New York City defaulted, it would continue to exist and to operate. Tax payments, Federal and State assistance payments, and other sources of revenue would continue to flow. Indeed, the growth in New York City's tax revenues continues to outpace virtually every other large city: The growth rates in Los

Angeles, San Francisco, and Boston, for example, are substantially lower. Over the last 5 years alone, general fund and real estate taxes have increased from $4.6 billion to $7 billion. While much of this new taxation may have been counterproductive by driving businesses and residents out of the city, the fact remains that we cannot attribute New York City's difficulties to an inability to generate revenues. And while there is a cash-flow shortage which must be met, as the President indicated, services essential to life and property will be provided.

In short, it is essential not to confuse the legal and idiomatic meanings of the term "bankruptcy." In common parlance, we may use bankruptcy to define a condition devoid of substance or resources. By that definition, New York has not been, is not now, and will not be bankrupt. However, a Federal debt restructuring proceeding is an appropriate solution for dealing with New York City's creditors in an orderly way.

Analysis

My views on the impact of a potential default have not changed materially. I have always believed that a default would be undesirable. I have always believed that a default should be avoided by any appropriate means. But putting aside for a moment the desirability of avoiding default, I cannot conclude that a default would devastate our financial markets or our economy.

At the same time, I have often underscored the importance of psychological factors and our inability to predict psychological reactions with any certainty. We have been carefully monitoring the marketplace daily and have noted the developing psychological impact. Restraint is of utmost importance: Dire predictions of impending doom could well become self-fulfilling.

Today, the municipal market is proceeding along two tracks. On the one hand, the market is in the midst of its most vigorous rally of the year. At the same time the doomsayers are promising collapse as a consequence of the New York crisis, the market is going the other way: Interest costs have dropped one-half percent in 3 weeks.

I remain deeply concerned, however, about the confidence factor. How long can we stand the daily battering, the consistent misinformation generated by those who will stop at nothing to obtain Federal assistance? While my overall views remain the same, there is little question that such rhetoric will make the impact of default more severe than it otherwise would have been.

My views on the overall question of the impact of default are fully expressed in my testimony before the Joint Economic Committee and other committees and I do not need to repeat them in detail here. I will submit all of my testimony on this subject for the record. I do want to concentrate and expand upon one particular concern: The impact of a potential default on the ability of other State and local governments to raise necessary funds in the municipal market.

Earlier in my testimony, I noted that municipal governments are facing the same pressures as all other borrowers: A diminishing supply of capital at higher and higher rates caused primarily by inflation and the growing Federal usurpation of the supply of credit in this country. I mentioned that within the municipal market itself there are structural problems which need to be addressed as State and local capital requirements grow faster than the demand for tax-exempt securities. I have also noted that all investors are increasingly sensitive to quality considerations and are demanding more and more evidence of financial soundness. These phenomena will continue to play an important role in the market, regardless of what happens to New York City.

Perhaps the most important factor in today's market is uncertainty, a psychological factor which markets do not tolerate well. A number of intermediaries and investors are, we understand, refusing to commit funds to the market—thus impairing the borrowing ability of many State and local governments—until the New York City situation is resolved. New York City's difficulties have been the major factor in the uncertainty and have intensified investor concern with quality. But New York's financial crisis did not create the other problems besetting the market, and an end to that crisis will not make them go away.

Markets have a tendency to discount future events and a potential New York City default has been discounted to a significant degree in the form of higher yields and shifts in quality preferences. If default actually occurs, a possible further shift in quality preferences could influence the ability of credits which are perceived to be weak to raise funds in the capital markets. By contrast, the stronger credits may well benefit as investors' preferences shift even further in the direction of the higher grade issues.

Let's look at the way the municipal market has performed in the fact of a possible default by New York City and in the face of all the uncertainty that possibility has engendered. As I indicated earlier, many local governments throughout the country—including cities in the Northeast and in New York State itself—have raised funds at reasonable rates. In the last 3 weeks alone, average yields in the municipal market—that is, the borrowing costs of State and local governments—have dropped a full one-half percentage point. And yields on the higher grade securities of the better run issuers have dropped even further. All in all, the market has performed extremely well.

It is such market performance that leads me to the judgment that a default by New York City will not mean that other cities throughout the country will not have access to credit. All cities are facing investor demands for more and better disclosure and a default by New York City will not still those demands. But no other city has had a cumulative deficit like New York City's and thus none must borrow simply to meet operating needs from year to year. To the extent other cities must borrow within a fiscal year to deal with seasonal cash-flow variations, I cannot conclude that a default will materially impair their ability to do so. The market has and should continue to distinguish between cities which have the money to pay their debts and those that do not. To repeat, bad bonds do not make good bonds bad; they make good bonds better.

In asking ourselves what the impact of a default would be, we must also ask the corollary question of what could be the impact of various mechanisms to avoid default. If, for example, New York City were able to avoid default by implementation of the plan discussed at the beginning of my testimony, I believe that the result would be a renewed sense of faith in the ability of the State and local government sector and our financial institutions to deal with even the most severe problems in a responsible manner.

If, on the other hand, default were to be avoided by a Federal assistance program, the reaction could be more complex. If default were avoided only through the Federal Government paying New York City's debts, it would not signify that New York City or any other State or local government was able to carry out its financial obligations. Just the contrary would be the case. Meanwhile, there could be far more incentive for State and local governments to embark on more spending programs, irrespective of whether resources were available to finance them. The discipline built into the present system would be lost.

And even if the assistance program were limited to New York City, its impact would be felt throughout the country. Issuers and investors would come to believe that every municipal security—or certainly those of major borrowers—in effect carried the moral obligation of the United States, even without a guarantee in advance. What the Federal Government would do for New York, all would believe, it would necessarily do for any other jurisdiction which became unable to meet its obligations.

But perceptive investors would recognize the fundamental change in our system of finance and would see the risks presented. The inflationary expectations generated by the actual and potential expansion of Federal credit involved would serve to accelerate some of the adverse trends we have seen in the markets over the recent past. Investors would become even more wary of long-term commitments and would demand even higher yields on the commitments which are made. The ability of all sectors of the economy to finance investments in our future growth could be further impaired.

This committee faces some difficult choices. The risks of a default, given the psychological aspect, are, in the final analysis, unknown and unknowable. My own judgment—and I must emphasize the highly subjective nature of any judgment in this area—is that such risks should be manageable. Moreover, as I have indicated in my testimony today, the legislative proposals present a series of concerns which outweigh the risks as I perceive them. I would urge the committee to concentrate its resources and its influence on approaches to the problem which will restore confidence in the fiscal and political integrity of the State and local governmental sector.

Mr. Chairman, it has been more than 7 months since the market closed for the securities of New York City. For this entire period, the citizens of the greatest city in the world—its financial, industrial, and cultural hub—have lived from crisis to crisis. As one with deep personal and professional ties to New York City, I have great compassion for the plight of the citizens of New York and I share their determination to achieve a prompt and proper end to the crisis.

Over this period much in the way of laudable progress has been made. An "untouchable" expenditure increase for fiscal year 1975–76 was pared somewhat. The municipal payroll has been reduced by some 31,000 employees. The cumbersome overlay of bureaucratic structures has been partially reorganized and financial professionals are now playing an increasingly important role in the affairs of the city.

If this degree of progress has been made, one may legitimately ask, why hasn't the market reopened to the city? I am afraid the answer lies in timing. Each of these steps, while laudable in and of itself, invariably came too late.

It is difficult to state precisely what actions would have reopened the market at any given point in time. But it must be clear to all that what would have reopened the market in April would no longer do the job in June. And what would have been adequate in June was insufficient in August. In short, throughout these long and enervating months, events and demands consistently outdistanced actions.

Another important point emerges from this troublesome history. There can be no doubt that Federal financial assistance at any point along the way would have stopped the reform process dead in its tracks. We need only look at what occurred when MAC was created in early June. For 6 weeks, virtually nothing in the way of reforms was accomplished. In late June, the need to obtain legislative approval of the city's budget caused a brief flurry of activity—announcements of layoffs, hospital and firehouse closings. But as the garbage piled up over the Fourth of July weekend, most layoffs were rescinded, and the closing orders were largely ignored.

It was not until it became clear that MAC would be unable to borrow in August that the process of reform began anew. Each new deadline was faced with more strident demands for Federal assistance. And, after such assistance was again refused, the city and the State managed to take another hesitant, painful step in the right direction.

At the end of August, after nearly 6 months of crisis, the first meaningful data regarding the city's finances was released. While subsequent events have revealed that even such data was inaccurate and inadequate, at least a benchmark with which to measure the accomplishments of the past and the challenges of the future had been established. Again I asked the inevitable question: Would such actions have taken place if Federal assistance had been promised or provided?

Much has been done, but much more needs to be done:

- The plan for the prompt elimination of the budget deficit must be fully implemented;
- In that regard, the State must act to provide a temporary supplement to the city's existing revenue base;
- Capital expenditures must be reduced severely and operating expenses must be fully eliminated from the capital budget;
- New revenue sources must be explored. For example, the Environmental Protection Agency has called for new and increased tolls on the city's bridges for environmental reasons. Why not for revenue reasons as well?
- The drain on city revenues from the City University must be halted, either through State takeover or through reasonable tuition charges;
- The health and hospitals program, with its massive payroll and 25 percent vacancy rate, should be scaled down;
- More economically sound standards for future pension benefits must be implemented;
- The city's accounts must be fully conformed to acceptable accounting principles;
- Reform of the city's management structure must be completed;
- Steps must be taken to restructure the city's debt.

If these things are done, and the market does not reopen, is default the only solution? In recent weeks and again today, I have expressed the view that the financial risks presented by a default can be managed and, in such circumstances, the impact need only be temporary and manageable. At the same time, I have been equally candid about our inability to measure the psychological impact. Let me repeat once again: While the market has performed well to date, it can only stand for so long the consistent battering—the dire predictions and vigorous rhetoric—which the proponents of Federal assistance have brought to bear.

The time has come to concentrate all of our efforts on restoring our greatest city to fiscal integrity. I have said many times that fiscal integrity is easy to lose and hard to recover. As we proceed through this difficult period in our history, I can only hope that the travails of New York City will have some impact on our attitudes as to the proper role of government in our society. As the President said yesterday, what New York City has learned in the past 7 months is a valuable lesson for us all. As we proceed with legislative consideration of the city's financial crisis, let us not ignore this important message.

Exhibit 16.— Statement by Under Secretary for Monetary Affairs Yeo, December 9, 1975, before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs, on the securities activities of commercial banks

Mr. Chairman and members of this distinguished committee, I am pleased to testify before you today on behalf of the Treasury Department in connection with your study of securities activities of commercial banks. The role of commercial banks in the securities markets has attracted increasing attention in recent years. Spurred by changing economic conditions and market forces, commercial banks have gradually expanded their financial services in the securities field.

This expansion, of course, has been circumscribed by the boundaries of the Banking Act of 1933, more popularly known as the Glass-Steagall Act, and has been inhibited in some cases by uncertainty and confusion concerning the extent to which the act limits bank securities activities. This is particularly true with respect to those activities which commercial banks did not perform in 1933 and which Congress consequently did not contemplate when enacting the Glass-Steagall Act restrictions. It seems clear that a thorough review of the Glass-Steagall Act restrictions is desirable at this time. We should determine to what extent the act's restrictions on bank entry into the securities business remain valid in light of changes that have occurred in the economy, the banking industry, and government regulation of banking and securities transactions since 1933.

As you are aware, the Capital Markets Working Group is conducting a review of these matters. That review does not emphasize the legal aspects of current bank security activities. Although these questions are important, in our view, the first priority should be to examine each bank security activity to determine whether as a matter of public policy each is desirable and should be permitted by law. Only after the determination is made that a bank security activity be permitted, need the question of regulation be considered.

Our initial issues paper, titled "Public Policy Aspects of Bank Securities Activities" which I will submit for the record [excerpt follows], Mr. Chairman, attempts to identify the various public policy considerations that should be weighed in determining the proper scope of commercial bank participation in the securities business. As our issues paper indicates, we have avoided definite judgments on these questions because we believe that they would be premature. Instead, the paper presents the potential advantages and disadvantages of each activity for the purpose of eliciting comment and factual data that will enable us to reach conclusions. I would like to summarize for this committee the major areas covered by the study.

Public policy considerations

In assessing the desirability of bank participation in particular securities activities, the foremost consideration should be the effect of such bank activities upon the long-term health of the securities markets and their ability to meet the capital needs of American enterprise. A second and perhaps equally important consideration is the effect that such bank activities would have on the stability and integrity of the commercial banking system. This will require an examination of the probable impact of these activities upon competition between various segments of the financial community and an assessment of the likely benefits in terms of increased efficiencies and lower costs in obtaining financial services. The broad ramifications of increased economic concentration within the financial community must also be explored. With respect to bank brokerage-oriented and money management activities, the effect on the liquidity and efficiency of secondary markets is an important public policy consideration. Finally, bank security activities must be analyzed in terms of their compatibility with sound bank practices and their potential for creating conflicts of interest and other difficulties within the commercial banking system.

Agency and brokerage-oriented services.—Commercial banks presently offer several agency and brokerage-oriented services which provide customers with access to securities markets. These services include the dividend reinvestment plans, automatic investment services, and voluntary investment plans. In each of these services, the bank acts as a conduit between their customers and the broker-dealer community by channeling the bank's customers' orders to purchase or sell securities to a broker or dealer.

Bank sponsorship of these brokerage-oriented services has several advantages. First, these services could increase competition within the brokerage business. Secondly, the introduction of these services could benefit investors and the capital markets by providing a convenient and low-cost means of purchasing securities and thereby encouraging greater participation by small individual investors in the securities markets.

However, the concentration of investment services within a relatively small number of banks could lead to an overconcentration in investment in a few favored stocks, usually well-established issues, and in an allocation of investment funds away from smaller emerging companies to larger established ones. Thus, bank investment services could reinforce tendencies toward a tiered market.

Stated another way, the concern is that such concentration could harm market efficiency by greatly reducing the diversity of investment opinions and the number of independent investment decisionmakers in the marketplace. Financial market efficiency, as opposed to efficiency in executing and clearing transactions, may well depend upon the maintenance of a broad range of diverse viewpoints and decisionmakers in the market.

Money management activities.—Commercial banks have provided money management services to individual customers on a fiduciary as well as agency basis. However, commercial banks may collectively manage in a commingled investment account only assets held on a true fiduciary (as opposed to investment) basis. Thus, the principal question in the money management area is whether commercial banks should be permitted to sponsor and manage commingled investment accounts or mutual funds.

The primary advantage of allowing banks to sponsor mutual funds is that the small investor would have access to the sophisticated portfolio management services of commercial banks.

Many bank trust departments, particularly in the larger banks, have large, highly trained staffs devoted to the management of funds entrusted to the bank. Through the sponsorship of mutual funds, the bank could make this expertise available to the general public. While the small investor currently has access to the money management expertise of bank trust department through the common trust fund, participation in a common trust fund is limited to the bank's trust customers.

Bank participation in the mutual fund field might also benefit the investing public by providing increased competition within the industry, which could encourage better investment services and lower sales load charges and investment advisory fees.

Bank participation in the mutual fund field could give rise to certain concerns. The promotional incentives and pressures created by virtue of the bank's pecuniary stake in the success of the fund, it can be argued, could be destructive of prudent and disinterested banking. A bank sponsoring a mutual fund would have a strong interest in insuring the successful performance of its fund so as to attract investors, and avoid a loss of public confidence and good will because of poor performance of its fund.

Some fear that the bank's stake in the fund might distort its credit decisions. For example, the bank could be tempted to make unsound loans to investors to finance the purchase of shares in the fund, or for the purpose of assisting companies in which the fund had invested. In addition, the bank could be tempted to undertake, directly or indirectly, to make its credit resources available to the fund, or to exploit its access to confidential information in its commercial department for the benefit of the fund.

These potential abuses may be controlled through appropriate regulation and supervision by bank authorities. The Federal Reserve System, for example, has carefully limited the dealings between a bank holding company and a closed-end investment company for which it acts as an investment adviser.

Corporate financing services.—Perhaps the central policy issue raised by the expansion of bank corporate financing services is whether such activities will result in greater concentration of economic power within the financial community, and, if so, would such concentration result in more or less efficient, competitive financial markets better able to serve the needs of American enterprise, both large and small.

Bank expansion into new markets offers the potential for additional competition, which may be especially desirable where the new market is highly concentrated. Such competition could provide consumers with more innovative and less costly services. It is generally recognized that the competitive benefits of bank expansion into new financial activities are maximized where such expansion occurs through de novo entry, rather than through the acquisition of existing concerns. De novo entry of new competitors not only increases the number of competitors, but also provides an incentive for the entering company to compete vigorously in order to build its share of the market.

On the other hand, some observers contend that banks possess such leverage in so many key areas of finance that, if banks are permitted to engage in these financial activities, they would possess unfair competitive advantages over other financial institutions. A danger may exist that bank activities in related financial fields could have an anticompetitive effect through the potential tying of one bank service to another. For example, a customer seeking credit from a bank might determine voluntarily to purchase other bank services, not on their economic merit, but only to enhance its chances of obtaining credit. Thus, the mere offering of related financial services by banks could have a tying effect.

Medium- and long-term lending.—As a practical matter, banks have provided corporations with an alternative source of long-term financing. Many corporate entities rely on bank credit for longer term financing needs. Commercial banks—along with certain insurance companies—have helped in providing financing and financial advice to many less than prime credits which have faced difficulties in publicly issuing securities in the capital markets.

To the extent that commercial bank long-term lending displaces—rather than supplements—corporate securities underwriting as a means of corporate financing, there could be an adverse impact on investment banking firms. Thus, the evolution of commercial banking services in the area of long-term lending must be considered in the context of the possible long-range effects on interindustry competition and economic concentration within the financial community.

Conclusion

Mr. Chairman, I have summarized for you today some of the public policy considerations of various bank securities activities. The issues are explained in much greater detail in the Treasury issues paper. These questions require careful review by the Congress and others interested in the formulation of public policy in this area. The ultimate decisions that are made could be of great importance to the future of our financial system.

We at Treasury look forward to working with the subcommittee on these issues in the future.

EXCERPT FROM ISSUES PAPER ENTITLED "PUBLIC POLICY ASPECTS OF BANK SECURITIES ACTIVITIES"

V. Analysis of the Advantages and Disadvantages of Bank Participation in Securities Activities

In assessing the desirability of bank participation in the above-described securities activities, the foremost consideration should be the effect of such bank activities upon the long-term health of the securities markets and their ability to meet the capital needs of American enterprise. A second, and perhaps equally important, consideration is the effect that such bank activities would have on the stability and integrity of the commercial banking system.

The impact of bank participation in the various securities activities on the capital markets may be analyzed in terms of the impact on the primary capital markets or the "new issues" markets, and on the secondary capital markets. For example, bank underwriting or corporate securities would bear more directly on the functioning of the primary markets while dealing—i.e., market making—would involve the secondary markets.

As assessment of the desirability of such bank activity would require a consideration of the probable effect on the competitive posture of the investment banking industry and its ability to service the capital needs of corporations, especially smaller companies. Some argue that the lifting of the restriction on bank underwriting would result in a more competitive investment banking industry. Others contend that, because of the competitive advantages possessed by banks, bank entry into the investment banking business would eventually result in a single integrated industry and a greater concentration of economic power within the financial community. Thus, it is argued, lifting of the Glass-Steagall restrictions could result in less competition within the investment banking business through the consolidation of closely related financial activities in a single group of institutions.

The desirability of other bank securities activities must be assessed in terms of their immediate effect on the secondary markets. Some argue that bank participation in brokerage-oriented and investment activities could reinforce the trend toward centralization of investment decisions in a small number of large institutions. Centralization of investment decisions, it is feared, could distort the valuation function of the market and, therefore, the allocation of capital to American enterprise. For example, it is alleged that institutional investors have in the past favored a few favorite stocks to the detriment of less favored companies, generally smaller or emerging companies. It further argued that the domination of secondary trading by large institutions may also decrease market liquidity and increase price volatility. On the other hand, proponents of such bank activities contend that they would increase investor participation in the secondary markets by providing investors with convenient and less costly access to those markets.

Some claim that bank sponsorship of the various investment services could also indirectly affect the primary markets. For example, bank automatic investment plans and the other investment services, it is argued, may cause a net reduction in commission revenues paid to brokerage firms in a competitive rate environment. A reduction in commission revenues could result in a shrinkage in the number of retail brokerage firms that could affect the viability of the distribution system for new issues.

The second important public policy consideration in assessing the desirability of bank entrance into the securities field is the effect that such an expansion of bank operations would have on the stability and integrity of the commercial bank system. The securities business, especially underwriting and dealing in securities, is inherently risky and subject to wide fluctuation in earnings. Concern has been expressed that bank participation in this business could seriously threaten the adequacy of bank capital, and could weaken public confidence in commercial banks since there is a risk that the fortunes and good will of the bank and its securities affiliates will rise and fall together. Moreover, some people fear that the combination of investment banking and commercial banking would give rise to potential conflicts in that banks would be encouraged to make undesirable loans and investments to support their investment banking operations.

This latter consideration is less cogent in some areas of the securities business than in others. Thus, for example, the provision by banks of investment services to customers would not appear to threaten the capitalization of banks since such business generally requires very little capital investment. Similarly, it can be argued that the provision of financial advice to corporate clients or the arrangement of private placements on an agency basis for corporate clients would not appear to pose any direct risk to bank capital or to threaten public confidence in commercial banks, although potential conflicts between their financial advisory and commercial lending business do exist.

Investment services

In analyzing the advantages and disadvantages of bank participation in brokerage-oriented and money management activities, the focus must be on the economic and financial impact of concentration of such services in a few financial institutions. Other issues such as conflicts of interest, institutionalization of markets, efficiency of markets and financial intermediaries, and competition all seem to result from or relate to the issue of concentration.

Bank entry into various brokerage-oriented and money management activities could result in either of two forms of concentration. Conglomerate concentration would result where a single financial institution, such as a bank, provides a broad range of investment services. Horizontal concentration occurs when the number of financial entities providing investment services is reduced. Horizontal concentration could result from the entry by banks into new securities activities through merger with, or acquisition of, existing financial entities that perform these services, or through the attrition of competitors that provide services which banks offer. Conversely, bank entry into new securities activities de novo could result in horizontal deconcentration.

The concentration of investment services in one institution such as a bank has several advantages and disadvantages. Some observers argue that such conglomerate concentration can lower costs of providing investment services by spreading the overhead of investment advisory, account maintenance and processing functions over a broader customer base. To the extent that such cost savings are passed on to customers, the cost of securities transactions would be reduced, thereby enhancing the efficiency of securities markets and encouraging greater investor participation.

In addition, it is argued that the concentration of investment and other financial services in a single institution may provide customers with more convenient access to securities markets, and thereby further encourage participation by small individual investors in securities markets. On the other hand, it can be argued that providing individual investors more convenient and less costly access to investment services may not necessarily result in a net increase in savings and investment. Whether a net increase in investment resulted would depend on whether investors diverted funds from consumption of goods and services or diverted funds from other investments such as time deposits.

A principal disadvantage of conglomerate concentration of investment and other financial services within banks rests in the increased potential for conflicts of interest. It is claimed, for example, that potential conflicts may arise between a bank's investment management activities and its commercial lending operations.

The principal advantages of horizontal concentration whereby the number of institutions providing investment services is reduced are the increased efficiencies resulting from economies of scale. Horizontal concentration of investment services in a few multiservice banks, however, may produce several adverse effects on the capital markets. Many observers argue that increased concentration of investment services in banks could lead to an overconcentration in investment in a few favored stocks, usually well-established issues, and in an allocation of investment funds away from smaller emerging companies to larger established ones. Thus, bank investment services, it is argued, reinforce tendencies toward a tiered market.

Stated another way, the argument is that such concentration harms market efficiency by reducing the diversity of investment opinions and the number of independent investment decisionmakers in the marketplace. Financial market efficiency, as opposed to efficiency in executing and clearing transactions, may well depend upon the maintenance of a broad range of diverse viewpoints and decisionmakers in the marketplace. Moreover, the concentrations of investment advice in a small number of large institutions could adversely affect the liquidity and stability of the securities markets.

Agency and brokerage-oriented services

As noted above, commercial banks presently offer several agency services which provide customers with access to securities markets. These include voluntary investment plans, automatic investment plans, dividend reinvestment plans, and custodial accounts.

It is argued that these services benefit investors and our capital markets by providing bank customers with a convenient, low-cost, and more competitive means of purchasing securities. While it is clear that these plans do provide customers with a convenient means of access to securities markets, the extent to which such services provide cost savings to investors is uncertain. On the one hand, banks, through their strong competitive position and by virtue of the economies associated with large orders, may be able to negotiate lower brokerage fees for their customers than the latter would be able to obtain by themselves. On the other hand, it is argued that the banks' own service charges may, in many cases, offset to a great extent any commission savings.

To date, these investment services have had limited success in attracting new investors to the securities markets. However, they may have had some success in attracting new capital to the securities markets. Dividend reinvestment plans have experienced substantial growth in recent years and are now offered by almost 500 issuers.[18] Individuals participating in such plans often augment the amounts made available through dividends for investment.

[18]See William E. Chatlos, "Growth of Automatic Dividend Investment Plans," Financial Executive at 38. (October 1974.)

Therefore, it appears that these plans have had a positive effect in attracting additional capital to securities markets on the part of small investors. Because of the automatic nature of such plans and the allocation of fractional shares, they not only facilitate, but in many cases make possible, the reinvestment of typically small amounts of cash dividends. In so doing, they may reduce the tendency of shareholders to allocate dividend payments to consumption rather than savings.

While automatic investment plans also have a potential for attracting new investors to the markets, they have generally not realized this potential to date. Banks sponsoring automatic investment plans report that approximately 40 to 60 percent of participants in the plans are first-time stock market investors.[19] However, investor participation in these plans has fallen dramatically short of market projections by the industry itself and, thus, the volume of investment through these plans has not been significant.[20] Voluntary investment plans have apparently had even less success in attracting bank customers to participate in the securities markets. It can be argued that declining stock prices, rather than the nature of the investment service itself, has been the primary reason for low investor participation in these plans.

It is argued that bank sponsorship of investment plans creates opportunities for abuse. One alleged abuse arises from the bank's interest-free use of customers' funds during the acquisition interval of the investment plans.

Banks offering automatic investment services are permitted to invest customers' funds pending the banks' execution of securities transactions for the investment plans. The banks' use of customers' funds during the acquisition interval of investment plans, it is argued, conflicts with the interest of customers in receiving prompt or best execution for their securities transactions. The banks contend that the Comptroller of the Currency regulations, requiring that funds held in a fiduciary capacity by national banks awaiting investment shall not be held uninvested any longer than is reasonable for the proper management of the account, provide adequate protection.[21] In addition, banks are subject to an examination by Federal and State banking authorities to protect and prevent abuses with respect to funds held during the acquisition interval.

Some observers contend that potential conflicts also arise in connection with bank trust operations. The knowledge of impending purchases or sales of securities for automatic investment plans, it is argued, could influence the investment decisions of the trust department and other investment operations of banks.

The sponsorship by banks of various investment services may also give rise to potential conflicts with respect to their commercial loan business. It is argued that a bank may be in a position to favor a borrowing corporation through its automatic investment service or to use that service as a means of gaining new loan business. Spokesmen for the banking industry respond that banks have little incentive to invest in the securities of issuers solely because the issuers are borrowers. Such an investment in the secondary market for an issuer's security would only be of an indirect benefit to the issuer, and would be substantially outweighed by the potential loss of a bank's reputation as an investment adviser.

It is also alleged that banks may be encouraged to make loans to issuers whose stocks have been purchased by bank customers through a bank investment service in order to enhance the financial condition of the issuer so as to prevent a loss of public confidence in its investment services. Banking industry spokesmen respond that banks would not possess any incentive to make such loans because the bank's reputation is not at risk inasmuch as it is not acting as an investment adviser, but is merely providing a nondiscretionary investment service to customers. Nonetheless, it can be argued that there would be a strong association in the public mind between the bank and its investment services. As a result, the bank's public image could suffer if stocks offered through its investment services declined substantially in value. The existing bank examination procedures may, however, deter banks from making unsound loans for the purpose of assisting issuers whose stocks are held by bank customers of bank-sponsored investment services.

Banks might attempt to engage in the retail brokerage business in direct competition with broker-dealer firms, assuming they are not prohibited from doing so by the Glass-Steagall Act. The principal advantage of this activity would be increased competition within the brokerage industry which could perhaps result in lower transaction costs for small investors. In addition, customers may find it more convenient to have their brokerage needs met at the same institution which handles other financial matters.

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[19]The American Bankers Association, in its response to the SEC's inquiry concerning bank-sponsored investment services (Securities Act Release No. 5491 of Apr. 30, 1974), reported that approximately 40 percent to 60 percent of automatic investment plan participants were first-time stock investors.

[20]The New York Clearing House Association, responding to the SEC's inquiry concerning bank-sponsored investment services, reported that, while there are approximately 18,000 automatic investor service accounts administered by banks, investor participation has fallen short of market projections. Similarly, the Security Pacific National Bank responded that after 1 year of operation, its service had only approximately 1,500 participants, or less than 2 percent of the projected market.

[21]12 CFR sec. 9.10.

On the other hand, some fear that increased competition within the brokerage industry may cause an undesirable shrinkage in the number of broker-dealer firms, especially during the current difficult period. Substantial attrition among retail brokerage houses because of bank entry could threaten the viability of the existing capital-raising system which depends on a strong network of broker-dealers to distribute new corporate issues. Some fear that, should this occur, pressures would be created to permit commercial banks to engage in the underwriting of corporate issues, as well as retail brokerage. Thus, it is argued, the question of bank participation in retail brokerage cannot be considered apart from the broader question of the role of banks in the investment banking field.

Moreover, the brokerage operations of banks could pose a threat to the integrity and financial stability of commercial banks. First, a large retail brokerage operation would require significant capital to support the necessary investment in plant and equipment, as well as the brokerage operation itself. Asset growth has outpaced growth in capital and the commercial banking industry presently faces a capital adequacy problem. Banks have generally been unable to raise equity capital in recent years due to low stock prices. Moreover, high loan losses are, in some cases, making inroads into existing capital resources. It may be questioned whether existing levels of bank capital could support entry by banks on a significant scale into a new area requiring substantial amounts of additional capital.

Secondly, banks would be associated in the public's mind with various securities investments by virtue of their brokerage activities. Public confidence in commercial banks could suffer if securities held by customers of bank investment services declined substantially in value.

In addition, the cyclical nature and low predictability of earnings from brokerage operations could hinder the ability of commercial banks to raise capital. One reason for the relatively low price/earnings ratios of most bank stocks today is the fact bank earnings recently experienced a decline after many years of steady growth. Investors generally bought bank stocks for steady, if moderate, growth in earnings. Banks are now in the process of attempting to make their earnings less susceptible to changes in interest rates and the health of the economy. The return to a steady earnings growth pattern, it is hoped, will allow the banks to regain investor confidence in their stocks and thereby bring about high price levels. Bank entrance into the retail brokerage business, it can be argued, would not be in harmony with this objective.

Money management activities

Commercial banks have provided money management services to individual customers on a fiduciary as well as an agency basis. However, commercial banks may collectively manage in a commingled investment account only assets held on a true fiduciary (as opposed to investment) basis.[22] Thus, the principal question in the money management area is whether commercial banks should be permitted to sponsor and manage commingled investment accounts or mutual funds.

The primary advantage of allowing banks to sponsor mutual funds is that the small investor would have access to the sophisticated portfolio management services of commercial banks. Many bank trust departments, particularly in the larger banks, have large, highly trained staffs devoted to the management of funds entrusted to the bank. Through the sponsorship of mutual funds, the bank could make this expertise available to the general public. While the small investor currently has access to the money management expertise of bank trust departments through the common trust fund, this investment vehicle possesses certain disadvantages. Common trust funds of banks generally provide less frequent and complete disclosure of investment performance than do mutual funds. Moreover, participation in a common trust fund is limited to the bank's trust customers, while participation in a mutual fund is open to any investor.

Bank participation in the mutual fund field might also benefit the investing public by providing increased competition within the industry. Some observers believe that this competition could encourage better investment services and lower sales load charges and investment advisory fees.

On the other hand, bank expansion into the mutual fund field could pose the risk of economic concentration within that industry. As noted above, such concentration could have potential adverse consequences for our capital markets.

Furthermore, bank participation in the mutual fund field would appear to give rise to the same potential abuses and hazards which the Glass-Steagall Act was designed to eliminate. The promotional incentives and pressures incidental to a bank's sponsorship of a mutual fund, as well as the bank's pecuniary stake in the success of the fund, it can be argued, could be destructive of prudent and disinterested commercial banking and of public confidence

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22The Supreme Court, in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), held that the Glass-Steagall Act prohibits commercial banks from operating commingled investment funds comprised of numerous individual agency investment accounts.

in the commercial banking system. A bank sponsoring a mutual fund obviously would have an incentive to promote the sale of participations in the fund in order to insure its profitable operation. Thus, the bank would have a strong interest in insuring the successful performance of its fund so as to attract investors. But, the bank's stake in the fund's success is more than this. The bank's reputation and goodwill stands squarely behind the fund so that imprudent or unsuccessful management of the fund could result in a loss of public confidence in the bank itself, as is evidenced by the experience of bank-managed real estate investment trusts.

These promotional incentives and pressures, it is argued, create the potential for abuses within the commercial bank's operation. Some fear that the bank's stake in the fund might distort its credit decisions. Thus, the bank could be tempted to make unsound loans to finance the purchase of shares in the fund, or for the purpose of assisting companies in which the fund had invested. In addition, the bank could be tempted to undertake, directly or indirectly, to make its credit resources available to the fund, or to exploit its access to confidential information in its commercial department for the benefit of the fund.

These potential abuses may be limited to some extent through appropriate regulation and supervision by banking authorities. The Federal Reserve System, for example, has carefully limited the dealings between a bank holding company and an investment company for which it acts as an investment adviser. The bank holding company is prohibited from (1) purchasing for its own account securities of such an investment company, (2) making discretionary purchases of such securities in an agency or fiduciary capacity, (3) extending credit to such an investment company, and (4) accepting securities of such an investment company as collateral for loans for the purchase of such securities.[23]

While potential abuses arising from bank sponsorship of mutual funds may be limited by similar restrictions enforced through examination procedures, it can be argued that it is impossible to prevent all such abuses from occurring by regulatory fiat. It can be further argued that no amount of regulation could protect against the risk that the fortunes and goodwill of the bank and the mutual fund will rise and fall together.

Corporate financing services

Some commercial banks have aggressively expanded the types of financial services offered to corporate and governmental clients. They have offered corporations medium-term loans, financial consulting advice, and services in arranging private placements. In addition, commercial banks have sought legislation to permit them to underwrite municipal revenue bonds. This expansion is limited by the boundaries of the Glass-Steagall Act, which continues to prohibit banks from underwriting and dealing in corporate securities.

Perhaps the central policy issue raised by the expansion of bank financial services is whether such activities will result in greater concentration of economic power within the financial community, and, if so, would such concentration result in more or less efficient, competitive financial markets better able to serve the needs of American enterprise, both large and small.

Bank expansion into new markets offers the potential for additional competition, which may be especially desirable where the new market is highly concentrated. Such competition could provide consumers with more innovative and less costly services. It is generally recognized that the competitive benefits of bank expansion into new financial activities are maximized where such expansion occurs through de novo entry, rather than through the acquisition of existing concerns. De novo entry of new competitors not only increases the number of competitors, but also provides an incentive for the entering company to compete vigorously in order to build its share of the market.[24]

On the other hand, some observers contend that banks possess such enormous leverage in so many key areas of finance that, if banks are permitted to engage in these financial activities, they would possess unfair competitive advantages over other financial institutions. Thus, it is argued that, if banks are permitted to continue to expand their financial activities in competition with investment bankers, a few large money center banks will eventually dominate the securities and investment banking business.

A danger may exist that bank activities in related financial fields could have an anticompetitive effect through the potential tying of one bank service to another. Such tying could occur through formal or informal agreements or tying arrangements between a bank and its customer whereby the bank agrees to sell one product over which it has substantial

[23] 12 CFR sec. 225.125(g).

[24] Scherer, "Industrial Market Structure and Economic Performance," 366-78 (1970). The Bank Holding Company Act amendments of 1970 recognize the greater competitive benefits of de novo entry vis-a-vis entry by acquisition of existing firms. Thus, in authorizing the Federal Reserve Board to authorize bank holding companies to engage in nonbanking activities, the act permits the Board to differentiate between activities commenced de novo and activities commenced by the acquisition of a going concern. 12 U.S.C. 1843. The Board has done so by providing for an expedited procedure for de novo entry by banking holding companies into each of the nonbanking activities which the Board has thus far authorized under the 1970 amendments. Sec. 225.4(b) of Regulation Y, 12 CFR sec. 225.4(b).

market power (such as credit) only on the condition that the customer agree to purchase another bank product.

Tying arrangements are possible where the seller possesses substantial market power or monopoly power over a particular product (tying product) so that it can use its power over that product to acquire market power over another product (tied product). Since banks possess substantial market power with respect to a variety of financial services, especially credit, banks may be encouraged to use that market power to increase their power with respect to other financial services which they are authorized to provide.

However, the ability of banks to engage in tying is sharply limited by the antitrust laws, particularly section 1 of the Sherman Act. Moreover, a special statutory provision makes it illegal per se for banks to enter into tying arrangements.[25] However, the possibility of voluntary tying, or what is called tying effect, still exists. For example, a customer seeking credit from a bank might determine voluntarily to purchase other bank services, not on their economic merit, but only to enhance its chances of obtaining credit. Thus, the mere offering of related financial services by banks could have a potentially anticompetitive tying effect.

The offering of more than one service by a bank is not necessarily entirely anticompetitive. Credit customers of a bank may choose to purchase other services from the same financial institution to achieve economies, to reduce the risk of disclosure of confidential information, or simply for convenience. It is only where the customer purchases the tied product solely to curry favor with the bank and thereby enhance its access to other bank services that tying effect undesirably distorts the marketplace.

Accordingly, it has been suggested that in assessing whether banks should be permitted to engage in the various proposed securities activities, each activity should be evaluated in terms of the potential undesirable tying effect that might result. If it is determined that bank entrance into a particular securities activity raises a strong likelihood of an undesirable tying effect, consideration should be given to whether such activity should be prohibited, or, short of that, whether restrictions or regulations should be implemented to alleviate the possibility of a tying effect. For example, it may be possible to require banks to notify their customers that their purchase of other bank services will have no effect upon their decision to provide a particular service to a customer.

But, some observers believe that the question of economic concentration is more than the possibility that banks may exercise their substantial market power in anticompetitive ways that distort market decisions. They argue that if banks are permitted to engage in various financial activities, they may eventually come to dominate these financial areas through their natural competitive advantages. Thus, in their view, the broader question that must be faced is whether such a concentration of economic power within commercial banks would be in the best interest of the capital markets.

Financial advisory work

Several policy arguments can be made in favor of commercial banks being permitted to offer corporation customers financial advisory services. To begin with, the provision of financial advice to corporations seems a logical supplement to existing bank services such as providing short- and medium-term credit. Financial counseling in individual and family financial affairs has traditionally been an integral part of the banking business. Business enterprises also require counseling on a wide range of matters relating to financial aspects of their operations. It seems quite natural that commercial banks should seek to meet the financial counseling needs of business enterprises as well as individuals.

Allowing commercial banks to offer corporations financial consulting services would provide an added convenience to corporate customers who could receive financial advice as well as other bank services from the same financial institution. Bank entrance into the financial counseling business would also increase competition in this business and thereby could result in more efficient, less costly, and a wider variety of services than might otherwise be available.

Finally, the offering of financial advisory services by banks clearly falls outside the scope of those activities proscribed by the Glass-Steagall Act, nor does the offering of such services give rise to the potential abuses that the Glass-Steagall Act was designed to prevent. The provision of financial advice for a fee does not involve the promotion of securities activities such as underwriting, in which the bank has a pecuniary stake. Therefore, the offering of financial advice does not produce promotional pressures and incentives on the part of the bank which creates the potential for abuses within commercial banking operations.

On the other hand, it can be argued that permitting commercial banks to offer financial advisory services may tend to increase concentration of economic power in the commercial banking industry. It seems reasonable to conclude that commercial banks, by virtue of their

[25]Sec. 106(b) of the Bank Holding Company Act amendments of 1970, Public Law 91-607, 84 Stat. 1766-67, 12 U.S.C. sec. 1972.

natural competitive advantages, such as economies and providing customers the convenience of a multiservice financial institution, would capture a significant portion of financial advisory business from the investment banking industry. Investment banking firms may thus be stripped of one source of revenues that helps cushion the cyclicality of their earnings in their investment banking operations. The net result may be an enhancement of the economic power of commercial banks at the expense of the investment banking industry.

In addition, there is a danger that banks would possess an unfair competitive advantage in providing financial advisory services by virtue of their market power in providing traditional banking services such as credit. Thus, corporate clients, especially during periods of tight credit, may voluntarily choose to purchase financial advisory services from the bank so as to enhance their chances of obtaining credit from the bank. This undesirable tying effect could perhaps be alleviated by appropriate regulation.

Finally, some people feel that potential conflicts could arise between commercial bank lending and trust operations and the provision of disinterested financial advice in mergers and acquisitions. For example, a bank, in advising a corporate client to acquire a particular company, could be influenced by the fact that the bank has a substantial investment in the target corporation, either in the form of a commercial loan or a securities holding of the trust department. Furthermore, a bank might have an incentive to recommend a financing alternative in which it could participate.

The Comptroller of the Currency has authorized national banks to provide financial advisory services to corporate clients on the ground that such services are incidental to the business of banking and are not prohibited by the Glass-Steagall Act.[26] However, uncertainties concerning the extent to which the Glass-Steagall Act applies to bank financial advisory activities, coupled with the act's harsh criminal penalties,[27] have inhibited the evolution of bank financial advisory services. For example, in advising corporate clients in mergers and acquisitions, which may involve the issuance of securities, banks are uncertain to what extent they can become involved in the negotiations without risking a violation of the Glass-Steagall Act's prohibitions against underwriting corporate securities. Similar uncertainties arise in connection with banks arranging private placements for corporate clients.

In view of these considerations, the Comptroller of the Currency is of the view that the criminal penalties provided in section 21 of the Glass-Steagall Act[28] should be repealed. These harsh measures, it is argued, are inappropriate in a statute containing such gray areas between what is permissible and what is forbidden.

Medium- and long-term lending and private placements

As noted above, commercial banks, particularly the large money center banks, offer a range of services that are designed to meet corporate needs for long-term financing. These include the granting of medium- and long-term loans and the arranging of private placements. Such services could be viewed as substitutes for securities underwritings.

The trend toward longer term lending, it is argued, is beneficial. Proponents argue that such lending provides corporations with an alternative source of long-term financing. This additional competition in financial markets could benefit corporations by lowering the costs of capital.

Moreover, medium- and long-term lending represents a part of the traditional banking business and does not violate the underwriting prohibitions of the Glass-Steagall Act. Nor do such lending practices give rise to the potential abuses of the commercial banking system against which the Glass-Steagall Act was intended to protect. Because such lending does not involve the bank in buying and selling investments for its own account, such bank activity does not create the promotional pressures and incentives associated with investment banking that threaten prudent and disinterested commercial banking.

On the other hand, to the extent that commercial bank long-term lending displaces corporate securities underwriting as a means of corporate financing, the net effect could be a diminution of investment banking firms and a corresponding increase in the importance of commercial banks as suppliers of long-term capital. Thus, the evolution of commercial banking services in the area of long-term lending must be considered in the context of the possible long-range effects on interindustry competition and economic concentration within the financial community.

The participation of commercial banks in arranging private placements of corporate debt securities would also appear to have several benefits. An obvious benefit is increased competition in providing private placement services to corporations, which could lower the

[26]In many cases, national banks seek to offer financial advisory services through a new operating subsidiary of the bank. The Comptroller of the Currency must approve the creation of a subsidiary for that purpose under 12 CFR sec. 7.7376, which provides that a national bank may engage in any activity that is incidental to the business of banking by means of an operating subsidiary.

[27]The Glass-Steagall Act provides for up to 5 years' imprisonment for violations. 12 U.S.C. 378(b).

[28]12 U.S.C. 378(b).

costs to corporations of raising debt capital. In addition, increasing the number of financial institutions that are able to arrange private placements, particularly outside of the major financial centers, could make this type of financing more readily available to smaller corporations. Corporations often prefer to raise funds through private placements rather than public offerings in order to avoid the delay involved in registered public offerings, to save on costs of flotation, and to permit the tailoring of each loan indenture to each particular situation. Moreover, for those small corporations that do not have access to public markets, private placements provide an alternative means of access to the capital markets.

Bank participation in the private placement area produces other benefits. Commercial banks are able to serve more efficiently the financial needs and convenience of corporate clients by offering a complete package of services. By offering full financial services, banks permit corporate clients to satisfy all their financial needs at the same financial institution.

Moreover, the arrangement of private placements by commercial banks would not appear to create the same inherent conflicts of interest which arise when a commercial bank also engages in the underwriting and distribution of corporate securities. When arranging private placements, a bank acts as an agent for its corporate client rather than as a principal in buying and selling securities for its own account. Thus, the bank would not be subject to the same promotional pressures or incentives associated with investment banking that could threaten prudent and disinterested commercial banking.

On the other hand, commercial bank expansion in the private placement business raises the same concerns over economic concentration that are raised by commercial bank expansion into other financial advisory services. Banks could reduce private placement and financial advisory business of investment banking firms. The lending function may be an important advantage in competing with the investment banking industry for this business. For example, if a commercial bank advises a corporate client, which has an outstanding line of credit with the bank, that it needs long-term financing in the form of a private placement, the client may feel obligated to use the bank's services in arranging the private placement.

Thus, it is argued, bank private placement and financial advisory activities may threaten the viability of some investment banking firms, especially smaller firms specializing in mergers, acquisitions, and private placements. In the long term, this would lead to a further concentration of economic power within the commercial banking industry and a weakening of the investment banking industry.

Finally, while bank participation in arranging private placements would not appear to create the same potential for abuse that occurs when commercial banks underwrite corporate securities, it can be argued that this bank activity is not entirely free of potential conflicts. In arranging a private placement, a bank will necessarily have a stake in insuring that the offering is successfully placed, especially if the bank's fee is contingent upon the successful placement of the offerings, and even more so if the proceeds of the placement are used to retire an interim obligation to the bank. The promotional pressures thus created in arranging a private placement for a corporation could cause a bank to make imprudent loans to the corporation in order to complete or facilitate the successful placement of securities. For example, the bank could make a long-term loan to satisfy that portion of the offering that could not be placed with an institutional investor. Alternatively, the bank could make a loan to the corporate issuer in order to enhance its financial condition and thereby encourage an institution to invest in a private placement of the issuer's securities.

The policies and objectives of the Glass-Steagall prohibition against commercial bank underwriting and dealing in corporate securities are discussed in detail in the appendix: "Review of the History, Policies and Objectives of the Glass-Steagall Separation of Commercial and Investment Banking." As noted above, three primary reasons for enactment of the prohibition can be identified from the legislative history. First, it is evident that the Congress concluded that the separation of commercial and investment banking was necessary to protect and maintain the financial stability of commercial bank operations and to ensure public confidence in commercial banking.

Secondly, Congress desired to eliminate the potential for conflicts of interest which could arise from performance of both commercial banking and investment banking operations. Congressional investigation[29] into the breakdown of the banking system in the early 1930's revealed the following actual or potential conflicts arising from the operations of security affiliates of commercial banks:

(1) Banks made excessive and nonprudent loans to their security affiliates, which they would not normally have made if they were dealing with nonrelated entities.

(2) Securities were sold by the security affiliates to their parent banks or another of their affiliates under repurchase agreements.

(3) Bank funds were used to purchase excessive security holdings of security affiliates.

[29]Hearings before a subcommittee of the Senate Committee on Banking and Currency pursuant to S. Res. 71, 71st Cong., 3d sess., part 1 1064 (1931).

(4) Banks made excessive and nonprudent loans to their customers to purchase securities underwritten by their security affiliates, or in which their security affiliates otherwise had an interest.

(5) Security affiliates of banks conducted manipulative transactions in their parent banks' stock.

(6) Bank officers received compensation from security affiliates far in excess of that paid to them by their banks and otherwise personally profited from the operations of security affiliates.

(7) Security affiliates engaged in high leveraging and unwise risk-taking in reliance upon access to the resources of their parent banks.

(8) Banks faced a significant loss of confidence by depositors and others as a result of losses by such persons in the operations of the banks' security affiliates and the resultant termination of depositor relationships.

A final concern that motivated Congress in enacting the Glass-Steagall prohibition was the feeling that bank securities operations tended to exaggerate financial and business fluctuations and undermine the economic stability of the country by channeling bank deposits into "speculative" securities investments. Underlying these judgments, however, was the belief held by Senator Glass and others that investment banking was outside the traditional and proper sphere of commercial banks whose role was viewed as limited mainly to making short-term, self-liquidating loans to finance goods in the process of production and commerce.

Many of the concerns underlying Congress' decision to divorce commercial and investment banking appear to have been allayed in large part by subsequent economic and regulatory developments. By enacting the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress subjected underwriting and dealing in corporate securities to a pervasive regulatory framework. The 1933 act provided investors with protection against abuses related to false or misleading information in connection with securities underwritings. The 1934 act also provided investors with protection against insider self-dealing and manipulation of securities markets, and prohibited the extension of credit by broker-dealers to customers for the purchase of new issues.[30]

In addition, commercial banks have been subject to a far more extensive Federal regulatory system than existed prior to 1933. The Bank Holding Company Act of 1956 granted the Board of Governors of the Federal Reserve System authority to supervise the nonbanking affiliates of banks. Section 7 of the Securities Exchange Act of 1934 authorized the Board to regulate the extension of bank credit for the purchase of securities.[31] This provision effectively achieved one of the underlying objectives of the Glass-Steagall legislation which was to control speculative uses of commercial banks' assets in the securities markets. Federal and State laws have provided increasingly stricter standards for commercial bank fiduciaries in exercising investment discretion on behalf of public investors. All these developments tend to reduce the potential for the abuses of commercial bank securities operations which occurred in the 1920–30's.

It is against this background that the question whether banks should be again permitted to engage in investment banking must be assessed. It appears, however, that some of the inherent conflicts and potential hazards that arise from the combination of commercial and investment banking remain valid concerns even in light of the development of securities and banking regulation since 1933. For example, the securities business is inherently risky and subject to wide fluctuations in earnings. Some people, both within and outside the banking industry, have expressed concern that the severe cyclical nature of this business might lead to a weakening of public confidence in banks should they be permitted to engage in it once again. While Federal deposit insurance might mitigate any adverse effects on public confidence, they fear that the risk remains that the fortunes and goodwill of the bank and its securities affiliate will rise and fall together.

In addition, it is argued that the possibility always exists that banks will be encouraged to make imprudent loans and investments to promote or support their investment banking activities. While these potential abuses may be limited through examination and oversight by banking authorities, it is impossible to prevent all such abuses from occurring by legislative or regulatory fiat.

A review of the Glass-Steagall provisions separating commercial banking and investment banking should not be limited to a consideration of the policies and objectives that motivated Congress in 1933. Rather, the review should encompass broader policy considerations that reflect current financial and economic concerns. Two such policy considerations that may not have been contemplated by Congress in enacting the Glass-Steagall prohibitions concern

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[30]Securities Exchange Act of 1934, sec. 11(d), 15 U.S.C. sec. 78k(d).

[31]15 U.S.C. sec. 78g.

the question of economic concentration within the financial community and the problem of capital adequacy. These policy considerations are explored below.

An assessment of the desirability of bank underwriting and dealing in corporate securities requires a consideration of the effect of such bank activity on the competitive structure of the investment banking industry and its ability to service the capital needs of corporations, particularly small and emerging companies. Some observers argue that the entry of commercial banks into the underwriting field would significantly enhance the competitive environment in the existing investment banking industry. They point to the present highly concentrated structure of the investment banking industry in which the top 10 firms managed 85 percent of corporate underwritings in 1974.[32] Bank entry, it is argued, would increase the number of competitors and result in more efficient, less costly services for corporate issuers.

On the other hand, some people fear that, while bank entry into the investment banking field might provide increased competition in the short term, the integration of commercial and investment banking, in the long term, could result in less competition and less liquidity in our capital markets. This would be especially true, it is argued, should the commercial banking system become more streamlined and dominated by a few large money center banks possessing extensive networks of correspondent banks.

This fear is grounded on the belief that, in the long term, commercial banks would dominate the investment banking business. It is contemplated that commercial banks would seek to enter the underwriting business by acquiring existing investment banking firms, rather than taking the more difficult course of starting a de novo investment banking operation. The existence of firmly established client relationships within the current investment banking industry and the commercial banks' lack of skills and experience in this area would make it unlikely that commercial banks could establish new investment banking operations and promptly obtain a meaningful position in the industry through de novo activities. On the other hand, entry by acquisition of going concerns should be easy since many investment banking firms, particularly those with financial difficulties or capital ownership concentrated in a few individuals or families, would probably be eager to affiliate with a commercial bank.

Thus, it is argued that ultimately commercial banks would acquire a dominant position in the investment banking industry, although a substantial number of the large and well-established investment banking firms would probably survive. However, these investment banking firms would eventually enter the commercial banking business in order to remain competitive with the commercial banks. Thus, the full integration of commercial and investment banking would be completed.

On the other hand, it can be argued that the foregoing analysis fails to take into account the probable regulatory system under which such bank entry into the investment banking field would occur. First, bank entry into a new nonbanking activity such as investment banking would be subject to the strictures of the antitrust law. While the ways in which the antitrust laws might affect such bank expansion are uncertain, there are several potential theories under which the antitrust laws could be applied to restrict or control bank expansion into the investment banking field.

Secondly, if banks were permitted to enter the investment banking business, the Congress could determine that such entry should take place under the existing provisions of the Bank Holding Company Act, which provide a vehicle for bank expansion into nonbanking activities under Federal Reserve Board supervision. If this were to occur, bank entry into the investment banking business would be carefully regulated by the Board to insure that the public benefits of such entry are not outweighed by the adverse effects of decreased competition or undue concentration of resources.[33] In considering the effect of bank entry on competition, the Board is concerned with the loss of potential competition and, thus, encourages de novo entry or entry by "foothold" acquisition of one of the smaller firms in the market, as opposed to entry by acquisition of a major existing concern.[34] Where the bank holding company has the capacity to enter de novo, the Board views entry through acquisition of an existing business as a loss of potential competition.

Thus, it can be argued that, if banks were permitted to enter the underwriting business under the present Bank Holding Company Act provisions, the Federal Reserve Board would

[32]Investment Dealers Digest, Corporate Financing Directory at 18 (Mar. 11, 1975).

[33]The Bank Holding Company Act authorizes the Federal Reserve Board to permit bank holding companies to engage in nonbanking activities which the Board determines "to be so closely related to banking or managing and controlling banks as to be a proper incident thereto." In determining whether a particular nonbanking activity is so related to banking as to be a proper incident thereto, the Board is directed to weigh the expected benefits of the requested bank activity against possible adverse effects, such as undue concentration of resources, and decreased or unfair competition. Sec. 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. sec. 1843(c)(8). This provision, which was added by 1970 amendments to the act, was designed to permit bank holding company expansion into related financial areas where the Federal Reserve Board finds such expansion to be in the public interest.

[34]For a description of the Federal Reserve Board's policy in this regard, see Note, "Implementation of the Bank Holding Company Act Amendments of 1970: The Scope of Banking Activities," 71 Mich. L. Rev. 1170, 1199-1200 (1973).

regulate such entry so as to promote competition and to avoid undue concentration within the investment banking industry.

A second policy consideration that may not have been a primary basis for the Glass-Steagall prohibitions is the impact of investment banking operations on the adequacy of bank capital. It is clear that both regulators and investors are concerned over the adequacy of current levels of capital in both the commercial and investment banking industry. Not only are commercial bank capital-to-asset ratios very low by traditional standards, but a number of broker-dealers have declared bankruptcy or been forced to merge in recent years because of capital problems.

On the other hand, it has been suggested that banks could enter the corporate underwriting business by the use of security affiliates and thereby limit the direct risk to bank capital. In such cases, banks would be under strict limitations as to the aggregate amount of credit or investments that they could extend to or make in their security affiliates.[35] In addition, the amount of dividends they could pay to their holding companies would be limited.[36] While these and other restrictions would in some measure insulate the bank from any financial problems of a security affiliate, some observers believe that in reality it is extremely unlikely that a bank would fail to support a nonbank affiliate in financial difficulty to the extent permitted by law. If a bank did fail to honor this "moral obligation," public confidence in that bank, and perhaps in the banking system as a whole, could be severely shaken.

It can be further argued that bank entry into investment banking also poses a risk to the earnings stability of commercial banks. Although corporate underwriting can be a highly profitable enterprise,[37] it is a risky business subject to wide fluctuations in earnings. A good market can produce high profit levels whereas in a bad market there may be few, if any, corporations able to seek new capital in the long-term markets. Some fear that investment banking would introduce added cyclicality to bank earnings at a time when commercial banks are trying to regain the stable earnings growth trends of the 1960's. They maintain that it is unlikely the multiples on bank equities will improve materially until some earnings predictability and stability is regained. And until the market prices of bank stocks improve, it is unlikely banks will be able to significantly improve their capital positions.

Underwriting of municipal revenue bonds

As described in an earlier section, commercial banks may now underwrite and deal in general obligation bonds issued by a political subdivision of a State, but not in revenue bonds offered by the same issuer. It has long been argued that banks should be allowed to underwrite both types of municipal obligations. Several government agencies have recently supported this change. The Senate passed legislation in the 93d Congress that would have permitted commercial banks to underwrite municipal revenue bonds, but the House failed to act on it.[38]

Proponents of the change argue that, insofar as issue characteristics and marketability are concerned, there are no significant differences between general obligation issues and revenue issues. However, the prohibition of bank underwriting of revenue bonds, they maintain, has a marked influence on the sale and distribution of such bonds to the detriment of the issuers involved. Extensive studies have demonstrated that issuers of revenue bonds receive fewer bids from underwriting syndicates than do issuers of general obligation bonds of comparable size, maturity, and quality. As a result, those issuers of revenue bonds pay relatively higher interest costs.[39] It is estimated that the interest costs that could be saved by allowing bank underwriting of revenue bonds would amount to millions of dollars annually.[40] No systematic quantitative study that refutes these conclusions has been conducted.

Opponents of allowing banks to underwrite revenue bonds contend that such action would ultimately lead to an undesirable concentration of economic activity in commercial banks. Proponents argue, however, that the history of commercial bank activity in underwriting general obligation municipal bonds indicates that the banks would not dominate the

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[35] Sec. 23A of the Federal Reserve Act, 12 U.S.C. 371c, prohibits, with certain exceptions, a member bank from extending credit to or making investments in any affiliate in an amount in excess of 10 percent of the capital stock and surplus of the member bank. Where credit and investments are made in more than one affiliate, the aggregate amount of such credit and investments shall not exceed 20 percent of the capital stock and surplus of the member bank.

[36] A national bank must obtain the approval of the Comptroller of the Currency in order to pay dividends in excess of the total of its net profits for the year, combined with its retained net profits of the previous 2 years. 12 U.S.C. 60(b). Member banks that are not national banks must seek such approval from the Board of Governors of the Federal Reserve System. 12 U.S.C. 324.

[37] Hayes, "Investment Banking: Power Structure in Flux," Harvard Bus. Rev. at 137-138 (March-April 1971).

[38] S. 3838, 93d Cong., 2d sess. (1974).

[39] Peter Keir and James Kichline, "Interest Cost Effects of Commercial Bank Underwriting of Municipal Revenue Bonds," Federal Reserve Bulletin (August 1967); Reuben Kessel, "A Study of the Effects of Competition in the Tax-exempt Bond Market," The Journal of Political Economy, vol. 79, No. 4 (July-August 1971); and Wm. Paul Smith, "Commercial Bank Entry into Revenue Bond Underwriting; Competitive Impact & Public Benefits," Washington, D.C.: Office of the Comptroller of the Currency, 1968.

[40] See Report of the Senate Committee on Banking, Housing, and Urban Affairs on S. 3838, S. Rep. No. 93-1120, 93d Cong., 2d sess. 12-13 (1974).

underwriting of revenue bonds to the exclusion of existing investment banking firms. Throughout the past 40 years, commercial banks have been joined by investment bankers as participants and as managers of underwriting syndicates. There is a well-established record of cooperation in the underwriting of general obligation issues, but little evidence of either intent or opportunity for commercial banks to engage in predatory practices or to exclude investment bankers. While commercial banks have been highly successful as underwriters of general obligation issues, investment banking houses have always played a major role as underwriters of such issues. There is also little evidence to support the theory that commercial bankers could, or indeed would wish to, exclude investment bankers from the underwriting of municipal revenue bonds. Thus, it is argued that commercial bank entry into revenue bond underwriting would not lead to an undesirable concentration of activity in commercial banks.

It is also alleged that permitting commercial banks to underwrite revenue bonds would create conflicts of interest between the banks' investment banking and fiduciary functions. Certainly a potential conflict exists between the interest of the underwriting section of a commercial bank in achieving the minimum yield for the agency offering the security issue and the goals of bank investment managers and trust account managers who seek to achieve some desirable combination of risk and return on investment. However, while the potential for conflicts exist, there is no record of actual conflicts arising from commercial bank underwriting of general obligation municipals during the past 40 years that they have engaged in such activity.[41] Since municipal revenue bonds are comparable to general obligation municipals in all essential characteristics, there is no reason to believe that actual conflicts of interest would arise in bank underwriting of revenue bonds.

Furthermore, under Federal and State law, member banks may not now sell their dealer inventory to fiduciary accounts except when lawfully authorized in the trust instrument, by local law or under specific direction of a court. However, member banks could sell their dealer inventory to their own portfolios. Moreover, most States prohibit banks from selling underwritten securities to fiduciary accounts except under specific direction of a court. In any event, it is argued that a safeguard of this nature can be easily incorporated into Federal law permitting commercial banks to underwrite municipal revenue bonds.

Exhibit 17.—Statement of Under Secretary for Monetary Affairs Yeo, January 21, 1976, before the House Ways and Means Committee, on proposals relating to tax-exempt financing

Mr. Chairman and members of this distinguished committee, I want to discuss with you a question of major importance to the Nation as a whole and to government at all levels. The subject is tax-exempt financing and the municipal bond market.

The market for tax-exempt bonds is basically strong and provides a necessary mechanism for State and local government financing. We do not seek to diminish in any way the vitality of the municipal market. On the contrary, our proposals will build upon its basic strength to create a more stable, efficient, and equitable market for financing the future capital needs of State and local governments.

Our focus is on whether new tax measures are needed to improve conditions in that market and, if so, what form they should take. And our view is that State and local governments, issuing debt for public purposes, should be afforded the option of doing so on a fully taxable basis, with a 30-percent interest subsidy from the Federal Government.

Basically, our proposal is designed to eliminate an artificial and unnecessary constraint on the efficient financing of State and local government: the present limitation of the class of potential lenders to those entities which can profitably use tax-exempt income. The paradoxes in the current situation are manifold:

First, the second largest borrowing sector in our capital markets (after the Federal Government) is narrowly confined to only a segment of the potential lender class.

Second, some of the Nation's largest groupings of financial assets are effectively denied opportunity to make investments in the future growth of our States and cities.

Third, the value of holdings of tax-exempt securities can be significantly affected by changes in tax rates, changes which may occur without consideration of, and with no desire to create, such an impact.

It is such concerns which have led us to the conclusion that the taxable bond option is an idea whose time has come.

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[41]This issue was probed extensively in 1967 hearings before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency on S. 1306, 90th Cong., 1st sess. (1967). Opponents of commercial bank underwriting of revenue bonds were unable to present a single instance where a bank had been guilty of a conflict of interest in underwriting and dealing in general obligation issues.

Tax-exempt status under the Internal Revenue Code

State and local governments issue three types of obligations which qualify for the interest exemption under the Internal Revenue Code. The first category consists of general obligations issued by a State or its political subdivisions. In the second category are obligations not secured by general funds but by revenues which the State or political subdivision derives from specific projects. The third group consists of industrial development bonds, or IDB's, which are obligations secured by the revenues or property of a private party. In 1968, Congress sought to limit the growth of tax-exempt IDB financing by providing that such bonds will be taxable unless issued for specified purposes, such as housing, transportation, solid waste disposal, or pollution control.

The municipal market

At the outset, I want to emphasize that the municipal bond market as a whole performed very well in 1975. A record of $29 billion in new issues was established last year. Table 1 shows that this was the culmination of a steady upward trend over the past 15 years.

Despite its generally favorable performance, the municipal bond market is not without its difficulties. There are three basic problems which any proposed changes should address: The cyclical instability of the municipal bond market; critical changes in supply/demand patterns; and the present inefficiency of the exemption as a financing mechanism. Although these problems are interrelated, I will discuss each separately.

The cyclical volatility of the market is caused by the behavior of the major purchasers of State and local debt. There are three major participants in the market—commercial banks, fire and casualty insurance companies, and individual investors, including personal trusts. All other investors taken together comprise a small fraction of the purchasers of net new issues of municipal securities. Table 2 indicates the composition of ownership. As shown in this table, commercial banks historically have been the most important purchasers of State and local debt. The participation of commercial banks means that the market may be adversely affected during periods of credit stringency or strong demand for bank loans or when the banking system's need for tax exemption diminishes. In such periods, the bond market tends to perform relatively poorly. And as the role of the banks becomes less significant, individual investors are called upon to take up part of the slack.

The volatility problem thus has two dimensions. First, individual investors will not completely offset the decrease in participation of commercial banks so that the total volume of debt that State and local governments can issue tends to decline. Secondly, individuals are only willing to absorb larger amounts of municipal debt at sharply increasing interest rates. The result, as shown in table 3, is a fluctuating relationship between taxable and tax-exempt interest rates.

The volume of municipal debt and the interest rates at which it can be sold are thus critically influenced by the fact that the market responds not only to overall changes in the supply and demand for credit, but also to shortrun changes in the financial situation of a single group of institutional lenders. A primary objective of tax proposals concerning municipal bonds must be to moderate the market impact of these cyclical phenomena.

Our second area of concern involves the longrun prospects for the municipal bond market. The role of commercial banks is also important in this regard. Because their need for tax-exempt income has declined, there is growing concern that commercial banks will on average

TABLE 1.—*Volume of gross new issues of long-term municipal bonds by year*

[Millions of dollars]

Year	Gross issues
1960	7,229
1961	8,359
1962	8,558
1963	10,107
1964	10,544
1965	11,084
1966	11,089
1967	14,288
1968	16,374
1969	11,460
1970	17,762
1971	24,370
1972	22,941
1973	22,953
1974	22,824
1975	29,224

Source: Bond Buyer.

TABLE 2.—*Net change in ownership of municipal securities*
Seasonally adjusted annual rates

Year	Total		Individuals		Commercial banks		Fire and casualty insurance companies		All other	
	Billions of dollars	Percent	Billions of dollars	Percent	Billions of dollars	Percent	Billions of dollars	Percent	Billions of dollars	Percent
1960	5.3	100.0	3.5	66.0	0.6	11.3	0.8	15.1	0.4	7.6
1961	5.1	100.0	1.2	23.5	2.8	54.9	1.0	19.6	0.1	2.0
1962	5.4	100.0	−1.0	−18.5	5.7	105.6	0.8	14.8	−0.1	−1.9
1963	5.7	100.0	1.0	17.6	3.9	68.4	0.7	12.3	0.1	1.8
1964	6.0	100.0	2.6	43.3	3.6	60.0	0.4	6.7	−0.6	−10.0
1965	7.3	100.0	1.7	23.3	5.2	71.2	0.4	5.5	0.0	....
1966	5.6	100.0	3.6	64.3	2.3	41.1	1.3	23.2	−1.6	−28.6
1967	7.8	100.0	−2.2	−28.2	9.1	116.7	1.4	18.0	−0.5	−6.4
1968	9.5	100.0	−0.7	−7.4	8.6	90.5	1.0	10.5	0.6	6.3
1969	9.9	100.0	9.6	96.9	0.2	2.0	1.2	12.1	−1.1	−11.1
1970	11.2	100.0	−0.8	−7.2	10.7	95.5	1.5	13.4	−0.2	−1.8
1971	17.6	100.0	−0.2	−1.1	12.6	71.6	3.9	22.2	1.3	7.4
1972	14.4	100.0	1.0	7.0	7.2	50.0	4.8	33.3	1.4	9.7
1973	13.7	100.0	4.3	31.4	5.7	41.6	3.9	28.5	−0.2	−1.5
1974	17.4	100.0	10.0	57.5	5.5	31.6	1.8	10.4	0.1	0.6
1975[1]	16.2	100.0	10.0	61.7	2.4	14.8	2.2	13.6	1.6	9.8

[1] First three quarters annualized.

Source: Federal Reserve Board, flow of funds data.

TABLE 3.—*Tax-exempt and taxable interest rates and ratio of the two*

Year	Tax-exempt interest rate (Bond Buyer 20)	Taxable interest rate (Moody's Corporate New Issue)	Ratio
	Percent	*Percent*	
1960	3.54	4.82	73.5
1961	3.45	4.70	71.6
1962	3.17	4.46	71.1
1963	3.16	4.41	71.7
1964	3.22	4.54	70.9
1965	3.25	4.71	69.0
1966	3.81	5.59	68.2
1967	3.92	5.91	66.3
1968	4.42	6.70	66.0
1969	5.66	7.97	71.0
1970	6.36	8.85	71.9
1971	5.52	7.74	73.9
1972	5.25	7.47	70.3
1973	5.22	7.88	66.3
1974	6.09	9.08	67.1
1975	7.06	9.42	75.0

be less interested in municipal bonds in the future. Table 4 shows the ownership of municipal securities for selected periods since 1960. The data shown there indicates that commercial banks absorbed over 70 percent of the net new issues of municipal debt over the period from 1960 to 1970, a period which saw their share of the total debt outstanding almost double. Since 1970, however, commercial banks have absorbed only one-half of the net new issues, barely enough to keep their share of the total debt outstanding constant. Thus, so far as long-term development of the market is concerned, other sources of financing must be found if the volume of municipal borrowing is to be maintained.

At the same time, inflation in all of its manifestations has and will continue to create sharply increased levels of demand. The impact of inflation starts with the higher cost of capital improvements which tax-exempt credit is designed primarily to finance. A more indirect, but equally real, byproduct is the tendency of individuals to seek to shift certain functions to municipal government in order to preserve a standard of living. More mass transit, free university tuition, and public recreation facilities all impose strains on the market.

Moreover, the problem is aggravated by another development—the increasing use of the market to finance capital outlays, particularly pollution control and other industrial facilities, which do not fall within the traditional categories of State and local financing. Table 5 shows the growing volume of these two types of tax-exempt financing since 1971. At present, the published data indicate that $2.9 billion, or just less than 10 percent of new borrowing in the municipal bond market, is undertaken for these nongovernmental purposes, particularly for private pollution control facilities. Moreover, specialists in this field believe that these figures may be underestimated by a factor of two due to the relatively large volume of private placements which are not reflected in the published data. This contrasts sharply with the situation in 1968, when the IDB limitations were first enacted. Then the volume of industrial development bond financing was approaching $1.6 billion annually. Moreover, since these bonds are issued with long maturities, they impact on that part of the market which is already showing structural weakness, and exacerbate the problem.

In short, the long-range prospect for the municipal bond market is clouded by two interrelated elements: State supply of credit and growing demand for credit. If these two problems are not dealt with now, State and local governments borrowing for conventional municipal purposes will find, over time, their market outlets further constrained and their interest rates rising higher.

This leads to the third problem—the present inefficiency of the exemption and the resulting growth in Federal revenue losses and tax sheltering. We believe that the Federal and State and local governments have a strong, mutual interest in improving the efficiency of the tax-exempt market and that we must seek new ways to achieve this important objective.

Tax exemption has provided lower interest costs to State and local governments in a particularly inefficient way—the cost to the Federal Government is greater than the benefits to municipal borrowers. The degree to which tax exemption reduces interest costs paid by governmental borrowers varies with the length of the maturity of the particular debt obligation. Tax-exempt securities enjoy a greater reduction in interest rates relative to taxable securities for short-term maturities than for longer term obligations. On average, tax-exempt interest rates are more than 40 percent below taxable rates for issues of 1 year or less, about 30 percent for intermediate issues, and about 20 percent for 30-year bonds. This represents the saving to municipal borrowers.

TABLE 4.—*Ownership of municipal securities, yearend outstandings, selected years*

Year	Total	Households: Billions of dollars	Households: Percent of total	Commercial banks: Billions of dollars	Commercial banks: Percent of total	Nonlife insurance: Billions of dollars	Nonlife insurance: Percent of total	All others: Billions of dollars	All others: Percent of total
1960	70.8	30.8	43.5	17.7	25.0	8.1	11.4	14.2	20.1
1965	100.3	36.4	36.3	38.9	38.8	11.3	11.3	13.7	13.7
1970	144.5	45.6	31.6	70.2	48.6	17.8	12.3	10.9	7.6
1974	204.1	60.3	29.6	100.3	49.2	30.7	15.1	12.8	6.3

Source: Federal Reserve Board, flow of funds data.

TABLE 5.—*Tax-exempt borrowing*

[Dollar amounts in millions]

Year	Gross long-term tax-exempt borrowing	Pollution control	Other industrial development bonds	Total nongovernmental	Percent of market
1971	$24,370	$ 93	$220	$ 313	1.3
1972	22,941	594	471	1,065	4.6
1973	22,953	1,750	270	2,020	8.8
1974	22,824	2,140	337	2,477	10.9
1975	29,224	2,508	398	2,906	9.9

Source: Bond Buyer.

At the same time, the cost to the Treasury can be estimated by reference to the marginal tax rate of the average tax-exempt investor. It has been estimated that the average marginal tax bracket of all investors in tax-exempt bonds is over 40 percent. In other words, if all these investors purchased taxable rather than tax-exempt bonds, the U.S. Treasury would receive additional revenues equal to over 40 percent of the interest on these bonds. Thus, the revenue loss to the Treasury is equal to over 40 percent of the bond interest that would be paid if that interest were taxable. Yet, as indicated above, the benefit to the issuing State and local governments is substantially less than 40 percent of the interest that would be paid on such taxable obligations. For this reason, the present exemption is a very inefficient means of providing lower borrowing costs for State and local governments.

For example, if in one year $30 billion of long-term debt were issued at a tax-exempt interest rate of, say, 6.3 percent rather than a taxable rate of 9 percent, State and local governments would secure a reduction in interest payments of some $800 million in the first year of that debt. On the other hand, if all that interest had been fully taxable and if purchasers of that debt had no investment alternatives available except taxable bonds, the Treasury would have realized revenue gains of $1.1 billion. The $300 million difference represents revenue losses not passed through to issuing governments, or the benefit accruing to investors under present exemption.

Treasury proposals

Let me now turn to measures which I feel can significantly improve the performance of the municipal bond market with respect to all three of these problem areas. The measures proposed here will deal with the volatility problem by freeing the market from its current overdependence on the need for tax-exempt income and the availability of credit from particular classes of lenders. At the same time, new long-term sources of funds will be made available to the municipal market. Finally, tax-exempt interest rates will be reduced and will be maintained at a lower ratio to taxable rates than has been achieved historically, particularly for longer term maturities. Finally, as a result of our recommendations, State and local governments will receive substantial benefits in terms of lower net borrowing costs.

The taxable bond option

We believe the market should decide the basis upon which State and local securities are issued. To accomplish this objective, issuers should be afforded the opportunity of issuing debt on a taxable basis and, in such circumstances, would receive an automatic 30-percent interest subsidy from the Federal Government.

Let me be clear. By supporting the taxable bond option, I am not implying that State or local government must or should have a higher level of subsidy from the Federal Government. Our objective is not more in the way of direct subsidy but rather assistance in a more meaningful form: the removal of significant constraints on the functioning of the second largest sector of our capital markets.

After the Federal Government itself, State and local governments as a class are the largest borrowers in our capital markets. Yet this enormous borrowing class is severely restricted in the sources of funds it may tap. It is, as a practical matter, shut off from the billions of dollars held by pension funds and the billions more held by foundations and other nontaxpaying institutions. It is largely barred from other important potential lenders—for example, life insurance companies—whose need for tax-exempt income is normally insubstantial. In short, the taxable bond option would introduce to this market a much-needed element of flexibility of freedom, under which the market should function more efficiently.

Participation by State and local governments in this program would be entirely voluntary. The issuing governments would decide whether they wish to continue to use conventional tax-exempt financing or the new subsidized taxable instrument. In most cases, we anticipate that issuers will advertise bonds for sale seeking bids on both a taxable and tax-exempt basis.

Issuers would switch from one market to the other depending on which provided the lower net interest cost. As a general rule, we would expect that once the option is working effectively the after-subsidy interest costs in the taxable market would be equal to the interest cost prevailing in the tax-exempt market. If this were not the case, State and local governments would issue debt in the less expensive market until interest rates were again brought into close alinement.

Municipal borrowers will not elect the subsidized taxable and option unless the subsidy is sufficiently large to induce some borrowers to switch from the tax-exempt to the taxable market. An option offering very low subsidy would not be utilized. It is also clear, however, that we cannot look at the tax-exempt market as if it were completely homogeneous. Within this market, instruments differ with respect to their maturity, their creditworthiness, and other factors. The ratio of tax-exempt to taxable interest rates not only varies over time but, as noted earlier, also varies with the maturity of the instrument. Generally, for shorter term maturities tax-exempt yields are a much lower proportion of taxable yields than is the case for longer term instruments. Thus, a relatively low subsidy may offer a limited inducement for municipalities borrowing short term to enter the taxable market, but a number of issuers of longer term securities may be attracted. Perhaps more importantly, at any given time investors otherwise similarly situated may differ substantially in their need for—and therefore the value of—tax-exempt income. Over time, it is short-range considerations of this nature which may turn out to be most significant.

Assuming the option induces a portion of State and local government borrowing to come to the taxable market, the reduced volume of tax-exempt borrowing will, in turn, lead to lower tax-exempt interest costs regardless of whether individual issuers choose to issue their debt on a taxable or a tax-exempt basis.

How does the taxable bond option answer the three problem areas of the municipal market considered earlier? Both the cyclical volatility of the current tax-exempt market and the supply/demand imbalances are directly counteracted by this proposal. This will occur because State and local borrowers will be able to appeal to new types of lenders if they are able to offer taxable instruments. Pension funds and life insurance companies, for example, can be expected to be attracted to such securities. Their preference for liquidity is less than that of the banks and they would, therefore, be interested in longer term obligations having the higher yields.

These results can be predicted with some confidence. The specific effects of the taxable bond option will, of course, depend on many factors, including the market's acceptance of the new instrument and the need for tax-exempt income at any given time.

It is important to remember that the benefits of reduced borrowing costs for State and local governments come only partly from the interest subsidy. They also result from lower yields accepted by those high-bracket investors who purchase tax-exempt bonds. That is, the net return to them on new tax-exempt investments will decline as a portion of the new issues are transferred from the tax-exempt to the taxable market. The benefit to State and local governments will exceed the net cost of the interest subsidy.

Revenue impact

In our judgment, a subsidy of 30 percent of the net interest cost will provide much-needed flexibility in the longer end of the market and should induce a number of issuers of longer term obligations to switch from the tax-exempt market. The net cost of the plan will depend on the gross subsidy which is paid to all municipal issuers of taxable securities, reduced by the additional revenues generated by the higher volume of taxable, as opposed to tax-exempt, issues. While the tax revenue inflow may be expected to offset some of the gross subsidy costs, it is unreasonable to expect that, on balance, Treasury will make money from this plan. This is because the plan is an optional one for State and local governments. Consequently, they will only use it if there are cost benefits to be realized. Therefore, the taxable bond option should not be advocated as a revenue raiser. It is fully justifiable because the benefits from improvement in the structure of the market and in the efficiency of the exemption will be large relative to any net Federal costs.

In table 6, we show the cost components of the interest subsidy and how those costs will vary over time. It should be noted here that the first-year costs are only a fraction of what the total longrun costs will be, since each successive year's issue of new debt will generate subsidy costs in addition to those of the previous years. The gross subsidy costs are $39 million the first year and climb to $486 million per year by the 10th year. Offsetting these costs are Federal tax revenues of $32 million the first year and $405 million per year by the 10th year. Thus, the net annual costs grow from $7 million to $81 million over 10 years. The table also indicates the benefits to State and local governments in terms of lower net interest expense. As a result of the plan, interest rates paid by State and local governments decline by about 46 basis points in the over 15-year maturity range. Therefore, over 10 years, these savings in annual interest payments grow from $69 million to $868 million. Thus, the ratio of State

TABLE 6.—*Annual costs and benefits of taxable municipal bond plan with 30 percent subsidy*

[Millions of dollars]

Year	1	2	3	4	5	10
Gross subsidy cost	39	79	122	166	213	486
Revenues generated	32	66	102	139	178	405
Net subsidy cost	7	13	20	27	35	81
Reduction in State and local interest costs	69	141	218	297	381	868

and local benefits to net Federal costs exceeds 10 to 1. I want to caution you that the precise costs and benefits will depend on market conditions which cannot be foreseen in advance. However, while the figures shown in the table can only reflect the particular assumptions made, we believe them to be indicative of general market conditions which may be expected to prevail in the future.

Recommended procedures for the taxable bond option

If a governmental unit elects to issue federally taxable obligations, and Treasury agrees to pay the subsidy, neither the election nor the subsidy could be revoked or adversely modified, even if the statute were later amended or repealed. In most cases the subsidy agreement should be obtainable automatically through appropriate certification that certain general standards have been fulfilled. For example, the subsidy would be payable only if the instrument is marked to show clearly that all interest payments are subject to Federal tax. The subsidy itself would be a fixed percentage of the issuer's net interest expense and could not be varied administratively.

An issuer could elect the taxable bond option only for State or local obligations which would be exempt under section 103 but for the election. Certain obligations otherwise eligible would not qualify: Obligations where the net interest expense is unrealistically high based on fair market value; obligations having maturity of less than 1 year; obligations held by a congressionally established entity owned wholly or partly by the United States; and obligations held by a State or local issuer of exempt bonds. The first and second limitations are designed to avoid administrative burdens and excessive subsidy costs. The third is necessary to prevent additional Federal subsidies for certain transactions already subsidized by Federal agencies. The rule disqualifying obligations to be acquired by a State or local government issuer is intended to prevent the issuance of bonds merely to obtain the Federal interest subsidy—for example, where two issuers swap their new obligations.

Initially, an issuer's net interest expense in excess of 12 percent would not be subsidized. This ceiling could be modified prospectively based on subsequent experience. Where necessary net interest expense would be adjusted to reflect discounts or premiums. The subsidizable amount would be determined after deducting appropriate and administrative costs. We anticipate that such costs will be low because, unlike certain other proponents of an option, we contemplate *minimum* Federal involvement.

The interest subsidy payment would be made to the paying agent immediately before the interest is payable to the holder. The subsidy would be held in escrow. It would be released for payment to the holder only upon receipt from the issuer of its portion of interest then due. The payer would file an information return with the Internal Revenue Service reporting the payment of taxable interest, including the subsidy.

The statute must be drafted carefully to prevent arbitrage—issuing obligations in one market for the purpose of investing the proceeds in a different market at a higher yield. With respect to tax-exempt obligations, Congress attempted to limit arbitrage in 1969. The Code now provides that the bonds will be taxable if the proceeds are invested in Federal or other securities producing a materially higher yield over the term of the bonds. The artificially low yields so required had the unintended effect of creating windfalls. By using such devices as deep discount bonds and stripped coupons, promoters could show municipal finance officers that there were still opportunities for arbitrage profit. The promoters thus induced many advance refundings and other bond issues in situations where they would not otherwise have occurred. This included issues of housing authority bonds where no more than 10 percent of the proceeds went into housing. While Treasury believes that we have ended most of the abuses, the situation still bears close watching. Based on this experience, we caution you that the taxable bond option must incorporate appropriate restrictions on arbitrage.

In addition to the specific protections set forth above, we also believe it would be prudent to limit the option to obligations which are sold through a competitive public offering, insuring thereby that all terms are set on an arm's-length basis and not with an eye to taking unfair advantage of benefits provided. Some will contend that this would be an unwarranted discrimination against the many legitimate negotiated transactions. In our judgment, however, it is an infinitely more desirable approach than the alternative of giving the Treasury discretion to disapprove yields and other terms of all issues. That would involve a serious and unnecessary intrusion into State and local affairs.

Since 1973, when Treasury previously recommended the taxable bond option, there have been significant changes in the budget process. The option cannot work unless those who want to purchase taxable obligations know that Federal funds will be available to pay the subsidy for the life of the bonds. This will require a change in the normal appropriations process. You may wish to consider making or authorizing appropriations without fiscal year limitation.

The pollution control exemption

The Municipal Finance Officers Association and the Securities Industry Association have recommended repeal or substantial limitation of the pollution control exemption for private companies. This recommendation warrants serious consideration as an additional method of improving the market for State and local securities. The large volume of such issues has had an adverse effect on interest rates for longer term municipal obligations, with which these private credits compete.

Last year Treasury recommended that the pollution control exemption be limited to identifiable facilities installed in plants already in operation. This would focus the exemption more clearly and eliminate some of the difficulty in applying the current provision. The 1975 proposal would, however, tend to favor certain kinds of plant and equipment and certain industries. Furthermore, there would still be considerable difficulty in attempting to identify the portion of a facility which functions only for pollution control and the net costs allocable to it.

Conclusion

Ladies and gentlemen, it is important not to misunderstand either the purpose or the nature of the measures before us today. These measures are not the product of the New York City financial crisis. Nor are they a direct consequence of the pressures on State and local governments to provide more and more services. The purpose of the taxable bond option is far more basic. It is designed to broaden the market for financing the various needs of State and local governments. The new market can function in a truly free manner, since it will no longer be severely constrained by the changing tax considerations of investors. The proposal is also designed to insure that the $220 billion par value of our Nation's wealth now held in the form of State and local securities is not impacted adversely by tax changes.

I am delighted that your committee is giving this important subject such prompt and careful attention. We look forward to working closely with you in formulating a sound legislative program.

Exhibit 18.—Statement of Secretary Simon, February 17, 1976, before the House Ways and Means Committee, on the public debt limit, increased long-term Treasury borrowing, and removal of the 6-percent rate ceiling on savings bonds

It is never easy to go through the process of reconciling the manifold demands for more Government spending on the one hand with our willingness and ability to pay for these demands on the other. But while the budget, and particularly the fact of a substantial budget deficit, are of course intimately related to the issues which face us, we are not here to consider proposals to increase or reduce the size of the deficit. Today, we are here to consider another substantial increase in the temporary debt ceiling. But in addition, we also have the rare opportunity to consider legislative proposals which, simply stated, help everyone and hurt no one.

I refer, of course, to Treasury's proposals to amend the Second Liberty Bond Act in two respects. First, we are proposing that the authorized maximum maturity of notes issued pursuant to that act be changed from 7 years to 10 years. And second, we are proposing that the amount of long-term debt exempted from the 4 1/4-percent rate ceiling imposed by the act be increased by $10 billion.

While these proposals are not new, they are more important today than ever before. The reasons upon which the restrictions in existing law were originally based simply no longer apply. Indeed, there are few, if any, observers of the capital markets who believe the existing restrictions are healthy for the Government, for the capital markets, for the economy, or for the people of the Nation.

In addition, we are also proposing that the 6-percent rate ceiling on savings bonds be removed. Such action would permit the rate on savings bonds to be varied from time to time, reflecting the interests of both taxpayers and savers.

Debt Limit

Before turning to these key proposals, let me address the primary question facing this committee today: An increase in the temporary debt limitation.

As you know, the present temporary debt ceiling of $595 billion (enacted on November 14, 1975) will expire on March 15, at which time the limit will revert to the permanent ceiling of $400 billion. The committee estimates of when the debt subject to the limit would approach the $595 billion level have been quite accurate. In the final week before the expiration of the temporary limit, the actual amount of debt subject to limit will closely approach the temporary limit. Accordingly, during that week, the limit may hinder the effective management of the Treasury's debt and cash balance.

As is customary, I have provided you with a monthly record of the debt subject to limit from June 30, 1975, through September 30, 1977, and interim monthly estimates for months in which the peak does not occur on the last day of the month. While today we are concerned primarily with establishing a debt limit for the near term, data is provided as an indicator of our financing requirements based upon the President's budget through fiscal 1977. As I will discuss in detail later, these requirements have serious debt management implications.

Specific requirements

The Second Concurrent Resolution on the 1976 budget provided for levels of public debt of $622.6 billion at the end of the fiscal year 1976 and $641 billion at the end of the transition quarter. It is, however, not clear what level for cash balance was assumed in the congressional budget resolution. Furthermore, the level of debt in the resolution apparently does not provide for agency debt that is subject to the statutory limitation. As a technical matter, moreover, depending on the cash volume assumption, the peak debt levels are reached on June 15 and August 31.

In the Federal budget for fiscal year 1977, debt subject to statutory limitation is estimated at $624.2 billion at the end of fiscal year 1976 and $643.1 billion on September 30. These figures are based on an assumed $9 billion cash balance. The Treasury estimates assume a $6 billion cash balance and a $3 billion margin for contingencies and show debt limit needs of $630 billion at the June peak and $645 billion at the August peak. Accordingly, we are requesting that the temporary debt limitation be reenacted at $645 billion through September 30, or, in any event, not less than $630 billion for June 30.

Second Liberty Bond Act Amendments

Let me now turn to an issue of only slightly less urgency and far greater concern: the current confinement of Treasury borrowing to maturities of 7 years or less. To state our position most directly, we believe this restriction poses severe risks to the capital markets and provides nothing in the way of economic benefits.

Objectives of Treasury debt management

It is clear to all of us that the national debt cannot be managed without careful consideration of its impact. Because Federal borrowing now accounts for almost 80 percent of all financing in our Nation's capital markets, all other markets, all other financial assets are directly influenced by the structure of the Federal debt. As a result, the structure of the debt has an impact on our economy; it can contribute to economic stabilization or detract from it.

What are the implications of this tremendous influence? In my view, it means that we must use every available tool to insure that Federal borrowing needs are met in such a way that the resulting debt structure permits financing at the lowest cost, both in terms of interest rates and economic and financial dislocation. Given these objectives, it is no longer possible to justify severe and anachronistic constraints that result in a debt structure that has been very expensive in an economic, as well as a financial, sense. Moreover, in light of our massive borrowing needs, these constraints are destined to have an even greater adverse impact in the future. The extensive economic work which has been done in the area of debt structure has not only confirmed the potential for harm, but has also demonstrated conclusively that there are no countervailing benefits.

Consequences of the current restrictions

We know what the current restrictions have meant in absolute terms: a decline of more than 33 percent in the average maturity of the publicly held debt in the last 3 years alone and more frequent and larger Treasury borrowings. But the question I want to concentrate on today is why we care: why we believe there are serious dangers in confining Treasury borrowing to only the short end of the market.

We care primarily because overreliance on short-term financing, as reflected in a short and shortening maturity structure and the resulting lack of balance in the overall debt structure, exposes us to adverse financial and economic effects:

- First, it poses the risk of higher Federal borrowing costs and imposes unnecessary transaction costs;
- Second, it contributes to a more volatile market environment, placing substantial burdens on financial intermediaries and threatening the ability of the private sector—and particularly small and medium-sized businesses—to meet financing needs;
- Finally, it poses an unmeasurable and uncontrollable threat to sound fiscal and monetary policies.

Cost

Our concerns begin with the fact that unless the Treasury is authorized to balance its borrowing throughout the maturity ranges, the taxpayer will be vulnerable to shortrun changes in interest rates. Moreover, whatever may happen with respect to interest rates, a debt structure weighted heavily to the short end imposes unnecessary transaction costs.

In periods of unexpected rises in interest rates, such as we have experienced during most of the last decade, the average cost of borrowing in the short-term market, and subsequent refunding in this market, may well exceed the rate for borrowing long-term in the first place. But in pursuing these proposals, it is not our purpose to suggest that interest rates are headed higher, or that any such estimates—guesses may be more accurate—ought to play a role in our consideration of these statutory limitations. Rather, I am suggesting that, from the standpoint of costs, it is imprudent to have statutory limitations that in effect mandate further dramatic shortening in the maturity structure of the debt. We need a balanced debt structure, not an extreme one.

In addition to possible interest rate costs, there are heavy transaction costs, which must be borne by the taxpayer. When Treasury borrowings are confined to the short-term area, obviously a large amount of debt rollover is necessary, relative to what would be necessary if we could borrow more in the long-term area. Each time there is a rollover, there are inevitable direct transaction costs. Moreover, the proliferation of short-term borrowings means that dealers have to carry larger inventories of securities. The cost of carrying such larger inventories adds further to the transaction price, increasing the overall cost which is ultimately borne by the taxpayer.

Effect on private borrowers

A concentration of Treasury financing in the short-term area also has potentially adverse effects on private users of short-term credit. With the Treasury constantly tapping the short-term market for substantial funds, both short-term interest rates and the availability of short-term financing become vulnerable to episodes of market congestion and to changes in the general monetary environment.

To understand the potential risks involved, we must first examine the enormous change in the magnitude of the Treasury's demands upon the market. Just in the last 2 years, the overall amount of privately held marketable Federal debt outstanding has grown from $171 billion to $263 billion. When this overall growth is viewed in the context of a shortening maturity structure—occasioned primarily by the limitations which concern us today—the results are even more disturbing. For the first 2 months of this year, Treasury borrowed an average $9 1/2 billion per week. For the comparable period in 1974, the figure was $5 1/2 billion.

Part of this increase is, of course, due to our large new money requirements, primarily to finance the deficits. But the bulk of the borrowing is to finance the rollover of maturing debt. And the shorter the debt structure, the greater the rollover burden.

From the market's standpoint, there is virtually no difference between the two components. Each type of borrowing requires a new underwriting and investment decision. Rollovers are not automatic; a holder of a maturing bill must make the choice between lending to the Treasury, lending to another borrower, or spending the proceeds. Accordingly, all of the costs and pressures of borrowing are there, irrespective of the purpose of the borrowing.

Let's be clear about the implications.

First, there are substantial pressures on intermediaries: Given a greater amount of securities outstanding and a sharp growth in periodic refunding, dealers must take larger and larger positions. To the degree that dealers cannot or will not increase their position-taking capacity, the breadth, depth, and resiliency of the market is reduced. In everyday terms, the market becomes thinner, and prices—that is, interest rates—become more volatile.

Volatility is also enhanced by other factors. The enormous supply of riskless, liquid Treasury securities provides a tempting alternative for investors with psychological concerns about other assets—e.g., commercial paper, certificates of deposits. Thus, in effect our debt structure facilitates large-scale and highly disruptive shifts of funds from one short-term sector to another, irrespective of whether such shifts are economically justifiable.

Finally, the sheer increase in the number of decisions the market must make enhances the possibility of distortions.

Consider the process. The dealers on which we depend to distribute our securities must decide, separately, the amount they will purchase from us, and the price thereof, as well as the terms on which they will sell to their customers. Holders of maturing instruments have to decide whether and where to reinvest the proceeds, giving them an opportunity to rethink their needs in terms of the type of security to purchase as well as the maturity. And other investors have to decide whether they are going to buy our new securities, how much, and at what price. In terms of volatility versus stability, what kind of debt structure would we prefer: one that causes this unsettling process to occur less than 100 times a year, as was the case only a few years ago? Or today's, under which the process occurs, on average, nearly every business day.

What are volatility's ultimate byproducts? At a minimum, we are likely to see an increase in rates on new short-term debt and a higher dealer markup on debt trading in the secondary market. These phenomena are the natural reaction of investors and dealers to a condition markets do not tolerate well: uncertainty.

If the uncertainty reaches greater levels—for example, as might be the case if market disruption is accompanied by perceptions of change in Federal Reserve policy—many market participants may temporarily withdraw from the market altogether.

In such circumstances, Treasury's ability to finance is obviously impaired. But, more importantly, the non-Federal portion of the market may feel far more serious repercussions. Local governmental units, small and medium-sized business—indeed all but the top-rated credits—may find themselves facing serious difficulties as they are cut off from sources of funds to roll over maturing short-term debt.

Moreover, these shocks are not confined to the short-term market. They spread rapidly into the intermediate and longer term markets and begin to interfere with orderly financing plans of business corporations and State and municipal governments, as well as with the growing volume of mortgage financing which is handled through securities markets.

Again, the impact is particularly acute on the smaller or lower rated issuers. Because of the risks set forth above, investors know that such entities are especially vulnerable to even normal changes in the business cycle, especially when they have substantial short-term debt outstanding.

In the final analysis, therefore, perhaps the most dangerous consequence is a further reluctance on the part of investors to make long-term commitments to our Nation's capital growth. This reaction, which accentuates the pressures on long-term investment caused by fears of future inflation, has grave implications for our future economic growth. It discourages outlays for new expansion, it discourages risk-taking, and it discourages entrepreneurship at precisely the time in our Nation's economic history when such conduct is needed most.

Impact on economic policy

Another aspect of this continued trend toward a shorter and shorter debt maturity—which if carried to an extreme could give us a national debt with zero maturity, i.e., a huge stock of green pieces of paper called money—is growing liquidity in the economy. By pumping more and more liquidity into the system, spending may be increased at the expense of savings and investment.

Even more disturbing is the fact that these consequences are unmeasurable and uncontrollable. Such spending effects could come at any time, irrespective of the course of fiscal and monetary policy at the time. And if the dam bursts, so to speak, in a period of growing inflation, the resulting sharp acceleration of the inflationary trend may be invulnerable to fiscal and monetary efforts.

We believe debt management should complement longrun economic and financial stabilization goals. An unbalanced debt structure poses the risk that policy efforts to control cyclical excesses—such as might be appropriate at a future time when the economy is expanding rapidly—will be thwarted by an accumulation of liquidity; and accumulation in the form of short-term Treasury securities. Given the debt structure in effect mandated by the size of recent deficits and the maturity limitations, this risk is serious.

Impact on interest rate structure

The old argument against these proposals is that more long-term Federal borrowing would drive up long-term interest rates; in other words, that a balanced debt structure and judicious borrowing in all maturities would somehow be harmful to the long-term market. This argument, taken at face value, would imply that the Government should always finance in the short-term markets—a conclusion which not only is wrong in concept but, as we have shown, has in the past been extremely costly in both financial and economic terms.

Long-term interest rate levels respond primarily to investors' views regarding inflation and the future course of inflation. If inflation is expected to persist, investors demand to be compensated not only for the use of their money, but also for the fact that when the money is repaid, it is worth less, as a consequence of inflation, than when it was lent out. The result is higher long-term rates.

In addition, inflation makes all borrowers—but particularly the smaller or lower rated firms—more vulnerable to economic reversals. Accordingly, it tends to enhance the investment risk, with respect to many long-term investments. Again, this higher investment risk will be reflected in the interest rate, providing another source of upward pressure on long-term rate levels.

Other factors in the level of long-term interest rates include expectations about the future course of short-term rates and existing short-term rates. If short-term interest rates are expected to rise, a potential long-term investor will demand a rate which compensates him not only for the principal risk presented by the investment, but also for the lost opportunity to roll over short-term debt at higher and higher returns.

Current short-term rate levels also play a role because many financial intermediaries rely on short-term credit as a principal source of funds. Thus, for example, if a savings and loan association is forced to pay higher rates on short-term deposits, the higher costs must ultimately be reflected in the rate at which it is willing to make long-term mortgage loans, and in the amount of long-term credit it is able to supply.

By contrast, there is no evidence that greater Treasury access to the longer maturities—if judiciously employed—would play any role whatsoever in the determination of long-term rates.

Indeed, for at least two reasons, just the contrary is likely to be the case. First, as we have shown, concentration of Federal borrowing in the short-term area can lead to greater uncertainty and, at some point, inflation in the economy. This leads to an increase both in short-term rate expectations and in the inflation premium demanded by long-term investors and, hence, to an increase in long-term interest rates.

Second, as heavy Treasury short-term borrowing drives up short-term rates, disintermediation takes place. As outflows occur, the ability of intermediaries to make long-term loans is curtailed and what loans are made are at higher rates, reflecting the relative scarcity of this form of credit.

In short, as we would expect, the distortion of the market mechanism caused by the artificial maturity limitations has no demonstrable benefits in terms of long-term interest rates or any other legitimate objective.

Debt management in 1976–77

I have dwelled at length on the principles involved because they are crucial to an understanding of the issues. But let me turn now to the very real practical problems we face in the immediate future.

Our Government securities market is an immensely flexible, immensely capable market. Perhaps a good comparison is a freeway. With all lanes open, a freeway can handle a tremendous volume of traffic at the most efficient speeds. But when overloaded, either because traffic volume is simply too high, or because an accident or construction has closed some of the lanes, efficiency drops precipitously. Not only is traffic on the freeway slowed, but the effects spill over on to other roads.

The capital markets today are hampered by the fact that, in effect, two of the four lanes are blocked off, insofar as the Treasury is concerned. We are forced to confine ourselves to the below 2-year and 2- to 7-year ranges and these lanes, Mr. Chairman, have become severely congested.

Congestion exists not only because we must enter the market to raise new funds to finance our deficits and meet other new needs, but also because we must borrow to retire maturing debt. Looking first at new borrowing alone, by the end of this month, the Treasury will have borrowed nearly $16 billion in the market in 1976. And during the remainder of the fiscal year, through June, we will need to borrow an additional $19–$24 billion of new funds; a total of $35–$40 billion in the first 6 months of 1976.

In later periods, we will need to borrow nearly $20 billion in the transition quarter, and some $50 billion of new money in the market in fiscal year 1977.

All in all, our new money market borrowing needs in the next 19 months, based on the President's budget, will total upwards of $90 billion. This is nearly $5 billion a month and more than $1 billion every week.

On top of these new money borrowing requirements, we also have an immense refunding job to do. In the same 19-month period, over $51 billion of privately held coupon debt will mature. Our weekly issues of 13- and 26-week bills are now in the $7 billion range and will inevitably increase. And our issues of 52-week bills, every 4 weeks, are now in the $3 billion range and may well be in the $4 billion range by the end of fiscal year 1977. In short, our total requirements for both purposes are some 10 times our new money needs: approaching $2 billion of borrowing every day.

To meet these needs, since 1972, we have relied primarily on the auction technique; that is, the yield on a particular issue is determined by public bids. While the auction technique has resulted in substantial savings to the taxpayer, it has one important limitation. We have found from experience that, given the absorptive capacity of the market, auctions of much more than $2.5 billion at one time result in disproportionately high interest costs.

All in all, we face a formidable financing job. It is one that can be managed, but there are severe costs and serious risks. And I hope, in my testimony this morning, I have conveyed some of these concerns to you.

Let me add that there is another legacy in this dilemma, one that will be faced by my successor, and yours as well. Even if we are successful in reducing the size of our deficits and the consequent need for new money financing, the enormous concentration of short-term financing will require similar magnitudes of financing, just for refunding, week after week, far into the future.

Accordingly, I must urge this committee, as strongly as I can, to respond to these immediate needs. What is done in managing the public debt this month, and this year, will have a direct effect on the strength and sustainability of the economic recovery. Treasury must promptly minimize its reliance on short-term bills and maximize its use of the longer intermediate and longer term markets. If, instead, we are forced to rely on short-term financing, we will be obliged to come to the market more frequently and for larger amounts. The excessive liquidity injected into the economy as a result of such shorter term financing, when coupled with these more frequent incursions, will destabilize the overall market environment and will pose a continuing threat to all other borrowers and to the financial institutions on which the housing industry, small business, and all of us must rely.

Savings Bond Rate Ceiling

Finally, let me also urge that Congress act to remove the current 6-percent interest rate ceiling on savings bonds. Since savings bonds account for approximately one-fourth of the total privately held Treasury debt, greater flexibility in this area can make a significant contribution to our overall debt management objectives. Savings bonds provide a stable and important source of credit for the Government and we must have the flexibility to insure that the return to savers is a fair one—one that reflects financial and economic conditions as they may change from time to time.

Authority to vary the rate on savings bonds would, of course, be exercised with due regard for the impact of rate changes on depositary institutions. In this connection, I would note that we have consistently supported legislation such as the Financial Institutions Act which would allow all forms of institutions to compete, on an equal basis, in a free market environment. Freedom to compete and competitive equality, in our view, will contribute far more to the health of all institutions than artificial constraints such as the 6-percent limitation.

It is in no one's interest to price savings bonds at rates which would significantly erode depositary institutions' sources of funds. But it would be equally undesirable to deny the Government a stable source of credit by artificial constraints. We need the flexibility to strike the balance.

Ladies and gentlemen, we are not faced with a Gordian knot which can be cut only with Herculean effort. It's a slipknot that can be undone by a simple pull from the Congress. As Winston Churchill once said, "Give us the tools and we will do the job." Give us in the Treasury the tools and we will do our job of debt management in a manner in which the Congress can take pride.

Exhibit 19.—Statement by Assistant Secretary Gerard, June 1, 1976, before the House Ways and Means Committee, on the public debt limit

As the committee is aware, the temporary increase in the public debt limit enacted in March will expire on June 30. We are here this morning, therefore, to provide the committee with our views as to provisions for meeting the financing needs of the Federal Government during the transition quarter and fiscal year 1977.

There are two essential aspects to this process. First, a new dollar limit must be established at a level consistent with the expected imbalance between receipts and outlays and with the level of debt above the $400 billion limit already outstanding. Second, we must have adequate flexibility in our available debt management techniques to insure that the substantial deficits anticipated over the 15-month period are financed with the least possible disruption of financial markets. Specifically, we believe an increase in the amount of bonds which may be issued without regard for the 4 1/4-percent ceiling and a grant of authority to change the rate of return on savings bonds to reflect changing financial conditions are required.

The debt limit

The first concurrent budget resolution, adopted in May, established the unified budget deficit for the transition quarter at $16.2 billion and provided for an increase in the temporary statutory debt limit of $20.2 billion: an overall limitation of $647.2 billion. The resolution also called for a budget resulting in a unified budget deficit of $50.8 billion in fiscal year 1977 and an increase in the temporary statutory debt limit of $65.9 billion over the amount specified for the transition quarter: a $713 billion limit through September 30, 1977.

Consistent with the committee's procedures, we have provided the committee with an array of tables relating to the debt limit and the management of the public debt. The tables showing the debt subject to limit by month through the end of fiscal year 1977 are based on the President's proposals as amended by subsequent legislation. Based on this premise, we believe our debt requirements—with a $6 billion cash balance and a $3 billion contingency allowance—will be $711 billion at September 30, 1977. Our peak need, however, is $716 billion at June 15, 1977.

Since the permanent limit is now $400 billion, implementation of the concurrent resolution would require a temporary limitation of $247 billion for the period from July 1, 1976, through September 30, 1976, and a temporary limitation of $313 billion for the period from October 1, 1976, through September 30, 1977. Based on our figures, and assuming a cash balance of $6 billion and a $3 billion contingency allowance, these limits would be slightly below our estimated peak need on June 15. Assuming we can clarify this point, we would have no difficulty in accepting the limits in the resolution.

I would like to turn now to the question of the debt management tools I mentioned earlier: flexibility with respect to the rate of interest payable on savings bonds and the additional bond authority.

Public debt subject to limitation, fiscal year 1976, based on budget receipts of $298 billion, budget outlays of $372 billion, off-budget outlays of $9 billion

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1975		ACTUAL	
June 30	7.6	534.2	
July 31	4.2	539.2	
Aug. 31	3.6	548.7	
Sept. 30	10.5	554.3	
Oct. 31	10.3	563.1	
Nov. 30	6.5	567.9	
Dec. 31	8.5	577.8	
1976			
Jan. 31	12.0	585.5	
Feb. 29	12.1	595.0	
Mar. 15	5.9	597.0	
Mar. 31	8.0	601.6	
Apr. 15	2.7	604.9	
Apr. 30	11.5	603.1	
May 27	8.8	608.9	
		ESTIMATED	
June 15 (peak)	6	617	620
June 30	6	616	619

Public debt subject to limitation, transition quarter, July–September 1976, based on budget receipts of $84 billion, budget outlays of $99 billion, off-budget outlays of $5 billion

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1976		ESTIMATED	
June 30	6	616	619
July 31	6	627	630
Aug. 31	6	637	640
Sept. 30	6	636	639

Public debt subject to limitation, fiscal year 1977, based on budget receipts of $352 billion, budget outlays of $397 billion, off-budget outlays of $11 billion

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1976		ESTIMATED	
Sept. 30	6	636	639
Oct. 31	6	646	649
Nov. 30	6	656	659
Dec. 31	6	660	663
1977			
Jan. 31	6	663	666
Feb. 28	6	678	681
Mar. 31	6	693	696
Apr. 15	6	701	704
Apr. 30	6	690	693
May 31	6	706	709
June 15 (peak)	6	713	716
June 30	6	696	699
July 31	6	701	704
Aug. 31	6	706	709
Sept. 30	6	708	711

Savings bonds

We have, as the committee knows, several times recommended that the Secretary, with the approval of the President, be given full discretion to vary the terms and conditions applying to savings bonds, including the rate of return. I want to repeat that recommendation, because I feel that flexibility in altering the terms of savings bonds may, at times, be important, not only for the continued success of the savings bonds program, but for Treasury debt management in the broad sense.

I will not take the time now to reiterate all of the arguments that have been brought forward in the past to support this recommendation. Previous hearings before this committee have gone into the matter in some detail. I would be pleased, however, to respond to any questions the committee may have with respect to the savings bonds program. I should emphasize, however, that if the savings bonds program is to remain viable—and this is important for Treasury debt management—the purchasers and holders of savings bonds must continue to believe that it is a fair program that provides them with a reasonable rate of return. That is the basic purpose of our recommendation: to give that continuing assurance.

Bond authority

At the time of its last consideration of the debt limit, the Congress provided an additional $2 billion exception to the 4 1/4-percent ceiling. Although the 4 1/4-percent ceiling is an anomaly, the exception provided by the Congress has prevented the ceiling from seriously affecting the financing of the Government. However, as recently as the February 15 quarterly refunding, it was necessary to restrict the amount of new long bonds to $400 million at a time when a larger amount could have been sold without adverse effects on the market for agency, corporate, or municipal securities.

We presently have $1.25 billion of the $2 billion exemption remaining. In the period ahead, it would seem reasonable that we may have the opportunity to issue additional long-term debt, without adverse consequences for other borrowers and with great benefit to the maturity structure of the public debt.

I am sure I need not reiterate in detail the position expressed to this committee by Secretary Simon last February. We believe it is in the long-term best interests of our economy to have a well-balanced national debt structure.

For this reason, we need the flexibility to seize all opportunities to achieve greater balance in our debt as they arise. If the committee agrees, we would urge you to raise the exception to the 4 1/4-percent limit to a total of $22 billion.

Mr. Chairman, the Treasury Department has several times in great detail discussed the importance which it attaches to the ability to finance in all sectors of the market, including the longest term sector. In this we have had the support of the vast majority of the participants in our financial markets. I am glad to say that we now also have the support of the Comptroller General. In his letter of transmittal of his report on the 4 1/4-percent ceiling, Mr. Staats said:

> The inability to at least partially finance these deficits with long-term debt means that the Federal Government will become an increasingly active participant, and a potentially disruptive influence, in private capital markets and in the short segment of the capital market.

I commend the report in its entirety to you. Indeed, I feel it is of such great importance that I would like to read here the four interrelated conclusions reached by the General Accounting Office along with the recommendations suggested for consideration by the Congress:

1. Considering the apparent rationale for the original legislation—that is, to minimize the costs of Treasury borrowing operations, given market conditions, in a national emergency—one cannot argue for either the current level or the continued existence of the 4 1/4-percent interest limitation. It no longer serves to reduce the cost of borrowing; instead, it simply keeps the Treasury from any further borrowing in the long-term securities market.
2. The limitation (and the exhaustion of the $10 billion exclusion) encourages a shortening of the maturity of the national debt. This shortening tendency may, in turn, place the Treasury in a more vulnerable position with respect to the interest rate terms that it accepts on borrowings. That is, the Treasury may find itself in the unfavorable position (1) of having to refinance massive amounts of short-term debt at very high interest rates and (2) of being a potentially destabilizing influence on money and capital markets.
3. Aside from an overriding concern with lengthening the maturity of the public debt, there are three differing philosophies regarding the objectives of debt management: avoiding disruption through more systematized securities flotations, stabilizing economic activity, and minimizing interest costs. Given contemporary and foreseeable levels of interest rates, achieving any of these objectives will not be possible as long as the 4 1/4-percent interest limitation on long-term Treasury debt remains in effect.
4. A theoretical basis and some supporting practical experience indicate that the limitation has at times distorted the term structure of interest rates, thus causing a reallocation of credit among various sectors of the economy and increased costs of servicing the Government debt. On the other hand, the relevant empirical evidence suggests that neither the current existence nor the repeal of the limitation causes, or would cause, much distortion in the term structure of interest rates and, hence, would not affect the relative costs of borrowing in various maturity sectors. Weighing theory and the experience of Treasury officials and market practitioners against the available empirical evidence (and its shortcomings), we can reasonably conclude that (1) at worst, the ceiling should be repealed because it may disrupt credit markets and raise the costs of Government borrowing; (2) at best, it is neither harmful nor beneficial to credit market stability and borrowing costs and is therefore unnecessary, and (3) it does not reduce the costs of Government borrowing and may in fact raise those costs.

Matters for consideration by the Congress

> In view of our conclusions, the Congress should consider immediately repealing the 4 1/4-percent interest limitation. Alternatives which would have essentially the same long-term effects are systematically phasing out the limitation through annual redefinition of the maximum maturity of securities whose flotation is subject to the ceiling and/or annual increases in the dollar volume of long-term securities which may be floated without regard to the ceiling.

Summary

In conclusion, Mr. Chairman, we would urge the committee to adopt the debt limit figures for the transition quarter and fiscal year 1977 we have proposed today. On the other hand, we would have no serious objection if the committee chooses to adopt different figures. In either case, there will be appropriate opportunities in the sequence of events to amend the limits if such action should appear desirable or necessary.

Second, we believe it desirable, Mr. Chairman, that the Secretary of the Treasury have flexibility over the setting of rates and other terms in the savings bonds program. We are aware of the relationship of rates in the savings bonds program with rates paid by depositary institutions. Indeed, the Secretary of the Treasury is an actively participating member of the Coordinating Committee when changes in Regulation Q ceilings are under consideration. Moreover, changes in savings bonds rates have always been undertaken with due regard to the consequences for depositary institutions as well as fairness to savers.

Third, Mr. Chairman, it is essential that the Treasury have adequate authority to issue long-term securities when the opportunity affords. The redevelopment of the long-term Treasury market has been constructive, not only for Treasury financing but for other debt markets for which outstanding long-term Treasury obligations have served as a benchmark. From the viewpoint of Treasury debt management, however, the development of a long-term market offers the possibility of reversing the steady decline in the average length of outstanding Treasury debt and reducing the buildup in very short-term, highly liquid securities that has resulted from the necessity of financing the immense deficits of recent years. We are as much concerned by the threat to future economic and financial stability, posed by this immense liquidity buildup, as you are. We need, therefore, to have the tools that will allow us to do the most responsible job possible of debt management, one that will contribute to economic and financial stability. An increase in the exception to the 4 1/4-percent ceiling by an additional $10 billion will go far in that direction.

Domestic Economic Policy

Exhibit 20.—Excerpt from statement by Assistant Secretary Jones, August 19, 1975, before the American Accounting Association, Tucson, Ariz., on the economic recovery and future fiscal and monetary policies

The famous author George Santayana once wrote: "Those who cannot remember the past are condemned to repeat it." Analysis indicates that each repetition requires a higher price to be paid.

While public attention is focused on current developments, as the economy moves from severe recession into moderate recovery, the major challenge is to plan beyond existing problems and uncertainties. Economic policies at this turning point must concentrate on the persistent problems of inflation, excessive unemployment, low productivity, capital formation, energy resource development and conservation, and international economic instability.

The United States has generally experienced rising output, expanding personal consumption, relatively low levels of inflation, and growing employment opportunities. At the same time, the dominant influence of rising expectations has created a confrontation between two basic economic truths: (1) The list of claims against the national output of goods and services is literally endless; and (2) human, material, and capital resources are limited even in the advanced U.S. economy.

This obvious contradiction requires a more careful ranking of claim priorities and effective management of economic policies. In particular, we need more stable fiscal and monetary programs which do not overreact to fluctuating economic developments. Over the past decade recession and expansion trends have too often been exaggerated by frequent fine-tuning policy adjustments. It is not so much a problem of deciding what to do as it is one of sustaining basic policies long enough to encourage stable growth and longer term planning.

While there is widespread agreement that a moderate-to-strong economic recovery has begun, there is justified concern about its sustainability. The severe recession just experienced clearly demonstrated that the U.S. economy can be constrained by shortages of oil and other industrial raw materials. Consumer sentiment is still fragile and directly dependent upon future employment developments. Business capital investment must be increased if the near-term expansion is to continue and needed productive capacity and future jobs are to be created.

Because the immediate pattern of business investment will be largely determined by the strength of personal consumption, it is crucial at this stage of the recovery that a surge of new inflation pressures be avoided. Prices are still increasing at an unsatisfactory seasonally adjusted annual rate of 6 to 7 percent. An escalation of current prices- or of inflationary expectations- during the next few months would quickly disrupt both personal and business spending plans which would, in turn, curtail both the strength and sustainability of the recovery. Therefore, current policies must guard against fiscal and monetary excesses which would disrupt the current expansion and complicate the problems of creating a more stable economy.

The fiscal dilemma of rapidly increasing Government expenditures and lagging revenues continues to distort economic planning. During the past decade, fiscal policies have had to adapt to the surge of spending for the Vietnam war and various social spending programs, the major impact of inflation, and the sharp erosion of revenues and increased transfer payments caused by two recessions. From fiscal year 1966 through fiscal year 1975, Federal budget outlays increased from $134.6 billion to $325.1 billion. During that decade, the cumulative budget deficit totaled $148.7 billion and the "net increase" in borrowing for various off-budget programs excluded from the Federal budget totaled an additional $149.7 billion.

In attempting to respond to the severe recession, the President originally submitted a proposed Federal budget for fiscal year 1976 which called for outlays of $349.4 billion and a deficit of $51.9 billion. The midsession review published May 30 subsequently increased the expected outlays to $358.9 billion and the deficit to $59.9 billion. In a separate action by Congress, their first concurrent resolution on the budget, published May 9, recommended outlays of $367 billion and a deficit of $68.8 billion. Whatever the final figures turn out to be, it is obvious that another large increase in spending and a record-level budget deficit will occur.

The President also asked for a temporary cut in taxes to help stimulate the economic recovery expected by midyear. In March the Tax Reduction Act of 1975 was finally passed which provided approximately $20 billion of net tax relief. About $17 billion of the total was allocated to individuals in the form of a rebate on 1974 taxes and temporary reductions for 1975 were provided by increasing the standard deductions, an additional $30 exemption credit, a 5-percent housing credit, and an earned income credit for eligible low-income families.

Business tax relief was provided by increasing the investment tax credit to 10 percent and by raising the surtax exemption for small firms. At the same time, the depletion allowance for oil and natural gas was phased out and limitations added in the use of foreign tax credits associated with foreign oil and gas operations. During the next few months, important decisions about possible extension of parts of the 1975 tax cuts must be made as the pattern of economic recovery becomes clearer.

The rapid growth of Federal spending during the past decade has increasingly eroded our fiscal flexibility. Many Government programs involve an "entitlement authority" which makes the actual outlays open ended, depending upon the eligibility rules and benefit levels established. There has been a tendency to liberalize both guidelines, and benefits for Federal retirement, social security, and other income maintenance programs are now indexed so that they rise automatically as inflation occurs. Other outlays are required by specific legislation and contractual agreements. As a result, the Federal budget is increasingly committed to the priorities of the past, which makes it difficult to respond to current problems and future claims.

Approximately three-fourths of the Federal budget is now considered to be "uncontrollable" because of existing entitlement and contractual obligations. In theory, there is no such thing as an "uncontrollable" budget commitment since Congress controls the annual appropriations process. In reality, existing programs are rarely eliminated or reduced and new claims are typically "added on" to current outlays. The near-term prospects are for continued increases in outlays and more Federal budget deficits. This trend can either be modified by congressional action or resources can be transferred from the private sector, which would mean a further increase in the role of Government in the economy.

A second important problem concerns the proper role of the Federal budget. In preparing the budget plan, Government officials are actually allocating the human and material resources available and determining the division of responsibilities between the public and private sectors. This is clearly a proper function.

However, since the 1930's the Federal budget has been used more and more as a tool for economic stabilization. Increased outlays and resultant deficits are defended by claiming that Federal spending is required to replace private demand during periods of slack. The size of the Federal budget is then manipulated to meet current economic stabilization goals in this system of economic management. Unfortunately, the balance turns out to be asymmetrical, because deficits usually occur during periods of both strong and weak economic activity. Federal budget deficits have been recorded in 14 out of the last 15 fiscal years—or 40 of the last 48 years—and more are expected according to our current 5-year projections.

The overall results of using the budget for stabilization purposes are not clear because of the complexity of the total economy and the lagged impact of such policies. But one specific result does seem obvious: The creation of new spending programs during periods of economic slack typically creates a permanent sequence of outlays that continues far beyond the immediate need for stabilization.

Hopefully, increased realism in determining future fiscal policies will result from the recent creation of a Congressional Budget Office which is required to provide overall Federal budget targets for receipts and outlays for the guidance of the new congressional budget committees. In the past, appropriations have been approved by individual committees so that it was impossible to develop a comprehensive overview of the total impact of the specific legislative actions. Under the new procedures, the two congressional budget committees prepare concurrent resolutions establishing the basic budget goals and identifying their impact on the entire economy. The actions of each appropriation committee will then be combined and compared with the budget committee recommendations before preparing a second concurrent resolution for Congress to approve. A trial run using these procedures over the past few months for coordinating spending decisions has been encouraging, and a new sense of priorities and discipline may well result from this new approach.

A combination of increased Government spending and tax reductions has provided extensive stimulus for the economy in moving back to a recovery pattern. Given the severity of the recession, particularly the large increase in unemployment, a sizable budget deficit during the past year was a suitable response.

But such fiscal actions must be carefully controlled, even during difficult periods, to avoid more permanent erosion of our future flexibility.

Fiscal responsibility is particularly important in providing a necessary balance with monetary policies.

Extensive criticism was directed at monetary authorities during the last few months of 1974 and early 1975 because of the very low rate of growth of the money supply at an annual rate of only 1 percent during the 6 months ending January 15, 1975. Since late January the money stock has increased at a seasonally adjusted annual rate of 9.4 percent. Combining these two periods indicates that the money supply has increased about 5 percent over the past year with almost all of the growth occurring during the last few months. Given the volatile nature of short-term monetary developments, a longer term perspective of monetary policy indicates that officials are moving toward the policy commitment of keeping the money supply growth in the 5- to 7.5-percent zone while also giving careful attention to interest rates and other monetary measures. This policy goal appears to be a reasonable target when combined with the existing stimulus being provided by fiscal actions.

Although the recovery is apparently well underway, the next few months are likely to be a turbulent period as fiscal and monetary policies will probably be under intense pressure to respond to specific inflation and unemployment developments. In such a volatile environment, those who advocate more stable economic policies will be considered naive at best and insensitive at worst. Nevertheless, there must be a longer term perspective in determining policies if we are to ever avoid the "stop-go" results of the past.

Recent events clearly demonstrate that the U.S. economy will not function properly with high single- or double-digit inflation just as it cannot survive for very long with such excessive levels of unemployment. The constant shifting of policies and resulting uncertainties about the lagged impact of such actions have too often frustrated the basic goal of promoting maximum employment, production, and purchasing power.

Exhibit 21.— Excerpt from statement of Secretary Simon, August 25, 1975, before the Senate Committee on Banking, Housing, and Urban Affairs, concerning the implications of Lockheed Aircraft Corp.'s foreign sales activities on the Government's emergency loan guarantee program

My testimony concerns the emergency loan guarantee program, and in particular the recent disclosures of secret payments made by Lockheed Aircraft Corp., the sole borrower under the program, to officials of foreign governments.

Let there be no misunderstanding: The Emergency Loan Guarantee Board does not, and will not, condone illegal or unethical activities by American business, here or abroad. The Board condemns such actions in the strongest terms and is deeply concerned about the possible improper use of Lockheed's corporate funds and its impact on the guarantee program.

We are disturbed that Lockheed's apparent longstanding practice of resorting to bribery to sell its products in foreign markets has escaped detection by the Board and others monitoring the company's activities. We are distressed that Lockheed's management has apparently not been forthright with the Board and with Congress.

As a Government official who has spoken out about the importance of maintaining the free enterprise system, I find Lockheed's actions deplorable. Lockheed's executives in making application for a Government benefit- a guarantee of some of their borrowings- have not disclosed what may prove to be material information to the administration and the Congress. We recognize that very serious consequences are involved for Lockheed, for the aerospace industry, and for the loan guarantee program.

Let me summarize briefly the steps the Board is taking:

- The Board has requested by letter that Lockheed: confirm its oral understanding with the Board that it is to provide all material information concerning the bribes; will request its auditor to furnish separately to the Board additional information regarding the transactions; and furnish any additional information regarding the payments that the Board may deem necessary.
- The Board has notified Lockheed that the guarantee agreement does not provide for any waiver of the Board's rights or remedies unless expressly waived in a writing signed by the Board. In addition, the acceptance of any certificates, representations, or other documents required to be furnished by Lockheed, under the agreement, should not be deemed to constitute a waiver of any of the Board's rights.
- As part of the ongoing monitoring activities by the fiscal agent (the Federal Reserve Bank of New York), the Board has requested that it prepare a current assessment of the Government's collateral under the credit agreement.

- The Board has asked the fiscal agent to carefully consider the expenditure plans which Lockheed furnished to the Board in connection with each drawdown of guarantee funds, to determine whether the expenditure plans should be regarded as false or incomplete in that no information regarding the bribes was provided.
- The Board's staff has questioned past officials associated with the guarantee program. None can recall any information coming to his attention which indicated that Lockheed was paying bribes to foreign officials.
- The Board has requested that Lockheed's agent banks review the information in their possession to advise whether it indicates that Lockheed has been paying bribes.
- The Board's staff is in the process of undertaking a complete review of its files, and has asked its fiscal agent to do the same, in order to confirm that the Board had no information about Lockheed's payments of bribes until June of this year.
- The Board has requested that the General Accounting Office (GAO), which is required to audit any borrowers under the emergency loan guarantee program and to report its findings to the Board, search its files to determine whether or not they contain any information regarding the payment of bribes by Lockheed.
- The Board's staff met with the GAO staff on August 19 for the purpose of creating a cooperative program whereby the Board may obtain whatever additional information it deems necessary to assess its position under the Guarantee Act and the agreements.

There are difficult questions for the Board to resolve. Among them:

1. How can the Board distinguish between proper commissions to sales consultants and instances where consultants use a portion of their fees to bribe foreign governmental officials?
2. With the purpose of the guarantee program being the preservation of Lockheed's viability, should the Board take action which (a) might put the company at a competitive disadvantage with respect to both other U.S. corporations and foreign competitors, or (b) might cause Lockheed to fail, especially where rules have yet to be prescribed?
3. Would Board action have broad application affecting the ability of U.S. corporations to compete in certain parts of the world, given local business practices and customs?

From Lockheed's public statements, as well as from information which we received from Lockheed, it is clear that bribes had been paid prior to the guarantee program.

A broad policy is at stake here. The Emergency Loan Guarantee Board has been put in the position of seeking to protect the Government's interest as guarantor for creditors of Lockheed. In so doing, it finds itself working with a company that alleges that foreign payments of this nature are a normal and necessary method of doing business abroad in the highly competitive aerospace market.

While the Board does not believe it is the appropriate agency to develop rules or standards of general applicability, it is formulating its own assessment of what has transpired in order to determine an appropriate course of action under the Guarantee Act. This assessment will include a balance of competing interests between the public's right to know and the alleged potential adverse impact of detailed disclosure on Lockheed's outstanding orders. Congress likewise has a responsibility to determine what actions it should take in connection with the Government guarantee of loans to Lockheed.

When the Board has completed its review, it will then be in a position to recommend whether a change in the guarantee legislation is desirable.

A crucial challenge facing us today is the preservation of the free enterprise system. Practices such as bribes made to secure foreign business can only increase the distrust and suspicion that is straining our national institutions. To argue that bribes to foreign officials are necessary for effective competition is contrary to every principle under the free market system. The Emergency Loan Guarantee Board wants to go on record as condemning these practices.

Exhibit 22.— Excerpt of statement by Under Secretary Schmults, September 24, 1975, before the House Budget Committee's Community and General Government Task Force, urging renewal of the general revenue sharing program

A vital federalism capable of guarding against the overcentralization of power and of providing responsive government in a large and diverse nation is as much a priority today as it was 200 years ago. In an age when a large and distant Federal Government must concentrate on foreign affairs, defense, and other national issues, there is a pressing need to make sure that governments close to our citizens have the fiscal strength to carry out those local tasks they can best accomplish.

While revenue sharing has been a success, the needs which the Congress originally intended that it address continue to exist. President Ford feels that this approach to Federal domestic assistance claims a top priority in competition with other important claims on our national tax dollars. The goals which revenue sharing works toward—a strong Federal system, a balanced system of intergovernmental aid, and an effort to better relate local needs to local resources—are all important national priorities.

Resources drawn from the relatively more efficient and equitable Federal tax system have been made available to States and localities through revenue sharing, for use as they see fit, without the redtape associated with most other Federal assistance.

We have not proposed major amendments for several reasons. We feel that the existing program has done a very creditable job of meeting its priorities. At the same time, we do not think that general revenue sharing can be designed to solve all the political and social problems of our society. To attempt to make it do so will reduce its contribution as flexible, unencumbered Federal assistance.

The existing revenue sharing allocation formulas have performed well in directing relatively more resources per capita into needier jurisdictions.

A way in which to assess revenue sharing's response to need is through the manner in which recipient governments utilize the funds they receive under the program. There does not seem to be much doubt that allocations have been widely used to maintain existing vital services, to make possible needed capital expenditures, and to lessen the burden of State and local taxation.

These broad impacts of revenue sharing clearly result in benefits to all citizens. Yet, some commentators have felt that general revenue sharing plays too small a role in solving the numerous social problems of our Nation and directs too little money to meeting the needs of the poor, aged, and minorities. Again, I must point out that other programs are targeted onto these important issues. Revenue sharing seeks primarily to respond to the institutional needs of our Federal system and the governments which are within that system. We as individuals all benefit from the greater effectiveness of our governments.

However, revenue sharing has more direct impact in solving social problems than is evident at first glance. Some of the ways it does so are:

- Local resources are freed for social expenditure.
- Education is the main use reported by States.
- Capital expenditures are often for schools, hospitals, low-cost housing, et cetera.
- Funds reported as spent in functional categories other than for the poor and aged often can be of benefit to the underprivileged—e.g., health, transportation, law enforcement, environmental, and recreational expenditures.
- Some jurisdictions use allocations to redress past discrimination.
- Revenue sharing shifts the financing of activities away from relatively more regressive State and local taxes to the relatively more progressive Federal income tax.
- As recipients become more certain about the program's future and perhaps more financially pressed, they are spending more money on recurring program costs than on capital expenditures.

The funding levels for revenue sharing proposed by the administration—a continuation of the annual $150 million increase in funds—represent a compromise between the national necessity to keep down Federal budgetary deficits, the need to adequately fund competing priorities and the real fiscal needs of States and communities. Similarly, the manner of funding we are recommending, i.e., a single appropriation of 5 3/4 years, balances the need for Congress and the President to control and regularly review expenditures against the very real need which States and localities have for the certainty and predictability of Federal support.

We applaud the efforts that Congress has recently made to strengthen its budgetary process. These improvements should increase the predictability of much of the Federal funding going to State and local activities by providing more timely appropriations, as well as appropriations that are in line with authorizations.

At the same time, we feel that adequate planning for wise use of shared funds requires sufficient advanced knowledge of funding levels by recipient governments. Clearly, annual appropriations for revenue sharing would not provide such.

Ineffective and hasty planning, expensive construction delays, and delays in important people-oriented services all result from such uncertainty. These developments can mean that citizens receive less than maximum benefit from revenue sharing dollars. The capital projects on which small governments spend considerable portions of their shared revenues require especially long leadtimes.

An important reality of State and local budgeting that further increases the need to know how much Federal funding will be available is the fact that most State and local executives must present a balanced budget to their legislative bodies. Officials are aided by the fact that borrowing is normally counted on the receipt side of these budgets. However, the flexibility of non-Federal governments to borrow and tax to meet short-term deficits varies and, on the whole, is more restricted than that of the Federal Government.

Many of these problems are immediate in that States and localities are currently beginning to put together budgets for fiscal year 1977. In a matter of weeks, most State budget offices will begin to evaluate agency requests for fiscal year 1977 and weigh them against possible revenues. Fiscal year 1977 budget planning will often begin this fall at the local government level, too.

So it is extremely important to both States and local governments that Congress act upon the renewal of the State and Local Fiscal Assistance Act as soon as possible.

In summary, revenue sharing contributes to a vital Federal system, provides a more balanced and effective array of Federal intergovernmental assistance, and successfully responds to pressing governmental and human needs in our States and localities. We hope that Congress will agree with our assessment and see fit to extend this essential program.

Exhibit 23.—Excerpt of remarks by Secretary Simon, October 22, 1975, at Pepperdine University in Los Angeles, urging business leaders to put their "own house in order" as part of an effort to restore public confidence in the American economic system

There is a lesson of recent years that we may not have learned well. Unless we heed it, our struggle to preserve and strengthen the private enterprise system in America is doomed to fail.

The lesson is simply this: To restore public faith in the American economic system we must not only make basic changes in the way that government behaves but the business community must also undertake a far-reaching effort to put its own house in order.

The fact is that the public has almost as little faith in business today as it has in government. All of you are familiar with the opinion polls showing a sharply plunging loss of confidence in most of our major institutions. The government, the church, the courts- all have suffered. But the percentage decline has been larger and more precipitous for business than for anyone else. According to the polls, confidence in business has slipped from more than two-thirds of the people to less than one-fifth.

Clearly we must be concerned with what lies behind this collapse. Earlier this year, Daniel Yankelovich, a respected polling figure and a professor of psychology, offered several insights into the problem.

The Yankelovich data reveal a remarkable degree of public support for free enterprise itself. Fully 91 percent of the public feels that the Government should not own or run big business in the same way that business is run in Socialist countries. And about 6 out of every 10 people say they're prepared to sacrifice, if necessary, to preserve the free enterprise system.

What has been lost, he finds, is not public faith in free enterprise principles but in the practices of those who are now part of that system. The rules of the game still make sense to people, but there is a deepening sense that the rules are being violated. In the terms of Mr. Yankelovich, while business retains its ideological legitimacy, it is losing its moral legitimacy.

And the heart of the matter is a belief that business has become not only too powerful but also too greedy. Instead of serving the public interest, business is now regarded as serving its own selfish private interest- and at the public's expense. The public outcry that the oil companies manipulated the energy crisis to line their own pockets is perhaps the most obvious example, but there have been many other illustrations, extending from Government subsidies for big corporations to the well-publicized corporate bribery of public officials. In theory at least, the public does not object to profitmaking. But it does object to what it perceives to be widespread profiteering.

These objections could have a decisive impact on the future of the private enterprise system. History has shown us time and again that the public attitudes of one era become the public statutes of the next. Thus, it is entirely possible in coming years that we will see not less governmental regulation of business- as the administration is now advocating- but far more governmental regulation. In fact, the Yankelovich polls showing high popularity for free enterprise also find that three-quarters of the American people want more regulation. They want the Federal Government to "regulate major companies, industries and institutions to be sure they don't take advantage of the public."

Given these circumstances, I would suggest that business leaders who care about the future of free enterprise- and indeed, of freedom itself- have an urgent responsibility to set about restoring greater public trust and confidence in the institutions they run. And there are, I would suggest, three major steps that must be taken as rapidly and as aggressively as possible.

The first and most obvious step is that the business community must set a high moral standard. We all recognize, of course, that corporate corruption is limited. But we must also recognize that instances of corruption have been highly publicized and the reputation of the entire business community is now being stained with them. Specifically, each of you must hold yourself and your colleagues to the highest possible standard of business ethics.

In the post-Watergate environment, when a relentless, almost obsessive search goes on to find new villains, it is hardly surprising that unwholesome business practices have attracted widespread attention. Rather than hiding from the publicity or denying that anything ever goes wrong, businessmen should welcome this opportunity to put an end to the corporate abuses that do exist so that they will regain the public confidence that they deserve. If corporate leaders will only take it upon themselves to examine their own organizations and get rid of all practices that they believe to be questionable, they will do far more to improve the environment for the business community than any number of pious speeches extolling the virtues of free enterprise. And let us be clear: If business is unsuccessful in policing itself, we can expect that the public will insist upon doing it for them—through the heavy hand of Government.

The second major step that must be taken logically follows the first: I believe it is absolutely necessary for the business community to begin squaring its practices with its principles. One of my saddest experiences in public life has been to see businessmen—the public champions of free enterprise—come trooping into Washington, hat in hand, whenever they need shelter from an economic storm.

Franklin Roosevelt used to take great delight in needling businessmen who sought out the protection of the New Deal. "I know how the knees of all our rugged individualists were trembling 4 years ago," he said toward the end of his first term. "They came to Washington in great numbers. Washington did not look like a dangerous bureaucracy to them then. Oh, no! It looked like an emergency hospital. All of the distinguished patients wanted two things—a quick hypodermic to end the pain and a course of treatment to cure the disease. They wanted them in a hurry; we gave them both."

Unfortunately, what those businessmen took had a narcotic effect, and we've never shaken the habit. I can well remember George Shultz telling me of a meeting with business leaders. They were strenuously urging that the Government impose wage and price controls, and they were impatient with him. Business learned soon enough why he opposed controls, and within 2 years after controls were imposed those same leaders were begging him to help get the Government out of the marketplace. Controls have been tried throughout history; not once have they worked. And much the same can be said of other forms of government intervention and protection. Tariffs, subsidies, quotas, handouts, bailouts—I've seen them all and not one is worth its ultimate price. They all offer a hollow, empty promise of security, and they all lead in the end to a sacrifice of freedom.

The third obvious step the business community must take is to initiate a far more energetic program of basic public education in the economic as well as political values of freedom. We must ensure that the lessons of recent years sink in at the grassroots levels—that people clearly understand where we're headed.

Let us begin by teaching everyone the fundamentals again—about profits, capital investment, and productivity. A majority of Americans now believe that 33 cents out of every dollar of sales is recorded as corporate profits. In reality, profits are less than 5 cents out of every dollar. This gap in public understanding speaks volumes about the task ahead.

But the argument for free enterprise must not rest on fundamentals alone. It must also be cast in human terms. Being pro-business is the same as being pro-people. You must make it clear what the fundamentals mean: That economic growth yields direct benefits to wage earners, consumers, and producers—more jobs, higher wages, and less inflation. Our painful experience with the deep recession should put the lie once and for all to the notion that zero growth would be good for America.

Those who practice free enterprise—more than anyone else—should be responsible for getting its success story across to the American people. Over the years, the U.S. economy has created the highest standard of living in the world. The average family income approached $13,000 in 1974; poverty has been sharply reduced to 13 percent of the population; jobs have been created for over 86 million people; and we continue to spend about 90 percent of our personal disposable income on ourselves. This is not a "trickle down" system. It is the most effective "flow through" system of benefits and personal gains ever devised, and no sarcastic slogans will ever refute that reality.

In a free economy, the products which people are willing to pay for will be produced, just as an adequate price will ensure an adequate return. Things for which the people are not willing to pay an adequate price, we will not get. That is not only the essence but the genius of the American economic system. The principal difficulty today is not that our economic system will not work, but rather that our political system is subverting it.

It is up to all of us here to combat the false belief that the Government can identify, solve, and somehow pay for all of the problems of society. That belief has no validity in either fact or theory. What it has produced instead is one of the worst cases of inflation in our history—inflation that has far-reaching social and political implications.

A continuation of this inflation will place this country's entire private enterprise system in jeopardy. If our financial markets remain under their current strains, if utilities have trouble obtaining necessary financing to keep up with inflation, if money flows out of the thrift institutions because of inflation, if the housing industry suffers along with the thrifts, and if the airlines, the real estate investment trusts, and others go to the wall, who will be called into the rescue? If the retired people of this country cannot protect themselves against inflation, who is it that can serve as a rescuer? You know the answer: The Government. Clearly, continued inflation would bring a massive expansion of the public sector and would threaten the very survival of large areas of the private sector. And what I am talking about tonight is not big business, not the Fortune 500, but all business—small, medium, and large.

The American economic system today is under attack as it never has been before. And that attack comes as the country is drifting dangerously down the path toward a centralized economy. Now it is time for leaders of the business community to come to the defense of our economic system. It's time to lay it on the line for the American people. We have reached a watershed. Either we continue down the path of recent years—a path that will inevitably lead to socialism in the United States of America—or we fight now to preserve our economic and political freedoms.

Let us make it clear to the American people that the choice is between those who believe that government should make the choices for individuals and those who believe that individuals should choose for themselves. And let us make it equally clear where the so-called liberalism of today really leads: To the destruction of our liberty.

America is still incredibly strong. Its mainspring is the largest and most dynamic marketplace in the world. We have the resources, and we know how to rebuild our economy. The central question is whether we have the will and the courage to rescue ourselves from the relentless drift we have experienced in recent years. As leaders of the business community, each of you will have an important voice in deciding our country's direction and fate. Let there be no doubt of your choice for a free America.

Exhibit 24.—Excerpt from statement by Secretary Simon, February 4, 1976, before the Joint Economic Committee, regarding the impact of government regulation on the private sector

Without question, this country has developed the most efficient and creative economic system the world has ever known. It has been particularly responsive in satisfying the consumption demands of our large population, and the real standard of living for most Americans has risen sharply during the postwar era.

Yet, as I take soundings of people throughout our country, I sense a growing concern about the long-term outlook for continued economic development. America seems to be on a path that may not hold the same promise for the future. There appears to be declining recognition of the fundamental importance of markets and a narrowing of the boundaries in which individual Americans can make personal economic decisions.

Of course, the market system adapts to change. The population has grown, the availability of resources has fluctuated, concerns about the environment have increased, and the United States has become a major part of an increasingly integrated world economy. As our economy has become more complex, new approaches to difficult problems have been needed to achieve our general economic goals, to prevent specific abuses, and to stimulate and preserve competition in the markets. I believe that free, competitive markets are the most effective way to provide for increased output and the equitable distribution of the results of economic activity.

We do need government regulations and other safeguards to protect the public interest. But I am disturbed by my discussions with individual consumers and businessmen which indicate that the government at all levels is increasingly constraining innovation, entrepreneurship, and individual spending decisions. In particular, the small businessman attempting to create a new enterprise today is curtailed at almost every turn.

He must comply with thousands of government regulations on health, safety, pollution control, hiring practices, product liability, tax reporting, employee pensions and compensation, advertising, distribution practices, and other requirements too numerous to list. This compliance burden is costly to large and small businesses alike. These costs ultimately must be passed on to consumers in the form of higher prices. Moreover, such costs are particularly heavy for the smaller businessman because of the fixed-cost nature of many of the regulations. If profits are earned- and that is obviously the basic reason for creating most new businesses- they are taxed by the Federal Government, usually by the States, and increasingly by local governments, to support the enormous growth of government spending at all levels.

Just the paperwork burden of government regulation is staggering. Individuals and business firms spend over 130 million person-hours a year filling out over 5,000 government forms. Even more costly is the paperwork burden within government itself. The Commission on Federal Paperwork estimates that Federal spending to process forms totals an incredible $15 billion a year. In fact, just the cost for forms themselves runs to a billion dollars annually, and one department—Agriculture—maintains nearly a million cubic feet of records and spends $150 million yearly on reporting systems. When government and businesses are so burdened, it is not just they who pay the penalty. Everyone pays—the taxpayer and the consumer alike.

Small businessmen are increasingly questioning the desirability of working so hard and bearing so much risk when others are able to claim virtually the same financial rewards in our society with shorter hours, far fewer headaches, much less responsibility, and little risk. Is it any wonder that the entrepreneurial spirit in this country is fading?

Employees also have growing concerns about the future as they see an increasing share of their financial resources eroded by personal income taxes, paid to several layers of government, payroll taxes, property taxes, sales taxes on most of the goods and services they purchase and many other indirect taxes. Although earnings continue to rise rapidly, the real purchasing power of these higher incomes is quickly erased by higher taxes and inflation.

These personal concerns raise fundamental questions about the proper allocation of resources and decisionmaking between the public and private sectors. Determining the proper functions of government and the means of financing those activities is a critical issue facing our society. The key, of course, is, what is the appropriate balance?

If the balance is almost entirely in the private sector, the public's interest may not be properly safeguarded. There would be little or no national defense, national parks, or other public goods of this sort, and we would still have the difficult challenge of providing a basic level of income and services for those Americans who are currently not able to pay for their basic needs. Clearly, there is an important role for government.

However, when resource allocation and other economic decisions become dominated by a government bureaucracy, innovation and productivity are too often restricted. Moreover, the individual finds he has less freedom of economic choice as greater portions of his paycheck go to support growing government outlays at all levels, as prices rise, and as the total economy becomes less productive. The potential entrepreneur considering a new business because he has an idea he thinks is really good finds himself stymied at almost every turn. The danger of all of this is that in many cases he concludes that the risks and inconvenience far outweigh the potential rewards and he drops the idea. At the extreme, economic decisionmaking by people in the market is supplanted by people in government, individual incentives evaporate, and the economy deteriorates into conditions of stagflation.

Reasonable people will agree that we do not want either extreme. Too little government results in an absence of public goods and safeguards of the public interest. Too much government, on the other hand, stymies the workings of efficient and competitive markets and reduces the individual's freedom of economic choice. We obviously must have a balance. But what is the appropriate mix of public and private decisionmaking? There is no exact answer to this question, but I do believe that we can make a reasoned assessment.

We must recognize that the resources of this great country—the number of people, their education and skills, the amount and types of capital goods, the abundance of raw materials, and the infrastructure of transportation, communication, utility, and other services—are limited, particularly in the short run. Yet, as we all know, there are numerous claims on these resources. Each special interest group assumes that its claim is somewhat unique and deserves satisfaction. When we total all of the worthwhile claims, we find that they far exceed our

The recovery—actual and projected

[Growth in percentages]

	Economic results for 1975	Economic forecast for 1976
	Actual	*Forecast January 1976*
Gross national product (current dollars)	6.5	12.4
Gross national product (constant dollars)	-2.0	6.2
GNP price deflator (yearly average)	8.7	5.9
Consumer Price Index (yearly average)	9.1	6.3
Unemployment rate (yearly average)	8.5	7.7

Secretary Simon's testimony to the Joint Economic Committee contained the above measurements of the pace of the U.S. economic recovery.

ability as a Nation to satisfy them, particularly in the unrealistically short time frames that are sometimes expected. Obviously, hard choices must be made.

I believe that the balance has tipped too far in the direction of bigger and bigger government at the relative expense of the private sector. The American people are beginning to resent this growth, for many of them know that ultimately it must be paid for directly with their taxes and/or indirectly by accelerating inflation.

Regulatory agencies have come to exercise direct control over transportation, energy, communications, and the securities market—industries that account for almost 10 percent of the value of everything made and sold—and to exercise indirect control over much of the rest of our private economy. Business activities have become more controlled in areas of environmental protection, job safety, consumer requirements, hiring practices and information reporting, and much more.

To be sure, many of these regulations are necessary and important in safeguarding the public interest. For example, regulations to prevent monopolistic pricing, to assure product safety, to provide reasonable and effective standards for environmental protection and worker safety, to make possible fair employment and other things of this sort are important to us all. However, too many regulations are overlapping, inefficiently administered with long delays, or obsolete. Others are actually anticompetitive. Regulators regulate with a frenzy and in so doing hamper the basic efficiency of competitive markets.

An underlying problem is that many regulations have never been subjected to a true cost-benefit type of analysis. The benefits are always cited, but very seldom are they documented by evidence showing that the regulation proposed is really going to make a difference. In other words, is there going to be a measurable and significant benefit which will exceed the combined cost of administering the regulations and the costs resulting from reduced efficiency of the U.S. economic system—costs which ultimately must be borne by the consumer?

In cases where the benefits are less than the total costs, we should consider changing or eliminating the government regulations and administrative actions that have caused the problems. Many regulations designed to cope with yesterday's problems are obsolete today. Frequently these regulations impede innovation by creating barriers to entry which preserve the status quo and limit competition. Other regulations simply are ineffectively administered, creating needless redtape and delays.

By eliminating unnecessary regulations and streamlining others, the negative impact of government actions that restrain the economic decisionmaking ability of the private sector would be reduced. The consumer would benefit in being able to purchase the product or service at a lower price and/or with less inconvenience than would otherwise be the case.

The reform of government regulation is a principal goal of the administration and many Members of Congress as well. I know of no issue that has the agreement of so many people—from liberals to conservatives, from business to labor. Yet the special interest groups are vociferous and tenacious. Witness the reactions of airline and trucking executives to the President's reform proposals for these industries. We should all recognize that we have an enormous stake in restoring competition to the marketplace.

Exhibit 25.—Remarks of Assistant Secretary Jones, June 26, 1976, before the Western Economic Association and the Western Finance Association, San Francisco, Calif., on the "Challenge of Economic Leadership"

The challenge of leadership is to look beyond the current expansion to consider the long-term outlook for the U.S. economy. My good friend Paul W. McCracken once described this process as looking across the valley to see what is on the other side. His message was: "What will be different on the other side of the valley is far more relevant to business planning than the valley itself."[1] Such advice is particularly meaningful at this time because of the basic need for more stability in our economic policies.

I. Background of current decisions

In the mid-1960's the United States began an unfortunate series of economic booms and recessions: Serious overheating of the economy created severe price pressures; accelerating inflation caused recessions by restricting housing construction, personal spending, and business investment; the recessions created unwanted unemployment which wastes resources and causes personal suffering; rising unemployment too often triggered well-intentioned but poorly planned and ill-timed Government fiscal and monetary policies setting off another round of excessive stimulus leading once again to overheating- inflation- recession-

[1] Paul W. McCracken, "The Other Side of That Valley," *White House Briefing for Businessmen*, Washington, D.C., Nov. 21, 1969.

unemployment—and even more Government intervention. To break this unfortunate cycle and return the U.S. economy to full output, four guidelines are required:

First, the complete range of economic difficulties must be recognized to avoid policy myopia. Inflation, unemployment, declining output, the adequacy of productive resources, and international trade and investment are interrelated problems.

Second, policy initiatives should solve more problems than they create. During a period of difficulty it is often expedient to respond to strident calls to "do something—anything—to demonstrate leadership." But this naively activist approach is a basic source of problems, not the desired solution. Courage and wisdom are necessary to avoid actions offering the illusion of short-term benefits in exchange for further erosion of the long-term creativity and productivity of the U.S. economic system. There is, of course, an important role for governments in protecting public interests but I strongly disagree with the claim that they can or should control the economy.

Third, to restore economic stability the inflation which began in the mid-1960's and accelerated rapidly in the 1970's must be significantly reduced. From 1890 to 1970, prices in the United States increased at an annual rate of 1.8 percent. From December 1973 to December 1974, they jumped 12.2 percent. It is obvious that any long-term solution to our economic problems will be impossible as long as inflation continues to distort spending and investment decisions. Inflation should be recognized for what it is: The greatest threat to the sustained progress of our economy and the ultimate survival of all of our basic institutions.

Fourth, the transitional problems of moving through different stages of the business cycle require further improvement in the automatic stabilizers built into many Government programs, particularly the response to unemployment and declining personal income.

Since the turning point in the spring of 1975 a relatively strong and balanced recovery has occurred: Real output has increased 7.2 percent over the last four quarters while inflation has declined to an average annual rate of 5.5 percent; employment has increased sharply by 3.6 million persons and the unemployment rate has dropped from a peak of 8.9 to 7.3 percent by May; and international trade and investment have continued despite the serious disruptions caused by unexpected increases in oil prices and a worldwide recession. These are impressive achievements but focusing on the current economic situation would leave us vulnerable to a repetition of the policy errors of the past. I believe that we can achieve long-term progress—with less inflation and unemployment—if Government policies facilitate, rather than restrict, the efficiency of the private sectors.

II. Economic policy views

Despite the turnaround in economic activity there is still considerable concern about the long-term economic outlook. Part of this apprehension is the result of misconceptions about economic policies.

Myth Number 1: "We don't know how we got here."—Americans are used to strong economic growth, not recessions; to abundance, not shortages; to moderate inflation, not a double-digit pace. The economic distortions of the last decade have been puzzling—even frightening—but it is possible to identify the factors that have led to unacceptable inflation and unemployment. Even more important, such understanding is necessary for restoring public confidence.

One reason we have had so much instability is the excessive stimulus provided by Government fiscal policies. For many years political leaders have tried to convince the electorate that a central government can identify, solve, and pay for the problems of society—right now. In fiscal year 1966 Federal outlays totaled $135 billion; by fiscal year 1974 expenditures had doubled to a level of $268 billion. During the next 2 fiscal years—1974 to 1976—Federal spending increased 39 percent to a level in excess of $370 billion. Another large increase will occur in fiscal year 1977 as the President has proposed a budget of $396 billion and the concurrent resolution of Congress calls for spending of $413 billion. Part of this sharp increase in outlays is the result of "automatic stabilizers" related to recession problems such as unemployment compensation benefits, but most of the added spending has become part of the permanent programs of Government. Government spending, for both temporary stimulus and permanent programs, has increased at a rate that is creating serious resource allocation problems which will not conveniently disappear as the current economic expansion continues.

Unfortunately, debates about setting national economic policies are too often limited to disputes about the proper distribution of functions between the public and private sectors. In considering national economic priorities a much broader perspective is required. The total productive capability of the entire economy must be considered before attempting to identify specific claims against that potential output. Estimating the total capacity of the system avoids the simplistic arguments that additional Government programs can be continuously created merely by increasing total output or by shifting resources from the private to the public sector. Honest differences of opinion can exist about the proper functions of

Government but simply adding new Government commitments is not feasible if the total productive capacity of the economy is exceeded. This guideline has been frequently violated as the momentum of Government spending combined with expanding private demand has gone beyond the capacity of the system. The results of such excesses persist long after the initiation of the original spending program because Government activities are rarely curtailed or eliminated.

A study of total capacity was prepared in 1969 by the Council of Economic Advisers and published in the Economic Report of the President for 1970. The pattern of real increases in gross national product was projected for 1976 using trend estimates of the growth of the labor force, national productivity gains, expected unemployment, and the annual average number of hours worked per person. Existing claims against the projected GNP were then identified, including personal consumption, business investment, housing, and Government spending. All of these claims were adjusted to reflect demographic and economic assumptions. Federal spending was projected to include only existing programs plus new proposals for revenue sharing, welfare reform, and pollution abatement outlays. As summarized in table 1, the fulfillment of the total claims already identified in 1969 required a relatively rapid expansion of output to keep pace:

* * * the existing, visible, and strongly supported claims already exhaust the national output for some years ahead. This is not to say that no other claims will be satisfied, or that claims included in these calculations should have preference over claims not recognized here. The basic point is that if other claims are to be satisfied some of those recognized here will have

The projections prepared by the Council of Economic Advisers are hypothetical estimates based on somewhat arbitrary assumptions and actual results have varied during the intervening years since the study was completed. Nevertheless, a crucial point is evident: Decisions on national economic priorities must reflect total output potential and all existing claims rather than focusing only on Federal budget outlays. Whenever resources are limited, recommendations to add new Government programs must

TABLE 1.—*Real gross national product—1955, 1966, and 1969, and projections for 1975–76*

	Actuals			Projections	
	1955	1966	1969	1975	1976
	Billions of dollars, 1969 prices				
Gross national product available	569.0	845.5	931.4	1,199	1,251
Claims on available GNP	569.0	845.5	931.4	1,188	1,232
Federal Government purchases	69.8	88.3	101.3	83	83
State and local government purchases	53.8	94.4	110.8	140	144
Personal consumption expenditures	344.3	519.2	577.5	768	802
Gross private domestic investment	96.9	137.5	139.8	192	198
Business fixed investment	55.1	92.0	99.3	128	134
Residential structures	34.5	29.4	32.0	52	52
Change in business inventories	7.3	16.1	8.5	12	13
Net exports of goods and services	4.2	6.1	1.9	5	5
Unallocated resources	.0	.0	.0	11	19
Addendum: Federal surplus or deficit (−), national income accounts basis	5.6	−.2	9.3	25	32
Per capita personal consumption expenditures	2,083	2,637	2,842	3,529	3,641
	Percent of total GNP available				
Gross national product available	100.0	100.0	100.0	100	100
Claims on available GNP	100.0	100.0	100.0	99	99
Federal Government purchases	12.3	10.4	10.9	7	7
State and local government purchases	9.5	11.2	11.9	12	12
Personal consumption expenditures	60.5	61.4	62.0	64	64
Gross private domestic investment	17.0	16.3	15.0	16	16
Business fixed investment	9.7	10.9	10.7	11	11
Residential structures	6.1	3.5	3.4	4	4
Change in business inventories	1.3	1.9	.9	1	1
Net exports of goods and services	.8	.7	.2	(1)	(1)
Unallocated resources	.0	.0	.0	1	2
Addendum: Federal surplus or deficit (−), national income accounts basis	1.0	.0	1.0	2	3

[1] Less than 0.5 percent.

NOTE:—Projections are based on projected Federal expenditures and their influence on various components of GNP.

consider the prospective impact on the private sector. In short, the creation of new priorities, or expansion of existing commitments at an accelerated rate, will require giving up or curtailing some existing claim. Once it is recognized that the potential GNP has already been committed to existing claims, the consideration of new outlay requests should become more realistic. Spending decisions should then concentrate on realining claims rather than merely adding commitments to satisfy diverse interest groups.

The rapid growth of Federal spending during the past decade has increasingly eroded our fiscal flexibility. Many Government programs involve an entitlement authority which makes the actual outlays open ended, depending upon the eligibility rules and benefit levels established. For example, there has been a tendency to liberalize both guidelines and benefits for various income maintenance programs which are now indexed so that they rise automatically as inflation occurs. Other outlays are required by specific legislation and contractual agreements. As a result, the Federal budget is increasingly committed to the priorities of the past which makes it difficult to respond to current problems and future claims. Approximately three-fourths of the Federal budget is now considered to be "uncontrollable" because of existing entitlement and contractual obligations. In theory, there is no such thing as an "uncontrollable" budget commitment since Congress controls the annual appropriations process. In reality, existing programs are rarely eliminated or reduced and new claims are typically added on to current outlays. The near-term prospects are for continued increases in outlays and more Federal budget deficits. This trend can either be modified by congressional action or resources can be transferred from the private sector which would mean a further increase in the role of Government in the economy.

A second important issue concerns the proper role of the Federal budget. In preparing the budget plan, Government officials are actually allocating the human and material resources available and determining the division of responsibilities between the public and private sectors. This is clearly a proper function. However, the Federal budget has been used more and more as a tool for economic stabilization. Increased outlays and resultant deficits are defended by claiming that Federal spending is required to replace private demand during periods of reduced private demand. The size of the Federal budget is then manipulated to meet current economic stabilization goals. Unfortunately, the balance turns out to be asymmetrical because deficits usually occur during periods of both strong and weak economic activity. The upward momentum of subsequent Government spending is accelerated by such short-term decisions, and the resulting deficits disrupt the capital market and create heavy interest burdens for the future.

Another problem involves the negative impact of Federal deficits on the stability of financial markets and the formation of capital. The Federal Government will have reported a deficit in 16 of the past 17 fiscal years—or 39 of the last 47—at yearend fiscal year 1977. During the single decade, fiscal year 1968 through fiscal year 1977, the cumulative Federal deficits will total over $265 billion. In addition, net borrowings to support over 100 off-budget programs, not even included in the Federal budget, will total at least another $230 billion. That means that Federal demands on the financial markets will total one-half of a trillion dollars in a single decade. The reality of these chronic Federal deficits must be compared with the consensus view that the budget must be balanced over time if we are to achieve the levels of capital investment considered necessary to return to and sustain full employment. The strong underlying growth trends in the U.S. economy will provide for economic progress but the basic challenge of allocating total resources is becoming even more difficult.

The course of monetary policies is a second important factor affecting the Nation's economic performance. Unfortunately, the stop-and-go pattern of economic activity and the effects of fiscal policy excesses have made it difficult to pursue stable monetary policies. In addition, the rate of growth in the money supply has increased over time. From 1956 to 1965, the narrowly defined money supply expanded at an average annual rate of 2.3 percent; from 1966 to 1975, a period of rapidly increasing Government spending and large Federal deficits, the average annual growth rate was 5.8 percent. The publicly announced target for expansion of the money supply is currently a range extending from 4 1/2 to 7 percent. In his recent testimony before the Joint Economic Committee, Chairman Arthur F. Burns emphasized the importance of reducing the underlying rate of inflation and repeated the strong intent of the Federal Reserve System to avoid excessive growth of the monetary aggregates which would aggravate inflation and create even more problems in the future.

The third reason for our current inflation and restricted productivity is that we have been unwilling or unable to eliminate the hundreds of Government policies that inhibit the efficiency and effectiveness of our economic system. Basic common sense, certainly a beginning course in economics, tells us that unless we use our resources efficiently, we will either produce fewer goods and services with those same resources or we will have to devote still more valuable resources to produce the same volume of goods and services. Examples of wasted resources include the restrictions on agricultural production, controlled labor productivity, trade barriers, subsidies to inefficient industries, and so forth.

The Federal Government has unnecessarily restricted the operation of our entire economic system. This policy might have been tolerable for another time—perhaps the 1930's when economic stagnation existed—but in today's world, even in a country as affluent, creative, and productive as America, we clearly cannot continue to waste our valuable human and material resources. We need to stimulate competition and innovation rather than artificially protecting the status quo through a maze of regulations and administrative rulings. This process should include development of dynamic new industries to replace those that have become obsolete or noncompetitive in an integrated world economy. This more aggressive approach will create jobs, not destroy them, and it will moderate price pressures. It will improve the use of available capital resources. Best of all, it will make our entire system more efficient in contributing to the welfare of all 215 million Americans.

The fourth reason we are in our current position is that we have had an unfortunate series of international and national agricultural difficulties, which have combined to create serious worldwide food shortages. The Rome World Food Conference in 1974 originally was planned to discuss the long-term future of agriculture. Instead, the meeting was dominated by discussions of existing shortages. The worldwide disruptions of food output have had a particularly serious impact on inflation. In 1973 retail food price gains accounted for over 50 percent of the increase in the Consumer Price Index.

Fifth, we have experienced an unreasonable and largely unexpected quadrupling of prices of crude petroleum. The average American recognizes the impact of this change on gasoline and home heating fuel prices, but he often ignores the pervasive effects on chemicals, plastics, transportation, manmade fibers, petrochemicals, and many other products.

The sixth reason for the surge of inflation was the international overlapping of demand in 1972 and 1973 which occurred when most industrialized nations overheated their economies at the same time. At that time, many industrialized countries were chasing the same raw materials and the same markets, creating excessive output pressures and accompanying inflation.

Seventh, the inflation explosion of 1973 and 1974 was partially the result of the accumulated distortions caused by 3 years of wage and price controls. Such controls are most unfortunate. They create shortages and distort the proper operation of an economy such as ours, which depends upon flexible price and wage adjustments to allocate resources. In specific terms, such controls divert capital investment, create artificial motivations for exports, disrupt competitive relations, and in general reduce economic efficiency. In addition, they don't work. The inflation figures for the 3 years covered by controls and the record of World War II and Korean war experiences indicate that artificial restrictions only suppress but cannot stop the underlying wage and price pressures. When the controls are eliminated there is usually a surge of price increases.

There are at least seven major variables that have contributed to the disappointing economic performance of the last decade. The myth that we don't know how we got here is false. Too much Federal, State, and local government spending, fluctuating monetary policies, our unwillingness to attack governmental policies that inhibit economic efficiency, the agricultural difficulties of recent years, the quadrupling of petroleum prices, the international overlapping of demand, and the accumulated distortions caused by wage and price controls—all of these forces contributed to the disruption of economic activity.

Myth Number 2: "We don't know how to get out of here."—This particular myth is just as false as the first one but it is equally widespread. The return to economic stability is entirely within our capability but policy initiatives have too often been contrary to achievement of that goal. The Federal Government has a crucial role because its actions shape the overall environment within which the private economy must function. The beginning point is to regain control over the upward momentum of Federal spending. In fiscal years 1966, 1967, and 1968, Federal outlays increased 13.8, 17.5, and 13.0 percent respectively (table 2). From fiscal year 1974 to fiscal year 1976, Federal spending increased 39 percent. These increases are not compatible with a noninflationary environment in the U.S. economy which now has a potential for real growth of approximately 3 1/2 percent each year. For example, from 1965 through 1975 the GNP increased from $753 to $1,499 billion, an increase of 99 percent. From fiscal year 1966 through fiscal year 1976, Federal spending increased from $135 billion to approximately $372 billion, an increase of 175 percent. The President has proposed that the rate of increase be brought back into alinement with the underlying capability of the economy. Similarly, the new congressional budget committees have attempted to apply more discipline in the development of Government spending bills. This correction process will not be quick or easy but the President has put forth a specific program for bringing the Federal budget back into balance.

TABLE 2.—*Federal budgets, changes in the unified budget outlays by fiscal year, 1961–77*

[Dollars in billions]

Fiscal year over preceding year	Federal outlays	Dollar increase	Percentage increase	Surplus or deficit (−)
1961	$ 97.8	$ 5.6	6.1	−3.4
1962	106.8	9.0	9.2	−7.1
1963	111.3	4.5	4.2	−4.8
1964	118.6	7.3	6.1	−5.9
1965	118.4	−.2	—	−1.6
1966	134.7	16.3	13.8	−3.8
1967	158.3	23.6	17.5	−8.7
1968	178.8	20.5	13.0	−25.2
1969	184.5	5.7	3.2	3.2
1970	196.6	12.1	6.6	−2.8
1971	211.4	14.8	7.5	−23.0
1972	231.9	20.5	9.7	−23.2
1973	246.5	14.6	6.3	−14.3
1974	268.4	21.9	8.8	−3.5
1975	324.6	56.2	20.9	−43.6
1976 (est)	372.2	47.6	14.7	−72.6
1977 (est)	397.2	25.0	6.7	−45.7

Source: Economic Report of the President, January 1976, Table B-63, p. 245, for 1961-75. Estimates for 1976 and 1977 from testimony of Office of Management and Budget before the Senate Committee on Finance on the Public Debt, June 24, 1976, Attachment B.

The outlook for sustained economic expansion will also be aided by policy actions of the Federal Reserve System which are intended to support the continued expansion of output and employment while preventing a new acceleration of inflation which would once again disrupt the entire U.S. economy. While it is sometimes difficult to identify the course of monetary policies because of volatile weekly changes in the aggregate measures and technical adjustments in the financial markets, a longer term perspective indicates that the Federal Reserve has been able to bring the growth rate of the monetary aggregates into the desired range. Hopefully, fiscal policies will be consistent with the goal of sustaining economic expansion while continuing the necessary anti-inflation effort so that monetary policies will not be forced to bear a disproportionate share of the responsibility.

The third policy involves a more aggressive effort to reduce government policies that waste our human and material resources through unnecessary regulations and administrative practices. A couple of years ago, I met with senior officials of many government agencies to solicit their ideas. Their recommendations were then summarized in a list of 86 specific policy initiatives for immediate action and over 200 additional suggestions for future action. The administration has moved ahead with numerous legislative initiatives and internal efforts to improve the regulatory and administrative practices that influence our transportation system, agricultural programs, environmental policies, labor practices, business competition, development of energy resources, and almost every other phase of our economy. However, these desirable corrections will not occur until there is more widespread recognition of the problems and support for remedial efforts.

The fourth policy focuses on achieving maximum output of food. It can be simply stated: all-out production. After 40 years of curtailing agricultural output through artificial restrictions, new farm legislation was finally passed in 1973 that emphasizes production. Millions of acres that previously were set aside to curtail output now have been returned to production. Other restrictive practices which inhibit the efficiency of operations and the distribution of agricultural products have been changed.

The fifth policy area concerns the energy problems that were unfortunately ignored until the oil embargo and the sharp jump in gasoline prices. There are basically two energy-policy options: To expand efforts to conserve energy and to accelerate development of domestic resources. The experience of the temporary oil import embargo demonstrated what can be accomplished by conservation efforts. Conservation of energy is possible—and it is good economics for consumers and businessmen.

As to the development of additional energy resources, we need to emphasize the immediate use of available technology and known energy reserves. Once again, Government intervention has restricted the development of these resources by disrupting the market forces. In terms of meeting our oil needs we already know about Alaska's North Slope reserves, offshore drilling, oil shale deposits, improved recovery from existing producing wells, accelerated exploration efforts, and the potential of nuclear and solar sources of energy. We are not helpless. But we need to act. We also should give increased attention to our coal resources, which far exceed the oil holdings of the current oil-producing countries. We need to move ahead with the necessary technology for the mining and utilization of coal in ways that will be consistent with environmental and safety standards.

On the international side the United States has a particular responsibility to provide leadership for the development of a more open and efficient international system of trade and investment. First, we should follow more stable fiscal and monetary policies at home. The strength of the U.S. economic system is a basic factor in the continued progress and stability of other nations. Second, in shaping our international economic policies we must emphasize the same principles of open markets and competition that have served America so well. The current monetary and trade reform efforts will determine the world economic system far into the future. We can either promote increased competition, the reduction of tariffs and nontariff barriers, equitable trading rules, and open access to markets and raw materials; or the world economy will develop unwanted cartels to control prices and supplies, and protectionism will once again disrupt the flow of trade and capital.

Finally, we must guard against a renewal of wage and price controls which are ineffective at best and counterproductive at worst. Controls simply do not solve the underlying problems and their ultimate effect is to disrupt real economic progress.

Myth Number 3: The Federal Government has been able to refine its economic tools to the point where "fine tuning" of policies can avoid business cycles.—Part of the unfortunate "stop-and-go" economic performance during the last decade must be attributed to the effects of constantly changing economic policies to concentrate on short-term stabilization goals. In particular, when unemployment begins to rise there is typically pressure to increase fiscal and monetary stimulus in the hope that some of the benefits will trickle down to the unemployed workers. Many government officials and economists evidently believe that the Federal budget is an effective short-term economic stabilization tool. To the contrary, the Federal budget should focus on the long-term allocation of resources and the mix of public and private-sector responsibilities. When it is used as a stabilization tool its real long-term function is disrupted and short-term results are disappointing because of the long timelags involved. In too many cases, the stimulus arrives too late to alleviate the economic slowdown but in time to exaggerate the subsequent boom and inflation.

Periods of rapid expansion of Government programs have been followed by the impoundment of specific funds and temporary spending limits; occasional tax increases have been interspersed with a series of tax cuts while Federal deficits will have been recorded in 16 of the past 17 fiscal years by the end of fiscal year 1977, and State and local government debt has increased sharply; expansion of the money supply has vacillated between periods of little growth to levels well above the amount required for stable economic expansion; pervasive Government regulatory practices have been developed and frequent changes have confused the private sector; a necessary national energy policy has not been developed; and the Federal Government has sporadically resorted to wage and price controls and arbitrary export and import restrictions to seek temporary relief for economic problems caused by basic fiscal and monetary actions.

The historical concentration on short-term policy adjustments is based on planning horizons that typically stretch only to the next election. That economic policies would be so responsive to each new "crisis" and to fears of being labeled a "do nothing" government is understandable in a democratic political economy. But this short-term approach is inadequate for directing the affairs of the world's largest and most complicated economy. We have already suffered two repetitions of the boom-recession sequence during the past decade and each time we have ratcheted upward to higher levels of inflation and unemployment. Such distortions are an excessive price to pay for creating so much economic instability.

Myth Number 4: There is some unique solution that will provide a quick and painless end to these problems.—Such rhetoric usually has a political appeal but little economic substance. It should be emphasized that it is a myth that there is an easy solution, that we can complete the difficult adjustment quickly, or that the process will be painless. It is not easy. It is not quick. And it is certainly not painless. Nevertheless, I have increasing confidence in the effectiveness of monetary and fiscal policies if they are responsible, consistent, and sustained. The only basic change in my economic expectations has been to stretch out the duration of the adjustment process. The current problems are the results of many years of policy errors and it will take considerable time to correct them.

While I have discussed a series of policy issues I would like to close with one fundamental personal observation: The American economy is the most creative and productive system in the world. It has provided our people with an unparalleled standard of living and has contributed to the economic development of the rest of the world. While some critics may decry such measures of progress, I believe that economic growth is desired by most people. I am confident that this progress will continue and form the basis for an even higher standard for the quality of life in the future. Our existing economic system is certainly not perfect, but it should not be discarded in favor of unproven experiments or alternative approaches that have clearly failed to serve the real interests of people in other nations. Those of us who want to improve the U.S. economic system must continue to emphasize the importance of granting it the freedom to function efficiently. If such freedom is provided, the U.S. economic system will continue to contribute to the well-being of Americans and the rest of the world.

Exhibit 26.—Other Treasury testimony published in hearings before congressional committees, July 1, 1975-September 30, 1976

Secretary Simon

Statement before the Joint Economic Committee, on New York City's financial situation, September 24, 1975.

Statement before the Senate Committee on Banking, Housing, and Urban Affairs, on New York City's financial situation, October 9, 1975.

Statement before the Joint Economic Committee, to review current economic conditions and policies, November 7, 1975.

Statement before the Joint Economic Committee and the Senate Select Committee on Small Business, to discuss the capital formation and financing problems of small business firms, November 21, 1975.

Statement before the House Committee on Appropriations, on budget planning, January 27 and 28, 1976.

Statements before the House Committee on the Budget, February 3, 1976, and the Senate Committee on the Budget, February 5, 1976, to discuss the President's economic program.

Statement before the Subcommittee on Aviation of the Senate Commerce Committee, to discuss S. 2551, the Aviation Act, April 7, 1976.

Statement before the Senate Finance Committee, on major tax revisions and extension of expiring tax cut provisions, April 13, 1976.

Deputy Secretary Gardner

Statement before the Senate Finance Committee, to urge prompt action to increase the temporary limit on the public debt, November 12, 1975.

Statement before the Senate Committee on Banking, Housing, and Urban Affairs, on the Federal Bank Commission Act, S. 2298, December 8, 1975.

Statement before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Currency and Housing, on the "Discussion Principles" of the Financial Institutions and the Nation's Economy (FINE) Study, December 9, 1975.

Statement before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs, to discuss S. 958, the Foreign Bank Act of 1975, January 28, 1976.

Deputy Secretary Dixon

Statement before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Currency and Housing, concerning financial institutional reform, March 11, 1976.

Statement before the Subcommittee on Financial Institutions of the Senate Banking Committee, on S. 2631, which would establish a National Consumer Cooperative Bank and a new independent agency to supervise the bank, March 16, 1976.

Assistant Secretary Jones

Statement before the Subcommittee on Financial Markets of the Senate Finance Committee, to discuss the process of capital formation, financial institutions, and possible incentives for encouraging capital investment, February 19, 1976.

Enforcement, Operations, and Tariff Affairs

Exhibit 27.—Statement by Assistant Secretary Macdonald, November 18, 1975, before the Subcommittee on Trade of the House Ways and Means Committee, on Customs appraisement of imports of automobiles

It is a pleasure to appear before the relatively new Subcommittee on Trade of the Ways and Means Committee.

The subject of today's hearing concerns Customs appraisement of imports of automobiles as it relates to the pending investigations of automobile imports under the Antidumping Act of 1921 (19 U.S.C. 160). As you know, there are eight such cases pending, involving imports from Belgium, Canada, France, Italy, Japan, Sweden, the United Kingdom, and West Germany, which include products of 31 different manufacturers. In 1974 imports of these products amounted to $7.5 billion.

Two petitions were received which resulted in the initiation of these investigations. One was received on July 8, 1975, and covered all of the eight countries mentioned above. A second, received on July 11, 1975, concerned importations from the United Kingdom, Italy, and West Germany.

Because of the position taken at that time by various spokesmen for the domestic industry, to the effect that imports were not a contributing cause of the then-depressed state of the U.S. auto industry, we found that substantial doubt existed with respect to injury and the matter was referred to the International Trade Commission (ITC) on August 8, 1975 (as provided for in sec. 321 of the Trade Act of 1974, which amended sec. 201(c)(2) of the Antidumping Act). A determination was made by the ITC on September 8, 1975, that it was not able to find "no reasonable indication of injury." Our investigations therefore continue.

At this point it might be useful for me to explain in some detail how antidumping procedures work. The Treasury has 30 days after receipt of a valid petition within which to make a preliminary inquiry and decide whether or not to initiate a formal investigation (sec. 201(c)(1) of the act, as amended). Regulations promulgated under the act set forth what information is necessary to constitute such a petition. The law requires that for "dumping" to occur there must be present both sales at less than fair value, and injury or threat thereof to a U.S. industry. Therefore, a petition must give evidence both as to differential pricing and injury or threat thereof as a result. Once we are satisfied that sufficient information on both these factors has been presented, an antidumping proceeding notice is published, which marks the opening of a formal investigation.

Treasury conducts only the inquiry into the alleged sales at less than fair value. The ITC, under the act, must decide on the question of injury and that is why the Treasury refers the case to the ITC during the preliminary stage if the information on hand during this first 30-day period creates a substantial doubt as to the existence of injury. Treasury has no other role in the injury phase of the case other than to ensure that evidence of injury is present, and the *full* injury inquiry by the ITC follows the Treasury price investigation.

The price investigation usually takes 6 months to reach a preliminary determination following publication of the proceeding notice. In complicated cases we may take up to 9 months to complete this part of the inquiry (sec. 201(b)(2) of the act, as amended).

As I mentioned, our purpose is to determine whether sales at less than fair value are or have been occurring. A determination of sales at less than fair value does not require a comparison of import prices with the prices of competing domestically manufactured goods. What is compared normally is the home market price of the goods with the price of the same merchandise for export to the United States. In certain circumstances where home market prices are nonexistent or inappropriate, either export prices to third markets or constructed value is used. All of these prices are of course subject to various adjustments so that the two are comparable—we back out differences in transportation costs, tariffs, taxes, levels of trade, and so forth so as not to be comparing apples and oranges. What we want is the ex-factory price for both sales.

At the conclusion of this 6- (or 9-) month period in normal cases a tentative decision as to the existence of sales at less than fair value is made. If it is positive, an order is issued withholding appraisement on the merchandise entered on or after the date of publication of the order. (Sec. 201(b)(1)(B), as amended.) This means that additional duties may be assessable on imports as of that date if the final finding is affirmative, even though the final dumping finding may be some months off. There is then a 3-month period during which an opportunity is afforded interested parties to submit views on Treasury's tentative finding. At the end of that 3 months, if the final sales at less than fair value determination is positive, then the case goes to the ITC for a 3-month injury inquiry. If the ITC finds the existence of injury, or the threat thereof, a final dumping finding is published and dumping duties are assessable on all unappraised entries entered "not more than one hundred and twenty days before the question of dumping was * * * presented to the Secretary * * *" (sec. 202(a) of the act, 19 U.S.C. 161). This is a very important provision for the issue under discussion here and I shall return to it shortly.

The auto cases are presently in the 6- or 9-month price investigation phase. Notice of the investigation was published on August 8, and our tentative sales at less than fair value decision is due in either February or at the latest May, depending upon whether complications develop. Customs Service personnel in the field are just now receiving pricing data from the manufacturers concerned, and will shortly begin on-the-spot verification procedures so that we can begin to analyze the information. It is obviously too early for me to have any basis for a judgment as to what that data will show, nor would it be appropriate for me to voice any opinion on the matter.

While these antidumping inquiries are proceeding, the liquidation of entries of autos from all major manufacturers has been suspended, for unrelated reasons for some time. These reasons concern (1) cost of production verification, (2) the resolution of certain legal issues, and (3) with respect to imports from Canada, the receipt of certain documentation in connection with duty-free importations under the Automotive Products Trade Act. The cost of production verifications involve extensive foreign inquiries. These inquiries have been underway for some months and are expected to be completed by November 30, 1975.

The major legal issue to be resolved with respect to all automobile entries is the manner of determining the amount of profit to be used in calculating the cost of production (the agreed basis of appraisement). In the past the record has not established as a matter of fact that there was a profit usual in the trade that was different than that realized by the individual manufacturers. This matter has now been raised again and is under study.

The so-called "old law" or "final list" (19 U.S.C. 1402) provides the statutory basis for making these calculations. Automobile imports are valued for Customs purposes under this statute. 1402(f) states that the cost of production of imported merchandise shall include "(4) an addition for profit * * * equal to the profit which ordinarily is added, in the case of merchandise of the same general character," if such exists and is different than that added by the given manufacturer, and if it is not less than 8 percent. Resolution of this issue at this time necessitates findings on a country-by-country basis, of which automobiles are of the "same general character." Although we have been appraising automobiles for years, this issue continues to arise for various reasons. For instance, while there is information on automobiles which are imported into the United States, section 1402(f)(4) requires that we also consider automobiles that are not produced for export in the country of manufacture. Also, the number of models and the volume of production constantly vary. It is further possible that this problem may defy total solution in some instances and that we may have to use individual company profits. To reiterate, it is not an easy task to establish a "usual profit" in the automobile industry of a particular country.

The valuation statute requires that value be determined as of a point in time before entry which would allow for the manufacture of the automobiles and their subsequent shipment to the United States. There are daily importations of automobiles arriving in the United States. It is obvious that information required to appraise these entries cannot be updated on a daily basis. It is doubtful that any manufacturer could supply this information and certain that the Customs Service could not assimilate it in any meaningful manner which would allow for the orderly liquidation of entries. These periods of time in which cost data are to be updated must be established, which would not place an unreasonable burden on either manufacturers or Customs and still adequately protect the revenue. To further complicate matters, it appears that these updating periods will not necessarily be the same for each manufacturer of automobiles. In the past, updating of information was usually done on an annual basis. We are in the process of determining whether this is the best way to adequately protect the interests of the United States.

With respect to one manufacturer, Volkswagen, it must also be determined whether certain labor-related costs are unusual. Unusual costs are not included in a determination of cost of production.

At this time we cannot speculate with respect to other issues which may arise as a result of foreign inquiries which are still open. However, inasmuch as we expect to complete all foreign inquiries by the end of this month, we will shortly be in a position to attempt to resolve outstanding issues with the importers and exporters concerned.

At this point I believe it would be useful to relate these two ongoing procedures to each other and see how they can impact imports of autos.

As I've already mentioned, under the Antidumping Act, section 201(b)(1)(B) as amended, withholding of appraisement is usually ordered at the time a tentative SLFV determination is made, affecting entries on or after that date. However, the Secretary may order withholding to affect entries up to 120 days before the date of publication of a proceeding notice. This would mean that duties would be assessable on entries in these cases beginning about April 8, 1975, instead of February or May 1976.

As a matter of policy, the Treasury has not used this retroactive authority. Withholding has always been effective as of the date of publication of the notice ordering withholding of appraisement. This is the practice followed today by all our major trading partners.

A separate issue is raised by section 202(a) of the Antidumping Act, which provides that dumping duties be assessed, where appropriate, on imports unappraised at the time of any final dumping finding, which were entered up to 120 days "before the question of dumping was * * * presented to the Secretary" (in this case March 8, 1975). I want to make clear that this provision operates independently of the discretionary authority in section 201. Automatically under 202, all unappraised entries on the date of a dumping finding are subject to additional duties if they entered on or after that day 120 days prior to receipt of the petition. It is because of the operation of this provision that the pending inquiries under section 1402 could result in assessment of dumping duties on up to an additional 14 months of entries.

Two questions are therefore present: *First*, should the Secretary exercise his discretion and make any eventual withholding order retroactive to all entries beginning on April 8, 1975? *Second*, should the Customs and Treasury *intentionally* delay liquidations by leaving unresolved these unrelated valuation issues so as to have affected automatically all entries after March 8, 1975, by any dumping finding?

We presently believe the answer to both the questions ought to be no, but at the same time I am grateful for the opportunity presented by these hearings so that we can engage in a useful exchange of views on this complex yet extremely important matter.

As a matter of pure self-interest for the United States, it appears to us that the Secretary ought not to exercise the discretionary "retroactive" authority of section 201. Neither the United States nor our trading partners have ever initiated the practice of imposing dumping duties retroactively, even though both we and they have the authority to do so. Other nations would construe such an action as a change in U.S. policy toward a more restrictive use of our antidumping law and would in all probability feel released from the restraint they have heretofore exercised not to apply their remedies against our exports retroactively. And, of course, their reactions might go beyond modification of their antidumping procedures. Furthermore, I would question whether it would be consistent with traditional American ideas of fair play to suddenly change the rules for the taxpayers concerned—it is the importers who are liable here—without prior communication of such a radical departure from past policies. Taxpayers should be able to reasonably anticipate their liabilities.

With regard to the second alternative, intentional delay in liquidating entries subject to 1402 inquiries, the same points apply. Intentional withholding of liquidation would be viewed as a discretionary action, creating an unjustified impediment to trade. It has always been our policy to liquidate entries in an orderly and expeditious manner. There is no reason to deviate from this policy at this time. The difficulties that resulted in suspension of liquidation in this instance had nothing to do with dumping, but with the endemic vagaries of the valuation statutes, and we should not exact unexpected duties for statutory difficulties which we allow to exist.

Certain points regarding our tentative thinking ought to be clear.

First, liquidation will not affect any possible Customs penalty situations. The statute of limitations for assessment of applicable penalties runs from the date of entry or "discovery," whichever is later.

Second, we would be prepared to appraise and liquidate in a manner which would protect the revenue and yet be reasonable and defensible under the statute. If outstanding valuation issues are not resolved, we would of course not liquidate.

Third, speedy resolution of these issues will largely depend upon acceptance by the taxpayers here, that is, the importers, of the Government's position interpreting the statute and applying it to the facts. We feel that any U.S. taxpayer ought to have the option of settling an outstanding tax matter by accepting the Government's position.

Fourth, in large part resolution is dependent upon the receipt and verification by Customs of the data necessary to calculate "cost of production." To the extent foreign manufacturers drag their heels in producing that data, the possibility of liquidating these entries before any dumping finding is lessened. We would, of course, not proceed in any case where the full disclosure necessary is withheld.

One final point. If this case illustrates nothing else, it is that the old valuation statute, 19 U.S.C. 1402, the "final list," has outlived its usefulness. In the case of automobile appraisements, were it not for the existence of the old value law and the final list, in no case would these appraisements have been less than invoice value. Under the old law, where related party transactions occur we must use the cost of production to determine value. Under the new law, 19 U.S.C. 1401, if the transaction price fairly reflects the true market value, we can accept that price. Therefore, we would avoid this anomalous situation where the invoice price exceeds the value for Customs purposes, the cost of production. Under the new law, we would use the higher, invoice price. Furthermore, the tremendous information-gathering burden on Customs, often not related to the transactions involved, and often resulting in the collection of less revenue would be removed.

At an appropriate time, I believe it would be useful for this subcommittee to address itself to the issue of devising an up-to-date valuation system. We stand ready to engage in any such study with you and other interested parties.

Exhibit 28.—Address by Assistant Secretary Macdonald, March 11, 1976, before the International Trade Club of Chicago, Chicago, Ill., on international unfair trade practices

As one of the trustees over the administration of a portion of U.S. international trade policy, I would like to submit to you, as fellow shareholders in the Common Weal, an annual report concerning international unfair trade proceedings which have been or are now being processed by the Federal Government. As you know, there are four major laws designed to protect U.S. industry from foreign exporters who engage in unfair trade practices: The countervailing duty law; the Antidumping Act (which we administer at Treasury); section 301 of the Trade Act of 1974, relating to "unreasonable" and "unjustifiable" practices; and section 337 of the Tariff Act of 1930, prohibiting unfair practices in import trade.

The efforts of this administration have been directed at effecting the most favorable atmosphere for international trade, while at the same time acting expeditiously to provide relief for trade-distorting practices which can be harmful to domestic industry and labor. Furthermore, we operate on the premises that—

(1) There is no inconsistency between free trade and fair trade.

(2) Meaningful remedies must be provided for injury caused by unfair trade practices, and the failure to provide such remedies actually is harmful to broader efforts to expand and liberalize trade generally.

(3) If voluntary discontinuance by governments of an unfair trade practice can be attained, it is preferable to achieve our ends in this manner than to impose unilaterally the remedies available under existing legislation.

With these principles in mind, I would like to report the following for calendar 1975:

A. *Antidumping.*—The sale of products into the United States at discriminatorily low prices, causing injury.

(1) The Trade Act of 1974 amended the antidumping law (19 U.S.C. 160) to bring it into accord with preexisting Treasury practice and time schedules. It did not materially change Treasury's method of operation.

(2) In 1975, 25 cases were initiated (compared with 10 cases initiated in 1974, and 20 in 1973).

13 preliminary decisions

12 final decisions on complaints of sales at less than fair value, 8 affirmative, 4 negative.

Of the seven cases referred to the International Trade Commission (ITC) in 1975 for injury determination, the Commission found injury in two cases and no injury in five cases.

(3) Of the cases initiated in 1975, probably most significant from a trade standpoint are the allegations that automobiles from eight countries have been dumped. These cases involve total imports of $7.5 billion.

(4) There is one new procedure initiated by reason of the enactment of the Trade Act of 1974 which deserves comment. This is a provision allowing the referral of an antidumping petition to the International Trade Commission for an initial determination whether there is "no reasonable indication that industry is being injured, or likely to be injured." The idea is to terminate early those cases in which there is no likelihood of injury. Pursuant to this provision, three referrals were made to the International Trade Commission by Treasury and all were returned to the Treasury for investigation, the ITC being unable to determine that there was no probability of injury.

(5) My only observation regarding 1975's increase in antidumping activity is that antidumping petitions appear to be a lagging economic indicator. That is to say, an increase in dumping petitions begins to occur about 6 months after a downturn in the economy, later decreasing during recovery. So far in 1976, we have received no new dumping petitions. I can therefore affirm that we are definitely past the bottom of the recession!

B. *Countervailing duty law.*—The assessment of additional duties equal to bounties or grants bestowed upon exports from foreign governments or associations.

(1) The Trade Act of 1974 did impose substantial practical changes in the administration of the countervailing duty law. First, it placed time limits on the processing of petitions for relief—6 months for a preliminary determination whether a bounty or grant exists, and 12 months for a final determination and assessment of the duty. It also empowered the Secretary of the Treasury to waive the assessment of countervailing duties if three conditions are met:

(a) Adequate steps are taken to eliminate or substantially reduce the adverse effect of the bounty or grant.

(b) There is a reasonable prospect of success of MTN negotiation.
(c) To countervail would likely seriously jeopardize this chance of success.

(2) In 1975, Treasury initiated 38 cases under the countervailing duty law, including 30 which were pending from prior years. This set a record for these cases, since the total number of cases processed from the enactment of the act in 1897 to 1974 is approximately 65.

(3) Of the 38 investigations—
(a) Thirteen were terminated at the request of the petitioners.
(b) Twenty-five preliminary determinations were issued.
(c) In addition, 20 final determinations were issued, of which 10 were affirmative and 10 negative.

(4) These numbers, however, do not tell the entire story. Of the 10 negative determinations, several were decided in the negative only after the foreign country in question discontinued the bounties or grants due to the threat of countervailing duties. Of the 10 positive decisions, 4 resulted in countervailing duties with no waiver. Six waivers were granted, but of the six waivers, four were granted only after substantial reductions in the subsidies occurred. For example, on EC cheese, all subsidies on cheese for further processing or manufacture were removed and substantial percentage reductions were made on the export of table cheeses. In the case of canned hams from the EC, a 20-percent reduction was effected before the waiver was granted, and further reductions will be required in the event that the hog/corn ratio drops below 15 to 1.

(5) I should add that in the vast majority of cases, the domestic industry and interested Members of Congress are consulted prior to the issuance of any waivers.

C. *Section 301 of the Trade Act of 1974.*—"Unreasonable and unjustifiable" trade practices of foreign countries.

(1) Of five complaints received under this new section, one case, involving discriminatory treatment of non-Guatemalan shipping companies, has been determined to be an unjustifiable trade practice. An appropriate remedy is still under study. A second case, involving a quota placed by Canada on eggs exported from the United States, has been resolved with a largely increased quota for U.S. eggs.

D. *Section 337 cases.*—Unfair competition in import trade.

(1) Seventeen cases are under consideration by the International Trade Commission, the agency with primary jurisdiction. The bulk of these cases relate to patent infringement, in which the complainant intends to exclude the infringing product, but some cases involving tying arrangements and exclusive dealing arrangements are pending before the International Trade Commission.

In addition to the administration of existing unfair trade legislation, the administration is working in the General Agreement on Tariffs and Trade (GATT) to harmonize each country's practices in order to avoid trade confrontations and yet protect American interests from harmful and unjustifiable practices. The principal effort is taking place in the subsidies area.

The first meeting of the Subsidies/Countervailing Group of the GATT Tokyo Round negotiations took place last November; the next meeting is scheduled for April 5. The United States has submitted a position paper regarding a proposed Subsidy Code which would be binding upon subscribing countries.

Under the U.S. position paper, all subsidization which tends to promote exports would be prohibited, whether or not it causes injury to a domestic industry and whether or not the exports are destined for the United States or a third country. Those subsidies, on the other hand, which apply equally to domestic and foreign sales such as regional aid programs, would only be prohibited if injury resulted to an American industry. Finally, certain practices which technically may be regarded as subsidies such as export financing arrangements and trade fairs would be allowable, with appropriate limitations, without regard to injury.

The basic trade-off envisaged by the U.S. position paper would be that certain subsidized exports to the United States would be subjected to an injury test or would be allowable, while other subsidized exports to third countries as to which the United States can presently do very little would be effectively prohibited without an injury test. Up to this point, much of the discussion in Geneva has revolved around the fact that the United States applies its countervailing duties on the basis of foreign subsidies only, without being required to find injury to domestic industry. Although the GATT requires an injury determination before countervailing duties can be imposed, the United States is not subject to this requirement by reason of a "grandfather clause," which allows U.S. legislation antedating our accession to the GATT to stand. This is not, however, as much a derogation from the GATT requirement as may appear at first blush, since the Treasury Department will not initiate a countervailing duty investigation unless it has received a petition on behalf of an aggrieved industry. Our experience has been that when an industry is willing to go to the expense of acquiring information to file a complaint, it certainly feels it has been injured. In any case, it is our position that the GATT should be revised to eliminate the injury test in cases of an export-tilted subsidy. We analyze the export-tilted subsidy as nothing more than a unilateral negativing by one country of the legitimate tariff rate of the country to which the exported goods are shipped.

Finally, I should point out that the job of our special trade representatives in the Tokyo Round of negotiations is many times more difficult than it has been in the past. In prior negotiations, tariff reductions were the primary objective. These are quantifiable and measurable impediments which lend themselves to negotiated reductions. The present round of negotiations, on the other hand, is designed primarily to eliminate nontariff trade barriers. Oftentimes these trade barriers are found in the domestic practices of the negotiating country; they are not easily measured or compared; and they are the subject of sensitive "country interests." To dismantle as many of these barriers as possible is the ambition of the Tokyo Round.

At Rambouillet, the President gave new impetus to the Geneva negotiations by urging that the bulk of the agreements in many areas be completed by the end of 1977. This does not mean, of course, that our negotiators will be inclined to reach an agreement merely for agreement's sake. That mentality, as every businessman knows, causes disastrous results. If no arrangement advantageous to the United States and to the harmony of mutually beneficial trade can be made in the multilateral trade negotiations, no agreement will be made at all.

Exhibit 29.—Statement by Assistant Secretary Macdonald, March 24, 1976, before the Subcommittee on Trade of the House Ways and Means Committee, on the duty-free importation of U.S.-made materials

I am here today at your invitation to provide the administration's views on a number of bills introduced to repeal or amend items 807 and 806.30 of the Tariff Schedules of the United States. These items have continued to be matters of controversy over the years due to the allegations that they permit the transfer of American jobs abroad.

I would like to begin with a technical discussion of how the provision works. Item 807 is a duty exemption for U.S. components of any manufactured article assembled abroad. It was incorporated in the TSUS in 1963, after having been developed over the years as a Customs administrative practice, known as the doctrine of "constructive segregation." This doctrine allowed free entry for American-made components in articles assembled abroad if such components were capable of being identified and removed without injury to themselves or to the foreign-made components with which they had been assembled. Tariff Schedule item 807 adopted this administrative practice but eliminated the requirement that the American components not be advanced in value or condition.

In order to determine the dutiable value of item 807 merchandise, the value of the domestically produced components is subtracted from the full value of the imported article. The value of the domestically produced components is determined by their cost at the time of last purchase, their value at the time of export, their constructed value, or their cost of production, depending upon the information available and Customs judgment as to which method is most appropriate. We estimate that at least 95 percent of these imports are valued by constructed value or cost of production methods.

Administration of 807 is complicated by the requirements of determining such things as "usual general expenses," "profit," and the costs of manufacture when using constructed value and cost of production methods of valuation. As a result, liquidation of 807 entries is often delayed. Recently, however, Customs has adopted regulations which clarify the application of sections 806.30 and 807 to particular fact situations. Moreover, Customs has clarified its advance ruling process through which importers can determine the applicability of 806.30–807 to proposed assembly operations.

Item 806.30 was originally enacted into law in 1956 (as par. 1615(g) of the Tariff Act of 1930) in order to facilitate the processing of U.S. metal articles in contiguous areas of Canada during breakdowns and emergencies at nearby plants in the United States. It permits duty-free entry of metal products manufactured in the United States which are imported after having undergone further processing abroad. Duty is paid only on the cost or value of processing outside the United States.

Generally speaking, the administration of item 806.30 is simpler than that of 807 since it is not necessary to determine the full value of the imported article. However, it is often necessary to use the cost of production or constructed value methods in valuing the foreign processing and consequently many of the same problems in valuation exist under both 806.30 and 807.

An interesting question arises as to what would happen if these two provisions were repealed. So far as Customs workload is concerned, we anticipate that there would be little effect, assuming the volume of imports remains constant, since this merchandise would still be appraised under constructed value or cost of production methods.

Insofar as the dutiable status of U.S. components presently duty free under 806.30 and 807 is concerned, a determination would be necessary as to whether the doctrine of constructive segregation were still effective. There are judicial decisions which would need to be studied, along with the legislative history of the repeal action, before such a ruling could be made. Should the doctrine stand, there would of course continue to be some duty-free treatment for U.S. components.

The practice of permitting duty-free entry for domestically produced components of foreign-assembled articles is quite widespread among developed countries. While we do not have precise figures, we do know that Western European countries make extensive use of foreign assembly of goods in Eastern Europe. This practice seems to be increasing. Textiles form a considerably larger proportion of such goods reimported into EC countries than into the United States.

The European schemes are somewhat more restrictive than ours in that they generally require the domestically produced products to be exported, processed, and reimported for the account of a specific single domestic firm. The United States permits foreign-based firms to buy our components for such processing.

Since the Tariff Commission (now the U.S. International Trade Commission) study of 1970, statistics indicate that imports under these two items have risen relatively only slightly more than our total imports. For example, the total of such imports utilizing 806.30 or 807 amounted to 5.1 percent of our total imports in 1969, rose to around 6.2 percent in 1972 and 1973, and declined to 5.4 percent in 1974 and 1975. Related to manufactured goods alone, such imports under 807 and 806.30 amounted to about 10 percent in 1975 compared to about 8 percent in 1969. The American components of such imports have increased more than the value added abroad. The volume of foreign components of such imports is large, primarily because of the incorporation of American parts in foreign-made automobiles entered under item 807. We do not have individual product data for 1975, but for 1974, autos comprised about 40 percent of the total value of imports under 807. A total of 74 percent of 807 imports consists of manufactures of metal, including the automobiles mentioned previously, imported under schedule 6 of the TSUS.

In 1974, 806.30 imports totaled $554 million and 807, $4.83 billion. For 806.30, nondutiable U.S. components comprised 55.7 percent of the total ($303 million). For 807, the comparable figure was 20.9 percent ($1 billion).

Given these considerations, and we can supply more statistics for the committee if you wish, we do not consider that repeal of these two provisions is in the best interest of the United States. On the contrary, we continue to hold the views expressed to the committee in a letter from the Special Trade Representative to the chairman of the committee on October 27, 1971. To quote one of the concluding paragraphs, that letter says: "In summary, the facts at hand do not, in our view, indicate a need for special action by Congress at this time on items 807.00 and 806.30. However, the Administration will continue to keep under review developments in the level and patterns of trade under items 807.00 and 806.30, with a view to appropriate inclusion in its trade legislation program of suitable safeguards for those cases in which domestic industry or labor may be injured."

We continue to hold these views and wish to note that the administration recommended and the Congress approved legislation which would provide relief under the escape clause procedures of the Trade Act of 1974 by providing among the remedies available to the President suspension of these two provisions of the tariff in import injury cases. So far under the Trade Act of 1974 we are not aware that any of the petitions filed have claimed that either of these two items are a source of difficulty.

To the extent that provisions 806.30 and 807 permit components which U.S. manufacturers can produce efficiently to be included in labor-intensive imported goods, where such producers could not compete in producing these finished goods, the U.S. economy benefits.

There is doubtful validity to the assumption that repealing these provisions would result in a return of production of the finished product to the United States. A more likely result would be that the entire manufacturing and assembly process would be driven abroad with U.S. components replaced by similar articles from other industrial suppliers, or there would be a fall in domestic demand for the product as a result of price increases, with little or no increase in U.S. production. It would appear to us, therefore, that the net result of repeal of 806.30 and 807 would probably be a loss in U.S. jobs and production, as exports of components fall off, as well as an increase in the price of the products to the American consumer. If that analysis is correct, nobody benefits, least of all American labor, which suffers both job loss and higher prices. I note that the 1970 Tariff Commission report estimated that repeal would cause a $150–$200 million deterioration in the U.S. trade balance. While we continue to hold the belief that repeal of these items would result in a net economic loss, we think it might be desirable to update the extensive study made of these two items to determine if events since 1970 have changed the situation in any significant degree.

Exhibit 30.—Excerpt from statement by Deputy Assistant Secretary Featherstone, April 22, 1976, before the Privacy Protection Study Commission, on the Bank Secrecy Act

The Treasury Department appreciates this opportunity to comment upon its role and responsibilities with respect to titles I and II of Public Law 91–508, commonly referred to as the Bank Secrecy Act. We are grateful to the Commission for having scheduled hearings at this time to enable us to develop the underlying history and purposes of the law and the implementing regulations, and to clear up some misunderstandings about Government access to bank records.

The Treasury Department firmly supports the purpose of the act now just as it did when Chairman Patman introduced the initial legislation. The bank recordkeeping requirements and the reporting provisions contained in the regulations issued to implement the act have assured the public that the basic financial records essential to the proper investigation of white collar crime, corruption, and tax evasion will generally be available when the appropriate Government authorities need them. Furthermore, we believe that we have been able to accomplish this primary objective without sacrificing our interest in observing the constitutional prohibition against unreasonable searches and seizures and in avoiding unnecessary incursions into the privacy of individuals. Our desire to attain these goals is well documented in the legislative history of the act.

* * * * * * *

Mr. Chairman, since the enactment of the Bank Secrecy Act we have been confronted with various legislative proposals to amend substantively not only Public Law 91–508 but also the entire body of Federal law regarding law enforcement access to records. Our foremost concerns have been the possible legislative creation of a probable cause standard where it has never before existed and the establishing of a business customer's standing to receive notice of requests for access to records and to intervene in the criminal investigative process which seeks such records.

The creation of a probable cause standard for access to the financial records of a banking institution would have a very detrimental impact upon law enforcement, interfering with quite ordinary investigative techniques, and leaving investigators with a scarcity of preliminary informational resources. What is involved in the investigative process was described succinctly by the Department of Justice in testimony concerning H.R. 214, the Bill of Rights Procedures Act, before the House Judiciary Committee's Subcommittee on Courts, Civil Liberties, and the Administration of Justice:

> A criminal investigation must begin somewhere. Many, if not most, criminal investigations are instituted upon the basis of allegations and suspicions. Federal agents do not usually start out with probable cause to believe that a certain person committed a certain offense, and that certain items of real evidence, or the fruits of crime, or contraband can likely be found at a certain location. Investigations ordinarily proceed by inquiring of a large number of people in the hope of developing evidence amounting to probable cause. When investigators go to written records, they are not doing anything essentially different from when they ask questions of the persons who made or were involved in making the records, except that the records preserve memories that may be lost.

The financial records maintained by banks regarding their accountholders are often reviewed as an essential preliminary step in criminal investigations and are likely to be of particular significance in investigations of organized crime figures, narcotics traffickers, corrupt public officials, and other white collar criminals. A probable cause standard for examination of bank records would be a shield for criminals with large movements of money and complex financial maneuvers but would constitute a crucial impediment to the public's right to protection from criminal enterprises flourishing through predations concealed in our financial system.

Basic to the legislative initiatives for a probable cause standard for access to financial records is the presumption that a customer of a financial institution has a fourth amendment right, enforceable by him, in records of his financial transactions with others, when those records are the property of another party to the transaction. Yet nearly every Federal court to consider this issue has declined to recognize any proprietary interest by a customer in such records and has ruled that a bank customer has no standing to challenge reasonable access by Federal investigators to such records. *Harris* v. *United States,* 413 F2d 316 (9th Cir. 1969);

Dosek v. *United States*, 405 F2d 405 (8th Cir. 1968); *Galbraith* v. *United States*, 387 F2d 617 (10th Cir. 1968); *DeMasters* v. *Arend*, 313 F2d 79 (9th Cir. 1963); and *Foster* v. *United States*, 265 F2d 183 (2d Cir. 1959).

Again, Mr. Chairman, I direct the Commission's attention to the Justice Department's testimony on H.R. 214:

> The fourth amendment protection to which a person is entitled ought not to be extended solely because the person wishes something to be private. As the Supreme Court said in *Katz* v. *United States*, 389 U.S. 347, 351–52 (1967), the fourth amendment— * * * protects people, not places. What a person knowingly exposes to the public, even in his own home or office, is not a subject of fourth amendment protection. [Citations omitted.] But what he seeks to preserve as private, even in an area accessible to the public, may be constitutionally protected. The *Katz* case then raised the matter of the person's reasonable expectation of privacy. Many of the kinds of transactions that would be covered under [such legislative proposals] are indeed "private" transactions, in that they are not displayed for general public consumption. But they are hardly "private" transactions in any other sense. Records kept of these transactions, especially when owned and maintained and used by the other parties to the transactions, are records that are commonly inspected by or at least exposed to a number of people. For instance, one expects that when a check is written, records of its progress through the clearinghouses and eventually on the books of the drawee bank will be seen by many people. No expectation of privacy in such records, at least as the phrase is used in *Katz*, would appear to exist.
>
> It is our view that a warrantless search is not unreasonable unless the Government, without probable cause or exigent circumstances, intrudes into an area in which the "proprietor" has a reasonable expectation of privacy. See *Katz* v. *United States* 389 U.S. 347 (1967). Those things which an individual exposes to public scrutiny, things which he does not himself safeguard from third parties, are not protected by the Fourth Amendment. It follows that records of transactions of an individual which, in the normal course of events, can be viewed or obtained by persons whom that individual evidences no desire to select or restrict are not items in which the individual has an expectation of privacy."

Those legislative proposals which envision notification of and standing to oppose requests by law enforcement officials for access to financial records are clearly in conflict with the cases and would make records sacrosanct far beyond what is now the law. We cannot find a reasonable justification for granting such privileges to accountholders.

Certainly, before creation through legislation of rights which may adversely impact on the alleged beneficiaries of such rights is undertaken, the proponents of such "rights" should present clear and convincing examples of actual abuses of the access process. Equally essential would be proof that the demonstrated wrongs are of such volume and impact that the public interest in a remedy will clearly outweigh the advantages to the public which already inhere in the present system of access. We are confident that the advocates of such changes cannot sustain their burden of proof.

We are unaware of any record of measurable abuse by law enforcement officials resulting from their undisclosed access to financial records even though such access has been employed routinely over many years. However, we believe it is abundantly clear that the American public will suffer substantially from these unnecessary hindrances to criminal investigations. Clearly, notice to an accountholder that law enforcement officials wish to review bank records concerning him will frequently sabotage the ongoing investigation. Since access to financial records is commonly an initial element in developing a criminal case, exposure of the Government's interest in those records will allow a suspect to alter his operations, to falsify or destroy evidence (including witnesses), or to flee the jurisdiction even before an indictable case can be developed or an arrest made.

Even if an investigation survived notice to the accountholder, it would be equally vulnerable from the delay caused by the accountholder's "right" to contest the disclosure. Delay would be much more than a time-consuming burden upon and an additional physical hazard for a Federal agent; it would be another opportunity for a criminal suspect to alter his operations or take other evasive and escape actions as described above.

The duty to give evidence

This brief exposition of the case law has shown that bank customers have no proprietary interest within the scope of the fourth amendment in records maintained and owned by financial institutions simply because information about the customers is physically embodied in them. The records are the property of the financial institutions maintaining them, and the fourth and fifth amendments do not bar reasonable inspections of those records by law enforcement officials. Federal cases also hold that whatever duty, if any, a financial institution has to keep customers' account records confidential, it is outweighed by the greater duty to give evidence.

This obligation to give evidence is deeply rooted in the common law as imperative to the administration of justice, and it underlies the rejection of a "right of privacy" for customers regarding the records of financial institutions. Professor Wigmore has cogently stated the rule, thus: "For more than three centuries it has now been recognized as a fundamental maxim that the public (in the words sanctioned by Lord Hardwicke) has a right to every man's evidence." And while claims are made for exemption from this duty, those few which are recognized "are distinctly exceptional, being so many derogations from a positive general rule."

The duty to give evidence flows from fundamental requirements of justice in a society of ordered liberty. The administration of justice must be a search for truth regarding which men can, hopefully, exercise wisdom. From Hellenic antecedents, through the history of the English common law, to our own Constitution, men have recognized that civilized society must be more than an amalgam of free individuals but, on the other hand, it is not merely an ordered community. Justice has, thus, been made an institution of our society requiring that the knowledge of all men be made available to its instruments with allowance for only the most clearly drawn and strongly reasoned exceptions. Without the imposition of such an obligation, truth cannot be sought and justice cannot be done.

That special interests in some States have managed to achieve some legislative immunity from the duty to give evidence does not diminish the wisdom of the common law obligation or its recognition by the courts. Nor has its concomitant, that privileges are "derogations from a positive general rule * * * [and] therefore, to be discountenanced" lost its standing before the courts. Rather, the principles of the testimonial duty and the rejection of insufficiently based privileges have received recent reinforcement by two history-making decisions of the Supreme Court, *Branzburg* v. *Hayes*, 408 U.S. 665 (1972) and *United States* v. *Nixon*, 418 U.S. 683 (1974).

Branzburg dealt with a group of appeals from different journalists who had been subpoenaed by grand juries to provide information regarding criminals and extremist groups with whom the reporters had met, in one manner or another, in gathering material for exclusive stories. Various claims were made by the appellants including first amendment assertions that a privilege necessarily attached to communication between newsmen and their "confidential news sources." In addressing the case of one petitioner who had asserted a claim of a "newsman's" privilege, the Court cited with approval Professor Wigmore's description and analysis of the duty to give evidence and the strong argument against exemptions (408 U.S. at 690). In flatly rejecting the concept of a first amendment reporter's privilege, the Court stated:

> Until now the only testimonial privilege for unofficial witnesses that is rooted in the Federal Constitution is the Fifth Amendment privilege against compelled self-incrimination. We are asked to create another by interpreting the First Amendment to grant newsmen a testimonial privilege that other citizens do not enjoy. This we decline to do. Fair and effective law enforcement aimed at providing security for the person and property of the individual is a fundamental function of government and * * * we perceive no basis for holding that the public interest in law enforcement and in ensuring effective grand jury proceedings is insufficient to override the consequential, but uncertain, burden on news gathering that is said to result from insisting that reporters, like other citizens, respond to relevant questions * * * of a valid grand jury investigation or criminal trial. (408 U.S. at 689.)

More recent, of course, is the Supreme Court's discussion in *United States* v. *Nixon* of the *presumptive privilege* of the President described therein as having "all the values to which we accord deference for the privacy of all citizens [as well as] the necessity for protection of the public interest in candid, objective, and even blunt or harsh opinions in Presidential decision-making." (418 U.S. at 682.) Stated succinctly, the Presidential privilege is "fundamental to the operation of government and inextricably rooted in the separation of powers under the Constitution."

Yet despite the impelling bases for the Presidential privilege, the Supreme Court balanced it against "our historic commitment to the rule of law," and found that the "very integrity of the judicial system and public confidence in the system depend on full disclosure of all the facts * * *" (418 U.S. at 683). In reciting for comparison some of the other "weighty and legitimate competing interests" protected by privileges—fifth amendment self-incrimination protection, attorney-client and priest-penitent communications—the Court restated the rule that "exceptions to the demand for every man's evidence are not lightly created nor expansively construed, for they are in derogation of the search for truth." (418 U.S. at 710.) Following this principle, the Court then found that, in the absence of military, diplomatic, or national security secrets, even the extraordinary presumptive privilege of the President was outweighed by the need for information in the fair administration of justice.

These two landmark cases have again emphasized the compelling claim to "every man's evidence" which inheres in our Constitution and the precepts of justice. Strong arguments were made in *Branzburg* that the first amendment guarantee of a free press demands the recognition of a "reporter's privilege" and in *Nixon* that the separation of powers doctrine and the need for confidentiality of high-level communications establish privileges transcending the needs of our criminal justice system. In each instance the Court recognized the historically preferred status of the asserted privilege; and in each case the Court rejected the incursion on the criminal justice system. Should we, in the face of such decisions, now accept a claim of privilege for records of a business relationship which is, at best, tenuously associated with another person's expectation of privacy? Let us examine this further.

If a privilege were to be recognized for protecting the banker-customer association against examination of transactional records, it would have to meet the four fundamental conditions described by Wigmore as the recognized prerequisites to establishment of a communications privilege:

> (1) The communications must originate in a *confidence* that they will not be disclosed.
> (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relations between the parties.
> (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*.
> (4) The *injury* that would inure to the relation by the disclosure of the communication must be *greater than the benefit* thereby gained for the correct disposal of litigation. [Emphasis in original.]

Test Number One is certainly debatable since neither American case law nor Public Law 91–508 can reasonably serve as a predicate for banks to offer customers any assurance of confidentiality from authorized law enforcement officials. Furthermore, the movement of financial papers through ordinary channels of commerce necessarily involves the imposition of others into the association between customer and financial institution. An expectation of nondisclosure would be less than reasonable in the circumstances of today's business practices.

Test Number Two clearly cannot be met by the relationship of financial institution to customer. Confidentiality is patently not essential to the full and satisfactory maintenance of such a relationship. This is demonstrated by the practice of the financial community itself which, as a business convenience and precaution, exchanges information from records of customers seeking services from different institutions. Today's booming credit industry also involves intrusion by credit bureaus and other businesses upon bank information about customers. Yet no diminution in the public's use of checking accounts and credit arrangements has resulted.

Number Three is controverted by the line of court decisions holding against the assignment to financial records of a confidential status from Federal law enforcement officials. In addition, our credit-oriented society has continuously fostered more expeditious and accurate mechanisms for financial transactions rather than the confidentiality of information concerning the bank-customer relationship.

Test Number Four cannot be met because the public suffers no measurable injury from law enforcement access to records of financial institutions while it benefits greatly in the administration of justice. As I hope this testimony and the record of previous hearings on bank secrecy have made clear, society gains significantly from the availability to law enforcement authorities of relevant financial records but forfeits no rights.

* * * * * * *

Thus, limited in the manner in which the Government can bring a suspected criminal to account, we must rely upon each citizen for evidence and must be able to examine bits and pieces of information which are not constitutionally imbued under the fourth and fifth amendments with confidentiality. Only by this process of sifting and examining information which often proves to be irrelevant can we develop cases against criminals involved in complex illegal schemes.

Furthermore, under our fifth amendment a citizen is secure against compulsion to appear before police authorities and account for himself. We must develop our case from witnesses and physical evidence. But the civil law system will demand a personal explanation of charges even if the result is self-incriminatory.

For civil law countries, therefore, the investigatory-accusatory process is simpler. An individual under suspicion bears the burden of proof to justify his actions and, thus, to prove himself innocent. Under such circumstances, the liberty of "bank secrecy" need not be breached to achieve the Government's end, a prosecutable case against a criminal, since the suspect himself is bound to produce his own refutation of accusations against him.

The point here is that the recurring calls for "bank secrecy," like that of some civil law countries, ignore the crucial distinctions between our common law traditions of criminal justice and the civil law systems of most of Europe.

I am certain that none of us wish to exchange our form of criminal justice for the possible enhancement of a privacy interest in records of financial institutions. Yet if financial records were to be accorded a confidential privilege regarding law enforcement officials, it would encourage a system like that of the civil law nations in order to continue to enforce the criminal laws against major organized crime figures, narcotic traffickers, and white collar criminals engaging in sophisticated and complex illegal financial maneuvers.

Conclusion

Mr. Chairman, under current case law and Public Law 91-508, we have the means in our free society for the reasonable examination of records of financial institutions without undue burdening of the institutions possessing such records or unfair intrusions upon the persons to whom such records may relate. The availability of such information is a logical companion to our country's goal of achieving justice for all. Were we now to create a "right of privacy" where it has never existed, which strongly conflicts with society's right to evidence, and which has not been demonstrated to be needed, we will have taken a significant step toward inducing atrophy in the criminal investigative process. If expanded to other related business contexts such as hotel records or gasoline stations receipts, effective law enforcement would cease.

We urge the Commission to balance the strong need for law enforcement officials to gain evidence from financial institutions against the manufactured right of privacy in such information which the courts have rejected. Having done so, we are confident that you will join us in strong support of the Financial Transactions and Currency Reporting Act.

Exhibit 31.—Excerpt from statement by Assistant Secretary Macdonald, June 28, 1976, before the Commerce, Consumer, and Monetary Affairs Subcommittee of the House Committee on Government Operations, on the Bank Secrecy Act

I would like to thank you for this opportunity to testify today concerning the history and implementation of titles I and II of Public Law 91-508, which is commonly referred to as the Bank Secrecy Act. In my opinion, the act is playing a key, but unobtrusive, role in law enforcement activities directed against tax evasion, political and commercial corruption, and other white collar crime.

* * * * * * *

Foreign bank accounts

Obviously, one of the principal purposes of the regulations issued to implement the Bank Secrecy Act was to discourage the use of secret foreign bank accounts for illegal purposes by making the ownership of an unreported foreign bank account a crime in itself. In addition, the failure to report a foreign account that was used to further another violation might also be cited as an indication of the willfulness of that violation. This would be especially true in tax cases. Finally, it was intended that the information obtained as a result of the regulations would be compared with other related information and, in some instances, used as a basis for IRS investigations.

In 1970, the IRS had a substantial amount of information concerning the ownership of foreign bank accounts by U.S. persons. I understand that the Postal Service, with the approval of the Treasury Department, had conducted mail watches in 1968 and 1969 to help the IRS to identify those persons in the United States who had Swiss bank accounts and were using them in the evasion of U.S. taxes. At the time the Bank Secrecy Act was being considered for enactment, the IRS had another such survey in the planning stage.

It was intended that the information gathered from the mail surveys would be compared with the responses to the foreign bank account question on the tax returns. Those persons who appeared to have foreign bank accounts but who failed to disclose them to the IRS obviously would be of special interest to the IRS.

In addition, it was intended that the IRS select for audit a substantial sample of those taxpayers in the higher income brackets who had failed to answer the foreign bank account question. The theory was that a person in the higher income groups would be more likely to consider all of the questions on a tax return and to have professional help in preparing his tax return. Therefore, his failure to answer the question should be more indicative of a deliberate violation than the failure of a person who took a standard deduction.

To my knowledge, Federal law enforcement personnel had no specific plans for utilizing the IRS forms 4683 that were required to be filed by those persons who had foreign accounts.

The forms were to serve as simply another source of information to be considered when income tax returns were being screened for examination. The form 4683 was a followup to the question on the tax return itself; it required the taxpayer to identify and to provide specifics regarding his foreign bank account.

Apparently the IRS made a statistical analysis of a sample of the forms 4683 filed in 1970 for the Office of the Assistant Secretary (Tax Policy). We understand that because of the relatively small sample, about 3,300 forms, and the somewhat indefinite form of some of the questions on form 4683, the statisticians and economists were dissatisfied with the results.

Our recent review of that analysis indicates that although it may have been inadequate for the use of economists, it contained some interesting information for law enforcement officials. The study shows that only 2,607 taxpayers disclosed that they had a financial interest in one or more but less than 25 Swiss bank accounts exceeding $10,000 in value. The total number of accounts involved was 3,031. Based on this data, rough estimates can be made concerning the total number of Swiss accounts reported and the number of taxpayers involved. The number of taxpayers who reported Swiss bank accounts appears to have been in the neighborhood of 17,500. This is significant because the mail survey covering the same period, I am told, disclosed that more than 40,000 persons appeared to have had Swiss bank accounts during that period. From these statistics, it seems that about 20,000 persons failed to report Swiss bank accounts and, consequently, violated the regulations.

It is difficult to evaluate the effectiveness of the foreign bank account reporting requirement in combating white collar crime, narcotics trafficking, and other organized crime. Much of its effectiveness could not be measured. Its deterrent effect would be intangible. Obviously, since the IRS did not undertake the programs that had been planned, a great deal of the value of the question was lost.

We are unable to comment on the general availability of the IRS forms 4683 to the SEC, DEA, BATF, U.S. Customs Service, or other Federal agencies. To my knowledge, we have not received any requests for the forms. The information appearing on the income tax returns or the forms 4683 would, of course, be available to such agencies if they have a specific legitimate need and make a request for it.

It appears to me that, perhaps, the information that the IRS currently has available from the 1973 and 1974 tax year returns could be analyzed and utilized in much the same manner that the data from the 1970 returns was supposed to have been used. A suggestion to that effect has been sent to the IRS.

While other agencies very well could have an interest in learning about secret foreign accounts, the IRS would normally have the greatest interest in them. It is generally recognized that persons who use secret foreign bank accounts are usually violating the Federal tax laws in some way even if they are primarily interested in accomplishing some other illegal purpose. That is why the IRS and the Treasury Department had been trying for so many years prior to 1970 to overcome the obstacles presented by foreign bank secrecy. The IRS's very strong support for the Bank Secrecy Act and former Commissioner Thrower's action in putting the foreign bank account question on the tax returns, even before the Treasury regulations required it, demonstrated that desire.

While the IRS must be the lead agency in finding secret foreign accounts if the public is to obtain this maximum benefit from the legislation, there is no reason why other agencies should not receive under legal limitations IRS efforts in this area. As a matter of fact, I believe that I am only echoing the opinion of some recent IRS Commissioners when I say that the IRS should take the lead in the investigation of large international and domestic financial transactions and should assist and cooperate with the SEC, DEA, U.S. Customs Service, the FBI, and other Federal agencies in such inquiries to the full extent permitted by law. In order to fulfill that role, however, the IRS would have to take a more affirmative approach to its responsibilities under the Bank Secrecy Act regulations. Consequently, we have asked the Commissioner to participate in a program that would give the IRS a better opportunity to play a more meaningful part.

Disclosure under the act

One of the issues raised by any proposal that attempts to cause agencies to cooperate and to share information is the problem of unauthorized disclosure. It is the Department's view that the information required under the Bank Secrecy Act can be freely shared by agencies within Treasury, under guidelines appropriate for such confidential information, even though the information is filed on IRS forms 4683, 4789, and 4790.

Disclosure outside of the Department must be effected in accordance with the law and regulations. Section 212 of the act states:

> The Secretary shall, upon such conditions and pursuant to such procedures as he may by regulation prescribe, make any information set forth in reports filed pursuant to this title available for a purpose consistent with the provisions of this title to any other

department or agency of the Federal Government on the request of the head of such department or agency.

Obviously the Congress, for good reason, did not authorize full and uninhibited distribution of this sensitive data. Nevertheless, we believe that, with some effort on our part and the cooperation of DEA and other agencies that appear to have a legitimate need, the information can be made available to them on a timely basis. We are especially concerned about getting relevant financial information to DEA promptly so that it will be of maximum to drug enforcement agents.

Background on secret bank account question

The record clearly indicates that the Office of the Assistant Secretary (EOTA) has been very interested in having the IRS make use of the Secretary's authority to require members of the public to disclose their interests in foreign financial accounts. In February 1970, then-Assistant Secretary Eugene Rossides advised the Secretary that he was planning to include a proposal for such a question in his March 2, 1970, testimony before the House Committee on Banking and Currency, which was then considering the Bank Secrecy Act.

Later, in the summer of 1970, when it was determined that the IRS had authority under the Internal Revenue Code to put the foreign bank account question on tax returns, the wording to be used was carefully reviewed before it was approved by Treasury officials.

On November 4, 1970, the Deputy Commissioner, IRS, sent a memorandum to the Deputy Assistant Secretary (Tax Policy) which referred to several conversations and attached a description of the IRS program for dealing with the tax return question and forms 4683 related to foreign accounts. That program included the following actions:

1. Taxpayers who indicated that they had a foreign bank account, but who failed to attach a form 4683, were to be contacted and asked to file the form.
2. An indication was to be made on the computerized record tax returns, the IRS "master file," as to whether a taxpayer answered "Yes" or "No" or failed to respond to the question on the form 1040.
3. Forms 4683 were to be detached and the files of the original forms were to be centralized in one IRS service center.
4. A register containing all or a portion of the names of those persons who disclosed an interest in a foreign financial account was to be extracted from the master file. This computer tape was to be used to produce a printout and to match against other information concerning foreign financial transactions. (The other information referred to was, in large part, the data obtained from the Swiss bank mail survey.)
5. A statistical analysis of the distribution of the answers to the question was to be made as part of IRS's statistics of income program. A subsample of those returns on which the question was not answered was to be selected for followup with the possibility that a program for the examination of other such returns was to be developed, especially if a large number of taxpayers failed to respond.
6. A scientifically selected group of returns with "Yes" responses was to be examined for analytical purposes.
7. An IRS statistical study of the forms 4683 was to be designed to accommodate the needs of the Office of International Tax Affairs and the Office of Balance of Payment Programs—both within Treasury.

To our knowledge, the IRS made few, if any, of the field examinations that would be required to carry out the law enforcement part of the program.

On October 16, 1972, following the issuance of the regulations in July, the Assistant Secretary (EOTA) sent the Commissioner of Internal Revenue a memorandum outlining a suggested compliance program for the IRS. That memorandum contained the following paragraph:

> With respect to the requirement that persons report and keep records of their foreign financial accounts on their income tax returns, in addition to the compliance checks that examiners would make in the course of normal audits, the IRS should examine a sample of the individuals who failed to answer the question. The IRS should also examine all individuals who failed to answer or who answered in the negative where the IRS has information that there should have been an affirmative answer.

As the above paragraph clearly indicates, the Assistant Secretary had a great interest in securing taxpayer compliance in this area.

Incidentally, the Commissioner's response of January 3, 1973, indicated that the IRS was, in general, receptive to the suggested program. The principal disagreement appeared to be over the size of the program, the number of returns to be examined. The Treasury program would have required about 20,000 examinations and the IRS was not willing to commit the manpower necessary for that large a project.

Although we did not send additional memoranda to the IRS to follow up on the apparent failure to implement the program outlined in the Commissioner's January 3 memorandum, we did maintain contact, at the staff level, until April or May 1973. From January to May, we received a number of IRS papers that indicated IRS would eventually establish a program to investigate noncompliance with the requirement to disclose foreign bank accounts. It was not until June 1973 that we learned informally that the Commissioner was considering removing the question from the form 1040 and began to speculate about IRS intentions.

On July 6, 1973, the Assistant Secretary (EOTA) wrote the Commissioner and requested that the question remain on the form 1040. That memorandum pointed to the fact that the regulations "virtually" require the question to appear on the form. Perhaps it would have been better if the memorandum had emphasized the fact that, under the governing regulations (31 CFR 103), the Assistant Secretary is responsible for the overall coordination of the compliance agencies and for assuring compliance with the regulations and that, consequently, the IRS should have referred the matter to him before making any changes. Nevertheless, the IRS did agree to leave the question on the form 1040 and indicated some interest in the program. The Commissioner's September 24, 1973, memorandum to Deputy Assistant Secretary for Enforcement concerning the placement of the question on the return ends as follows:

> We share your concern and interest in this important program and we will remain alert to the most effective way of highlighting the question on the Form 1040, within the limits of space, based on our experience with the 1973 Form 1040.

Although the Office of the Assistant Secretary (EOTA) received no further communications from the Commissioner concerning the removal of the question from the tax returns, I understand that the Office of the Assistant Secretary (Tax Policy) reviewed the 1975 tax form before it was approved for publication; but that office apparently was not aware of our interest.

It has been the position of my office that, currently, 31 CFR 103.24, in effect, requires the question to appear on tax returns used by persons who must report their interest in foreign financial accounts. The language is as follows:

> Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship *as required* on his Federal income tax return for each year in which such relationship exists, and shall provide such information concerning each such account as shall be specified in a special tax form to be filed by such persons. [Emphasis supplied.]

Obviously, unless *as required* is construed to mean *if required*, the question is required under the regulations. The regulations, however, could be amended by the Secretary if he believed that to be necessary in order to permit the deletion of the question. It is my opinion that the Secretary has informally ratified the IRS actions in this matter, and that, perhaps, the regulations should be changed accordingly.

Since the reporting requirement was imposed under section 241 of the act, which does not discuss the methods by which the Secretary will gather information pertaining to foreign bank accounts, the act would not prohibit such a change.

If I had been consulted with respect to the removal of the question from form 1040, I would have pointed out the fact that having the question on the form 1040 greatly facilitated the enforcement of the reporting requirement. Under that arrangement, every person who filed a form 1040 had a good opportunity to become aware of the requirement. A person who had a foreign bank account during the years 1970 through 1974 and failed to report it would have difficulty pleading ignorance of the law. If he has answered the question "No" and his account is discovered later, the element of willfulness will be clearly indicated. If he has failed to answer the question at all, he may attract attention to himself by the oversight.

The information on the form 4683 is not nearly as valuable from an investigative point of view as is the response to the question on the return. If a person has failed to file a form 4683, it will be quite difficult to prove that his omission was willful. The form is not related to the computation of the tax. He might argue that he failed to read the instruction booklet and, consequently, was unaware of the requirement to file the additional form.

Current developments

In recent months, the Department has taken steps to improve the effectiveness of the implementation of the act and the current regulations. For example, last year we began to get strong indications that the bank examiners were not detecting some serious violations. Certain of these violations involved the failure to report large currency transactions that were alleged to have stemmed from illegal drug operations. For a small commission, certain bank employees would exchange a drug dealer's smaller bills for $50 and $100 bills and agree not to file the required currency transaction report with the IRS. The bank examiners, who had been relying very heavily on the internal auditors of the banks to catch violations, were generally unaware of this type of violation until the IRS and other law enforcement units brought them to our attention.

When it became apparent that a number of banks were not doing an adequate job in policing their currency activities, we met with the FDIC, the Federal Reserve System, and the Office of the Comptroller of the Currency to develop more detailed guidelines for the bank examiners. The new guidelines, which we believe will noticeably improve the effectiveness of the examiners, were approved on February 17, 1976, for distribution to the field organizations of the bank supervisory agencies.

As a result of the inquiries made by your staff in connection with these hearings, we also became aware of a need for an improvement in the utilization of the reports that the regulations require to be filed with the IRS and the U.S. Customs Service. In our opinion, they are not being utilized as fully as the Congress intended when it directed the Secretary to initiate them.

To overcome this deficiency, we have developed a system for processing the reports that would assure the close cooperation of the IRS and Customs and facilitate the timely disclosure of pertinent information from the reports to other Federal law enforcement agencies that have a legitimate interest in them. If the IRS reacts favorably to this proposal, we believe that we will be able to develop information concerning large currency transactions and movements that will be especially valuable to DEA and IRS.

We also intend to take the following actions to improve the administration of the regulations:

1. Meet with the bank supervisory agencies to review certain areas of what appears to be chronic noncompliance with the regulations. This would include such matters as the failure of large numbers of banks to record the purpose or nature of certain loans, and the failure of banks to request customers to supply taxpayer identification numbers when a new account is opened.
2. Issue a major revision of the regulations that would clarify the compliance responsibilities and eliminate recordkeeping and reporting requirements in certain instances where they do not appear to be useful.
3. Propose that some type of foreign financial accounts question be reinstated on form 1040.

Additional legislation

As you may be aware, President Ford has requested legislation that would amend the Bank Secrecy Act so that it would be more effective against international narcotic dealers. He has proposed that Customs be given specific authority, under certain conditions, to search travelers departing the United States. We would be grateful for any support the members of the subcommittee would be inclined to give the President's proposal.

Comments on the need for the act

It appears to me that in recent years the news media have reported many investigations that have illustrated a continuing need for the act. There have been a great many cases, involving corruption and organized crime, in which bank records played a vital role. In addition, each year there are more than a thousand criminal tax investigations in which bank records must be reviewed. It is also obvious that, while records of bank transactions are often obtained from sources outside the bank, the fact that the regulations require banks to retain records encourages the public to be forthcoming. People will often be cooperative when they realize that the information being requested is also available from another source. The recordkeeping regulations serve as an insurance policy to make certain that records of financial transactions will be available when they are needed.

The reporting provisions of the act serve two purposes. They direct the attention of Treasury law enforcement authorities to unusual financial behavior and provide a record of transactions or transfers that are not usually documented.

Although travelers enter and leave the United States more than 200 million times each year, only about 15,000 reports of the international movement of currency and monetary instruments are filed. The fact that less than 1 traveler in 10,000 files a report clearly shows that the international transportation of $5,000 in currency or its equivalent is unusual in today's world. Therefore, it is logical to assume that they would be a good source of leads to certain criminal operations, and it is not surprising that the Customs Service has found that several hundred of the reports appear to have been filed by persons who are on record with Customs as being related to some type of illegal activity.

The domestic currency transactions that are required to be reported are also very uncommon. Although there are tens of billions of banking transactions in this country each year, only about 20,000 of them are reported under the provisions of the regulations. Because these reports describe extremely unusual financial activity, they have proven useful to the IRS in its tax function, and we believe that they should also be useful to DEA and other enforcement agencies.

Since the reporting requirements make it more hazardous for criminals to deal in large amounts of currency, carry currency abroad, and operate a foreign bank account, we believe that the requirements must have a general deterrent effect on many persons who might be tempted to engage in illegal schemes that require such activities.

The arguments in IRS Commissioner Thrower's testimony, referred to earlier in this statement, concerning the connection between secret foreign bank accounts and tax fraud, are still valid today. In addition, it should be emphasized that, since domestic bank records are very important in all phases of tax enforcement and collection, the bank recordkeeping provisions in the regulations are needed to help maintain the integrity of the tax system.

The regulations serve to inhibit the laundering of money obtained from illegal sources. Financial institutions must keep records of transactions. Banks are required to report unusual currency transactions. Foreign bank accounts must be reported. Customs is on the alert for large international movements of currency. All of these conditions make it more difficult to move money without leaving a trail that law enforcement officers can follow.

The creation and retention of that audit trail is the basic benefit that is being obtained from the act. Whether the illegal activity involves commercial or political corruption, tax evasion, securities fraud or theft, smuggling, drug trafficking, or some other form of organized crime, the common ingredient is usually money; and, if the money can be traced, the criminals are likely to be apprehended.

In closing, Mr. Chairman, I would like to note that we in the United States pride ourselves on having a voluntary tax system which is designed to assess, equitably, upon all members of our society, the cost burdens of government. I believe that nothing so effectively promotes the voluntary acceptance of our tax system by the public than seeing those who flout the system brought to justice. The fact is that the hard-working wage earners find their income taxes withheld and paid into the Treasury without any further voluntary act on their part. Even the bulk of corporate taxpayers find their latitude in avoiding their tax liabilities quite restricted by the discipline and control imposed by independent public accountants and the necessity of reporting income to their shareholders.

The individual "entrepreneur" who is engaged in questionable or illegal activities, such as narcotics trafficking or securities fraud, however, finds his tax obligations to be truly "voluntary." This individual often files no tax return whatsoever or a false return that is concocted in such a way that it avoids those characteristics which would precipitate an audit. Illicit transfers of funds abroad and movements of large sums in currency are this man's stock in trade.

In order to have a tax system which does not truly discriminate in favor of illegal sources of income, special law enforcement efforts are necessary to identify illegal income and tax it. The Bank Secrecy Act was intended to support those efforts. It not only assists in locating illegal income, it encourages those who have such income to "voluntarily" pay their taxes.

Exhibit 32.—Statement by Assistant Secretary Macdonald, July 28, 1976, before the Subcommittee to Investigate Juvenile Delinquency of the Committee on the Judiciary, on President Ford's Narcotic Sentencing and Seizure Act of 1976

I am pleased to have the opportunity to appear before the subcommittee to testify concerning S.3411, President Ford's Narcotic Sentencing and Seizure Act of 1976 and Treasury's efforts to implement certain of the President's other antinarcotics initiatives. I will confine my comments on S.3411 to Title IV: Illegal Export of Cash. I understand that Commissioner Acree, U.S. Customs Service, will cover Title V: Prompt Reporting of Vessels in his remarks.

Before dealing with the specifics of the measure under consideration, I believe it would be useful to place the commercial aspects of drug trafficking into perspective. President Ford stated in his April 27 message that drug abuse costs us up to $17 billion a year. The retail value of the heroin sold in the United States each year has been estimated to be in the neighborhood of $6 or $7 billion. This is big business. In terms of dollars, it is one of the larger industries in the United States and exceeds the gross sales of many multinational corporations.

Since illegal drugs are big business, they generate large flows of money, both domestically and internationally. The heroin, cocaine, and marijuana consumed in the United States is, by and large, imported from other countries. The people who grow and refine these noxious substances do so to make a profit. Consequently, they must be paid. It is my understanding that hundreds of millions of dollars, usually in the form of currency, are moved out of the United States annually to pay foreign producers and processors for their services. Within the

United States, drugs are also a cash-and-carry business. At the retail level, it generates a large volume of currency. We have had reports that traffickers have carried shopping bags full of currency into banks to convert them into larger bills or have simply deposited them in a bank account.

I believe that attacking drug smugglers and traffickers through the currency and profits generated by their illegal activity could have greater impact than by concentrating solely on the drug transactions themselves. High-level traffickers, who may be insulated from drugs and consequently cannot readily be convicted on drug charges, are often vulnerable to financial investigations. Frequently, they have violated Federal income tax laws and can be prosecuted on tax charges.

I also believe that more attention must be paid to the trafficker's fiscal resources internationally as well as domestically, as a means of reducing the smuggling and trafficking in narcotics, and steps to this end are already underway.

In February 1976, the U.N. Commission on Narcotics Drugs meeting in Geneva adopted unanimously a U.S. (Treasury) proposed resolution urging governments which have not already done so to make the financing of narcotics trafficking a punishable offense and, in addition, to exchange information to identify persons committing such offenses. Subsequently, the resolution was adopted unanimously by the U.N. Economic and Social Council meeting in New York, and the U.N. Secretary General is now notifying U.N. members of the action taken. The law enforcement agencies of more than 100 foreign countries could be affected by that resolution.

Again on the international front, Treasury played a vital role in the negotiation of the United States-Swiss Mutual Assistance Treaty in Criminal Matters. That treaty, which was recently ratified by the Senate, should also prove to be a significant step forward in international cooperation in narcotics investigations. It will expedite the exchange of information concerning alleged drug traffickers even while a case is still in the investigatory state. U.S. authorities should be able to obtain bank information with much less difficulty than they have experienced at times in the past.

Moreover, since most of the drug traffickers of interest to Federal law enforcement agencies are in fact engaged in organized criminal activity, the treaty can be used to facilitate criminal tax investigations of those traffickers when information from Switzerland is required. It will permit the Internal Revenue Service to request the Swiss, through our Department of Justice, to provide bank records and other financial information essential to such investigations.

The enactment of title IV of S.3411 would also have a very positive effect on Treasury's efforts against international drug trafficking. It contains two badly needed amendments to chapter 3 of the Currency and Foreign Transactions Reporting Act. That chapter, which requires reports of the international transportation of currency and certain other monetary instruments in excess of $5,000, has been useful in combating drug trafficking. If the defects in it are remedied, the law will enable Customs to be of more assistance in the drug area. If the Drug Enforcement Administration (DEA) identifies someone it has good reason to believe is an international money courier for a drug ring, Customs should be able to stop them, and, if they are carrying unreported currency, arrest them for that violation. In addition, Customs can seize the money. The following examples illustrate my point.

Early this year, two individuals arrived in the United States by automobile at Blaine, Wash. In response to routine questioning, both subjects stated they were not carrying currency or other monetary instruments in excess of $5,000. A patdown search of both individuals, however, revealed that they were each carrying approximately $30,000 in U.S. currency in money belts they were wearing. This money was seized by customs officers. Further investigation disclosed that their suitcases had false bottoms. Although nothing was found in the suitcases, it appeared from the response of a Customs detector dog that they had been used to transport narcotics. The subjects also had a paper describing what appeared to be a chemical process used to purify heroin or cocaine. Additional inquiries revealed that one of the individuals had previously been arrested in New York for a drug violation and DEA had information that the other suspect was trafficking in cocaine and expected a shipment shortly.

Another recent case resulted in the indictment of 13 individuals, in May of this year, for the illegal importation of controlled substances. Five of the defendants were charged with the failure to report the transportation of currency. A task force, consisting of personnel from Customs, DEA, Bureau of Alcohol, Tobacco and Firearms, IRS, and the Royal Canadian Mounted Police, conducted the investigation which disclosed the smuggling of more than 25,000 pounds of marijuana from Mexico and the transportation of more than $1 million in unreported currency over U.S. borders to and from Mexico and Canada. The investigation also led to the seizure of two multiengined aircraft. This investigation illustrates not only the tie-in between currency reporting violations and narcotics violations, but also shows how productive the cooperative efforts of law enforcement agencies can be.

In August 1975, Mexican police searched a vehicle in Tijuana and found $102,000 in cash. A subsequent investigation revealed that the money was not reported to U.S. Customs and was to be used for a narcotics purchase. Five persons have already been arrested in the United States and indicted for conspiracy and the failure to report the transportation of currency, and the investigation is continuing.

In 1974, a U.S. vessel was boarded in the Windward passage between Cuba and Haiti by a joint Customs-Coast Guard-DEA team. A search of the vessel revealed some handguns, a small quantity of marijuana, and $43,000 in currency. A subsequent investigation disclosed that the individuals aboard were conspiring to purchase and import into the United States more than 5 tons of marijuana. Indictments were obtained in late 1975 and, as a result, four men were convicted of conspiracy to import marijuana from Colombia and to violate the currency reporting requirements. Their cases are now on appeal.

Although, as the above examples indicate, the currency reporting provisions have been an effective law enforcement tool, a recent court decision threatens to undermine their usefulness in the future. In March of this year, a Federal judge dismissed a criminal proceeding against a person who was discovered departing the United States with $250,000 in U.S. currency which he had failed to report. The defendant admitted knowledge of the requirement and made an offer to plead nolo contendere, which was rejected by the U.S. attorney's office. During the trial, however, the judge reasoned that no violation had occurred because the law is violated only after a person has actually left the United States without filing the required report. Obviously, if this view is adopted by other Federal judges, the law will be of little value in most narcotics cases. The currency flow in international narcotics operations is usually outgoing.

The provisions in section 401 of title IV of S.3411 would remedy this apparent defect in the law by requiring a traveler who intends to transport monetary instruments exceeding $5,000 to file a report prior to his departure. The implementing regulations could then authorize the Customs Service to issue more specific requirements, which would be related to the traveler's method of transportation. They might require a report to be filed no later than 30 minutes prior to scheduled departure of an aircraft or vessel, or before approaching within a certain distance of a land border. Although such instructions have not as yet been drafted, the possibilities are obvious.

In my opinion, if the proposed amendment is not enacted, it is likely that seizures of unreported currency leaving the United States, as well as the related criminal charges, will be increasingly challenged in court.

Currently, section 235 of the Currency and Foreign Transactions Reporting Act states that application may be made for a search warrant authorizing the search of any person, place, vehicle, or physical object when the Secretary has reason to believe that there will be a violation of certain reporting provisions of the act. The implication is that if there is reason to believe, for example, that there will be an attempt to transport a substantial amount of currency out of the country without filing the required report, a search may be conducted only after a search warrant is obtained. Decisions of the U.S. Supreme Court, however, have made it clear that in certain "exigent circumstances" warrantless searches can be conducted where there is probable cause to believe that a law has been violated. Section 402 of the proposed bill would remove any doubt as to the application of the "exigent circumstances" exception to currency reporting cases by authorizing warrantless searches to be made for violation of the Reporting Act where exigent circumstances can be shown. In many instances this may prove critical. Frequently, circumstances leading to probable cause do not surface until just before the departure of an aircraft or boat, and subsequent enforcement action by the Federal Government is severely restricted.

Under the proposed amendment, Customs would still have to show that probable cause as well as exigent circumstances existed at the time of any warrantless search.

As you can see, Mr. Chairman, both of the amendments contained in title IV of S.3411 are necessary in order for Customs to maximize its contribution to the antidrug effort.

In closing, I would like to reemphasize my belief that one of the more, if not the most, effective ways to apprehend major drug traffickers is through the analysis and investigation of the enormous cash flows and profits that are an inherent part of the business. In my opinion, the passage of S.3411 would significantly improve our capability in such investigations.

Tax Policy

Exhibit 33.—Statement of Secretary Simon, July 31, 1975, before the House Ways and Means Committee, on a tax program for increased national savings

I am pleased to be here this morning to present a tax program for increased national savings.

Reinvestment in America

We are about to enter the third century of our national existence. What I am proposing today will make a great deal of difference in how we live in the next century—whether there will be jobs to support an expanding population and whether we can continue the rising levels of prosperity we have enjoyed in recent decades.

The century which is drawing to a close has witnessed the most spectacular economic progress in history. During that century, our citizens have risen to levels of income which are unparalleled elsewhere in the world and have risen steadily over time. That prosperity has been directly attributable to the enormous investment in productive capacity we have made—a total which far exceeds that of any other nation. Without that investment we would be an economy of the most primitive sort, with only what we could turn out with our bare hands.

We got the investment we have and we will get future investment only by saving. And it is the saving and investment process with which today's proposals deal. Saving and investment concepts have many theoretical aspects for economists, and I don't want to get mired in those today. I want to try to explain what we need to do in as practical everyday language as I can, even at the risk of oversimplifying some of the theoretical niceties.

We have been hearing economists debate the question of whether, in a total sense, there is a need for a greater rate of investment to induce economic growth and create jobs. Whether we can find the academic answer or not, there is no question in my mind that the chief executive officers of corporations in this country know that there is a shortage of investment funds which is hampering expansion, creating unemployment, and threatening to snarl an orderly economic recovery.

These chief executive officers have been forced to the wall with low retained earnings and have had to turn increasingly to debt to finance modernization and expansion. Many have reached their limit in this area and that spells trouble for the economy ahead.

We have always been a rich country, and in dividing up our economic pie we find that we have bargained away more of the pie than is really available. For years we've been most worried about the second television set, a bigger boat, or a second car. Today, we need to shift our attention a little. The American people are faced with 8 1/2 million people unemployed, and, in addition, 10 million more coming into the work force by 1980. To take care of these men and women, we're going to have to make a studied decision to embark on a program of reinvestment in America.

We've let the engine of this great productive country get rusty. Workers and managers alike know that our equipment is becoming obsolete, and that many industries are short in capacity. We need to direct our attention to the massive job of rebuilding our economic engine and providing productive jobs for American workers.

Our proposal today is not to drastically change our economic principles—not a planned economy where we direct expenditures, but rather, a program that recognizes the need for capital to create jobs, and provides an opportunity for more people to invest in the American system.

There are risks involved in the program we propose, just as there were risks in funding the program of putting a man on the Moon. But knowing the American people and the American industry, we feel that the risks are minimal. Given the investment needed to expand our economy, we feel certain that jobs can be created and we can return our Nation to a position of full employment.

To accomplish these objectives, we are asking the Congress to moderately revise our tax laws to permit industry the funds needed for industrial expansion. In addition, we wish to provide an incentive for more Americans to invest and become partners in our free enterprise system. We feel strongly that a return to a more enterprising attitude is essential. There has to be a national desire and willingness to take risks for rewards, and unless we take this position, the United States cannot maintain its place, let alone improve its position, in the world economy.

The goals

The proposals for more savings have the following goals:

Jobs.—Increased saving is the quickest and most direct way to put resources at the disposal of those persons who will use them to expand business operations and jobs. Placing equal amounts at the disposal of individuals who will simply spend them would in due course—as they spent it—increase the incomes of business, but would do so less quickly, and with much less assurance that the proceeds would be used for new investment.

Debt-equity ratios.—Additional saving must be made available for equity investments. Steeply climbing debt ratios have left our businesses highly vulnerable to any adverse change in the business climate and handcuffed them in their ability to expand and modernize. This has become a very serious problem in the last several years and something *must* be done.

Productivity.—Increased savings will make possible the increased investment in capacity that enables workers to turn out more goods and services. Without modernization and new investment, that will not happen. In turn, increased productivity permits wages to increase—in real terms, not just dollars—and helps suppress inflation.

Real wages.—As increased savings and investment permits workers to turn out more goods and services, there is more to share and real wages can increase. On the other hand, if goods and services do not increase, then increased wages for one group means they get a larger slice of an economic pie that has not grown. That, in turn, means the slices of others will be reduced, either through inflation or unemployment.

Inflation.—Increased saving and investment, by increasing productivity and the amount of goods and services produced, helps keep prices down. Increased productivity also lets an employer raise wages without also raising prices to his customers. It is our chief insurance against wage demands turning into a wage-price spiral.

Efficiency.—To the extent we can make the investment that we already have work more efficiently, that is as good as getting more saving. We should remove those features of the tax system that cause saving flows to be channeled away from more productive investment and into less productive investment.

Proposals for increased saving—in general

After many months of deliberation, we have concluded that the most important step we can take to achieve greater savings through the tax system is to move towards the elimination of the double tax which presently is imposed on income from assets used in the corporate form of business. We propose to make that change as part of a total program that (1) will not subvert the progressivity of our income tax system, nor (2) create increases in budget deficits that would subtract from the pool of private savings even as tax measures are causing additions to it.

At the same time, we believe it is of prime importance to encourage greater savings by individual taxpayers, and, in particular, to broaden the ownership of stocks by middle and lower income persons. I have additional suggestions to accomplish that result.

The proposals rest on sound and fundamental economic principles. But all of those principles are not immediately apparent, and it will be very important to enlarge public understanding. It would be extraordinarily helpful to the art of government in times like these if economic principles were better understood. Unfortunately, our economy has become so complex that the job of education is a difficult one. It is critical that both Congress and the executive make every effort to seek wide public understanding of the factors underlying the savings problem, even if there is not total agreement on the solutions.

The proposals may seem to some to be "big business" proposals. But they are not. They are proposals to provide additional incentives for the individuals and businesses—large and small—that save. It is important to distinguish between the *form* of the proposals and their *effect*. The form of the proposal dealing with corporate double tax is such that it appears primarily to affect stockholders. But its effect will, in reality, be general. Just as the doctor may inject medicine in a patient's arm in order to cure a problem in his abdomen, so it is with our economic system. It is sometimes necessary to appear to deal with one segment in order to get at an ailment somewhere else. The proposal deals immediately with stock and stockholders, but the medicine injected at that point will be quickly disseminated through all of the persons and institutions in the system, large or small, who are saving. An existing bias against all such persons will be lessened and the system will work more productively for everyone by providing more jobs and larger incomes.

A reduction in taxes applicable directly or indirectly to shareholders will in the first instance be helpful to shareholders, but we must not stop thinking at the first step. We have to look to see what happens next if the returns on stock are increased. If stock sells at $100 and returns $5 to its shareholders, that is a 5-percent return. What happens if the return rises to $7, or 7 percent? The answer is that more people want to buy the stock. At the same time, bank deposits that pay 5 percent seem less attractive, and fewer people are willing to deposit. The price of stock goes up and the $7 return is no longer 7 percent, but maybe only 5 1/2 percent. And the banks have to pay more—maybe 5 1/2 percent—to keep depositors. Thus, what started initially as an increase in the return to stockholders is transformed quickly into a somewhat smaller increase for everybody. Just as nature fills a vacuum, the market levels an abnormal return; returns, like air pressures, are "equalized" by natural forces. Thus, a change which is in form addressed to those who have their savings in stock in the end increases the returns for all kinds of saving.

Recap of economic points on the need for more savings

The reasons why we need more savings were developed at length in the statement which I presented here on July 8. Additional aspects of the savings question were addressed in detail in a statement which I made to the Senate Finance Committee on May 7. Copies of both these statements have been distributed to you this morning.

I do not wish to review the materials in those statements in any detail this morning, but it may be helpful if I briefly recap the principal economic points in order that you can more readily see how our proposal would deal with the problem at hand. The important points to keep in mind are:

1. The total amount of savings in our economy measures the amount that will be invested, and we will get more investment only if we get more savings. It does not matter who saves. A dollar of savings by a low-bracket wage earner in a thrift account is as useful as a dollar set aside by a high-bracket investor to purchase stock. A dollar of saving by the Government is equally useful. Our financial system is extremely competitive and efficient, and, in the absence of interference, the dollars will get to the places where they are most useful.

2. The single most effective thing we can do to increase the total amount of savings in our system is to observe sound fiscal policies. Government deficits use up other people's savings, for the Government must dip into the private savings pool to finance those deficits.* But, it is foolhardy to rely on fiscal policy to increase national savings unless we are confident that there will be continued Federal surpluses in the future of a magnitude unknown in the recent past. Do we have any reason to expect that the leopard can change its spots?

3. In fact, most of our national savings occur in the business sector of our economy, and that is where special problems inhibiting savings have appeared. Sound changes in that area will produce the greatest results and must, therefore, be given top priority. We should, at the same time, however, undertake to encourage savings in individual households at all income levels.

4. The best estimates are that we will need additional savings if we are to maintain the rates of economic growth and prosperity to which our citizens and institutions are attuned. The need for additional savings is not an absolute need in the sense that the country will disappear if we fail to achieve it. The danger is rather that the economy will not grow in a stable, noninflationary manner and that we won't be able to maintain the number of existing jobs and create the new jobs that will be needed to employ the growing work force. We must employ at least 3 million more people to get back to full employment and when that is done we will need to create still another 2 million jobs a year on into the future to take care of new workers.

5. There appears to be a wide consensus among professionals of all political persuasions that in the absence of persistent Government surpluses we will need some additional degree of private savings in order to sustain the degree of growth and job creation which is desirable. Total private saving has been running about 15 percent of GNP and we need to increase that number to about 16 percent. While the increase is only 1 percent of GNP, or about $15 billion a year, it is an increase of about 7 percent in the amount which is saved. Furthermore, of the 15 percent of GNP which constitutes private savings, 55 percent represents depreciation (the amount necessary just to keep our capital stock at current levels) and the remaining 45 percent, or about $95 billion, represents the savings used for net new investment. Thus, the additional saving required represents an increase of nearly 16 percent in the rate of net new investment.

In sum, the desired increase in total savings seems quite reasonable in terms of the total economy, and surely within the range of accomplishment without radical change in our institutions and organizations. Nonetheless, it is a significant increase in current saving patterns and we won't get it by wishful thinking or half-hearted measures.

6. Additional savings is not the only factor contributing to economic growth but it is clearly an important factor and one that we can do something about.

Economic growth is important for several reasons: (1) It helps provide the employment necessary for a growing work force. (2) Growth accompanied by increased productivity permits real wages to increase and helps suppress inflation. (3) Growth is a critical element in increasing the upward economic mobility of the less advantaged individuals in our system. Without economic growth the less advantaged can rise only if they succeed in taking part of the economic pie away from those who are presently advantaged, a process which is always strenuously resisted by those whose share is threatened. It is much easier and surer if everyone shares in increases and the disadvantaged can move up relatively by having their shares increase faster than others. In this way, economic growth is a major political lubricant and contributes enormously to the lessening of social and political tensions.

7. Additional investment is the engine which produces additional productivity; i.e., greater output per worker. Without the business institutions, the technologies, and the facilities which past investment has provided, a worker's output would be limited to what he could turn out with his bare hands. In order to turn out our enormous national product, workers must be and are backed up with an enormous amount of investment. A worker who works all day and turns out 100 widgets is unlikely to turn out 110 widgets without new

* In limited circumstances, Government deficits can increase private incomes and thereby private savings by an amount sufficient to substantially offset the deficit. As we move back toward full employment, however, that will increasingly not be the case.

backup investment, and it is turning out the extra 10 widgets which permits real wages to rise.

8. Workers will continue to seek regular increases in their real wages. Higher real wages have been possible in our economy over the last three decades and our citizens have come to expect them. But we can't pay more real wages unless there is more output. Increased productivity is, therefore, critical.

Whether or not there is more output, workers will seek higher wages. That is the way the system works. But if wage demands exceed increased productivity, one of three things will happen:

(i) Management will resist the demands, workers may fail to secure higher wages, and there will, in any event, be labor strife.

(ii) Some will secure high real wages—i.e., a larger share of the pie—but only at the expense of others. That usually results in unemployment, as higher wages unaccompanied by increases in productivity eat into profits and cause employers to cut back hiring.

(iii) The Government will try to prevent the unemployment by fiscal and monetary policies. This is a politically attractive but essentially impossible goal of letting people have more when there is no more. Unfortunately, we have a tried and true method of seeming to achieve it. It is called inflation. We issue more money which permits money incomes to rise. That does not increase total real incomes but only permits the strong to take from the less strong in a manner which is sufficiently indirect that the latter do not usually realize what is happening. The process also creates the kinds of structural problems and instabilities which we have been experiencing.

All three of these alternatives are unattractive. If any one of them should occur, it would be the occasion for congressional alarm and cries for action to "do something." What is needed is preventive medicine. We must keep productivity increasing at a reasonable rate. Saving and investment are the surest way to do that.

9. Taxes may not be the sole cause of the problem, but tax changes hold the greatest practical promise of helping to increase saving and investment. It is sometimes argued that tax changes are less effective than budget surpluses, but given our existing institutions tax changes are more likely to be achievable than surpluses. We need both.

10. Our tax system—like any tax system which relies on an income tax—is biased against saving. The reasons why that is so are explained at pages 15 to 16 of my July 8 statement. In general, our tax system inhibits savings because it promises to take away a substantial part of the income from any amounts saved, thus reducing the incentive for saving. Tax changes will increase savings only to the extent they remove the disincentive created by existing taxes. Thus, the fundamental element in any tax proposal to increase saving is a net reduction in the tax on the income from savings. There are different mechanisms for achieving that net reduction and they have different advantages and disadvantages. But the active ingredient is the final net reduction, and there is no way to escape that fact.

11. Corporate profits, when stated in realistic terms, have been severely squeezed in the last few years. That has seriously impaired the ability of business to make new investment.

Let me now turn to the specific proposals.

I. A National Program for Personal Saving

I have, first, proposals to help individual Americans save.

It is true that business saving has been quantitatively much more important than personal savings in the United States, as in most other countries. But I am confident there is a great untapped reservoir of potential personal saving out there among our individual citizens. And apart from the dollars of additional saving immediately involved, we will be doing a great service for our citizens individually if we can help them save and help them understand how much better off they will individually be if they do. In our great country everybody can be a "capitalist"—maybe not great big ones, but big enough to improve their own standards of living. But they will get there only if they start saving and continue to save. I, for one, think we should help them. But we must be careful to approach the project on the basis of providing "seed money" and avoid any temptation to just distribute largesse which is likely to exceed the amount of additional saving that will be achieved.

Make adequate retirement saving available to all

Funded retirement plans are a significant source of savings in our economy. The assets in private retirement plans were estimated at nearly $200 billion at the end of 1974. These funds are invested primarily in American industry. They provide much of the capital which is necessary to achieve and maintain our standard of living.

As a matter of national policy, we encourage funded retirement plans. A major incentive to establish these plans is provided by our tax system. The Internal Revenue Code provides two major incentives for "qualified" plans which meet a set of special requirements: First, employer contributions are deductible by the employer, but are not taxed to participants until retirement benefits are paid; and, second, earnings on plan assets are exempt from tax until retirement benefits are paid.

Despite these tax incentives, half of the American work force is not covered by employer-sponsored retirement plans. Many employers cannot afford to establish a retirement plan without reducing wages, and those workers who need money currently more than they need retirement income prefer wages over future pensions. Before this year, a worker who was not covered by an employer-sponsored plan could not establish a retirement plan for himself. The 1974 pension legislation changed that. Workers who are not covered by existing plans are now permitted to set up their own individual retirement accounts (IRA's), and to enjoy substantially the same tax benefits available under qualified retirement plans.

The primary purpose of IRA's was to allow the uncovered half of our workers to have a chance to accumulate retirement benefits. The bias in our tax system against savings makes it difficult for ordinary individuals to save for their retirement without special tax benefits. IRA's were designed to achieve greater equity between covered employees and noncovered employees and to assure American workers an opportunity to supplement social security and thus secure more adequate security and dignity in their retirement years. However, another very important feature of the IRA's is that they increase savings. The IRA lessens the bias in our tax system against saving, and thereby encourages greater saving by individual taxpayers. Every day we see articles or advertisements in the newspaper explaining the advantages and benefits of an IRA, and people are responding to those advertisements. They are increasing their retirement savings.

IRA's also tend to broaden the base of corporate stock ownership. IRA investments are not limited to corporate stock. A broad range of investment media are available. However, a significant portion of IRA investments will be in corporate stocks.

Although the IRA provides a giant leap forward in providing an opportunity for retirement savings, there is a basic defect in the program. IRA's are not available to persons covered by a regular retirement plan promising low benefits. The administration had proposed a broader program to include these employees as well, but last year Congress was not ready to enact the whole program. This is understandable. IRA's are new, and many felt that it was better to test the water before plunging in. The consequence, however, is that we only have half a program. Now is the time to enact the other half.

The basic proposal is simple in concept. IRA's should be made available to persons covered by a regular retirement plan at a level below the IRA limit. Under current law, contributions to IRA's are limited to $1,500 per year. Persons covered by a regular retirement plan at a level below $1,500 should be allowed to make sufficient contributions to an IRA to bring these total retirement savings up to the $1,500 maximum. It is not only the individual with no employer retirement plan that needs help from the tax system. The individual with an inadequate plan is also deserving of our attention.

Increase the IRA limit

The $1,500 limit on contributions to an IRA is too low. This limit was proposed by the administration in December of 1971. It is now time to raise it. The precise level which is now appropriate should be worked out as the tax reform package takes shape. However, I would like to point out that since 1971 inflation alone, which increased 32 percent, would raise the limit to about $2,000.

I also recommend the addition of a cost-of-living adjustment in order to maintain the level which is now appropriate. The 1974 pension legislation put limitations on the maximum pensions which could be paid by qualified pension and profit-sharing plans established by corporations. The dollar limits were set at 1974 levels, but were subject to automatic cost-of-living adjustments. Logically, the IRA limits should be subject to the same adjustments, as should the limits for plans of self-employed individuals.

Individual savings account program

In addition to making IRA's available to those covered by inadequate plans and raising the IRA limits, we would like to explore with the committee the possibility of establishing an IRA-like vehicle which would serve to encourage savings generally, rather than being specifically aimed at retirement savings. As with the IRA, contributions to an individual savings account (ISA) would be tax deductible up to some maximum, at least in part, and investment income would be free of current income tax. There might be restrictions on how long the individual was required to leave savings in the account and perhaps a threshold or floor on the amount deductible in order to be sure, to the extent possible, that the contributions represented extra savings and not just something the employee would have saved anyway. However, unlike the IRA there would be no penalty on withdrawals if made after the specified period of time, or for specified purposes. Funds would not have to be held until retirement.

Although retirement saving is probably the most important goal of an individual saver, there are many other important goals. Typically, individuals save to purchase a home or a car. They save to provide education for their children, and they save to provide for unknown contingencies. These are important individual goals. And, from the standpoint of our economy as a whole, any saving is important. The IRA does not encourage any saving other than retirement saving.

The individual savings account could fill a real void. It would be similar in its basic structure to the individual retirement account, but it would meet a broader need. We are now familiar with IRA's and the ISA would be similar.

There are real technical problems in designing such a plan which will increase what would have been saved anyway and still not be too complicated for ordinary taxpayers to deal with on their returns. However, the goal seems very desirable. The ISA would be a highly visible incentive and the up-front feature of a deduction for additions to savings should be a very strong inducement to save. I hope that we can explore the feasibility of this together.

Revenue estimates

Of course, as a tax reform package is put together, revenue considerations must be taken into account. Making the IRA available to those covered by inadequate plans would cost roughly $500 million. Increasing the IRA limit might increase the cost by an additional $300 million. The cost of an individual saving account program would depend on the details of the program. These proposals, too, could take effect in 1977.

II. Proposal to Eliminate the Double Tax on Distributed Corporate Benefit

Roughly 75 percent of our total national investment, other than housing, is in the corporate sector. The small saver has no conception of what a large part of his saving ends up working in the corporate sector.

Under our system of taxation, income earned by corporations is taxed twice: First to the corporation and then again to the shareholder, if and when it is distributed as a dividend or realized on sale. If a saver in a 20-percent tax bracket invests $100 in corporate stock, the gross income earned by the corporation with that $100—let us say, $20—is taxed to the corporation at 48 percent, producing a tax liability of $9.60, leaving the corporation with a $10.40 after taxes. If that is distributed to the shareholder in a 20-percent bracket, he will pay another 20 percent tax, or $2.08, on the distribution. Thus, the total tax paid on the income from the investment is $11.68. That is a 58-percent tax rate, notwithstanding that the individual investor is in only a 20-percent bracket—an increase in rates of almost 200 percent. A similar though much smaller disparity occurs in the case of an investor in the top 70-percent bracket. The $20 of income from $100 invested by him would produce $9.60 of tax at the corporate level and $7.28 of tax upon distribution of the remainder, for a total tax of $16.88 on the $20. That is equivalent to an 84-percent tax rate, compared with the investor's 70-percent tax bracket—an increase in rate of approximately 20 percent.*

The existence of the two-tier tax has a number of perverse results:

1. It creates double taxation which is inherently inequitable when other kinds of income are taxed only once.

2. The system tends to inhibit savings from flowing into corporate equity investments because they will have to earn a higher level of income there in order to produce the same return. This causes an efficiency loss for everyone. It erects an extra cost barrier for consumers because the prices they pay for the goods the corporation produces must be sufficiently higher to cover two taxes rather than one, and causes them to end up with a different mix of goods and services than they would otherwise prefer in the absence of the additional cost barrier. Professor Harberger, who did the pioneer work in this area, estimates that the loss of efficiency is roughly equivalent to a decrease of 0.5 percent in our national income.

3. The two-tier tax creates a systematic bias against lower bracket taxpayers owning corporate stock. This seems generally undesirable both economically and socially. The experience in West Germany is relevant in this respect. Germany has for a number of years had a system which partially eliminates the two-tier tax. It was adopted in part in the hope that it would increase stock ownership by lower and middle income persons. In our recent discussions with officials of their government, we have been told that serious consideration is being given to complete elimination of the double tax, again with a principal objective of encouraging investments by small savers.

4. The double tax on corporate profits applies only to the income attributable to equity investment. Corporations must earn enough gross income to cover the interest payments made to compensate bondholders and other creditors for the savings which they have supplied. But interest payments are deductible at the corporate level and thus are not

* One must be careful not to draw simplistic conclusions from these numbers, for, as in so many other economic matters, they are only the first step to be considered. The fact that such tax burdens exist cause the prices of corporate investments to change relative to other investments with the result that the ultimate after-tax yields are, on an average basis, equalized. However, the situation may be different for individual investors, who will be affected differently depending upon their tax brackets.

included in the net income which is taxable to the corporation. The fact that interest income on debt is taxed only once, while income on equity investments is taxed twice, creates a very heavy bias toward debt financing. The double corporate tax thus is a very major contributor to the steep and dangerous increase in debt-equity ratios in recent years discussed at pages 28–29 and 34 of my July 8 statement. High debt ratios make business highly vulnerable to business cycle changes. As each additional borrowing leaves the business more vulnerable, potential new investors become more anxious. Thus, the growth in high debt ratios is a very undesirable development which tends to cause bankruptcies and other structural dislocations and generally suppresses economic growth.

5. A double corporate tax creates a market bias against high dividend stocks. So long as earnings are retained, the second tax on dividends need not be paid. If the stock is ultimately sold, the sales price will be greater because of the retained earnings (unless those earnings have been unwisely invested by the corporation), but that tax is imposed at half rates. It may be avoided entirely if the asset is held until death and in any event can be postponed indefinitely by the simple device of not selling. Either way the second tax may be substantially discounted. Thus, stocks like utilities, which have traditionally relied on high dividend payouts, are placed at a substantial disadvantage because the double tax imposed on their income (corporate tax + ordinary income tax on dividends) is greater than the double tax on companies which retain earnings and do not distribute (corporate tax + capital gains or no tax). Elimination of the second tax would greatly assist utilities and other companies similarly situated in raising equity money. Given our energy problems this is a particularly important point.

6. The double tax places a heavy penalty on corporate decisions to distribute earnings. In an ideal, free market, the tax system would be neutral with respect to retaining or distributing. Corporation managers would retain earnings if they could use them productively. But stockholders would call for larger distributions when it appeared that the money could be invested for a better return in some other company or enterprise. Corporation managers would thus be required to justify retention of earnings by demonstrating that they could do a better job of investing profits than the shareholders could do for themselves, and capital markets would be generally more competitive. At present the tax penalty on paying out earnings puts corporate managers under great pressure to do almost anything productive with retained earnings rather than pay them out. The double corporate tax thus "locks in" in corporate capital and keeps it out of the capital markets.

Mechanisms to remove the double tax

For many years our system of imposing a double tax on corporate profits by taxing them at each of two tiers was also widely used abroad, and it is often referred to as the "classical" system of corporate taxation. So long as tax rates at the corporate level remained relatively low, the system did not create undue mischief. In the United States, the corporate tax rate was less than 15 percent as late as 1935; it rose to 40 percent during World War II, dropped back to 38 percent in the last of the 1940's, and rose again to 52 percent during the Korean war. The current 48-percent rate was enacted in 1965. Thus, basically, it was only as recently as the Korean war in the early 1950's that corporate rates reached their present high levels. Similarly, corporate rates have been rising in other countries, but not so fast as in the United States. As rates have risen abroad and as the need for economic development and investment increased in other countries, changes were made in their corporate tax system. Today, virtually all of our major trading partners have a system which eliminates much of the double tax. Such systems are in effect in Canada, the United Kingdom, France, Germany, Belgium, Italy, Japan, and Iran. The European Economic Community has adopted a resolution urging all of its members to adopt such a system and is presently engaged in an effort to promote greater uniformity of existing systems and to harmonize the differences that remain.

The existing systems all operate with one or the other of two basic mechanisms: A stockholder credit or a dividend deduction (including its variant, the "split rate" system). Under both mechanisms, taxes are imposed at both the corporate and individual level, but an adjustment to prevent doubling up is made at the time the income is distributed to shareholders. It would be theoretically possible to tax all earnings initially and directly to the ultimate owners, the stockholders, regardless of whether or not the earnings were distributed. However desirable such a system might theoretically be, it would present practical problems which are probably insuperable, and while Canada considered such a system, no other country has, in fact, adopted one.

Under the dividend deduction system, the corporation is allowed a deduction for all or part of any dividend distributions which it makes. The deduction in effect reverses the tax which the corporation previously paid on such income. Assume, for example, that a corporation earned $100 and is subject to a corporate tax rate of 48 percent. If it pays a dividend of $100, a full deduction will completely eliminate taxable income. Stockholders will pay tax on the $100 distributed but the corporation, having distributed everything, will pay no tax. If the corporation distributes $60, the $60 deduction will cause it to pay tax on $40; i.e., on the earnings not distributed. The stockholders will pay tax on the $60 which is distributed. Note that if such a system were to be adopted, the initial effect would be to increase the after-tax dollars in the hands of the corporation, for it would get a deduction for the dividends it is presently paying. The corporation might or might not use that additional cash to increase further the amount of dividends paid. Thus, whether the tax reduction dollars actually end up in the hands of the corporation or its shareholders will depend upon the corporation's subsequent distribution policies.

Under the stockholder credit method, the corporation gets no deduction, but the shareholder is given a credit to compensate for the tax which the corporation has already paid. Taking the same corporation as an example, it earns $100, pays a $48 tax, and has $52 left. If the entire $52 is distributed, the stockholder is treated as if he had originally received the same amount of gross income as the corporation, i.e., $100, and is given a credit for the tax the corporation has already paid, i.e., $48. If that $52 is distributed to the shareholder, he "grosses it up" by the amount of tax attributable to the $52 he received, i.e., by $48. That produces a "grossed-up" amount equal to the gross income which was earned by the corporation. He then reports that $100 in his income and is allowed a credit for the $48 which the corporation paid. If he is in a 50-percent tax bracket, he will have a gross tax liability of $50, a credit of $48 for the tax paid by the corporation, and a tax bill of $2. On the other hand, if he is in a 20-percent bracket, he will have a gross tax liability of $20, the same credit of $48, and will get a refund of the difference, $28.

If the stockholder credit system were instituted, the initial result would be to put all the cash tax savings in the hands of shareholders, as the corporation would continue to pay corporate tax and the adjustment mechanism is a credit which goes to the shareholders. This, too, could be adjusted by a change in distribution patterns; i.e., the corporation could decide to decrease the actual dollars which it distributed because the shareholders would be getting supplementary amounts through the tax system.

You will note that in the case of a total distribution the two systems produce the same result: The corporation has nothing left and the entire $100 has, in effect, been taxed at the shareholders' rates. With less than total distributions, there are "first instance" differences. In the first instance, the dividend deduction is an adjustment at the corporate level and is reflected in increased cash flow at the corporate level; while the stockholder credit is an adjustment at the stockholder level and is reflected in increased cash flow to stockholders. However, by appropriate changes in the levels of dividend declaration, either mechanism can be tailored to produce the same result vis-a-vis the corporation and its shareholders—i.e., the same tax benefit can be divided in the same manner between the corporation and its shareholder in either case.

Thus, the two systems are economically the same. The differences between them are practical differences, of which there are principally three:

First, there may be a difference in public perception about where the benefits go depending upon which form is adopted. While any such difference in perceptions would be erroneous, it may, nonetheless, be a real factor to be reckoned with.

Second, the fact that the benefit of the tax reduction initially occurs at different places under the two methods may be important, particularly if corporations are required to give up other items at the corporate level in exchange. While it is always possible for the corporation to use changes in dividend declaration to get to the same place under either method, those changes may present practical problems. Just as it is easier for Congress to cut taxes than to increase them, so also it is easier for corporate managers to increase dividends than to cut them.

Third, the stockholder credit system permits greater flexibility in dealing with tax-exempt organizations and foreign stockholders. Under the dividend deduction method, whatever the benefit is, it accrues automatically to all stockholders. Under the stockholder credit method, however, it is possible to reduce or eliminate the credit for tax-exempt institutions or foreign stockholders. In the case of tax-exempt stockholders, the double tax has been eliminated under present law because there is only one tax at the corporate level and no tax whatever at the stockholder level. Under the dividend deduction method, tax would also be eliminated at the corporate level, with the result that there would be a total elimination of tax and not just an elimination of the double tax. The situation in the case of foreign stockholders is similar as they do not presently pay regular income tax on dividends received, although they do pay, in lieu of an income tax, withholding taxes at rates ranging from 5 percent to 30 percent.

Revenue implications of eliminating the double corporate tax

We clearly cannot afford to eliminate the double corporate tax completely in any short period of years, for the revenue losses are too great. At 1977 revenue levels, a complete deduction for dividends paid would create a revenue loss of approximately $15 billion. Alternatively, a stockholder credit would produce a revenue loss of approximately $19 billion if the credit were extended to tax-exempt and foreign stockholders, and approximately $12.5 billion if the credit were not extended to such stockholders.

The larger revenue loss for the stockholder credit method is attributable to the "first instance" effects described above and the fact that the adjustment mechanism operates at the stockholder level. As explained, the stockholder credit method initially puts more cash at the stockholder level, which has the same effect as if the total distributions were larger, thus creating a larger revenue loss. Under the dividend deduction method, it is the corporation which will have more cash. If it distributed all that additional cash, the result would be the same as the stockholder credit method (i.e., the cash benefit would appear at the stockholder level in the form of larger dividends), the revenue loss would increase to the $19 billion figure indicated for the stockholder credit method. Over time, it is probable that there will be some increase in the level of dividends under the deduction method and, therefore, a somewhat greater loss than the $15 billion indicated.

Recommended mechanism: combination of dividend deductions and stockholder credits

Specifically, I recommend that your committee eliminate the double tax on income from savings invested in assets held in corporate form and do so in six phases, with the first phase effective January 1, 1977. The remainder would phase in equally over the succeeding 5 years. Since there is a substantial lag between the time when tax changes become legally effective and the time that their effects show up in collections, the proposal would have only a very minor effect on the budget for FY 1977, and the revenue effects would show up gradually in the budget beginning with fiscal years after 1977.

We recommend that you eliminate the double tax by combining the dividend deduction and stockholder credit mechanisms, with part of the duplicate tax being eliminated by one mechanism and part by the other. This will have two major advantages:

(1) Use of the dividend deduction will create additional cash flow at the corporate level, which is probably the most immediate need.

(2) Use of the stockholder credit mechanism permits flexibility with respect to tax-exempt and foreign stockholders. We do not believe the stockholder credit should be extended to them. Like other stockholders, they will receive indirectly the benefits of the dividend deduction at the corporate level. Thus, the tax burden on income going to such stockholders will be reduced, but will not be totally eliminated. That seems an appropriate way to deal with such stockholders and it significantly reduces the revenue loss.

The dividend deduction

Approximately half of the total deduction would be accomplished by a dividend deduction. Thus, ultimately there would be a deduction for roughly 50 percent of the dividends distributed. The reason that I say "roughly 50 percent," rather than exactly 50 percent, is that by making it slightly less, it is possible to make the stockholder credit mechanism very much simpler for individual stockholders.

The dividend deduction provided for the first year, 1977, would be that percentage which produces a net reduction of approximately $2.5 billion in corporate tax liabilities for that year.

Additional dividend deductions required to bring the total deduction up to approximately 50 percent of dividends distributed would be phased in from 1978 through 1982, causing the revenue loss to increase at a rate of about $1 billion a year (at 1977 levels).

The stockholder credit

The balance of the double tax would be eliminated by a stockholder credit to be phased in equally over the 5-year period from 1978 to 1982 inclusive. This would cause a revenue loss in each of those years, increasing at the rate of about $1.25 billion a year (at 1977 levels).

The stockholder credit would not be available with respect to tax-exempt or foreign stockholders, for giving the credit would completely eliminate the tax on the income accruing to those classes.

The credit mechanism would be extremely simple. The taxpayer would "gross up" his dividend by adding to his taxable income an amount equal to 50 percent of the dividends he receives and would then take a tax credit equal to the gross-up. As a matter of arithmetic, the combination of a 50-percent dividends paid deduction and a 50-percent gross-up and credit, when combined with a 48-percent corporate rate, would more than eliminate the double tax. One or the other must be adjusted slightly. In terms of tax return simplicity, it is obviously very desirable for tens of millions of shareholders to use a gross-up and credit of 50 percent rather than an odd percentage which requires more complicated arithmetic. Therefore, we recommend that the required compensating adjustment be made by reducing somewhat the percentage of dividends which are deductible. It is for that reason that I suggested earlier that the dividend deduction might ultimately be for slightly less than 50 percent of the deduction.

Other options

Variations in the arithmetic and percentages are obviously possible. Thus, for example, the portions of benefits going under either mechanism could be altered. Much will depend upon what the total tax reform package looks like.

As always, a number of subsidiary questions will require attention in the drafting sessions—just as in the case of the other options on which our respective staffs have been working in preparation for your return in September. We need to agree, for example, on how to handle the intercorporate dividend deduction, the foreign tax credit, and similar items. Our Treasury staff has given careful thought to these aspects, and I suggest that we ask our staffs mutually to decide upon the best way to handle these matters.

Distribution of the tax burden

Considered in isolation, the proposal to eliminate the double tax will tend to produce reduction in the tax burden which is greater at the top and at the bottom of the economic scale than in the middle. The reason for the larger reduction at the bottom is that there are a large number of retired persons with low incomes of which a substantial part consists of income from savings.

But it is unrealistic, of course, to consider this element or any other element in isolation. We must keep our eye on the entire package of tax changes that you enact. The ultimate effect on distribution of the tax burden will depend upon whether or not overall individual income tax reductions are decided upon for individuals generally, and also upon whether other changes are made in the tax burdens on income from savings.

Given all the variables, it is not possible to arrive at clear conclusions at this point, except to say that given the gradual nature of the proposed phase-in and the likelihood of at least some changes in other tax provisions, we do not anticipate a major change in the progressivity of the tax burden.

Proposal is relief for all savers, not just for stockholders

At the outset of my statement, I made the point that the elimination of the double tax on corporate income would produce a benefit which will be quickly distributed by market forces across the income from all forms of saving and investment. The benefits do not come to rest in the hands of stockholders. This is not a program for big business. It is a program to benefit all savers. This is an absolutely fundamental point and one on which we all have an obligation to educate the public. Because it is so important, I want to restate that part of my July 8 statement which explains why that occurs. I said:

> In the case of corporations, net income is taxed once at the corporate level and again at the shareholder level. The existence of this double tax has a major effect on the manner in which capital is used. Regardless of who ultimately bears the tax—which is a separate question—two taxes are actually paid by somebody. That means either that prices must increase or that profits will be lower. Most economists believe that the result is some combination of higher prices and lower profits.
>
> However, viewing the economy in the aggregate, it is not just corporate shareholders who have lower profits. If that were the case—if corporate stock investments provided a lower rate of return than other kinds of investment—no one would invest in stock. What happens in a competitive capital market is that there are constant flows of capital from one kind of investment to another until the after-tax rates of return are comparable. If investment in corporate equities is less profitable, then capital will flow out of such investment (or less capital will flow in). If there is less demand for stock on the stock exchange, the price of stock will fall and yields will rise. For example, if a $100 stock pays a $5 dividend, the return is 5 percent. But if the demand for stock declines and the price falls to $80, the $5 dividend provides a yield of better than 6 percent. At the same time, the capital which is diverted from corporate stock will flow into other kinds of investment. Money in savings accounts will increase and there will be a greater demand for bonds and other debt instruments and a greater demand for investments in assets and enterprises not held in corporate form. That greater demand for that kind of investment will in turn depress the return on it. For example, when more people wish to have money in savings accounts, the interest rates which banks are willing to pay falls.
>
> Thus, the market operates to equalize rates of return between different kinds of investment. In the end, a part of the corporate tax is a net additional burden on consumers, and a part is a burden distributed across the owners of all kinds of capital, not just corporate shareholders. I believe it is fair to say that while economists differ in their estimates of the proportions of the tax which ultimately are borne by different classes of people, those economists who specialize in this aspect of their science are today in near unanimous agreement on the analysis I have outlined.
>
> All of this has major implications for the efficient use of capital and for tax purposes. There are several observations which should be made.

First, it is erroneous to think of the corporate tax as primarily affecting stockholders. For example, a significant increase in the corporate tax will, in the first instance, significantly affect existing stockholders. But in the longer run, the equalization process will come into play and depositors in savings accounts and other kinds of investors will help bear the economic incidence of the tax. Similarly, other investors, too, will benefit by decreases in the corporate tax.

Second, the price charged by corporations to their customers must be adequate to provide funds to cover the two-tier tax and still leave investors with a competitive return. Otherwise, no one will invest and the company will go out of business. That necessarily means that prices for goods produced by corporations must be relatively higher than prices of goods produced in the noncorporate sector, which means, in turn, that consumers are discouraged from purchasing goods in the corporate sector and spend less of their money on such goods than they would if taxes were neutral with respect to different kinds of investment. If the extra tax burden on corporate investment were eliminated, that bias would disappear and there would be a greater demand for corporate goods and services. People would be able to have more of the things which they prefer, and the efficiency of our stock of capital would be increased. The real income of the Nation would rise significantly, as more desired output was substituted for less desired output. Thus, the double tax is a barrier to the most efficient use of existing capital. Getting more out of the capital we already have is as good as having more capital. In fact, it is better because in order to get more capital we must give up some current consumption, which need not be the case if we are only increasing the efficiency of what we already have.

Third, the existence of the two-tier tax is directly responsible for much of the dangerous growth in debt-equity ratios. If a company wishes to expand, it must consider what goods it can sell and what prices it will be able to charge in order to provide an adequate return on its new investment. To the extent net expansion is financed with debt, after the costs have been covered, $1 of additional price will provide $1 of return to the investor. In the case of equity, however, the company must charge $2 to provide $1 of return. With that kind of a tax premium on debt as compared with equity, the pressure for greater debt is tremendous. This phenomenon can be observed in dramatic form in the case of public utilities. Regulatory commissions are very conscious of the fact that if they are to increase the return to equity investors by $1, they must increase prices to consumers by $2. The very difficult choice which that presents to a politically oriented commission is a significant part of the utility problem.

Benefits of the proposed change

The change recommended will, if adopted, have the following advantages.

(1) The net tax reductions on the income from saving will increase the rewards for saving and will thus increase the total amount which people and institutions will be willing and able to save. That will produce benefits not just for savers, but for everybody in the form of increased growth, more jobs, and greater prosperity generally.

(2) It would ultimately eliminate a double tax which is unfair and inefficient.

(3) It will eliminate the existing tax discrimination in favor of debt as compared with equity financing and strike at the heart of the debt-equity problem.

(4) American businesses will be better able to compete against foreign companies for whom the cost of capital has already been reduced by elimination of the double tax. Increased returns on saving in the United States will help attract additional foreign savings.

(5) It will greatly improve the efficiency of the process by which capital is allocated and produce the equivalent of an increase of perhaps 0.5 percent in our national income.

(6) It will make the capital markets more competitive. Corporate managers will have to demonstrate to stockholders that they can do a better job of investing profits than the shareholders can do for themselves. It would eliminate the tax penalty which presently induces corporate managers to "lock in" corporate capital and keep it out of the capital markets.

(7) It will be an immediate and major assist for equity financing. Businesses which have lost access to equity markets will again be able to compete.

(8) It will be a great help to utilities and to other industries whose investors rely upon steady dividends.

(9) It will greatly reduce the tensions and distortions which follow from the present large differential between the rates of tax on capital gain and on other income. This should be viewed as a major step forward by anyone who objects to the present favorable treatment of capital gains. Since it achieves this result without increasing taxes on capital gains, it should also make happy those who advocate the present favorable treatment of capital gains.

III. Other Actions Affecting National Savings

I have already emphasized the central effect of the Federal budget on the amount of savings in the economy. Federal surpluses will produce additional savings; but Federal deficits require the Treasury to borrow, thus depleting the pool of savings available for private investment. Thus, as we try to get a larger and more efficient amount of savings and investment through changes in the tax system, we must keep constantly in mind the pressing need also to continue to hold down the level of Federal expenditures.

You should also have clearly in mind that some of the other tax changes which have from time to time been suggested by various members of your committee would also increase the tax on the income from savings, and would thereby discourage savings and work contrary to the proposals which I have presented today. Here, again, it is important to understand that tax provisions relating to selected kinds of investments ultimately are distributed across all kinds of investment. I have explained how the burden of the corporate income tax is ultimately distributed across the income from corporate and noncorporate investments alike. The same economic principles operate in the case of such items as the domestic international sales corporation (DISC) and the investment credit. There is a tendency to think that those provisions affect only selected narrow areas and do not apply in a general fashion. But that is an erroneous conclusion, which confuses the form of the provisions with their effect. It is true that such provisions operate as incentives to selected kinds of investment rather than to investment generally. By being selective, they increase the flow of savings from less favored to more favored kinds of activities, just as the effect of the corporate tax is to allocate investment flows away from corporations. However, the benefits from such provisions are ultimately distributed across all kinds of savings, just as the burden of the corporate income tax is ultimately distributed across corporate and noncorporate savings alike. In the end, any increased tax from cutting back such items would decrease the income from and the incentive for saving generally.

Conclusion

This testimony completes the presentation of the administration's proposals in the area of tax reform. On July 8, I outlined a series of proposals for tax change consisting primarily of tax reform proposals first advanced in 1973, on which your committee worked last year. In a separate statement I also presented tax proposals dealing with the special problems of utilities.

The new proposals today go to the fundamentals of our economic system. All of these proposals interrelate with each other, and their effects must be determined as a whole. Looking at all provisions together will be important for purposes of determining the effects on the Federal budget—which goes to the heart of the savings problem I have been discussing—and will also be indispensable in assessing the net implications for distribution of the total tax burden.

We look forward, as always, to working with your distinguished committee.

Exhibit 34.—Statement by Secretary Simon, December 3, 1975, at the Tax Foundation's 27th National Conference, New York City, setting forth a proposal for basic tax reform

Since history has a habit of repeating itself, I'm sure I'm not the first Secretary of the Treasury who has reached the conclusions I want to discuss with you tonight. And no doubt, I will not be the last. But the time has come for a little plain talk about a subject that is important to all of us: our taxes.

The system of Federal taxation which has evolved since the early days of the Republic is in trouble today.

And after several years of seeking to reform the system, I am increasingly persuaded that tinkering may no longer be the answer.

Let me elaborate for a moment about the difficulties of the tax system.

First, it is readily apparent that the Federal tax system is poorly structured for a period of rampant inflation. Millions of taxpayers now legitimately complain that the extraordinarily high rates of inflation we have experienced recently have hit them with a double whammy: At the same time that inflation is eroding their real purchasing power, it is also pushing them into higher tax brackets.

Secondly, because of the rapid growth in the size of government at all levels since the early 1960's, the portion of personal income that must be paid into Federal, State, and local tax coffers is rising steadily. Many of you are familiar with the Conference Board study published this spring showing that the item which rose the fastest in the American family budget during the last 6 years was taxes. While the general cost of living climbed about 40 percent during that period, the total bill for taxes- Federal, State, and local- jumped by 65 percent.

Thirdly, it is becoming more widely recognized now that the Federal tax system is discouraging savings and investment when we need three times as much investment in the next decade as the last decade. By taxing corporate profits twice- once at the corporate level and then at the level of the shareholder- the United States is imposing a heavier tax burden on its business enterprises than in most other major industrialized nations of the free world.

And by allowing corporations to deduct interest payments on their debt but refusing to allow deductions for their dividends, the tax system is encouraging businesses to rely too heavily upon the debt markets, so that the corporate financial structure is increasingly unbalanced. Economists are properly cautious in saying that the way we collect taxes may not totally determine how much we save and invest. But the fact is that the share of our GNP devoted to capital investment over the last 15 years has been lower than in the economies of any of our major competitors. We have also had one of the poorest records in terms of productivity gains and in terms of real income growth. Furthermore, our recent unhappy experience in terms of high inflation is in part attributable to past inadequate capital formation. The Federal tax system has been a major influence on all of these developments.

Finally, it has become painfully obvious to most taxpayers that the present tax system is so riddled with exceptions and complexities that it almost defies human understanding. No one can adequately assess its basic fairness. The complexities have reached a point where I'm not even sure the IRS experts fully understand the system anymore. How can they when they are dealing with a tax code and regulations that now exceeds 6,000 pages of fine print? You may remember the informal survey conducted a few years ago by an executive in Atlanta, working in conjunction with the Wall Street Journal. This executive visited five different IRS Centers around the country, presenting to each of them the same set of facts about his income and possible deductions and then asking how much tax he should pay. The result? Five different answers, varying by as much as $300 in how much he owed. The offices could not even agree on how many forms he should fill out.

In these circumstances, it is hardly surprising that two taxpayers out of every five now seek outside assistance, usually at some expense, to complete their tax forms. It is even less surprising that more than three-quarters of the American people now want the tax code changed, and some 50 percent want major changes. There is a widespread feeling that the system favors the rich at the expense of working families.

As everyone in this chamber knows, the success of our tax system rests upon the voluntary compliance of our taxpayers. If there were widespread abuses of the system, we could not possibly police them. Yet, when people lose faith in the basic fairness of the system, it almost inevitably follows that the system itself will falter. In fact, the rate of compliance has begun to drop in recent years. We are faced, as former Treasury Secretary Joseph Barr first observed almost 10 years ago, with an incipient taxpayers revolt.

The fear of a revolt has not been lost upon Washington, but so far, I'm afraid, attempts to reform the tax system have fallen far short of the mark. I say this with full appreciation of the herculean labors performed by the House Ways and Means Committee under Wilbur Mills and by the administration in securing passage of the 1969 Tax Reform Act. That act did help to simplify the tax system: Some 8 million low-income taxpayers (poverty level or below) were removed from the tax rolls altogether, and another 11 million taxpayers were offered greater incentives to use the standard deduction, avoiding the time and trouble of itemizing their deductions. Nonetheless, considering all the labors that went into that bill, it was a great disappointment to those who were seriously interested in tax reform. If anything, the 1969 act, like the Revenue Act of 1971, was really more of a lawyers' and accountants' relief bill. There is still a decisive need to overhaul the code. I speak with some feeling on this because nearly 3 years have passed since the executive branch proposed a comprehensive series of changes, and most of them are still awaiting final congressional action. I know that many Members of the Congress have shared my frustrations this year as they have watched the House Ways and Means Committee spend literally thousands of man-hours on a complex series of changes in the code, only to have their efforts watered down at the last minute. As of tonight, there is a strong possibility that serious attempts to change the system will be put off until 1976, and possibly until after the election.

Given these circumstances, I would suggest three major steps must be considered. First and foremost, it is now incumbent upon elected leaders at every level of government to halt the relentless upward spiral in public spending. By cutting back on the growth in spending, we can also cut back on the growth in taxes and thus do as much to alleviate the distress of the taxpayer as any single reform could ever accomplish. We do not have financial resources to afford all of the bold new programs that have traditionally gotten people elected, and a large portion of our body politic now believes that government has already assumed too much responsibility within our society. Clearly, as the government has become more pervasive, the vitality of the private sector has diminished. In an illuminating article published this fall, the president of Stanford University argues that the Government has preempted so many responsibilities in education that it is now forcing many private universities and colleges to the wall. That same trend prevails elsewhere, and it is the taxpayer—victimized by the very system that supposedly represents him—who is forced to pay the bill, either through higher taxes, higher inflation, or both.

Restraining the growth of public spending is essential if we are to defuse the taxpayers' discontent. Equally important, by holding down spending, we will begin to return to the taxpayer the ability to control more of the economic decisions that affect his life. The choice about how to spend his earnings will not be made so often in Washington but in his own home. That is the essence of economic freedom, and in a very real sense it is also at the heart of our political and social freedom.

The proposal that President Ford has made to the Congress to cut projected spending for next year's budget by $28 billion and to return the savings dollar-for-dollar to the American taxpayer is a clear recognition of the linkage between spending and taxes. We have tried every other technique to restrain spending, and the Congress has turned a deaf ear. This one, the President believes, may be our last best hope. Moreover, by lowering taxes, it would help most taxpayers overcome the effects of past inflation on their tax liability.

Some economists are arguing that the President should sign tax cut legislation regardless of what the Congress does about spending. I am not persuaded by their argument. Whether or not we enact another tax cut immediately may not have a significant impact upon our immediate economic hopes; however, whether or not we bring spending under control and work our way out of horrendous budget deficits will most assuredly have a significant impact upon our hopes for the future. We must finally say no to the apologists for big spending, rejecting their misguided notions that the Government can identify, analyse, and solve every problem by throwing more money at it.

A second step that I believe essential is to achieve fundamental reforms in the way we tax business profits—reforms that will provide a stronger bulwark against future economic contractions; reforms that will help to redress the imbalances in corporate balance sheets and broaden equity ownership; and reforms that will encourage the levels of savings and capital investment that are so vitally needed for our future.

Toward these ends, the administration this summer proposed to the Congress a "Tax Program for Increased National Saving." This proposal would eliminate the double taxation of corporate earnings which I mentioned earlier. I strongly believe that this proposal—which has already been adopted in one form or another in most of the other major industrialized countries—would make a significant contribution toward financing our capital investment needs of the future. Moreover, it is the only major tax proposal of which I am aware that comes to grips with the growing imbalance between corporate debt and equity.

Some observers have asked whether the President's subsequent request for a cut in taxes, linked to a cut in projected spending, means that the administration has shelved its tax integration proposal. Let me set the record straight: The administration stands foursquare behind both measures. We regard the tax cut/spending cut as an item on the immediate agenda, and we remain hopeful that the Congress will act favorably on it this year. The tax integration measure is much more complicated and will require extensive hearings and debates so that, while we would like to have it passed quickly, we recognize that in reality it will require more time to enact. But both proposals still have our wholehearted support.

Let me turn now to the third and final step that I personally believe we should begin considering with regard to our tax system. This is a concept that has been suggested from time to time but it has rarely been given serious consideration. It is simply this: To wipe the slate clean of personal tax preferences, special deductions and credits, exclusions from income, and the like, imposing instead a single, progressive tax on all individuals.

I am increasingly attracted to the idea because of its simple elegance and its basic equity toward all taxpayers.

For years, politicians have been telling us that the tax system should be used to promote certain economic and social goals. But should it really? Isn't this precisely the kind of social engineering that lies behind so many of our troubles today? What has caused more disillusionment with government than the failure of government to deliver on so many of its promises? What has caused more bewilderment and distrust among taxpayers than the myriad of so-called loopholes which now litter our tax code?

There have been many studies by responsible organizations which indicate that if the special deductions and credits, exclusions from income, et cetera are eliminated or drastically curtailed, we could revise the individual tax rates substantially downwards and keep our total income tax revenues at present levels. Generally, it is suggested that rates could be set at 10–12 percent at the low end and 35–40 percent at the high end. Thus a family of four with income of $15,000 might have an annual Federal tax bill of $1,200; the lowest income families would continue to pay no Federal income taxes at all; and wealthier individuals would pay a tax of 35 percent on their income over $50,000—no ifs, ands, or buts. Everyone would pay his or her fair share.

Looking at it another way, if every taxpayer was allowed the standard deduction under the 1975 law but all other deductions were disallowed and capital gains and tax preferences were taxed as ordinary income, revenues from the personal income tax would increase by about $50 billion. Thus, even under this partial step, personal income tax rates could be cut across the board by about 30 percent without any loss of revenue.

Obviously, the wealthy taxpayer with income of $100,000 or more who is presently able to "shelter" his income will stand to lose from this proposal. As noted before, all of this income would be subjected to taxation at some significant rate rising to 35–40 percent. On the other hand, the working men and women of the country—families who earn $10,000 and $20,000 per year—should benefit through reduced tax burdens. And let us not overlook the fact that all citizens will benefit through increased public confidence in the tax system.

Developing the precise details of such a program would clearly involve hard work. Significant political decisions would also have to be made in establishing the tax rate schedules which would be applied to the broadened tax base. But innovation should be encouraged. For example, the idea of a consumption-type income tax discussed by Assistant Secretary Walker here today clearly merits further examination.

If we imposed a single, progressive tax on individual taxpayers, what should be done with corporate taxes? There are, of course, several alternatives that could be considered. My own predilection would be to press forward with the tax integration plan I mentioned earlier, and then to simplify the corporate tax itself in much the same way as we would the individual tax. By eliminating preferences and closing loopholes—that is, by broadening the corporate tax base—we should be able to effect a meaningful cut in corporate income tax rates without any loss in postintegration revenues from this source. Regardless of what form the corporate tax may take, we must bear in mind that ultimately corporations do not pay taxes: people do. It is axiomatic that corporations are simply legal entities. The revenues they turn over to the IRS come either from their customers in the form of higher prices or from their employees and shareholders in the form of lower salaries and lower dividends. In the end, the corporate tax always comes out of somebody's personal pocket. It never ceases to surprise me how often that point is misunderstood.

For years we have been talking about tax reform, and the executive branch continually sends up ad hoc measures that predictably draw the fire of special interest groups and are eventually overrun or changed beyond recognition by political opponents. If we truly want tax reform, I say that here's a place to start.

Let me emphasize that I am not trying to float a trial balloon for the administration. I am speaking here tonight strictly as a Secretary of the Treasury who shares the frustrations of so many Americans who want to bring greater equity and rationality to our tax system and who believe that we must now begin giving much more serious consideration to a tax system that rests upon the twin pillars of fairness and simplicity.

And I must say that I think I am also speaking for millions of Americans who are fed up with the current tax system and want it replaced by one that they can both understand and trust. Indeed, I doubt there is anyone in this audience who believes that if we could start over again, we would build a tax structure similar to the one we have today. As they say, if we didn't have it already, nobody would ever invent it.

Americans have habitually complained about taxes. Tax rebellions extend far back in our history. But during most of our history, the majority of our people have agreed with Justice Holmes that "Taxes are what we pay for civilized society."

Let me reemphasize: The success of the American tax system—and we should always remember that it has been one of the most successful in the world—is that our citizens voluntarily comply with its requirements. They pay their taxes because they believe that others are also paying their fair share, and because they are getting their money's worth.

Over the years, as one new wrinkle has been placed on top of another, the Federal tax system has come under increasing jeopardy.

We are threatening to erode basic faith in the fairness of the system because many people feel that taxes are being imposed upon them without their consent, that too many of their fellow taxpayers are escaping their responsibilities through dozens of loopholes, and that the code itself has become a labyrinth of legal doubletalk. In short, for the average taxpayers, the New Deal has given way to the "Raw Deal," and they don't like it one bit.

I think the time has come for some fundamental changes and far more imagination about what we can accomplish as a Nation if we only overcome our hesitations and fears. Some critics will tell you that what I am suggesting should be dismissed as pure politics. The charge of politics is a poor substitute for thinking. We have been talking and talking about tax reform for years, but we have yet to act in a comprehensive way. The question I leave with you tonight is this: Do we or do we not have the courage to act on our convictions? It's that simple.

Exhibit 35.—Statement of Secretary Simon, March 17, 1976, before the Senate Finance Committee, on major tax revisions and extension of expiring tax cut provisions

I am pleased to be here this morning as you begin your deliberations on major tax revisions and the extension of expiring tax cut provisions. You have before you an extremely challenging agenda.

This morning I will discuss H.R. 10612—the House-passed tax reform bill. While many of the provisions of H.R. 10612 incorporate proposals initiated by the administration in 1973, more work remains to be done.

I will also discuss the President's proposals to cut individual and business taxes and to reduce the rate of growth of Federal spending. I will present proposals to encourage capital formation. These proposals include integration of the corporate and personal income taxes; a job creation incentive proposal; the six-point utilities tax program; a proposal to reduce the tax on capital gains and alleviate the burden of taxation on inflationary gains by the mechanism of a sliding scale; and elimination of the withholding system on foreign investments. In addition, I will discuss general and specific estate tax revisions, as well as the relationship of the administration's energy policy and tax policy.

The overall objectives of the administration's tax policy are simple and fundamental. *First*, and foremost, our tax system must be *fair*. Its fairness and integrity rest upon three premises: *equity*, *simplicity*, and *efficiency*. A tax system not built on this foundation erodes both the confidence of taxpayers and the incentive required for economic progress and well-being.

Second, our tax policy must complement and supplement our basic economic goal of achieving a growing, vigorous, and noninflationary economy. We achieve this by removing the tax barriers which impede our growth and prevent the most efficient use of our economic resources.

Third, our tax policy must contribute to a sound energy policy. Here, again, I must emphasize that allowing market incentives to operate would be the most efficient and effective means of achieving energy independence. As long as we are unwilling to rely on the market, we should retain the tax incentives we now have in place and by no means erect further impediments by increasing the tax burden on oil and gas investments.

The administration has already proposed the following measures:

- Permanent personal and business income tax reductions coupled with corresponding reductions in the size of the Federal budget. This is the proposal which the President first made last October and reiterated in his 1976 state of the Union message.
- A plan to integrate corporate and personal income taxes and thereby eliminate the perverse effects of the current double tax on equity investments. This is the proposal I presented last July before the House Ways and Means Committee.
- A six-point utilities tax program to stimulate construction of additional facilities by electric utilities, to reduce imports of foreign oil, and to insure adequate electric generating capacity in the years ahead.
- A proposal to repeal the undesirable and inefficient present withholding system on portfolio dividends and interest earned by foreign investors on U.S. securities.

The administration has also taken new initiatives to maintain and improve the health and vigor of the economy. These proposals are:

- A job creation incentive program which provides for accelerated depreciation of new plant facilities and equipment in areas which experienced unemployment of 7 percent or more in 1975.
- A tax incentive to encourage broadened stock ownership by low- and middle-income working Americans by allowing deferral of taxes on certain funds invested in common stocks.
- Estate tax relief which will alleviate the effect of inflation by increasing the estate tax exemption from $60,000 to $150,000. The current exemption level has been in effect since 1942.
- Estate tax relief for farmers and owners of small businesses to make it easier to continue the family ownership of a small farm or business after the owner's death.
- A proposal to encourage capital formation and the efficient allocation of investment resources by the introduction of a sliding scale for the taxation of capital gains which will, in addition, alleviate the burden of taxation on inflationary gains.

The administration is also committed to an energy policy that will achieve our goal of energy self-sufficiency.

In January 1975, the President proposed measures to conserve energy, increase domestic production and provide for strategic reserves. Although the Energy Policy and Conservation Act contemplates eventual decontrol of oil prices, its immediate effect is to roll back the average price of oil. Prices of natural gas are still controlled in interstate markets. As long as we refuse to remove these Government-imposed controls, and thereby prevent free market incentives from increasing domestic energy supplies, we will continue our dependence on foreign imports and our vulnerability to political blackmail. For these reasons, we are opposed to the provisions of H.R. 10612 which would erect further impediments by increasing the tax burden on investments in oil and gas.

Further, in order to accelerate the replacement of obsolete oil- and gas-fired electric generating capacity, we are proposing that you enact the six-point electric utilities program recommended by the President's Labor-Management Advisory Committee.

With respect to tax reform, the administration's goals are to—

Improve the equity of our tax system at all income levels. This principle goes beyond the concept of vertical equity or progressivity which holds that those with higher incomes should pay a larger share. It extends to the more basic idea that the tax system of a democratic society must be fair to all taxpayers and must be widely recognized as such;

Simplify many of the tax provisions of the Code which seriously affect the taxpayer's ability to cope with the preparation of his income tax return;

Make improvements in the ways in which our tax law is administered.

At the same time, of course, our tax system must be conducive to the stable growth of our domestic economy and the longrun improvement of our position in world markets.

In 1973, the administration made a number of tax reform proposals. In the nearly 3 years that have elapsed, much has been done by the House Ways and Means Committee. H.R. 10612 incorporates to varying degrees many of our 1973 proposals. We are, therefore, renewing the following proposals:

- LAL (limitation on artificial losses) to deal effectively with the problems associated with tax shelters by a solution which reaches their most common feature: Bad tax accounting rules which mismatch expenses and revenues and thereby produce artificial accounting losses. While we continue to endorse the LAL concept, under current circumstances we find its application to oil and gas investments to be inappropriate and inefficient.
- MTI (minimum taxable income) which, in combination with LAL, deals with the problem of taxpayers with high economic income who pay little or no Federal income tax. H.R. 10612 rejects this proposal in favor of an expansion of the current minimum tax which does not subject taxpayers with high economic income to progressive tax rates.
- A simplification package designed to alleviate the intolerable reporting burden imposed upon the average taxpayer.

We also have a number of specific recommendations on various aspects of the House bill and I shall therefore devote a substantial portion of my time to H.R. 10612.

I. CONTEXT FOR TAX POLICY

Maintaining and Improving the Health and Vigor of the Economy

The administration's economic policies, as outlined by the President in his state of the Union message, are designed to keep the economy on an upward path toward two central long-term objectives: Increasing steadily the number of real, rewarding, permanent jobs, and sustained noninflationary economic growth.

The most immediate concern, of course, has been to support the recovery of the economy from the most severe recession in the post-World War II period in a manner which will achieve full employment as rapidly as possible without rekindling inflationary pressures and expectations. Achievement of this objective will not only provide jobs for all who wish to work but, equally important, will reestablish the basic economic conditions necessary to sustain strong and continuous real economic growth which can provide permanent employment gains and a rising standard of living for all Americans.

Status of economy

I am pleased to be able to report substantial progress in the recovery of the U.S. economy. Gross national product in real terms has increased by 5 percent since the trough of the first quarter of 1975 and is rapidly approaching the peak level of the fourth quarter of 1973. At the same time, the rate of increase in consumer prices has continued to diminish. During the last 3 months of 1975, the rate of inflation fell to 6.6 percent on an annual basis. January data are even more favorable, showing a seasonally adjusted annual rise of only 5 percent in the Consumer Price Index. The recent declines in the Wholesale Price Index augur well for continuing progress on the inflation front.

Civilian employment continues to improve, showing an increase, seasonally adjusted, of over 900,000 in January and February to 86.3 million, the highest level since mid-1974. This improvement is reflected in unemployment rates which dropped seven-tenths of a percentage point in January and February to 7.6 percent—substantially below the peak unemployment rate of 8.9 percent in May of last year. Furthermore, improvements in employment have been accompanied by greater labor productivity which increased over 4 percent from the first quarter to the last quarter of 1975.

Short-term policies

Despite this advance of the economy, the overall rate of utilization of physical and particularly human resources remains unacceptably low relative to long-term objectives.

Many advocate a highly stimulative fiscal and monetary policy to cure this problem quickly. However, the risk in greatly stimulating the economy at this time is that this will set off another round of inflation, thereby undermining the economic recovery underway. Thus, our policies for the short term must be to keep the present recovery on track in order to provide a steady and sustainable increase in productive jobs. While employment might be raised somewhat more rapidly in the short run with massive fiscal and monetary stimulation, such stimulus would lead to renewed inflation, an eventual decline in the pace of economic activity, and renewed unemployment.

There is still an important role for tax policy for the short term. Thus, as discussed in more detail later, the administration proposed special temporary tax incentives to encourage construction of new facilities and purchases of equipment in areas in which unemployment exceeds 7 percent. The objective of this program is twofold. First, it will provide immediate relief to the unemployment problem of the construction industry, one of the most depressed industries in our economy. Second, the incentive will be provided in areas of high unemployment where new jobs are most needed.

Long-term policies

Our policies for the long term must be to create an economic environment which encourages individuals to save and businesses to invest, and thereby to restore the dynamism of our economy. The administration has long and continuously emphasized the need for a higher rate of capital formation, and I shall have more to say on this topic in a moment. At this point, I simply note that we cannot expect businessmen to assume the risks of business expansion unless the Federal Government does its share to provide a stable climate in which sound business decisions can be made. This means stable prices, ready access to financial markets, and the certainty that the Federal Government will not make increasing tax claims on the returns flowing from these investments.

Two conditions are essential if we are to make substantial progress toward achieving our long-term goals:

First, the rate of growth of Federal spending must be reduced and we must move to a position of budgetary balance. The administration's program of spending restraint coupled with tax reductions will help us meet the first condition. The Federal deficit will be reduced from an estimated $76 billion in fiscal 1976 to $43 billion in fiscal 1977 and to budgetary balance by fiscal 1979.

Second, economic incentives must be provided for saving and investment in order to increase the rate of capital formation. Several of the tax proposals which the administration recommends are designed to promote such saving and investment. More precisely, these recommendations are designed to remove some of the disincentives to saving and investment which are inherent in our existing tax structure. Thus, as I will discuss in greater detail later, we recommend the following tax measures:

- A permanent reduction in corporate income tax rates from 48 percent to 46 percent and a permanent reduction of the tax rate on the first $50,000 of corporate income to replace the current temporary provisions,
- A permanent 10-percent investment tax credit,
- Elimination of the double tax on corporate dividends,
- Revisions in the taxation of capital gains,
- Tax incentives to broaden stock ownership,
- Tax incentives to expand the use of individual retirement accounts.

We also recommend the elimination of withholding taxes on foreign investment to encourage the inflow of capital from abroad.

All of these recommendations are made out of a deep concern that the failure to increase the rate of capital formation can have profound consequences for our economy for years to come.

The dangers that can arise from inadequate capital investment over a period of years are best illustrated by the 1973 production bottleneck. In that year, industries that process such materials as steel, paper, fertilizers, chemicals, cement, nonferrous metals, and textiles were operating at the limits of their physical capacity. But they still were not producing enough goods and services to meet the demands from industries that manufacture automobiles, clothing, machine tools, and other finished products. This situation contributed to the rapid rise in inflation and ultimately to the recession of 1974–75.

Another consequence of inadequate saving and investment is that annual gains in productivity, that is, total output per worker, have significantly slowed during the post-World War II period. As shown in the figures below, the growth rate of productivity, which had averaged between 2.0 and 3.3 percent per year until the mid-sixties, decreased to an average of 1.5 percent over the past 10 years.

U.S. productivity growth, 1950–74

[Average annual rate over 5-year intervals]

Period	Gross domestic product per employed person
1950-54	2.44
1955-59	2.13
1960-64	3.27
1965-69	1.73
1970-74	1.33

The diminishing of U.S. productivity gains takes on added significance when compared with the experience of our major trading partners. Over the past 15 years, Japan, West Germany, France, Canada, Italy, and the United Kingdom have all experienced more rapid rates of productivity growth than the United States; and, taken together, their rate of productivity growth is more than double ours.

The rate of capital formation is a major determinant of the growth of productivity. Therefore, an increased rate of capital formation is required to maintain the competitive positioning of U.S. business in world markets.

Increased productivity also means that higher wages need not be passed forward as higher prices so that real income can rise for all. This point should be emphasized. In a world where yearly increases in money wages are customarily expected, our main line of defense against inflation is an economy with growing productivity. Wage increases need not lead to higher per unit costs of production as long as output per worker, or productivity, rises sufficiently. This can happen if we provide workers with more and better equipment, that is, if we maintain high rates of capital formation.

However, as I have noted on other occasions, our investment performance has not been satisfactory. The share of our national output which goes to investment has been below that of other major industrialized countries. When we look at the future, we find little grounds for believing that our capital needs will become any less intense. Indeed, all studies on this subject conclude that if we are to realize our economic goals, we must commit an even higher portion of our income to national saving and investment in the future than we have in the past.

Consider, for example, a recent study by the Bureau of Economic Analysis of the Department of Commerce on projected capital needs of the country in 1980—only 4 years away. That study concluded that in order to achieve our goals of full employment, greater energy independence, and pollution abatement, the ratio of business fixed investment to GNP for the decade of the seventies must be increased.

Several other studies have also concluded that to meet employment and growth objectives, the demands for investment as a proportion of GNP will increase very substantially beyond what had been experienced in the recent past. To finance the shift in resources toward more investment, more private savings and sharp reversals of Government deficits will be required.

Results of these studies, taken together, imply a need for an increase in the rate of private savings from 15 percent to 16 percent of GNP.

Sources of demand for capital

The sources of demand for capital should be carefully identified.

First, there are enormous investment demands generated just in maintaining a growing labor force properly equipped with capital. Between now and 1985, the labor force will expand by approximately 16 million persons. When we add to this the 3 to 4 million unemployed today, the total is nearly half again the 13 million jobs generated during the past decade.

Second, capital is needed to achieve specific public policy objectives: Accelerated development of new energy resources to make us more self-sufficient; improvement of environmental quality; safer working conditions; better housing. In the energy field alone, estimated investment needs for the next decade total $1 trillion.

Third, and most important, is the economic necessity to increase our production efficiency to raise the real standard of living enjoyed by Americans. If anything has been clearly established by economic studies over the years, it is the close relationship between capital investment and productivity. Capital investment is a key factor in increasing productivity, economic growth, and real earnings.

I do not mean to imply that investment in plant and equipment is the only factor that affects productivity. There are, of course, other factors such as new technology, the skills and growth of the labor force, access to raw materials, and the stage of the business cycle. But the more capital investment we have, the more these other factors can increase productivity.

The tax proposals which I have already mentioned and will discuss in considerably more detail are directed towards stimulating more saving and investment to meet our long-term capital needs. They will operate through increasing the after-tax profitability of investment and thereby encourage businessmen to undertake more capital projects. The proposals will also provide a higher after-tax return to those who save, thereby encouraging them to reduce somewhat the customary amount of consumption. Along with the reduction in the growth of Federal spending, these proposals should help tilt slightly the overall allocation of our total income in favor of investment.

Other capital formation problems

There are a number of related problems concerning capital formation which our tax policies address. These problems are: The tax bias against savings and investment, the inefficiency with which the present capital stock is used, the overstatement of profits as a result of inflation, and the problems of corporate finance. Let me comment on each of these in turn.

Tax bias against savings and investment.—The willingness of people to save and invest depends in large part on the financial reward which flows from the investment. Thus, to the extent the income tax system takes away the reward, it lessens the incentive to save and invest. Our income tax system is heavily biased against investments producing financial returns that constitute taxable income.

A simple example illustrates this point: Assume you have $5,000 and that the question is whether to spend it on consumption items or to save it and buy a bond. In weighing the consumption alternative, you would not take income taxes into account, but in weighing the bond alternative, you would have to consider the fact that some percentage of the interest income on the bond would go to the Government in the form of income taxes. While this result is not necessarily improper, it does mean that the existence of the income tax system, or any income tax system, tilts the scale significantly when people are deciding whether to save or consume.

Moreover, it is frequently forgotten that income from capital is not only included in our income tax base, it is also taxed more than once in our Federal tax system—as corporate income, as personal income, and when transferred at death or by gift under the estate and gift taxes—and that such income is also taxed in State and local tax systems.

In sum, the existing tax system—the combination of income, estate and gift, and State and local property and income taxes—imposes a heavy burden on capital. Obviously, if we wish to increase saving and investment, a lessening of this tax burden is the logical place to begin.

Inefficiency in the use of capital.—While I have emphasized the need to increase the total volume of investment, we should be concerned as well about the tax system's effect on efficient allocation of investment among competing uses. In fact, to the extent that existing investment may be made to work more efficiently, we would be reaching much the same results as we would from additional investment. We should, therefore, work to remove those features of the tax system which cause the flow of savings to be channeled away from more productive investment and into less productive investment. The most important such distortion in the existing tax system is the two-tiered tax upon corporate income.

Moreover, viewing the economy in the aggregate, it is not just corporate shareholders who have lower earnings as a result of this tax. If that were the case, that is, if corporate stock investments provided a lower rate of return than other kinds of investment, no one would invest in stock. In a competitive capital market, capital is constantly flowing from one kind of investment to another until the after-tax rates of return are comparable. If investment in corporate equities is less profitable, then capital will flow out of such investment, or less capital will flow in. If there is less demand for stock on the stock exchange, the price of stock will fall and yields will rise. For example, if a $100 stock pays a $5 dividend, the return is 5 percent. But if the demand for stock declines and the price falls to $80, the $5 dividend provides a yield of better than 6 percent. At the same time, capital which is diverted from corporate stock accounts will increase and result in a greater demand for bonds and other debt instruments as well as a greater demand for investments in assets and enterprises not held in corporate form. The greater demand for that kind of investment will in turn depress the return on that investment.

The market, therefore, operates to equalize rates of return between different kinds of investment. In the end, a part of the corporate tax is a net additional burden on wage earners and consumers, and a part is a burden distributed across the owners of all kinds of capital, not just corporate shareholders.

The factors I have just described have major implications for the efficient use of capital and for tax policy. The price charged by corporations to their customers must be adequate to provide funds to cover the return. This necessarily means that prices for goods produced by corporations must be relatively higher than prices of goods produced in the noncorporate sector. In turn, consumers are discouraged from purchasing goods from the corporate sector and spend less of their money on such goods than they would if taxes were neutral with respect to different kinds of investment. If the extra tax burden on corporate investment were eliminated, this bias would disappear and there would be increased demand for corporate goods and services. People would be able to have more of the things which they prefer, and the efficiency of our stock of capital would be increased. The real income of the Nation would rise significantly as more desired output is substituted for less desired output. Thus, the two-tier tax on corporate income is a barrier to the most efficient use of existing capital.

Getting more out of the capital we already have is as good as having more capital. In fact, it is better because in order to get more capital we must give up some current consumption, which need not be the case if we are only increasing the efficiency of what we already have.

Overstatement of profits as a result of inflation.—Inventories and depreciation are two major elements which substantially overstate profits in periods of inflation.

The inventory situation may be illustrated by assuming a company that normally maintains an inventory of 100,000 widgets. Under traditional FIFO accounting, if inflation causes the price of widgets to increase by $1, from $2 to $3, the $100,000 increase in the value of the inventories is reported as profits, even though the company is no better off in real terms than it was before the inflation. Economists have long recognized that this increase is not a true "profit" and the Department of Commerce national income accounts have, from the inception of those accounts in the 1940's, separated it from profit figures.

A similar situation exists with respect to depreciation. In a period of rapid inflation, depreciation deductions based on historical cost result in reporting as income amounts which do not represent an increase in wealth but which are required merely to stay even.

These inventory and depreciation effects produce a dramatic overstatement of real income: Nonfinancial corporations reported profits after taxes in 1975 of $60.1 billion as compared to $37.2 billion in 1965, an apparent 62-percent increase. But, when depreciation is calculated (under the double declining balance method) on a basis that provides a more realistic accounting for the current value of the capital used in production, and when the effect of inflation on inventory values is eliminated, after-tax profits actually were constant: $35.8 billion in 1975 and $35.6 billion in 1965. However, income taxes were payable on the fictitious profit element. In effect, then, there has been a rise in the effective tax rate on true profits from about 43 percent in 1965 to 51 percent in 1975.

The overstatement and overtaxation of operating profits caused by inflation is a problem for all business which represents yet another barrier to our goal of stimulating a higher rate of capital formation. Our recommendations to reduce business taxes should be considered in this context.

Problems of corporate finance

One of the factors which can inhibit the future growth of needed capital formation is the financial condition of American corporations. Analysis of debt-equity ratios indicates that corporate balance sheets have shown signs of deterioration over the past decade, which is a break from the pattern which persisted in earlier periods. Debt has increased dramatically, both in absolute terms and relative to assets and income. Interest costs have risen appreciably, roughly doubling over the past 10 years. The combination of increased debt financing and higher interest rates has resulted in a decline in the coverage ratios reported by American corporations; that is, the ratio of earnings to interest charges. The ratio of liquid assets to debt has shrunk. As a result of these developments, there is a serious question about the potential capability of companies to be able to finance the capital investment that will be required to achieve our basic economic goals of reducing unemployment and inflation as I outlined earlier in my testimony.

For many years there has been a discernible trend toward growing dependence by business on outside funds to finance their growth. The percent of business financing needs raised externally by nonfinancial corporations declined from 1958 to 1964 and averaged about 30 percent of total needs during that period. However, that trend was reversed beginning in the mid-1960's and the proportion of external financing rose to over 60 percent in 1974. The growing dependence on external financing really began in the mid-1960's and has risen steadily since then. This shift in financing methods from reliance on internal to external sources of funds follows the pattern of inflation pressures which also began to accelerate in the mid-1960's. Inflation rapidly increases the costs of new investments and erodes corporate profits which are a major internal source of capital for financing new projects. The distorting effects of inflation force companies to rely more heavily on external sources of funds.

Another, and perhaps more important, change appearing on corporate balance sheets is that the increased emphasis on external financing has been dependent on debt rather than equity sources of funds. There are several fundamental reasons for the shift toward debt: (1) Corporate treasurers have been reluctant to raise new equity capital because the sale of additional shares of ownership dilutes the earnings per share and ownership rights of existing stockholders; (2) in the 1950's and throughout most of the 1960's, the cost of debt was low relative to the cost of equity; (3) because of the depressed level of stock prices in recent years, the shares of many companies have had historically low price earnings ratios—indeed many stocks are selling at prices below their book values which discourages new equity financing; (4) the financing costs of arranging new debt issues or loans are usually much less than the costs of selling new shares of stock and there is less uncertainty about placement of the securities; and (5) the use of debt enables the borrower to deduct the interest payments from earnings before determining the amount of taxes to be paid. The tax deductibility of interest payments creates a major advantage in favor of debt financing and has encouraged the sharp shift in the debt-equity relationship. Unfortunately, the emphasis on debt commitments has made our financial system more rigid and more vulnerable to economic shocks.

From 1965 to 1974 nonfinancial corporations raised a total of $267.4 billion of long-term funds. Long-term debt accounted for 83 percent of that total. This means that the incremental debt-equity ratio for external funds was an extremely high 4 to 1. The balance sheet impact of this change was to cause long-term debt outstanding to rise from $141.4 billion to $362.3 billion over the same timespan—a 2 1/2-fold increase in just 10 years' time. What this means, of course, is that there has been a significant rise in debt-equity ratios over the past decade. These have roughly doubled for manufacturing firms.

The implication of these fundamental shifts in the patterns of financing is that the structure of corporate balance sheets is much more brittle and less liquid than it was 10 years ago. Obviously there is no single level where the corporate financial structure suddenly becomes too illiquid and inflexible, but at the same time an ever higher burden of debt commitments relative both to financial assets and to income is a matter for some concern. Coverage ratios have dropped sharply over the past decade and operating break-even points have risen. This makes companies less able to withstand even modest-sized recessions. Accordingly, the potential for bankruptcy has greatly increased across the entire spectrum of U.S. business. This potential in and of itself will discourage future investment as lenders become more reluctant to make long-term commitments and companies become less willing to take on fixed payments of interest and repayment of debt obligations. Some investments which would have been undertaken in earlier periods will be passed over in the future.

We must achieve fundamental reforms in our tax system to redress the imbalances in corporate balance sheets and broaden equity ownership—reforms that will encourage the levels of savings and capital investment that are so vitally needed for our future. The increasing aversion to risk taking in the lending and investing process must be arrested.

Toward these ends, the administration is proposing to integrate corporate and personal income taxes. This proposal would eliminate the double taxation of corporate earnings which results from first taxing corporate incomes and then taxing individuals who receive dividends. I strongly believe that this proposal—which has already been adopted in most of the other major industrialized countries—would make a significant contribution toward meeting our capital needs of the future. Moreover, it is the only major tax proposal of which I am aware that comes to grips with the growing imbalances between corporate debt and equity.

Energy Policy

No subject is more basic to the future of our economic prosperity than energy. Unfortunately, we have been without a comprehensive energy policy for too long. The oil embargo of 1973 and subsequent price increases demonstrate how vulnerable we have become. Neither the supply nor the price of a central ingredient in our economy is under our control. Our well-being and progress have become subject to the will of others. If there is a major lesson to be learned from our past energy policies, or the lack of them, it is that a system of patchwork Government regulations and shortrun measures designed to head off specific crises leads to more patchwork regulations and short-term measures—not to a viable energy policy that will produce energy efficiently at the lowest prices to consumers.

The President is committed to ensuring an energy policy that will achieve our goals. In January 1975, he submitted a set of measures to conserve energy, increase domestic production and provide for strategic reserves. The Energy Policy and Conservation Act contains important steps in the right direction, but the penalty for ultimately ending oil decontrol is first to roll back the average oil price. This action, coupled with the action taken by Congress to effectively repeal 70 percent of the depletion allowance for oil and gas, cannot help but have a retarding effect on exploration and development. The President is committed to bringing about decontrol as rapidly as possible, and we must make sure that the 40-month period for decontrol is not extended.

This legislation is certainly not the end of our efforts to bring about a more rational energy policy. Prices of our natural gas are still prohibited from rising to their market level in interstate markets, and shortages will continually plague us unless price is allowed to rise.

Domestic marketed natural gas production has declined by approximately 11 percent in the last 2 years—a trend that must be reversed.

We have the resources to change this if we will only adopt policies that will develop these resources. As long as we refuse to remove these Government-imposed controls, and thereby prevent free market incentives from increasing domestic energy supplies, we will continue our dependence on foreign imports and our vulnerability to political blackmail. For these reasons, we are opposed to the provisions of H.R. 10612 which would erect further impediments by increasing the tax burden on investments in oil and gas.

Further, in order to accelerate the replacement of obsolete oil- and gas-fired electric generating capacity, I am once more urging this committee to enact the six-point electric utilities program recommended by the President's Labor-Management Advisory Committee.

Tax Reform

The third major issue before you concerns the ways to enhance the fairness and simplicity of the tax system.

Over the years, the continuing efforts by various groups to achieve narrow, but often worthy, objectives through the use of special provisions in the Code have led us to a situation in which the confidence of the American taxpayer in the very foundation of the Federal revenue system—the individual income tax—is being seriously threatened.

We are fortunate to have a highly successful tax system, one which has over the years commanded widespread respect and a high degree of voluntary compliance. We can be sure that Americans will continue to support this system so long as they have confidence that all are paying their fair share and as long as they feel they are getting their money's worth. However, as the system has become increasingly complex, we have begun to erode that basic faith in the fairness of the system. Many people today feel that taxes are being imposed upon them without their consent, that too many of their fellow taxpayers are escaping their responsibility through dozens of loopholes, and that the Code itself has become a Byzantine labyrinth of legal doubletalk.

To be sure, reasonable persons will differ on the importance of particular bits or pieces of the income tax law. Broad agreement can be reached on the overall objectives toward which meaningful tax reform strive: The tax system should be fair and equitable, the tax system should be simple, the tax system should promote efficient use of the Nation's resources.

I have addressed earlier some of the critical ways in which the tax system needs to be improved in the interests of efficient allocation of resources. When we focus instead on the fairness or equity of the tax system, we must be concerned with the relationship of tax burdens borne by households to their ability to pay. Tax burdens should be similar for taxpayers whose opportunities and capabilities of supporting a standard of living are the same. Further, the tax burdens of those relatively better off should also be relatively larger. Because of some of the provisions in the Code, we have reached a situation in which there is a widespread perception that neither of these criteria is sufficiently well satisfied by our tax law.

As I shall subsequently develop in greater detail, the administration's tax cuts will also promote fairness and simplicity. Thus, the proposed permanent increases in the standard deduction and personal exemptions as well as the reduction of the tax rates will more equitably relate tax burdens to the ability to pay and simplify considerably the preparation of tax returns. These tax cuts also continue the pattern of reducing the tax burdens of low-income families—removing many from the tax rolls—while moving to restore the eroded position of the middle-income group.

The House bill contains many provisions designed to limit the benefits which high-income individuals receive from certain investment incentives provided in the Code. These incentives include preferential capital cost recovery deductions to encourage investment in such activities as real estate, minerals, and farming. The effect of these incentives is a deferral of taxes which is worth more to taxpayers in the highest marginal tax brackets. Individuals responding to these incentives are not acting illegally and represent a small fraction of all taxpayers. However, excessive use of such incentives by high-income individuals may undermine the progressivity of the income tax as well as its perceived fairness.

In 1973, the administration originated the LAL (limitation on artificial losses) proposal which limits the benefits of these tax incentives—often called tax shelters. We are pleased that the House bill generally follows our proposal, and we continue to support the broad objectives toward which LAL is directed.

Further, to deal with the problem of high-income taxpayers who do not pay their fair share of tax, the administration is renewing, in modified form, its 1973 MTI (minimum taxable income) proposal. MTI is an alternative tax which will subject taxpayers to progressive income tax rates. We continue to feel that this approach is superior to the minimum tax which is an additional flat rate tax on tax preferences, primarily capital gains. H.R. 10612 would increase the minimum tax rate and would leave intact its structural deficiency as an additional tax.

The objectives of equity, simplicity, and efficiency can best be served by appropriate broadening of the base for the income tax, moving toward a more inclusive concept, and ultimately leading to a lower structure of rates for all. Whereas the minimum tax represents an additional layer of complexity in the system, the minimum taxable income concept is consistent with the long-term program of developing an alternative and more comprehensive tax base and taxing that new base at lower rates.

While the House bill contains some measures to improve the simplicity of the tax system as it is encountered by the average taxpayer, it need hardly be pointed out that the overall effect of H.R. 10612 is to add another substantial dose of complexity to the Code. In my view, we have reached the situation in which the objective of simplicity, which might ordinarily be viewed as merely a minor or supporting objective of the fundamental objectives of fairness and efficiency, has to be raised to a level of first importance.

Much of the complexity of the tax system is encountered by relatively affluent households or by business firms. Yet, the number of taxpayers affected by such complexities as the computation of the retirement income credit or the sick pay exclusion has steadily grown. Furthermore, the complexity of the Code as it confronts the relatively affluent must be of concern to *all* taxpayers since it is this very impenetrability of the law which leads to the feeling of the average taxpayer that his neighbor who can afford highly talented tax advisers is able to manipulate the system to his advantage. We are, therefore, renewing many of our 1973 simplification proposals including the miscellaneous deduction allowance to substitute for hard-to-itemize deductions, repeal of the sick pay exclusion, and revision of the retirement income credit.

Having set the context for our approach to the issues before this committee, let me turn now to some of the specifics. I shall take up first the main elements of the administration's tax proposals, discuss the relationship of energy policy and tax policy, and close with a discussion of tax reform, focusing specifically on H.R. 10612.

II. ADMINISTRATION PROPOSALS

Permanent Tax Reductions

Last October, President Ford proposed that permanent large tax reductions be made possible for American taxpayers by Congress joining with him to limit the rate of growth of Federal expenditures. Specifically, the President proposed a $28 billion tax cut linked to the adoption by the Congress of a spending ceiling of $395 billion for fiscal 1977. That spending ceiling, and the budget presented to the Congress this January, represent a reduction of about $28 billion from the projected levels of spending that would have applied for fiscal 1977 had actions to limit Federal spending not been taken.

In my testimony before this committee last December 9, I set forth in detail the budgetary and economic trends that had caused the President to conclude that decisive action to regain control over the budget was immediately required. Today I will summarize briefly the objectives underlying the administration's proposal for permanent tax reductions. I will also describe the details of that proposal, as modified to take account of the temporary tax cuts enacted last December.

Administration objectives

The proposed dollar-for-dollar reduction in Federal taxes and Federal expenditures has two fundamental objectives. The first is to restore fiscal discipline in the consideration of tax and expenditure measures; the second is to return more decisionmaking discretion to individuals and families to determine how they will allocate their incomes and personal financial resources.

Fiscal discipline.—Our recent fiscal history demonstrates that the failure to link tax cuts with expenditure cuts, and expenditure increases with tax increases, has resulted in substituting the capricious tax of inflation for the more equitable, but politically difficult, legislated tax increase.

In fiscal 1962 the Federal budget exceeded $100 billion for the first time in history. By fiscal 1971 it exceeded $200 billion. By fiscal 1975 it exceeded $300 billion, and a figure of $425 billion was in prospect for fiscal 1977 without some restraint—a fourfold increase in just 15 years! Federal Government outlays increased at an annual rate of 6.6 percent during the period 1961–66, at 9.4 percent per year during the next 5 years, and at 11.8 percent per year from 1971 to 1976. If fiscal 1977 expenditures should be permitted to grow to $423 billion, the rate of growth will reach 14.3 percent.

Furthermore, the growth in spending has far exceeded the growth in revenues. During these same years we have posted a string of budget deficits that are unprecedented in peacetime. The Federal Government (including its agencies) will have been forced to borrow over $350 billion from our private money markets over the decade ending with the current fiscal year. That is over a third of a trillion dollars that might otherwise have been used to build new plants and to create new jobs in the private sector.

It is no wonder that inflation has been such a severe problem and that interest rates have risen to historic levels as a natural consequence of these policies. Moreover, an even worse result of such budgetary practices is that continuing deficits tend to undermine the confidence of the public in the capacity of our Government to deal with inflation.

Thus, a principal goal of the President's program is to restore the Federal budget to balance. Reducing the projected fiscal 1977 deficit to $43 billion will make possible a balanced budget by fiscal 1979. We are, of course, extremely pleased that your committee, in its budget recommendations for fiscal 1977, has substantially agreed with the President's target for that year's deficit and, as provided in section 1A of the Revenue Adjustment Act of 1975, has accepted the basic premise underlying the President's program that expenditure increases reduce, dollar-for-dollar, the total tax reductions that may be enacted.

Decisionmaking process.—The second objective of the President's program is to return more decisionmaking discretion to individuals and families to determine how they will allocate their incomes and personal financial resources. The growth of Federal expenditures has brought with it increasing Government dominance in basic decisions respecting the use of our Nation's resources and a corresponding diminution in the role of private decisionmaking.

Over the past 10 fiscal years, Federal expenditures have grown 175 percent while total GNP has increased about 120 percent—that is, the rate of growth in Government outlays was nearly 50 percent greater than that of the economy itself.

Some analysts have claimed that the surge of Government spending and deficits is only temporary and that more moderate outlay growth rates and budget balance will return as soon as economic conditions stabilize. It is true that part of the increases in the budget outlays can be traced to the "automatic stabilizers" that should respond to recession problems. For example, unemployment compensation benefits have increased from $6 billion in fiscal 1974 to over $19 billion in fiscal 1976. However, a review of the actual budget figures clearly indicates that large spending increases have been occurring across the traditional programs of the entire Federal Government. These spending increases cannot realistically be regarded as "temporary" since Government programs are rarely eliminated or curtailed.

Our choice, then, is clear. We can regain control over Federal spending, stop the trend toward the Federal Government's direction of the use of an ever increasing portion of our national wealth, and restore a greater share in decisionmaking to individuals and families through large permanent tax cuts. Or, we can continue down the road of the past which leads toward even larger budgets, continuous deficits, and increasing domination of Government over our economic affairs.

Description of administration proposal

Let me turn now to the specifics of the administration proposal for permanent tax reductions. The enactment of the Revenue Adjustment Act of 1975 has made it impossible to apply the President's full proposed tax cuts for all of 1976. We are, thus, proposing distinct liability changes for 1976 and 1977, which have the combined effect of applying the administration's permanent tax reductions effective July 1, 1976.

Calendar year 1977 and beyond.—The administration's permanent program has the following major features: An increase in the personal exemption from $750 to $1,000; substitution of a single standard deduction—$2,500 for married couples filing jointly and $1,800 for single taxpayers—for the existing low-income allowance and percentage standard deduction; a reduction in individual income tax rates; a permanent 10-percent investment tax credit; a reduction in the maximum corporate income tax rate from 48 percent to 46 percent and making permanent the current temporary tax cuts on the first $50,000 of corporate income; a program to stimulate construction of new electric utility facilities to insure that longrun economic growth is not limited by capacity shortages in the production of electricity.

Calendar year 1976.—Since taxpayers compute their taxes on a calendar year basis, the administration is proposing tax liability changes for calendar year 1976 that mesh the permanent proposal with the Revenue Adjustment Act of 1975 and approximate the effect of applying in 1976 the current temporary tax cuts for 6 months and the administration's permanent tax cuts for 6 months. The administration's full proposed tax liability changes will apply for 1977 and subsequent years.

The administration's proposals would result in lower withholding tax rates (and higher take-home pay) effective July 1, 1976. The lower withholding tax rates would reflect the full impact of the tax cuts proposed by the President last October and would remain constant in 1977.

The specific tax liability provisions that will apply in calendar year 1976 are:

	Tax cuts (compared to 1974 law)
For individuals:	
A personal exemption of $875	$ 5.4 billion
A per capita exemption credit of $17.50, with alternative taxable income credit equal to 1 percent of the first $9,000 of taxable income (i.e., maximum credit equals $90)	4.9 billion
Standard deduction changes	3.9 billion
A low-income allowance of $2,300 for joint returns and $1,750 for singles; a percentage standard deduction of 16 percent of adjusted gross income with a maximum of $2,650 for joint returns and $2,100 for singles; an average of the rate structures under present law and the President's permanent tax cut program	3.6 billion
An earned income credit equal to 5 percent of earned income with a maximum of $200, phasing out at $8,000 of earned income or adjusted gross income, whichever is greater	.7 billion
Total individual cuts	18.5 billion
For business:	
A reduction in corporate rates	3.2 billion
(The rates will be 20 percent for the first $25,000 of taxable income, 22 percent for the second $25,000 of taxable income, and 47 percent for taxable income above $50,000.)	
The program to stimulate construction of electric facilities, effective July 1, 1976	.6 billion
Total individual and business tax cuts	22.2 billion

Individual tax cuts.—The recently adopted budget recommendations of your committee and of the House Ways and Means Committee contemplate that reductions in taxes from 1974 law will be provided through calendar year 1977, without specifying the details of those reductions. Consistent with that approach, and in recognition that the so-called temporary tax reductions are in fact in process of becoming permanent, we believe it is essential to face the necessity for making fundamental decisions regarding the permanent structure of the individual income tax, as opposed to the patchwork approach that has prevailed to date.

The administration's proposed individual tax reductions are designed to achieve two important goals. The first goal is to simplify the existing tax structure by providing a single standard deduction as a substitute for the present low-income allowance and maximum standard deduction. The second goal is to begin the difficult, but most vital, task of realining the tax rate structure to relieve the middle-income taxpayer from the onerous tax burden imposed as a result of industriousness and thrift.

Let me elaborate: Simplification should begin with those provisions that affect the greatest number of taxpayers. The provision of a single standard deduction would in itself be a major simplification. In contrast, the addition of the per capita exemption credit has been a major complication, and many taxpayers are failing to claim the credit. The situation will be worsened by the addition of the alternative taxable income credit by the Revenue Adjustment Act of 1975.

Because of rising productivity, but more particularly because of the effect of inflation on nominal money incomes, families comprising the middle and upper-middle classes of society have been moved up the tax scales to positions previously occupied by only the top 1 or 2 percent of American families. As a result, the middle-income taxpayers find that larger and larger tax bites are being taken from their paychecks and entrepreneurial incomes. For this particular group of taxpayers, the rewards of enterprise, of sustained effort, and of the accumulation of capital have been eroded. As we all benefit from the vigor of this group, so are we hurt when its vitality is threatened. The administration's proposals are designed to reverse the trend, by providing relief to the middle-income taxpayer while more than preserving the gains of the lower income taxpayer.

Business tax cuts.—The Tax Reduction Act of 1975 increased the nominal rate of the investment credit to 10 percent from 7 (4 percent in the case of utilities) for the years 1975 and 1976. The President's proposal would make the increase permanent. It is well known that any tax provision intended to encourage investment is most effective when investors may regard it as permanent, for then they may take it into account over the full range of their investment planning horizons, which are frequently 10 years or longer. As part of a program of structural fiscal change, the investment credit helps offset the anti-capital-formation bias of the Federal tax system and should have permanent status.

The Tax Reduction Act, for the year 1975, raised the corporation surtax exemption to $50,000 from $25,000, and lowered the tax rate on the first $25,000 of taxable income from 22 to 20 percent. The Revenue Adjustment Act of 1975 extended this tax reduction an additional 6 months. Again, the President's proposal would make this change permanent.

In addition to this modification of the corporation tax schedule, the President proposes to reduce the top rate 2 points so that the maximum applicable tax rate would be 46 percent. Until we, working with the committees of Congress, can effect integration of the corporation and personal income taxes, this modest relief of the extra burden of tax should cause beneficial increases in the rate of capital formation.

Finally, the President's proposals include a six-part tax incentive program for electric utilities to accelerate the replacement of facilities now made obsolete by the higher costs of fossil fuels and to encourage the application of more adequate capital cost pricing formulas by utility commissions.

Job creation incentives

As I mentioned earlier, this administration is committed to two fundamental economic policies: Sustained noninflationary economic growth and jobs for all who seek work. The proposed tax cuts, coupled with the corresponding reduction in the growth of Federal spending which I have just described, go a long way toward achieving our goal over the long run. But tax cuts alone are not enough. There is a pressing need for more immediate measures to alleviate the unemployment problem that is particularly severe in certain segments of our industry and in certain areas of our Nation. What we need and must do is to create a favorable climate for private industry to create more jobs. This, we believe, can best be accomplished by the adoption of tax incentives. As the President stated in his state of the Union message, "One test of a healthy economy is a job for every American who wants to work. Government—our kind of government—cannot create that many jobs. But the Federal Government can create conditions and incentives for private business and industry to make more and more jobs."

The administration has proposed just such a job creation incentive. Introduced in the House as H.R. 11854, the proposal will permit rapid depreciation for businesses which construct new plants or expand existing facilities in areas where the unemployment rate exceeds 7 percent, or purchase equipment for use in these new or expanded facilities. The tax incentive approach to provide jobs through the private sector is preferable to creating public service jobs. Public service jobs typically are temporary, often not productive, and subsequently require the recipient to find permanent employment after the program has been terminated. Public service jobs also typically require bureaucracies that are difficult to establish and difficult to liquidate. The purpose of the administration's proposal is to establish rewarding, permanent employment opportunities through the private sector.

The administration's proposal has the following advantages:

First, the stimulation of plant construction and expansion, and equipment purchases will lead to the creation of new and permanent jobs, in the private sector, in areas where they are needed most.

Second, we expect the proposed tax incentive will provide substantial impetus for businesses to embark upon projects now deferred and to undertake new projects which otherwise might not get started.

Third, the administration proposal will provide immediate benefit to the construction industry, one of the most depressed in the economy. The plan will stimulate construction in areas where that industry has been hardest hit by the recession and thereby provide jobs for unemployed persons concentrated in those areas.

Fourth, the proposal will also encourage capital investment. While not directly affecting the overall supply of capital, the plan will provide an incentive for capital spending to create jobs. By improving the cash flow of companies, it will encourage investment in 1976.

Let me turn now to some of the specifics of the administration's proposal.

Timing of plan

The plan is proposed as a temporary measure, pending return to full employment in an economy that is steadily recovering from the recession. Therefore, investment projects must begin during the year beginning on January 19, 1976, and must be completed within 36 months; that is, facility construction must be commenced, or production equipment ordered, on or after January 19, 1976, and before January 20, 1977, and must be completed and placed in service within 36 months thereafter.

This time period has been chosen for several reasons. The requirement that projects be begun in the year starting January 19, 1976, will result in immediate employment opportunities—particularly in the construction sector. The plan will also have immediate employment effects in the capital goods industries, which also have been badly hit in the current recession and are operating at well below normal utilization rates throughout the country. Furthermore, requiring projects to be completed and placed in service within 3 years will avoid the risk of unduly extending the temporary relief measure. The bulk of construction and equipment manufacture will take place in 1976 and 1977, when capacity will be available. Moreover, because of its short time period, the plan will not threaten the relocation of projects already planned.

Qualifying location

Facilities and equipment will qualify for rapid depreciation under the plan only if constructed and placed in service in areas which had an average unemployment rate of 7 percent or more for calendar year 1975. Geographic areas with high unemployment will be defined by the Department of Labor in accordance with the functional definition of labor market areas (LMA's) presently used by the Department of Labor in the development of unemployment statistics. Areas of a State that are outside defined LMA's will be considered as a whole, and if this portion of a State had an unemployment rate of 7 percent or more in 1975, it also will be eligible.

With the 7-percent trigger, about two-thirds of the metropolitan areas of the country will be eligible for the plan. Eligible areas are found in 42 States, plus the District of Columbia and the Virgin Islands, and include about 80 percent of the labor force.

According to the Department of Labor, since the middle 1960's there has been a dramatic shift toward greater regional variation in unemployment. Pockets of high unemployment are not only persisting but increasing. By focusing our efforts on pockets of high unemployment, we hope to provide stimulus to areas with the greatest need. A desirable byproduct of these efforts is the potential benefit to the Nation as a whole because equipment orders will flow to productive areas, whether or not they also may be an area eligible for relief.

Application to real estate

The administration proposal will apply to any commercial or industrial facility located in a qualifying area, the construction of which is started and finished within the time period previously described. Commercial and industrial facilities include factories, warehouses, shopping centers, and office buildings. Distinct additions to existing facilities will also qualify, but not mere alterations or improvements.

Certain limitations will be applicable to the proposal. Thus, the tax incentive will not be applied to facilities used for lodging or to governmental facilities or facilities of certain tax-exempt organizations. Moreover, the proposal will not apply to any residential real estate activities. Housing and residential construction have received substantial stimulus from recent actions by the Department of Housing and Urban Development and will receive additional stimulus from other proposals made by the President in his state of the Union message. This particular proposal seeks comparable incentives for the nonresidential sector.

Amortization of qualified real estate will be allowed over a period equal to one-half the shortest life which a taxpayer may now claim under the provisions of the Internal Revenue Code and the regulations. This is a very substantial tax incentive. For example, in the case of a building with a 30-year useful life, the taxpayer will be able to write off one-third of the cost in the first 5 years as compared with 23 percent under the most accelerated method of depreciation now available. Recapture of depreciation upon a disposition of qualified real estate, under the rules of Code section 1250, will apply.

Application to equipment

The proposal will also apply to equipment which is ordered during the year beginning January 19, 1976, and placed in service within 36 months thereafter in a facility or addition which also qualifies for the incentives under the administration's proposal. Equipment placed in existing facilities in areas of high unemployment will not qualify. Nor will over-the-road equipment or rolling stock.

Under the proposal, at the taxpayer's election, straight line amortization of qualified equipment will be allowed over 60 months commencing on the date the equipment is placed in service. For example, the amortizable cost of equipment with a 10-year useful life could be written off in 5 years compared to about 67 percent under the double declining balance method which would now be available. For this purpose, the definition of equipment—as distinguished from real estate—will be the same as is used in the investment credit provisions. Here, too, the depreciation recapture rules will apply upon a disposition of the property.

Notwithstanding the election to amortize qualified equipment over 5 years, the full investment tax credit will still be allowed if the useful life of such equipment is 7 years or more. This is a most significant benefit which will make the election to amortize much more attractive than if the electing taxpayer were limited to two-thirds of the investment credit as is the case under current law with respect to property with a useful life of 5 years.

This proposal will not apply to those electric utilities covered by the administration's six-point utility program which I will discuss later.

Revenue estimates

The revenue cost of the proposed job creation tax incentive is estimated at $300 million for fiscal year 1977, $650 million for 1978, $900 million for 1979, and $1 billion for 1980. However, over the long run, the same amount of taxes will be paid because, generally, accelerating depreciation of capital investment simply defers taxes.

Broadened Stock Ownership Proposal

I would like to turn now to the subject of broadened stock ownership in the United States. The administration believes that broadening the private ownership of business will further an American tradition, and thereby strengthen the economic, social, and political base of support for our free enterprise system. In this respect, it is important to encourage participation by low- and middle-income working Americans in private ownership. Widespread stock ownership among all Americans will promote stability in the financial markets, provide individuals with a greater sense of participation in the free market system, and give them an opportunity to build a reasonable estate for themselves and their heirs.

There are many approaches which can foster broadened stock ownership through the tax system. In his state of the Union address, the President proposed the adoption of a broadened stock ownership plan (BSOP). This plan would have three principal characteristics which the administration deems important to any program designed to encourage broadened stock ownership. First, the plan should be available to all Americans, whether self-employed, employed by a corporation, or employed by the government, Federal, State, or local. Second, participation should be voluntary, but the plan can be established by individuals or by their employers through payroll deductions. Third, participants in a BSOP should have a choice as to their investment in common stocks.

Other aspects of the plan include the following:

First, contributions should be deductible from taxable income, with participation being restricted to individuals in the low- and middle-income ranges and limited to the maximum amount eligible for deduction. In addition, there would be a phaseout of the amount deductible at the higher income levels. For example, a taxpayer might be allowed to deduct $1,500 a year or, if less, 15 percent of his compensation, subject to a phaseout in the case of compensation between $20,000 and $40,000.

Second, income earned by a BSOP would be exempt from income taxation until withdrawn from the plan. Upon withdrawal, a participant would be subject to a current tax at capital gain rates to provide participants with the benefits normally associated with the accumulation of capital values. However, there would be a holding period requirement. Thus, funds held in a BSOP would have to remain invested for at least 7 years. Premature withdrawals would be subject to a penalty tax in order to discourage early withdrawals.

Third, the contributions made to a BSOP would have to be invested in common stocks, the selection of which would be entirely up to the participant. He could, for example, select individual stocks or mutual funds.

Under the administration's proposal, taxpayers could establish a BSOP on or after July 1, 1976, and qualify for a full tax deduction for calendar year 1976. Further details of the BSOP proposal will be worked out with Congress.

It should be noted that BSOP's would have no effect upon a taxpayer's ability to participate in any pension or profit-sharing plan established by his employer, or to establish his own individual retirement account or Keogh plan. The contemplated statutory pattern for BSOP's would be unrelated to deferred compensation, retirement, or employee benefit plans.

Electric Utilities Tax Program

The electric utilities tax program is another important part of the administration's program. It not only will serve as a stimulus to construction of additional facilities by electric utilities, but will also provide a means to minimize imports of foreign oil and to insure adequate electric generating capacity in the several years ahead. The construction activity will help put many people back to work in the near term and, in the longer run, will help insure that economic expansion will not be limited by energy shortages. In sum, the program is highly important to the national economy.

Background

The proposal I presented last July 8 before the House Ways and Means Committee, and before your committee on December 9, represents the recommendations of the President's Labor-Management Committee, and the President has endorsed them. The need for this legislation has not lessened since I last urged its adoption. In summary, the reasons for this legislation are:

1. Financing difficulties have prevented the construction, or completion, of badly needed nuclear and coal-fired plants.

2. The need to minimize our dependence on foreign oil demands adoption of means to increase electric generating facilities fueled otherwise than by petroleum products.

3. The energy shortage must be met. Insufficient electric power will inhibit construction of new manufacturing and commercial facilities. This cannot be allowed to happen.

This committee is acutely aware of the nature of our overall energy shortage and the adjustments that our economy must make. We will never again want to rely on foreign oil as we did for so many years. We must greatly increase our domestic capacity for the generation of energy, and we must begin to make progress immediately. The indispensable core of any sensible energy program is the construction of electric power facilities which do not operate on petroleum products which, today, means primarily coal, nuclear, and hydroelectric. But these electric power facilities will not come off the shelf in someone's store. The leadtimes required to construct these generating plants range up to 7 or 8 years. Generating plants are complex and their construction cannot be turned on and off without incurring major expense and causing great delay. The coal- and nuclear-fueled electric power plants that we defer today will be missing tomorrow and will prolong our dependence on foreign oil imports.

A recapitulation of the problems of the electric power industry may be helpful. When fossil fuel prices started their rapid rise in mid-1973, the consequence for electric utilities, whose rates are regulated, was a shrinkage in the residual cash flow. This reduced the return to equity and made increasingly difficult the simultaneous (1) maintenance of dividend payments which were needed to continue to attract and hold equity capital, (2) payment of interest on obligations to bondholders, and (3) carrying out of investment programs to replace existing capacity as well as to add additional capacity needed to meet forecast growth in demand for electric power.

This squeeze on the electric power industry, resulting from what is commonly called regulatory lag or the slow adjustment of allowable prices to reflect changed cost conditions, was exacerbated by two other factors: The actual costs of replacement capital were pushed up by inflation while the allowances for this portion of capital cost embedded in utility rate structures remained unchanged; and interest rates on refunding and new issues of bonds rose to incorporate the inflation premium. For many utility companies the resultant drop in realized return to equity owners was so severe that dividend payments were suspended and/or construction programs were canceled or suspended.

It is true that the problems visited on the utility sector differed only in degree from those faced by the entire private sector. Unregulated businesses were also caught in a cash-flow squeeze as their costs rose more rapidly than the prices they could recapture in the market. But, in the unregulated sector, restoration of balance between prices and costs has been quicker, not only because price regulation procedural lags are generally absent, but also because their capital costs are generally a smaller fraction of total costs.

Specifics of program

I would now like to turn to the specifics of the six-point proposal.

First, the proposal would increase the investment tax credit permanently to 12 percent for all electric utility property except generating facilities fueled by petroleum products. Under current law, utilities, like other taxpayers, are eligible for a maximum investment tax credit of 10 percent. Although the 10-percent credit is scheduled to revert to lower rates at the end of this year, the administration has proposed the higher rates be made permanent.

Second, the proposal would give electric utilities full, immediate investment tax credits on construction progress payments for construction of property that takes 2 years or more to build, except generating facilities fueled by petroleum products. Under present law, utilities, like other taxpayers, are entitled to investment tax credits as they make progress payments on long-term construction projects. However, the Tax Reduction Act of 1975 provided a 5-year phase-in of construction progress payment credits so that entitlement to the full investment credit at the time a progress payment is made will not occur until 1980.

These proposed changes with respect to the investment credit would be limited to those utilities which normalize the increase in the investment credit for ratemaking purposes and which are permitted by their respective State regulatory agencies to include construction work in progress in their rate base for ratemaking purposes. "Normalization" means reflecting the tax benefit for ratemaking purposes pro rata over the life of the asset which generates the benefit instead of recognizing the entire tax benefit in the year the utility's taxes are actually reduced. In the absence of normalization, the entire tax benefit would flow through immediately in the form of reduced utility rates for consumers, and no real economic benefit would result for the utility.

Third, the proposal would permit electric utilities to begin depreciation of major construction projects during the construction period. Under present law, a deduction for depreciation is allowed commencing when a depreciation asset is placed in service. The depreciation deduction would be based on the accumulated construction costs which qualify for the investment credit under the construction progress payment system enacted as part of the Tax Reduction Act of 1975. Accelerated methods of depreciation would be permitted, and the depreciation deduction would be based on an assumed useful life which would include the remaining construction period plus the estimated useful life (or asset depreciation range period) attributable to the property as of the time it is placed in service. Depreciation after the property is placed in service would be reduced by depreciation taken during the construction period.

Electric generating facilities fueled by petroleum products would not qualify for this construction period depreciation. Further, construction period depreciation would be conditioned on the utility's normalizing the benefits of the provision for ratemaking purposes and upon the agreement of the relevant State regulatory agency to include construction work in progress in the utility's rate base for ratemaking purposes.

Fourth, the proposal would provide for extending to January 1, 1981, the period during which pollution control equipment installed in a pre-1969 plant or facility will qualify for rapid 5-year straight-line amortization in lieu of normal depreciation and qualification for the investment credit. Section 169 of the Internal Revenue Code, which provides for this treatment of pollution control equipment, expired December 31, 1975, and the proposal is to extend the qualification period an additional 5 years.

Fifth, the proposal would provide an election of 5-year amortization in lieu of normal depreciation and the investment credit for the costs of converting an electric power generating facility fueled by petroleum products into a facility fueled by nonpetroleum products, or for the cost of replacing petroleum product-fueled facilities.

Sixth, the proposal would permit a shareholder of a regulated electric utility to postpone tax on dividends paid by the utility on its common stock by electing to take additional common stock of the utility in lieu of a cash dividend. The receipt of the stock dividend would not be taxed. The amount of the dividend would be taxed as ordinary income when the shareholder sells the dividend stock, and the amount of capital gain realized on the sale would be decreased (or the amount of capital loss increased) accordingly. Dividend stock would be deemed sold by the shareholder before any other stock of the same utility.

Revenue estimates

Altogether, the six-point electric utilities tax program will reduce tax revenues by an estimated $200 million in the transition quarter of 1976 and $800 million in fiscal 1977. The longrun benefits are an orderly restructuring of the American electric utility plant to deemphasize the use of petroleum-based fuels and an acceleration of annual investment to meet future electric power needs of the economy.

Proposal For Integration of Corporate and Personal Income Taxes

I would like to turn now to a specific proposal to integrate corporate and personal income taxes. In my testimony before the House Ways and Means Committee last July, I discussed the details of such a proposal. Much of what I will present today is drawn from that testimony. I will also attempt to answer some of the criticism which has been leveled at the proposal.

Perverse effects of the double tax on corporate dividends

Under our system of taxation, income earned by corporations is taxed twice: first to the corporation and then again to the shareholder, if and when it is distributed as a dividend or realized on sale. The existence of this two-tier tax has a number of perverse results:

1. The system reduces rates of return for all savers. Viewing the economy in the aggregate, it is not just corporate shareholders who have lower profits because of the double tax on dividends.

With due allowance for risk, no one would invest in corporate equities if the return to him, after payment of tax at the corporate level, differed from that which he could earn from investment in real estate, bonds, or other assets. In a competitive capital market, there are constant flows of capital from one kind of investment to another until the after-tax rates of return are comparable. If investment in corporate equities is less profitable, then capital will flow out of such investment (or less capital will flow in). If there is less demand for stock on the stock exchange, the price of stock will fall and yields will rise. At the same time, capital which is diverted from corporate stock will flow into other kinds of investment. Money in savings accounts will increase and there will be a greater demand for bonds and other debt instruments and a greater demand for investments in assets and enterprises not held in corporate form. That greater demand for that kind of investment will in turn depress the return on it. For example, when more people wish to have money in savings accounts, the interest rates which banks are willing to pay falls.

Since investors have had 25 years to accommodate to the nearly 50-percent rate of corporate tax, yields to investors after the tax have surely been equalized with those elsewhere. This means that the corporate tax has reduced the yields on all forms of saving, and that eliminating the extra tax on dividends will reverse the process, raising rates of return to all savers.

2. By imposing an extra penalty on the rewards for saving, the existing system restrains the capital expansion needed to meet our economic goals. I have already detailed the crucial importance of increased capital formation. Integration will help to achieve our needed increases in the capital stock in three ways:

First, domestic savings will respond to the increased return. The response may be small, but even a modest change in savings habits would lead to a substantial savings increase in the aggregate. Several recent econometric studies of savings behavior have shown this saving response to be positive and significant.

Second, with a higher return to capital in the United States, relatively more of the world's investment will take place here. Less domestic savings will flow abroad, and more investment by foreigners will be undertaken here.

Third, the method of integration which we propose allows deductions to the corporation for a portion of dividends currently paid. This makes available additional cash flow to businesses for immediate investment. While in the long run this aspect of the policy is less important for capital formation than is increased profitability, additional cash flow may help to speed the adjustment to the larger volumes of capital investment.

3. The extra tax on corporate income leads to economic inefficiency by requiring that prices of corporate sector products be relatively higher than prices of products produced by unincorporated business. The products of corporations must sell at prices high enough to cover the additional burden of the corporation income tax or else corporations would be unable to attract and hold the capital needed to produce those goods.

This tilting of prices makes corporate products relatively less in demand than they would be in the absence of the extra corporate tax. Economic activity will, of course, be carried on in the corporate form in order to aggregate the large amounts of capital required and to assure continuity of management. Heavy manufacture, minerals development and production, and the utilities could operate in no other way, and there are many other activities for which the sheer economies of scale outweigh the advantages of personal management and the tax savings possible in a proprietorship or partnership. But, the inefficiency of the corporation income tax is that it makes it more expensive to realize these advantages of corporate organization.

Consequently, as measured by the prices we are willing to pay in the marketplace, we have too little output from the corporate sector and too much from elsewhere. If we could eliminate the cause of this misallocation of resources, we would clearly be better off: We would have more of the things we currently value more highly, fewer of the things we value less. Professor Harberger, who has pioneered the analysis of this waste, has estimated that the value of this loss to society is equal to 0.5 percent of our national product annually.

4. The double tax is an extra inducement for corporations to seek debt financing, rather than increased equity capital, because the tax applies only to the income attributable to equity investment. Corporations must earn enough gross income to cover the interest payments made to compensate bondholders and other creditors for the savings which they have supplied. But interest payments are deductible at the corporate level and thus—unlike dividends—are not included in the net income which is taxable to the corporation. If we were able to remove the extra tax on dividends, we would make equity financing much more attractive and would reverse the steep and dangerous increase in debt-equity ratios of recent years. I have already indicated how high debt-equity ratios make businesses extremely vulnerable to business cycle changes and that a high proportion of debt in the financial structure will further discourage investment by introducing added uncertainty for lenders and borrowers. This is just another example of how the tax structure hinders the efficient operation of markets, in this case by increasing the cost of equity compared to debt capital. We must remove this tax impediment to business expansion and economic growth.

5. A double corporate tax creates a market bias against dividend yielding stocks. So long as earnings are retained, the second tax on dividends need not be paid. If the stock is ultimately sold, its value will generally be higher because of the retained earnings, but the capital gains tax on the increase in value is imposed at preferential rates. Thus, the second tax in the case of retained earnings may be substantially lower than in the case of dividends. Consequently, companies like utilities which have traditionally relied on high dividend payouts to attract the capital needed for expansion are placed at a substantial disadvantage because the double tax imposed on their income is greater than the double tax on companies which retain earnings and do not distribute them. Moreover, moderate income investors who prefer dividends to capital gains are discouraged from stock ownership. Elimination of the second tax would greatly assist utilities and other companies similarly situated in raising equity money. Given our energy problems, this is a particularly important point.

6. The double tax places a heavy penalty on corporate decisions to distribute earnings. In an ideal free market, the tax system would be neutral with respect to retention or

distribution of earnings. Corporate managers would be led to retain earnings only if they would use them more productively in their businesses than their stockholders might use them in other investments. Integration would remove the tax reasons for retaining rather than distributing earnings. At present, the tax penalty on paying out earnings puts corporate managers under great pressure to do almost anything that might be productive with retained earnings rather than pay them out. The double corporate tax thus tends to "lock in" corporate capital and keep it out of the capital markets which allocate capital more efficiently among uses.

International comparisons

For many years our system of imposing a double tax on corporate profits by taxing them at each of two tiers was also widely used abroad, and it is often referred to as the classical system of corporate taxation. So long as tax rates at the corporate level remained relatively low, the system did not create undue mischief. In the United States, the corporate tax rate was less than 15 percent as late as 1935; it rose to 40 percent during World War II, dropped back to 38 percent in the last of the 1940's, and rose again to 52 percent during the Korean war. The current 48-percent rate was enacted in 1965. Thus, basically, it was only as recently as the Korean war in the early 1950's that corporate rates reached their present high levels.

Similarly, corporate rates have been rising in other countries, but not so fast as in the United States. As rates have risen abroad and as the need for economic development and investment increased in other countries, changes were made in their corporate tax system. Today, virtually all of our major trading partners eliminate much of the double tax. Such systems are in effect in Canada, the United Kingdom, France, Germany, Belgium, and Japan.

The European Economic Community has adopted a resolution urging all of its members to adopt such a system and is presently engaged in an effort to promote greater uniformity of existing systems and to harmonize the differences that remain. Since our two-tier tax system results in higher prices for corporate products, and our major trading partners have taken steps to eliminate this extra tax burden, we have placed U.S. corporations at a competitive disadvantage in international markets.

The administration's integration proposal: combination of dividend deductions and stockholder credits

We propose eliminating the double tax on income from savings invested in corporate equity and to do so in six phases, with the first phase effective January 1, 1978. The remainder would phase in equally over the succeeding 5 years. The proposal would, thus, have no effect on the budget for fiscal 1977.

We propose to eliminate the double tax by combining the two mechanisms of a dividend deduction and a stockholder credit. When fully effective, the credit at the stockholder level in combination with the dividend deduction at the corporate level will completely remove the double tax on dividends.

The dividend deduction.—Approximately half of the total relief would be accomplished by a dividend deduction. Thus, ultimately there would be a deduction from corporate taxable income of roughly 50 percent of the dividends distributed. The reason that I say "roughly 50 percent," rather than exactly 50 percent, is that in order for the mechanism to achieve its objective with the maximum simplicity, the fraction deductible at the corporate level must be geared to the stockholder credit procedure.

The accompanying table illustrates the effect of dividend deductibility at the corporate level.

Illustrative computation of 50 percent corporate dividend deduction

	Present law[1]	Proposed law with— Same dividend payout	Maximum dividend payout
A. Corporate income subject to tax	$100	$100.00	$100.00
B. Dividend paid	50	50.00	66.67
C. 50 percent dividend deduction (50 percent of line B)	—	25.00	33.33
D. Taxable corporate income (line A − line C)	100	75.00	66.67
E. Corporate income tax (50 percent of line D)	50	37.50	33.33
F. Corporate income after tax (line A − line E)	50	62.50	66.67
G. Retained Earnings (line F − line B)	0	12.50	0

[1] Assumes, for simplicity, a 50-percent corporate tax rate.

For simplicity, we assume the corporation earns $100, that the corporation tax rate is 50 percent, and that 50 percent of the dividends are deductible at the corporate level in computing the corporation income tax. Under present law, as is shown in the table, the corporation pays $50 in tax and has $50 left over, to retain or pay out in dividends. Under the proposed dividend deductibility procedure, if the corporation merely continues to pay out $50, its tax payment is reduced to $37.50, for its taxable income is $100 less 50 percent of $50, or $75, and the tax rate is 50 percent. Without changing its dividend payout, the corporation has $12.50 of additional retained earnings. On the other hand, if the corporation wishes to pay out the maximum amount of its earnings and retain nothing, it may pay out $66.67 in dividends and pay tax of $33.33. In this instance, the taxable income at the corporate level is $66.67—$100 less half the $66.67 in dividends paid—and it pays $33.33 in tax. Thus, the dividend deductibility feature of the administration's proposal provides great flexibility to corporate management in adjusting its financial policy to the overall reduction in corporate tax burden realized by integration.

The dividend deduction provided for the first year, 1978, would be that percentage which produces a net reduction of approximately $2.4 billion in corporate tax liabilities for that year.

Additional dividend deductions required to bring the total deduction up to approximately 50 percent of dividends distributed would be phased in from 1979 through 1983, causing the revenue loss to increase at a rate of about 1 billion per year (at 1978 levels).

The stockholder credit.—The balance of the double tax on dividends would be eliminated by a stockholder credit to be phased in equally over the 5-year period from 1979 to 1983 inclusive. This would cause a revenue loss in each of those years, increasing at the rate of about $1.5 to $2 billion a year (at 1978 levels).

The credit mechanism would be quite simple. The taxpayer would "gross up" his dividend by adding to his taxable income an amount equal to 50 percent of the dividends he receives and would then take a tax credit equal to the gross-up. This is precisely the same procedure as the taxpayer follows with labor income subject to withholding. The taxpayer adds the withheld income tax to his take-home pay, calculates the tax on the gross amount, then subtracts the taxes withheld. In the case of the proposed stockholder credit, the taxpayer adds to his take-home dividends corporate taxes paid by the corporation on his behalf, calculates his tax liability on the gross amount, and then takes a credit for the tax withheld for him by the corporation.

We may illustrate the operation of this portion of the proposal by extending the prior example to the cases of stockholders subject to personal tax at 20 to 50 percent in the following table.

Under present law, the 20-percent stockholder receives $50 in dividends, pays $10 in tax, and retains $40. In effect, the combined corporate and personal tax rate he has paid is 60 percent. If the corporation still pays out $50 under the proposed integration procedure, the stockholder would add $25 to the $50—that is, he could gross up for the 50-percent corporation income tax—and compute a $15 tax liability on the entire $75. He would then be permitted to take a tax credit for $25, receiving a net refund of $10. Altogether, this stockholder would net $60 after tax, 50 percent more than under present law, and additionally have a claim to $12.50 of retained earnings. And if the corporation maintains its policy of paying out all income possible, the 20-percent stockholder would receive a dividend of $66.67 which he would gross up to $100 to include the $33.33 tax paid by the corporation, and compute his tax at $20 which would entitle him to a refund of $13.33. This refund plus the $66.67 in dividends received yield the 20-percent taxpayer a total return of $80. This is exactly what he should net from a $100 income, given that he is subject to a 20-percent tax rate: and this is twice his yield from such an income under present law. In effect, this taxpayer's burden on income earned by the corporate enterprise has been reduced from 60 to 20 percent, and his return has doubled.

The table shows similar results for the stockholder who is a 50-percent taxpayer. Under present law, he nets $25 of the original $100 income, a tax rate of 75 percent. Under integration, with the same $50 dividend payment, he nets $37.50 plus retaining a claim to the $12.50 of retained earnings; and with maximum payout, he nets $50 after taxes. Again, the proposal imposes only the stockholder's own tax rate on the income of the corporation he owns, so that with full payout of corporate income the reduction in his tax rate is from 75 to 50 percent, and his return is also doubled.

As a matter of arithmetic, a 50-percent dividends paid deduction and a 50 percent gross-up and credit, when combined with a 50-percent corporate rate, exactly eliminates the double tax. With a 46- or 48-percent corporate tax rate, either the 50-percent dividends paid deduction or the 50-percent gross-up and credit must be adjusted slightly. In terms of tax return simplicity, it is obviously very desirable for tens of millions of shareholders to use a gross-up and credit of 50 percent rather than an odd percentage which requires more complicated arithmetic. Therefore, we recommend that the required compensating

Illustrative computation of 50 percent individual dividend gross-up and credit

	Case I—taxpayer in 20 percent marginal tax bracket			Case II—taxpayer in 50 percent marginal tax bracket		
		Proposed law with—			Proposed law with—	
	Present law	$50 dividend	Maximum dividend	Present law	$50 dividend	Maximum dividend
A. Dividend income received	$50	$50	$ 66.67	$50	$50.00	$ 66.67
B. Gross-up of dividend (50 percent of line A)	—	25	33.33	—	25.00	33.33
C. Dividend income plus gross-up (line A + line B)	—	75	100.00	—	75.00	100.00
D. Tentative tax (tax rate × line C)	10	15	20.00	25	37.50	50.00
E. Dividend tax credit (equals line B)	—	25	33.33	—	25.00	33.33
F. Tax liability or refund (−) (line D − line E)	10	−10	−13.33	25	12.50	16.67
G. Total income after tax (line A − line F)	40	60	80.00	25	37.50	50.00

adjustment be made by reducing somewhat the percentage of dividends which are deductible. It is for that reason that I suggested earlier that the dividend deduction might ultimately be for slightly less than 50 percent of the deduction.

The combination of the dividend deduction and the stockholder gross-up and credit has two major advantages:

First, use of the dividend deduction will initially create additional cash flow at the corporate level, which provides an immediate increase in funds available for investment.

Second, use of the stockholder credit mechanism permits flexibility with respect to tax-exempt organizations and foreign stockholders in U.S. corporations. We do not believe the stockholder credit should be extended automatically to them. Like other stockholders, they will receive indirectly the benefits of the dividend deduction at the corporate level. Thus, the tax burden on income going to such stockholders will be reduced, but will not be totally eliminated. That seems an appropriate way to deal generally with such stockholders and it significantly reduces the revenue loss. Of course, it may be appropriate in particular cases to extend the benefit of the stockholder credit to foreign stockholders by means of an income tax treaty.

Answering the critics

Four major arguments have been mounted against the integration plan. Let me answer these arguments.

1. *Plan favors big business.*—The first argument is that the plan is heavily weighted toward big business and high-income individuals at the expense of the "little guy."

This argument first ignores the fact that all Americans would benefit from the plan as higher levels of real income are generated by higher levels of productivity. As indicated earlier, our experience has been that we achieve greater productivity through increased capital investment. Greater productivity means more jobs, greater price stability, and more goods and services to fill rising demands. In short, it means a higher standard of living for all.

Second, the ownership of corporate capital is much more widespread than many may realize. In addition to the gains to direct owners of corporate stock, benefits will flow to people who receive corporate income indirectly through participation in pension funds, insurance companies, and other financial institutions. These institutions have been increasing their ownership of stock and now own about a quarter of all outstanding corporate shares.

About half of our work force is now covered by private pension plans. Eighty-four percent of American adults are covered by some type of life insurance policy, according to the Institute of Life Insurance. Other Americans have other types of insurance or participate in mutual funds, trust funds, and other types of dividend income. Thus, most American families have some direct or indirect dividend income, and they all would benefit from our program.

Third, the integrated nature of our Nation's capital markets assures that benefits will spread to people who receive all types of capital income, from bonds, notes, and savings accounts, as well as from stocks. Because in our competitive economic system investment flows to those opportunities with the highest after-tax returns, after-tax returns tend to be equalized. As more investment flows to the corporate sector, and corporate earnings before-tax will be reduced, the rates of return on other assets will rise until stockholding will again confer no differential advantage relative to other forms of capital people own. Thus, an initial buoyant effect of integration on rates of return to stockholders will be dispersed to all capital ownership, to higher money wages, and to higher real incomes for all, not just rich stockholders as the critics assert.

If corporations had it in their power to make their rates of return higher than others, they would now be exercising that power. If they do not have that power under present tax law, I am at a loss to see how the proposal I have outlined for you will confer that power.

Finally, I should like to note that the lengthy period which is proposed for phasing in this fundamental change in the tax law is calculated to mesh the changes in rates of return to feasible adjustment rates in the structure of the economy. There will be no sharp increases in rates of return, no stimulation of speculative activities in the capital markets. By 1983, when the plan is fully phased in, no financial evidence of full integration will be apparent. The economic gains of a more efficient use of our capital stock will, in fact, be realized although, since we always wish we had more, we may not then recognize how much better off we will have become.

2. *Cost of program.*—The second argument is that the cost of the program is too high in proportion to the benefits.

This argument fails to note that the whole thrust of the program will be to encourage people to save and invest more now as well as to make new capital more productive so that we will have more real output in the future to meet our economic needs. We can effect this reform by restraining growth in Federal expenditures. The cost, in this event, is merely the marginal programs which are abandoned. Or, if we regard these expenditure programs as more worthy than the benefits to be gained from this necessary reform of the tax system, we might consider moderate increases in other taxes which have less deleterious effects on our productivity and welfare.

But this program would be a good investment even if we had to increase other taxes to cover the revenue loss. For if efforts to improve capital formation and increase the efficiency of capital use are not undertaken, Americans will pay in the future through lower standards of living and poorer employment opportunities.

In either case, I fail to see how retaining a tax system which incurs for us a current loss of economic welfare and consigns us to a lower growth rate can be less costly than reforming it.

3. *The plan favors dividend-paying corporations.*—Plainly, the present unintegrated corporation income tax favors corporate retentions over dividend distributions, particularly for wealthy stockholders in tax brackets substantially above the corporate tax rate. For such stockholders, retained earnings are translated into enhanced stock values which may be cashed at favorable capital gains rates at some distant time, or never. This makes retention for them preferable to current receipt of dividend income. As I noted before, this has two consequences, both harmful to efficient use of our resources: Corporate managers are induced to retain more than they otherwise might, leading them to make poorer investment decisions, and those classes of stockholders who need to hold securities which yield them current income flow have fewer opportunities left to them to invest in stocks.

If we were to propose to so distort private choices by some tax scheme, we justifiably would be criticized. I am, therefore, puzzled when critics chastise me for proposing to neutralize the present distorting effect of tax policy on corporate financial management policies.

As to the corollary argument that integration penalizes growth companies, it should be noted that true growth companies have unusually good investment opportunities. Such companies will still find it easier to raise capital than nongrowth companies, for stockholders will always prefer shares which promise higher future earnings to those with stable or declining earnings.

4. *Reduction of corporate tax rates as an alternative.*—The fourth argument is that reducing the corporate income tax would be simpler and just as effective a means to stimulate capital formation.

I agree that this alternative is sound and would help achieve the overall objective. However, simply reducing corporate rates would fail to confront the inherent inequity and inefficiency of maintaining higher tax rates against income from corporate as compared to noncorporate capital. To make most productive use of savings available for investment, we must assure that all investment opportunities meet the same test for profitability before taxes. This requires that, as nearly as practicable, tax rates on capital income be equalized regardless of the form of business organization or method of financing.

Reducing the corporate tax rate by itself would also do nothing about the grave problem of tax bias in favor of debt financing. The corporate debt-equity ratio has risen dramatically in the past decade. Together with higher interest rates resulting from inflation, lower corporate profitability, and a serious recession, we have created a situation where suppliers of capital are increasingly concerned with the safety of their investments. New companies and new enterprises particularly are experiencing difficulties attracting venture capital.

Finally, reductions in the corporate rate unaccompanied by integration serve only to increase the effective tax differential favoring corporate retention of profits rather than payment of dividends. This encourages corporations to use retained earnings for projects which may be less profitable than the investments shareholders would make for themselves. Also, potential stockholders who prefer income will choose investments other than stocks.

Lowering corporate tax rates would lead to increased capital formation, but integration will improve corporate financial structures and bring about more effective use of that capital as well.

Benefits of the proposed change

First, the net tax reductions on the income from saving will increase the rewards for saving and will thus increase the total amount which people and institutions will be willing and able to save. That will produce benefits not just for savers, but for everybody in the form of increased growth, higher paying jobs, and greater prosperity generally.

Second, it would ultimately eliminate a double tax which is unfair and inefficient.

Third, it will eliminate the existing tax discrimination in favor of debt as compared with equity financing and strike at the heart of the debt-equity problem.

Fourth, American businesses will be better able to compete against foreign companies for whom the cost of capital has already been reduced by elimination of the double tax. At the same time, increased returns on saving in the United States will help attract additional foreign capital. Both of these consequences will help to maintain the stability of U.S. exports and employment and the strength of the dollar abroad.

Fifth, it will greatly improve the efficiency of the process by which capital is allocated and produce the equivalent of an increase of at least 0.5 percent in our national income.

Sixth, it will make the capital markets more competitive. Corporate managers will have to demonstrate to stockholders that they can do a better job of investing profits than the shareholders can do for themselves. It would eliminate the tax penalty which presently induces corporate managers to "lock in" corporate capital and keep it out of the capital markets.

Seventh, it will be an immediate and major assist for equity financing. Businesses which have lost access to equity markets will again be able to compete.

Eighth, it will be a great help to utilities and to other industries whose investors rely upon steady dividends.

Capital Gains and Losses

I would like to turn now to capital gains and losses.

H.R. 10612 contains two relevant provisions dealing with the taxation of capital gains. The first provides for an extension of the holding period requirement to qualify for long-term capital gains. Under this provision, the holding period requirement is increased from 6 months to 12 months over a 3-year period (1976, 8 months; 1977, 10 months; 1978 and thereafter, 12 months). The second provision increases from $1,000 to $4,000 the amount of net capital losses which may be used to offset ordinary income, also over a 3-year period (1976, $2,000; 1977, $3,000; 1978 and thereafter, $4,000).

We support both provisions of the House bill. The increase of the holding period requirement is warranted because the reasons for distinguishing between long-term and short-term capital gains—"bunching" and distinguishing between assets held for investment and those held for speculative profits—suggest that the holding period should be 1 full year. The increase in the amount of losses allowable as an offset against ordinary income is also warranted because the present law $1,000 limitation has not been changed since 1942 despite substantial increases in the Consumer Price Index.

Further, we are today proposing the adoption of a sliding-scale approach for the taxation of capital gains and losses. Under our proposal, the tax burdens on capital gains will be reduced the longer the asset has been held by a taxpayer. This will promote capital formation and the efficient allocation of investments. The proposal is a sensible rule-of-thumb to avoid converting the income tax into a capital levy on shifts in investments. In addition, we believe the sliding-scale mechanism will reduce the unwarranted taxation of inflationary gains.

The principal features of our proposal are:

- The amount of capital gain which may be deducted in computing adjusted gross income will be based on the holding period of the asset, as follows:

Holding period	Deduction
Up to 1 year (phased in)	None
1 year to 5 years	50 percent
5 years to 25 years	50-70 percent (additional deduction of 1 percent for each year)

- Capital losses will also be subject to the sliding-scale proposal.
- All transactions which presently generate capital gains and losses will be subject to the sliding scale.
- The 25-percent alternative tax on the first $50,000 of the excess of net long-term capital gains over net short-term capital losses will be repealed.
- The portion of any capital gain which is deductible under this proposal will be added back to a taxpayer's taxable income in order to compute his minimum taxable income.
- The House-adopted capital gains provisions are effective January 1, 1976. For reasons spelled out below, we recommend the following effective dates:
  House provisions: January 1, 1977
  Sliding scale for gains: January 1, 1976
  Sliding scale for losses: January 1, 1977
  Repeal of alternative tax: January 1, 1976
  Effect on minimum taxable income: January 1, 1976

Let me elaborate:

Sliding-scale period.—We propose that the sliding-scale period commence after the taxpayer has held a capital asset for 5 years and that the percentage increase in the amount deductible be set at 1 percent for each additional year through the 25th year.

In the short run, adoption of a sliding-scale approach will cause a burst of unlocking; in the long run, it may result in a new lock-in, at least insofar as appreciated assets are concerned. To soften the impact of this potential lock-in effect, the sliding-scale intervals have been pegged at 1 year, rather than at longer intervals.

Treatment of capital losses.—Under present law, a net long-term capital loss may first offset short-term capital gains on a 1 for 1 basis and then offset ordinary income (up to $1,000) on a 2 for 1 basis. Thus, under present law, it takes a $2 net long-term capital loss to offset $1 of ordinary income. An elaborate carryover system is provided to preserve the character (long-term or short-term) of carryover losses.

Under our recommended proposal, capital losses as well as gains will be subject to the sliding scale. Thus, for example, a $100 realized gain on a capital asset held for 15 years will result in a taxable gain of $40. A $100 realized loss on a capital asset held for 15 years will result in a $40 deductible loss, which may be offset against other capital gains, or against ordinary income (subject to the dollar limitation previously discussed).

The symmetrical treatment of gains and losses generally accords with the trend set by the Tax Reform Act of 1969 which introduced the 2 for 1 rule. A further advantage of applying a symmetrical rule for gains and losses, and computing reportable gain or loss on an asset-by-asset basis, is that the present law complex loss carryover system would be simplified considerably.

Qualifying assets.—The sliding-scale proposal will apply to all assets which are presently accorded capital asset status. Thus, all transactions which presently generate capital gains and losses will be treated in the same fashion without arbitrary distinctions.

Repeal of alternative tax.—We propose repeal of the 25-percent alternative capital gains tax on the first $50,000 of the excess of net long-term capital gains over net short-term capital losses. Repeal of the alternative tax is a necessary first step in enacting a sliding scale. Coupling a sliding scale with the alternative tax would require complex "stacking" and allocation rules.

Relationship to minimum taxable income.—Under our minimum taxable income (MTI) proposal, a taxpayer will be required to pay a tax at the regular rates of 14 to 70 percent on the greater of his minimum taxable income or his regular taxable income. We propose that the amount of the entire capital gain deduction be included in computing a taxpayer's MTI base, thus assuring that each taxpayer will bear a fair share of the tax burden.

Effective dates and revenue estimates.—The effective dates of January 1, 1976, for gains and January 1, 1977, for losses will have a maximum impact on unlocking both gains and losses in calendar year 1976. Gains will be unlocked because of the lower tax rates on realized gains. Losses will be unlocked because of the desire to realize losses in the current year rather than in 1977 when the sliding scale begins to impact on losses. The net effect will be that gain and loss transactions will, to a considerable degree, offset each other in calendar 1976.

Personally, I believe that the unlocking will be substantial and generate significant revenue increases in fiscal 1977. However, we are assuming that the sliding-scale proposal will produce no material change for budget purposes in fiscal 1977 receipts.

In the long run, when fully effective, the four capital gains provisions—(1) a sliding scale on gains and losses; (2) a holding period requirement of 1 year to qualify for long-term capital gain treatment; (3) an annual limitation of $4,000 on capital losses which may offset ordinary income; and (4) repeal of the 25-percent alternative tax—will generate revenue losses of about $800–$900 million per year.

Estate and Gift Tax Proposals

I would like to turn now to estate and gift taxes. As you know, the House Ways and Means Committee is now holding hearings on the major issues of estate and gift tax revisions, and Treasury Department officials will be testifying on that subject next Monday, March 22. We believe that a complete reexamination of estate and gift taxes is long overdue, and we look forward to cooperating with the tax-writing committees in this undertaking. As you also know, the President has already recommended an increase of the estate tax exemption from $60,000 to $150,000.

Estate tax exemptions and rates

The basic structure of the estate and gift tax has remained fundamentally unchanged since 1932, and the estate and gift tax exemptions were last changed in 1942. Since that time, the ravages of inflation have substantially eroded the value of the $60,000 estate tax exemption. No longer does the tax impact principally on the relatively larger estates. Rather, the estate tax now has shifted to a more broadly based tax on the private capital accumulations of more moderate estates.

Let me elaborate on these two points.

First, adjusting the $60,000 estate tax exemption for inflation since 1942 would require an estate tax exemption of $210,000. Moreover, while a person with a $60,000 estate in 1942 could leave it to his family without tax, today an individual must have an estate of $260,000, on which an estate tax of $50,700 will be levied, in order to leave the equivalent amount, $210,000, to his family.

Second, during the 1920's, 1930's, and 1940's, the estate tax reached about 1 to 2 percent of all estates. Thus, in 1950 there were 27,144 estate tax returns filed (1.9 percent of estates) and 18,697 taxable returns (1.3 percent of estates). By 1973 the number of estates filing tax returns had reached 174,899 (8.9 percent of all estates), of which 120,761 (6.1 percent) were taxable. And in the fiscal year ending June 30, 1974, there were 211,540 estates filing returns (10.7 percent of all estates) and 146,000 taxable estates (7.6 percent).

We believe that an increase in the estate tax exemption is clearly warranted. Indeed, such an increase is essential if the estate tax is to be returned to its historic role as an excise on the transfer of relatively larger wealth accumulations. At the same time, we cannot ignore the significant revenue consequences that would result from increasing the estate tax exemption. Thus, we recommend that the estate tax exemption be increased to $150,000 over a 5-year transition period and that the lower bracket estate tax rates on the first $90,000 of taxable estate be eliminated. Limiting the increase to $150,000 (with the proposed restructuring of rates) will permit the revenue loss to be held to an acceptable amount, which can be absorbed gradually during the phase-in period.

Our specific recommendations regarding the estate tax rates and exemptions are:

- Increase the estate tax exemption to $150,000 in equal $18,000 increments over 5 years.
- Eliminate the lower estate tax rate brackets so that the beginning estate tax rate would be 30 percent. The estate tax rate changes would be phased in over 5 years along with the increased exemption.

We estimate that the combination of the increased estate tax exemption and the restructuring of estate tax rates will result in a revenue loss of $1.1 to $1.2 billion when fully effective and a revenue loss of less than $100 million in fiscal year 1977. At the same time, much-needed relief will be provided for moderate estates.

Liberalized payment provisions for family farms and businesses

Inflation has had a particularly serious impact upon the family farm or business. Property values have risen dramatically with the result that owners have been faced with higher estate taxes. This has created a greater liquidity need than faced by many other taxpayers, because family farms or businesses generally tend to represent a significant portion of the owners' estates in terms of dollar values. Therefore, many families have found it necessary to sell the family farm or business to obtain cash to pay Federal estate taxes.

To meet these problems, the administration has proposed a change in the Federal estate tax laws to make it easier to continue the family ownership of a small farm or business following a substantial owner's death. In summary fashion, the details are as follows:

- At the estate's option, a 5-year moratorium will apply to payment of that portion of the tax liability attributable to an ownership interest in a family farm or other closely held business qualifying for 10-year installment payments under present section 6166 of the Internal Revenue Code. No interest will accrue during the 5-year moratorium period and no principal or interest payments will be required during that period.
- At the end of the 5-year period, the deferred tax will, at the estate's option, be payable in equal annual installments over the next 20 years.
- Interest on the installments will be reduced to 4 percent per annum from the 7-percent rate generally applicable to deferred tax payments.
- The 5-year moratorium and 20-year extended payment provisions will apply only to the estate tax liability attributable to the first $300,000 in value of the family farm or business. Between $300,000 and $600,000 there will be a dollar for dollar reduction in the value of the farm or business qualifying for the moratorium and extended payment provisions. That portion of the tax not qualifying will continue to be subject to 10-year installment payments with the 7-percent interest rate.

We believe that enactment of the administration's proposal would be a positive and essential step toward ensuring the survival of smaller farms and businesses for future generations.

Foreign Withholding

Let me turn briefly to the subject of foreign withholding. The administration strongly supports the elimination of the existing withholding taxes on dividends and interest paid by U.S. persons on nonresident aliens and foreign corporations.

Under present law, and subject to numerous exceptions, a 30-percent withholding tax is imposed on the gross amount of dividends and interest paid to foreign investors. This tax should be eliminated and it should be done now. Elimination of this tax is desirable because—

Removal of the tax will increase investment by foreigners in the United States. It will make investing more profitable and less difficult for investors, and will make it easier for U.S. companies to seek funds in international capital markets.

It will improve the relative attractiveness of long-term securities and reduce the present imbalance favoring short-term securities and bank deposits (which are presently exempt from withholding). Access to foreign funds will permit the United States to continue its role as a capital exporter, including the recycling of funds flowing into and out of the oil-producing countries.

It will put the U.S. financial community back in the center of international capital markets and help them to regain competitive ground lost.

It is consistent with principles of tax equity and other rules relative to source of income.

It will eliminate what has become a complex patchwork of legislative and treaty provisions and simplify one area of tax law.

The basic point is that the many benefits of eliminating the tax outweigh the small revenue loss.

The desirability of increased foreign investment

Increased investment by foreigners in the United States is desirable anytime. Proposals to remove impediments to investment have been under consideration for several years. Increased investment is especially important today when we are faced with a massive outflow of funds to pay for very expensive oil.

To the extent that dollars piling up abroad are used to buy goods and services produced in the United States—say, wheat, for example—we are exporting real wealth from our economy and are the poorer for it. Further, as dollars simply pile up abroad, their value falls in the foreign exchange market. The increased number of dollars that we must then pay for imports becomes a potential claim on an even larger part of our national production. For example, as the value of the U.S. dollar falls, every Mercedes we buy gives some German a potential claim on more bushels of our wheat than previously.

In contrast, dollars which are reinvested in the United States stay here and do not involve exporting our real wealth—at least initially. Furthermore, increased foreign investment here keeps dollars from simply piling up abroad and helps forestall further devaluation.

We have for years preached to other countries the value to them of foreign investment in their countries. It is time we took our own preaching seriously. Investment in the United States by foreigners provides capital needed by this country.

The existence of additional investment here is desirable for three reasons: First, it increases the productivity of labor within our country, which in turn increases the real income of our residents. That increased productivity is critical in the battle against inflation. Second, as capital investment located here wears out and depreciates, it tends to be replaced by machinery and equipment and other assets that are manufactured here; and that too helps our economy. Third, as the investment generates income here, we get the tax on that income. This happens whether the corporation is directly controlled by foreigners, or the corporation simply sells bonds and other securities to foreign investors.

It is true that the after-tax profits on investments by foreigners may eventually be removed from our economy and repatriated by the foreign investor. But repatriation of income is usually only partial. And even when it is total, it usually occurs gradually over time.

In sum, we are much better off to have the investment, even if the after-tax profits are ultimately lost to us, than not to have the investment at all.

Enhanced market efficiency

The statutory elimination of withholding will greatly increase market efficiency for investments in the United States.

There have been so many ways—all complicated—around the U.S. withholding tax that the tax is as imaginary as it is real. However, even an imaginary tax can have detrimental effects. While certain foreign investors enjoy exemption or reduced rates by statute or treaty, the tax remains an impediment to broader foreign ownership of U.S. investments.

The present withholding tax system handicaps U.S. companies seeking foreign capital by narrowing the market in which potential foreign investors operate. Those who are unable or unwilling to deal with the complexities are discouraged from investing. Since most of the exemptions depend on the status or residence of the investor, the investor cannot freely market this investment. Securities which are not freely marketable throughout the world are not competitively attractive investments.

U.S. borrowers seeking long-term funds are at a competitive disadvantage compared to borrowers of other major countries which do not impose withholding taxes on investments by nonresidents. U.S. withholding taxes increase the capital costs of American companies. They either deter borrowing abroad or cause the U.S. company to bear the burden of the tax. For example, an American borrower who would otherwise borrow at 9 percent may be required to pay a nonresident as much as 13 percent to secure the same loan.

Other countries that have recently taken legislative action to eliminate their withholding on long-term international bonds in order to give their borrowers greater access to international capital markets include Australia in 1973, Japan in 1975, and Canada in 1975. They have thus joined other countries such as Austria, France, the Scandinavian countries, and the United Kingdom that provide exemption of international issues from withholding tax.

Short-term debt investments rather than long-term debt or equity investments are favored by the present withholding tax system. This bias arises as a result of the present exemptions from withholding for interest on bank deposits and certain other short-term obligations.

We urge elimination of withholding not only with respect to interest income, where a 30-percent tax on gross payments of interest is a clear impediment, but also for dividend payments. There is no reason to perpetuate favorable tax treatment for debt investment over equity investment. Many foreign investors are interested not solely in capital appreciation, which we do not tax in the case of a foreign investor, but in yield. The 30-percent tax on portfolio dividends is clearly a deterrent to those relying on the investment yield. This deprives many of our businesses of access to a form of capital they urgently require.

Free capital markets and free capital flows are in the best interests of everyone. In early 1974, capital controls were eliminated, and it again became possible for American capital to move abroad. The repeal of withholding taxes on dividends and interest would be a further move toward unimpeded flows of capital.

The question of tax equity

The repeal of these taxes is consistent with generally accepted tax principles, and is a part of tax reform. Jurisdiction to tax dividend and interest income was considered more than 50 years ago by a commission of tax experts established by the League of Nations. They concluded, back in 1923, that the right to tax investment income properly belongs to the state of the taxpayer's residence. This principle has been reaffirmed in the commentaries to the OECD Model Convention, while recognizing that some states may wish to maintain some minimal withholding tax solely on revenue grounds.

Revenue

The present withholding tax system does not raise significant revenue, due to a patchwork of statutory and treaty provisions. For 1973, the withholding taxes collected on dividends and nonbank interest were less than 10 percent of the gross payments, despite a basic statutory rate of 30 percent. In 1973, only $210 million of withholding tax was collected, $20 million with respect to interest and $190 million with respect to dividends.

The House bill

H.R. 10612, as reported by the House Ways and Means Committee, repealed the withholding tax on portfolio dividends and interest, but a floor amendment struck the provision. This floor action was an unfortunate error which should be corrected. At the time, the House seemed to be focusing on the immediate revenue loss and to be ignoring the large potential benefits from the proposal, including the fact that increased foreign investment will produce increased domestic revenues to offset any immediate loss. In fact, the administration strongly believes that the repeal should be broader than the Ways and Means Committee provision; that is, withholding taxes on direct as well as portfolio investments should be repealed. In the case of direct investments the United States would continue to collect the corporate tax on the underlying profits.

H.R. 10612 as passed by the House contains a provision which makes permanent the temporary provision removing the tax on bank deposit interest until December 31, 1976. While we are very pleased that this provision was adopted by the House, there is a particular timing problem which requires your committee's attention. Foreign investors have already begun to withdraw their funds, or switch to shorter term investments, to remove any risk of withholding taxes being imposed next year. It is, therefore, essential that that particular provision be passed immediately.

To summarize, our present withholding system is counterproductive. It hampers our economy, denies access to foreign capital markets, favors short-term foreign debt investment, and needlessly complicates our tax law, in order to raise an insignificant amount of revenue. It should be repealed promptly.

Taxable Bond Option

The efficiency of the municipal bond market is a matter of major importance to the Nation and to government at all levels. While the municipal market is basically sound, there is an artificial and unnecessary constraint on its efficient operation—State and local borrowers are limited to only one group of potential lenders, those who can use tax-exempt income. This means that the interest rates for municipal debt are critically influenced by changes in the tax and financial situation of such lenders. In addition, the municipal market is experiencing important changes in supply/demand patterns. On average, commercial banks are absorbing smaller percentages of new municipal issues, particularly in the longer maturities. Consequently, other sources of financing must be found if the volume of municipal borrowing is to be maintained.

In order to broaden the municipal market, Treasury strongly recommends legislation giving State and local issuers the option to borrow on a taxable basis and obtain a Federal subsidy of 30 percent of the borrowing cost. For electing issuers of longer term debt, a 30-percent subsidy will restore the customary "spread" in interest rates between municipal bonds and other debt issues.

The taxable bond option will introduce a much-needed element of flexibility by permitting State and local borrowers to tap the investment resources of foundations, pension funds, and other tax-exempt institutions. The Federal subsidy will enable municipal borrowers to go to the taxable market to secure lower net interest costs. As municipal bonds are issued on a taxable basis, the borrowing costs for governments which continue to issue tax-exempts will also be reduced, since there will be a smaller supply of tax-exempt bonds to be absorbed. State and local governments can thus achieve lower interest costs regardless of whether they choose to issue debt on a taxable or a tax-exempt basis.

In making this proposal, we are not suggesting that State and local governments have need for higher subsidies from the Federal Government. Our objective is not to provide more in the way of a direct subsidy but rather to make the tax-exempt market itself more effective. The taxable bond option will ensure that all municipal borrowers receive a subsidy of at least 30 percent below taxable rates regardless of underlying credit conditions or the needs of particular institutions for tax-exempt income; and it will do this in a manner which maintains the viability of the tax-exempt market.

We are working to devise procedures that will minimize Federal involvement in the subsidy process. We firmly believe that State and local governments should retain their traditional rights to determine whether and when to borrow and the terms of the borrowing.

We estimate that the cost of the 30-percent subsidy, after allowance for estimated revenue gains, will be $7 million for the first full year of operation. This net cost will rise to about $80 million by the 10th year.

Social Security and Unemployment Taxes

To assist in protecting the financial integrity of the social security system, the President has proposed a slight increase in the payroll tax effective in January 1977.

The old-age and survivors and disability insurance trust funds are paying out more in benefits than their current payroll tax receipts. This is largely due to increased benefits in the past few years and payroll tax receipts which have lagged because of unemployment and slowed wage growth.

Presently the amount of trust funds is equal to about 7 months of expenditures. Under present law, the question is not whether the trust fund will be depleted; rather, it is a question of when it will be depleted. Recent estimates by the social security system show that if the recovery should proceed more slowly than expected, the combined trust fund would be depleted by 1981. If a recession were to develop, it would be depleted even sooner. I am not suggesting that I expect a recession, or a slow recovery. I am suggesting, however, that the rapidly diminishing trust fund affords us precious little cushion for adverse events.

To prevent the rapid decline of the social security trust funds over the next few years, the choices are either to restrain increases in retirement and disability benefits or to increase revenues. It is clear that we need to increase social security receipts.

The President has included a full cost-of-living increase in social security benefits in his fiscal 1977 budget. To assure the future financial stability of the social security system, the President proposed, effective January 1, 1977, a payroll tax increase of 0.3 percent of covered wages for employees and employers.

The current social security tax rate is 5.85 percent for each employee and employer of covered wages. Under this proposal, in 1977 the tax rate would be 6.15 percent on a maximum wage base of $16,500. This increase will cost workers with the maximum taxable income less than $1 a week and will help stabilize the trust funds so that current and future recipients can be assured of the benefits that they have earned.

The increase is in the form of a modest rate increase as opposed to a further increase in the maximum wage base. The base is already scheduled to rise in progressive steps. Increasing the base even further to solve our shortrun financial problem will lead to greater complications because of the increased benefits to which the social security system will be committed. Consequently, an increase in the tax rate is the responsible course of action.

Let me turn briefly to unemployment taxes.

The unemployment compensation program is no longer self-supported and the financial structure of the system at both the State and Federal levels is seriously threatened: As of March 15, 1976, 20 States have depleted their unemployment compensation funds and as many as 10 additional States will be forced to borrow from the Federal Government by the end of calendar year 1976. Also, as of March 15, $2 billion has been borrowed from the Federal loan fund. The Department of Labor estimates that under the present financing provisions, the State unemployment compensation trust fund will have deficits amounting to $16.5 billion in 1978, $19.3 billion in 1982, and $24.1 billion in 1984.

The Federal unemployment account (from which the States with depleted trust funds borrow money) and the extended unemployment compensation account (which finances the Federal share of the extended benefits program) are both depleted and borrowing Federal general revenues. The Department of Labor also projects that under the existing tax base and net Federal tax rate, the Federal unemployment compensation trust funds will have a deficit of $6.2 billion in 1978, increasing to $8.2 billion in 1982, and $9.6 billion in 1984.

To alleviate the urgent problem before us, the administration has proposed an increase to $6,000 in the amount of wages subject to the Federal unemployment tax, beginning calendar year 1977. We also propose to increase the net Federal tax rate from 0.5 percent to 0.65 percent as of January 1, 1977, and reduce it to 0.45 percent in the calendar year following the year in which all advances to the extended unemployment compensation account have been repaid. Since many States tie their State unemployment taxes to the Federal rate base, State unemployment tax receipts will increase as well.

III. ENERGY POLICY AND TAX POLICY

I would like to turn now to the topic of energy and the relationship of energy policy with tax policy. Let me note at the very outset that there are four provisions in H.R. 10612 which relate to oil and gas which we believe will have a negative impact on our efforts to deal with the Nation's energy problem. It is just as important to avoid programs that aggravate the problem as it is to implement programs to resolve the problem. This bill seems to assume that we have solved the problem of declining oil production in this country. It signals a return to the complacency that prevailed before 1973. Have we forgotten so quickly the effects of the embargo on the American people or the effects of OPEC's price increases on our economy?

Nature of the problem

Let's be clear about what the problem is. Forty out of every 100 barrels of oil we consume in the United States are imported from foreign sources. Unless we take actions to increase the portion of our consumption from domestic sources, the number of imported barrels will increase as a result of increasing demand and declining domestic production.

The price of foreign oil paid by consumers is nominally about $12.50 per barrel. However, we must recognize that there are additional costs involved in each barrel of foreign oil; for we increase our dependence and vulnerability to OPEC and hurt our balance of payments.

Therefore, each barrel of domestic oil which could be produced for $12.50 is worth a premium to this Nation if it replaces a barrel of foreign oil. Tax measures which encourage domestic exploration, in effect, pay for this premium and are justifiable to the extent they make it possible to replace imported oil with domestic oil. Any provisions of the House bill which reduce the effectiveness of those tax measures would, along with other recent actions, discourage domestic production. The cost of the resulting increased dependence on imported oil outweighs any revenue gain from those provisions.

Administration efforts

Let's review what we've done that affects our dependence on imports since the embargo. In January 1975, the President sent to Congress a comprehensive energy program. The thrust of that program was to limit our dependence on foreign oil by seeking both an increased domestic oil and gas supply and an elimination of wasteful demand. If the free market were permitted to work, without obstruction by Government interference, these goals could be achieved.

The major aspects of the President's package included immediate decontrol of oil and gas prices, an import fee on foreign crude oil, a windfall profits tax on domestic producers, a residential insulation credit, and return of the revenue from the new taxes to consumers to compensate them for higher prices. Under this program, energy would cost more, but consumers would have no reduction in their spendable income. Oil producers would have an incentive to find and produce the more costly domestic reserves that, under current world market conditions, would be competitive with expensive foreign oil. However, they would realize no windfall profits on the lower cost oil produced from preexisting capacity.

The President's program was not accepted by the Congress. What have we achieved instead in terms of either conservation or increasing our supply of oil and gas?

Price decontrol

In the case of natural gas, interstate sales remain subject to price regulation. Some initial steps in the right direction have been taken by the Congress with respect to small producers.

Unfortunately, however, the House has voted to extend controls for large producers to cover intrastate, as well as interstate, sales. I urge the Congress to avoid this backward step and recognize the high priority of full decontrol of new natural gas.

In the case of crude oil prices, Congress agreed to a decontrol program after numerous compromise offers by the President. Last December, the President signed the Energy Policy and Conservation Act, under which controls will be removed after 40 months. It is expected that such action will increase domestic production by a million barrels a day by 1985. However, production of new reserves will occur only after a 5-year leadtime for exploration and development. This means that the industry needs capital today to search for and develop the higher cost, harder to find domestic reserves that we expect to be produced 40 months from now.

Delay in decontrol will certainly have an impact on the ability of the industry to generate the needed revenues. Further, we must not forget that in March 1975, the Congress repealed percentage depletion for that sector of the oil industry which accounts for 75 to 80 percent of expenditures made to discover, develop, and produce from new reserves. For the small producers, percentage depletion was retained for a small, and declining, amount of production. What remains is subject to rules which are so complex that the uncertainty and confusion in some cases may outweigh the tax benefit. In any event, the repeal of percentage depletion took from the industry $1.6 billion of after-tax revenues for 1976 that could have been reinvested in exploration and development of new reserves.

H.R. 10612 oil and gas provisions

Now, we have before us the proposals of H.R. 10612 which would further jeopardize sources of capital needed for exploration and development. Under this bill, the limitations on artificial losses would be applied to all but exploratory wells on every oil and gas property. Intangible drilling cost deductions would be included as a tax preference for minimum tax purposes, along with percentage depletion which is already included under present law. The deduction for intangible drilling costs would be denied where nonrecourse loans are used to finance drilling. Finally, the tax burden would be increased on dispositions of oil and gas properties with respect to which intangible drilling costs have been deducted.

The combined effect of these measures would be a further reduction of the after-tax revenues from oil investment by almost $300 million in 1976. The problem will be compounded if outside investors, an important source of capital, become disenchanted by these actions and redirect their investments to other businesses. With the reduction of net revenues available for internal financing, the dependence on sources of outside financing becomes more acute. This is not the time to create more uncertainty or eliminate those incentives which influence potential investors in oil and gas ventures. Potential investors in a business which is inherently very risky can certainly be expected to turn to other investments if we continue to make oil investment less attractive.

We believe that your committee should take affirmative steps to eliminate these measures from H.R. 10612, as well as the present treatment of percentage depletion as an item of tax preference, if we are to fully achieve the objectives of increased domestic oil supply and reduced dependence on imports. It was this mutual objective which, after months of give-and-take by the Congress and the President, led to a decontrol program. To enact these measures and dry up a significant source of capital needed today to start finding and producing those additional reserves would be patently counterproductive. Almost as detrimental is the uncertainty created by the existence of such proposals. They should be disposed of quickly.

H.R. 6860

Your committee is now considering H.R. 6860, the energy tax bill, a product of an effort by the House to solve the energy problem with oil import quotas and tax measures to encourage conservation of oil and gas and conversion to alternative sources of energy. Although the effort was well intentioned, the result is a list of provisions which would have only a modest energy savings at the cost of significant economic distortion induced by discriminatory excise taxes, amortization, and investment credit provisions. Let me give you just a few illustrations of the problems we perceive with H.R. 6860:

The bill includes a proposed excise tax on business use of oil and gas which is objectionable on several grounds. First, it imposes the conservation burden selectively on a few members of one economic sector and only on certain kinds of uses of energy. We all need to conserve the whole barrel of oil. Second, it would produce an undesirable distortion in petroleum usage by tilting prices of products in favor of nonbusiness uses. Third, it will be extremely difficult to administer because of the multitude of exceptions, even within the business sector.

The bill would repeal excise taxes on radial tires and buses. This would be an unwise reshaping of the sole function of such user taxes which is to raise revenue for highway maintenance uniformly from highway users.

It also would allow tax credits for installation of insulation and solar energy equipment and the purchase of electric cars. Such credits would make some sense in the case of residential insulation, the energy-saving facilities of which have been proven for use on a broad scale. However, solar energy and electric cars, early in their development, are available and useful for only a few taxpayers for whom such credits would be a windfall. Little, if any, additional use of solar energy equipment or electric cars would result from such credits at this time.

Finally, the bill includes several provisions which employ rapid amortization or a selective increase or denial of the investment credit to induce the business sector to either conserve oil and gas or convert to alternative sources. Wherever economics are favorable, there is no need for special public subsidies to induce private business decisions. When oil is sold at a given price, energy users will convert to alternative sources which are competitive at that given price. It is wasteful to subsidize conversion to alternative sources which are not competitive at that price.

Thus, there are very few provisions of H.R. 6860 that we could support.

IV. TAX REFORM—H.R. 10612

As I stated earlier, another major item before your committee is H.R. 10612—the tax reform bill. In 1973 the administration presented to the House Ways and Means Committee specific proposals to improve significantly the fairness, equity, simplicity, and efficiency of our tax system. Our three principal proposals were:

- LAL (limitation on artificial losses) to deal effectively with the problems associated with tax shelters by a solution which reaches their most common feature: Bad tax accounting rules which mismatch expenses and revenues and thereby produce artificial accounting losses.
- MTI (minimum taxable income) which, in combination with LAL, deals with the problem of taxpayers with high economic income who pay little or no Federal income tax.
- A simplification package designed to alleviate the intolerable reporting burden imposed upon the average taxpayer.

After nearly 3 years of labor on the House side, you now have before you H.R. 10612. In broad outline, the bill deals with the same problems we identified in 1973. Overall, it is clearly a step in the right direction. However, in a limited number of cases, we believe that certain features should be strengthened or deleted.

Because of our crowded agenda this morning, I will limit my comments only to certain aspects of the bill. With your permission, we will submit shortly a technical memorandum of Treasury position on the bill. The specific areas I will address are: The limitation on artificial losses and other tax shelter amendments, the minimum taxable income proposal, the simplification provisions, the provisions affecting the taxation of foreign income and DISC, and certain administrative provisions.

Limitation on Artificial Losses and Other Shelter Provisions of the House Bill

LAL background

LAL was first proposed by the administration in 1973. It was designed to eliminate "tax shelters" which introduce substantial distortions into the income tax system. Under the proposal, tax accounting rules would no longer be permitted to create from a profitable enterprise an artificial tax loss to be deducted against (and shelter from tax) other unrelated income. Under present law, such losses reduce adjusted gross income and make tax shelters possible.

Artificial accounting losses limited by LAL would neither be permanently disallowed nor capitalized. Instead, they would be suspended and carried forward to be deducted in full against net related income in a future taxable year, thus more correctly matching income with the expense of earning it.

Because LAL was carefully directed at a narrow, but significant, problem under present law, it would affect relatively few taxpayers. LAL would apply only where there are artificial losses. While such losses are frequently generated in the real estate and agricultural industries, LAL would normally not affect either the ordinary farmer or the ordinary real estate developer, but rather the outsider who buys into those industries in search of tax losses. Artificial losses from such sources as accelerated depreciation, the current deduction of preopening costs, and prepaid feed deals would no longer be permitted to shelter unrelated income.

LAL would apply to individuals but not to corporations. In combination with the proposal for a MTI provision, LAL would be substituted for the present minimum tax on individuals.

The House bill contains a modified version of the administration's 1973 LAL proposal. In addition, the bill also contains other provisions dealing with tax shelters. I will comment briefly on LAL and the other tax shelter provisions.

Real estate

With respect to real estate, the House bill applies LAL to commercial and residential real estate. The accelerated deductions subject to LAL are limited to the deductions for (1) construction period interest and taxes, and (2) accelerated depreciation in excess of straight-line depreciation. A taxpayer may aggregate all income from real estate activities in determining the accelerated deductions on real property which are currently allowable.

Although our 1973 proposals would have allowed aggregation of all income from residential real estate, and applied a property-by-property rule for commercial real estate, we favor the provision of the House bill. Aggregation will lessen the impact of LAL on the professional real estate developer and thereby have no significant adverse effect on new construction. It will also tend to isolate the impact of LAL to the one-time passive investor. Moreover, the aggregation rule will simplify the LAL computations.

Farming activities

Under the House bill, LAL applies to losses generated by accelerated deductions attributable to farm operations. Subject to numerous exceptions, LAL applies to (1) preproductive period expenses attributable to any property having a crop or yield, (2) prepaid feed, seed, fertilizer, and similar farm supply expenses, and (3) accelerated depreciation on any property having a crop or yield (which may be taken after the property begins to be productive). LAL should have little impact on the ordinary farmer who works during the off-season to supplement his income since farmers are permitted to deduct up to $20,000 of farm losses against nonfarm income.

Although aggregation is generally permitted for farming activities, LAL applies separately to each farm interest in the case of farming syndicates.

We generally support the application of LAL to farming activities but do not favor the application of more stringent rules to farm syndicates. Instead, we propose that syndicates be required to use the accrual and inventory method of accounting. In this way, the tax shelter abuses resulting from the cash method of accounting are dealt with directly. These syndicates should be treated in the same manner as farm corporations (other than family corporations) which, under the House bill, are required to use the accrual method of accounting. Existing income tax regulations have long exempted farmers from the accrual method of accounting because of the difficulty of maintaining the books and records required for accrual accounting. However, today's nonfamily farm corporations and syndicates are sophisticated business ventures with ready access to the necessary expertise to maintain these records.

Oil and gas

Under the House bill, LAL does not apply to exploratory wells but it does apply to development wells. The House bill also provides that gain on the disposition of oil and gas interests will be treated as ordinary income to the extent of the excess intangible drilling cost deductions over the amount that would be allowed had the costs been capitalized.

We strongly oppose the application of LAL to *any* oil and gas activities. We also strongly oppose the recapture of intangible drilling cost deductions. Admittedly, our position on LAL is a change from our 1973 proposal. However, the situation has changed markedly. We have witnessed a sharp decline in domestic sources of oil and gas. We have experienced the painful dislocations caused by our dependence on foreign sources for oil. Energy exploration and development activities have already been severely hampered by the repeal of percentage depletion, the limitations on the foreign tax credit, and the continuation of price controls. For reasons I spelled out earlier, the existence of Government-imposed controls will prevent the market incentives from increasing domestic energy supplies. Surely, now is not the time to erect further impediments by increasing the tax burden on oil and gas.

Sports franchises

The House bill applies LAL to sports franchises. While LAL is a sound concept, this is an unwarranted extension of the rules the administration proposed in 1973. These rules did not contemplate that LAL would apply to sports franchises.

The Internal Revenue Code contains no special tax benefits for sports franchises. In this area, abuses arise only when too high a value is placed on player contracts, or when they are written off over too short a period of time. However, abuses of this type are possible in the case of any business property which may be amortized or depreciated. These abuses can be dealt with adequately by the Internal Revenue Service. Although the disputes surrounding the value and life of player contracts are the subject of litigation, resolution of these disputes should eliminate the tax controversies in this area.

The House bill also applies special rules for the allocation of the purchase price on the purchase and sale of sports franchises. It also provides that single sale of a player contract will trigger depreciation recapture on previously unrecaptured depreciation and abandonment losses taken on all other player contracts.

These proposals are arbitrary since they apply only to sports franchises. Allocating the purchase price among the assets of a sports franchise is no different from allocating the purchase price among the assets of any other business. Applying special rules to sports franchises to deal with a problem that the Internal Revenue Service can handle adequately is not warranted. Further, the unique depreciation recapture rule goes far beyond the usual asset-by-asset depreciation recapture rules in the Code. Here, too, there is no apparent reason to isolate sports franchises for special treatment.

Limitation on nonbusiness interest

The House bill imposes a $12,000-a-year limitation on the amount of personal interest, and investment interest in excess of investment income, that an individual may deduct. Unused investment interest, but not unused personal interest, would be available as a carryforward and be deductible in future years to the extent of related investment income in those years.

We oppose the $12,000 limitation since it is an arbitrary limit on the interest deduction. It would deter individuals from purchasing assets with borrowed funds. Moreover, the $12,000 limitation can have the effect of disallowing permanently deductions for home mortgage interest. This is a fundamental change from current law since home mortgage interest will be subject for the first time to a dollar limitation and, in some cases, will be disallowed permanently. The permanent disallowance can occur because of the absence of a carryover for unused personal interest.

We believe that the problem presented by taxpayers who use the interest deduction and other itemized deductions to reduce their tax liability will be handled adequately by treating the amount of itemized deductions in excess of 70 percent of adjusted gross income as an item of tax preference includable in the minimum taxable income base. I will discuss this point in detail shortly.

"At risk" limitation

The House bill limits deductions to the amount of capital which a taxpayer has "at risk" in a venture in the case of motion picture films, livestock, certain 1-year crops (grain, oil seed, fiber, and others), and oil and gas wells. The at risk limitation is intended to prevent a taxpayer from deducting losses where the deductions are attributable to property acquired with borrowed funds for which he has no personal liability, that is, nonrecourse financing. The losses would be suspended and become deductible only in the future as the taxpayer increases his at risk capital.

The at risk limitation is premised on the assumption that the present tax treatment of nonrecourse financing is unsound. The present law is based on the Supreme Court's decision in *Crane* v. *United States*, 331 U.S. 1 (1947), which held that nonrecourse financing is treated in the same manner, for tax purposes, as financing for which taxpayers are personally liable. The Supreme Court's decision in *Crane* recognizes that nonrecourse financing is an accepted financing medium in many industries. It is a valuable method of encouraging individuals to invest in ventures with a high degree of risk. An at risk limitation would overturn more than 20 years of established commercial practice, and adversely affect the general business community as well as passive investors.

We believe that LAL is a better remedy to the tax shelter problem than the at risk limitation. The limitation—applicable to corporations as well as to individuals—can result in distortions of income. Taxpayers would include income from ventures but would not have the benefit of offsetting deductions. Moreover, taxpayers will be able to control the timing of their deductions merely by electing to increase their capital at risk in those years in which the deductions yield the greatest tax benefit. Further, the scope of the definition of "at risk" is not clear. The House Ways and Means Committee report accompanying H.R. 10612 adopted an expansive definition of the term which would include within its scope many types of insurance arrangements obtained in the normal course of business. Thus, the reach of at risk may be far greater and affect far more transactions than necessary or desirable to cure the potential abuse of nonrecourse financing.

Minimum Taxable Income

In 1973, the administration recommended a proposal which would require each individual to pay tax at regular rates on a minimum amount of taxable income. Last July, in testimony before the House Ways and Means Committee, I recommended that the House follow our 1973 proposal with some modifications. Today, I am renewing our MTI proposal.

MTI was formulated with a view to balancing two competing considerations. First, Congress has provided various tax incentives designed to encourage specific economic activities. Second, excessive use of these tax incentives by some taxpayers with large economic incomes enables them to avoid paying a reasonable amount of tax, or in some cases, any tax at all. This conflicts directly with the basic tenets of equity and fairness—the income tax should be based on ability to pay; the income tax should be fair and should be perceived as such by all taxpayers.

The House did not adopt MTI. Instead, it perpetuates the minimum tax. Let me review briefly the defects of the minimum tax.

Defects of present minimum tax

The minimum tax is a flat 10-percent tax on certain preference items such as the excluded portion of capital gains, accelerated depreciation on real property, and the excess of percentage over cost depletion. An exemption for the first $30,000 of preferences and a full offset for regular income taxes paid are applied to reduce the amount subject to the minimum tax.

The minimum tax is defective in two critical respects:

First, since it is an additional tax, it penalizes the use of preferences, or incentives, even where an individual has paid significant amounts of regular tax. By contrast, MTI comes into play only if the taxpayer's taxable income is not sufficiently large, in relation to his economic income, to assure that he is paying his fair share of taxes.

Second, because minimum tax is imposed at a flat rate, it serves merely to "slap the wrist" of those taxpayers who are able to shelter large amounts of income from regular tax. By contrast, MTI is predicated on the proposition that taxpayers should not be permitted to avoid the graduated rates through exclusion preferences, itemized deductions, or the payment of a 10-percent surcharge.

Previous proposals

Because of the deficiencies of the current minimum tax, the administration proposed in 1973, and again in 1975, repeal of the minimum tax and the substitution of MTI and LAL. MTI would prevent individuals from avoiding tax on high economic income by the use of exclusions or large itemized deductions. LAL would prevent individuals from deducting artificial losses against unrelated salary or investment income.

The prior MTI proposal called for taxing an individual at regular rates on one-half of an expanded income base if the expanded base exceeded his regular taxable income. The expanded base consisted of adjusted gross income plus the excluded half of net long-term capital gains, the bargain element in stock options, the excess of percentage over cost depletion, and excludible income earned abroad. The expanded income base was then reduced by personal exemptions, certain deductions, and a $10,000 exemption.

House action

Instead of adopting MTI, the House merely restructured the minimum tax. The rate of tax is increased from 10 to 14 percent, the $30,000 exemption is reduced to $20,000 and is subject to a phaseout. Moreover, new items of tax preference are added. A most serious consequence of the House action is the denial of any offset for regular income taxes paid. This means that individuals who have paid significant amounts of regular tax will now be subject for the first time to an additional minimum tax.

The House bill also treats as preferences certain accelerated deductions which result in deferral of tax rather than a permanent exemption from tax. To illustrate, as an incentive for real estate development, taxpayers may elect to deduct taxes and interest during the construction period. To prevent the mismatching of income and deductions, the House adopted the administration's LAL proposal, which allows these deductions only to the extent of related real estate income. Having closed the potential abuse, the House proceeded to treat construction period interest and taxes not limited by LAL as items of tax preference for minimum tax purposes. We believe this action is conceptually unsound since the deductions, when allowed, are offsetting income from a related activity. Furthermore, HUD and Treasury are convinced that this treatment can have an adverse effect on real estate development.

Revised MTI proposal

We are convinced that neither the current minimum tax nor the amendments made by the House bill properly deal with the problem of high economic income taxpayers who pay little or no income tax. We propose that your committee repeal the minimum tax and adopt an alternative tax along the lines of our prior MTI proposal. We have modified our MTI proposal somewhat in light of concerns expressed since it was first proposed in 1973.

Adjusted gross income was the starting point for computations under the original MTI proposal. A taxpayer with large, but legitimate, itemized deductions and little taxable income might have been taxable under MTI. We have reconsidered this aspect of the proposal and have concluded that this result is not warranted. We recommend, therefore, that the starting point for MTI calculations should be taxable income.

Permit me to review how MTI will work. MTI will be an alternative tax. Under MTI, a taxpayer will pay tax at the regular rates on the larger of his taxable income or on his MTI base. The MTI base is calculated by (1) adding items of tax preference to a taxpayer's taxable income, and (2) taking 60 percent of that expanded base. A $10,000 exclusion is allowed (before applying the 60-percent factor) to assure that MTI does not affect either low-income taxpayers or taxpayers with only a small amount of tax preferences. For MTI purposes, there are only two tax preferences: (1) The excluded portion of net long-term capital gains, and (2) itemized deductions (other than charitable contributions) to the extent that they exceed 70 percent of the taxpayer's adjusted gross income.

There are several preference items which are included under the present minimum tax which are not included as preference items under our MTI proposal. Our tax shelter program consists of two parts: LAL takes care of some shelters; MTI will take care of others. Thus, to the extent that LAL deals with an item of preference, there is no reason to include it under MTI. Most of the preference items under the minimum tax are handled under LAL. We have not included percentage depletion in excess of basis as an item of tax preference since percentage depletion has been virtually eliminated. The remaining preferences are excessive itemized deductions and capital gains. Therefore, they are the only two included under MTI.

Under our present proposal, the alternative tax will be computed on 60 percent of the MTI base instead of the 50 percent which the administration recommended in 1973. The increase from 50 to 60 percent will make MTI more effective in insuring that individuals with large economic incomes pay a tax which is significant in relation to that income.

Charitable contributions under MTI

In 1974, when the House Ways and Means Committee in its tentative decisions adopted the MTI concept, one of the controversial issues was the impact of MTI on charitable contributions. After considerable discussion, the committee decided to put charitable deductions entirely outside the scope of MTI. In view of the dire financial position in which inflation has left so many private charities, we became persuaded that the committee decision was appropriate and we supported it in our July 1975 testimony.

Accordingly, we have carefully structured our present MTI proposal to avoid completely all impact on charitable contributions. Under our proposal, charitable contributions, no matter how large, will not be an item of preference. We will exclude contributions in computing the extent to which itemized deductions will be a preference item.

In short, we have treated charitable contributions very generously. Under no circumstances can MTI adversely affect contributions.

Overall, we believe that MTI is superior to the minimum tax as a way of dealing with the problem of taxpayers who make excessive use of tax preferences. MTI will not affect taxpayers who use tax preferences—which the Congress has provided to encourage various economic activities—and who otherwise pay substantial ordinary tax. At the same time, MTI will assure that every taxpayer bears a fair share of the tax burden. The idea of fair share is related to the taxpayer's ability to pay. Whereas the minimum tax is an additional tax at a flat rate, our minimum taxable income proposal involves an alternative tax, at progressive rates, based directly on a measure of ability to pay. Not only is this in itself a desirable feature, it is compatible with long-term tax reform in the direction of a more inclusive definition of income, taxed at a lower structure of rates.

Simplification Provisions

As I mentioned earlier, simplification of the tax law must be a major objective of any meaningful tax reform.

Much of the complexity faced by the average taxpayer is in itemizing deductions. Expansion and revision of the standard deduction under the administration's current tax proposal will result in substantial tax simplification by increasing the number of taxpayers who will use the standard deduction. However, it is also necessary to simplify the tax law directly, and thereby enhance its fairness, through the elimination or restructuring of certain provisions which require complex recordkeeping by taxpayers.

In 1973, the administration made specific proposals to achieve simplification. H.R. 10612 generally follows our proposals by expanding the optional tax tables and by revising the sick pay exclusion, the retirement income credit, and the child care deduction. Overall, the changes are in the right direction. However, the House did not adopt the miscellaneous deduction allowance proposal recommended by the administration in 1973. We believe that further action is required and that certain aspects of H.R. 10612 relating to simplification should be revised.

Miscellaneous deduction allowance

The administration recommends the adoption of a miscellaneous deduction allowance of $400 ($200 in the case of a married individual filing a separate return) for taxpayers who itemize their deductions. This simplification deduction will replace or modify the following hard-to-itemize deductions:

- The deduction for State and local gasoline taxes.
- Medical expenses and casualty losses.
- Certain miscellaneous investment expenses and employee business expenses.

These deductions are sources of complexity in the present tax law. While they are used by many taxpayers, they generally do not significantly affect a taxpayer's ability to pay or provide substantial incentives. They require taxpayers to keep track of numerous small bills and receipts which are difficult to classify, summarize, and correctly reflect on the tax return. These items also cause substantial problems on the administrative side at the audit level.

Let me discuss briefly some of the specific deductions which will be affected by our proposal.

First, we propose repeal of the deduction for State and local gasoline taxes. The gasoline tax deduction involves complications out of proportion to any benefit to the taxpayer. There is a substantial amount of guessing in the computation of the deduction (where the tax tables are not utilized) and the amount of the tax saving to the average taxpayer is generally small.

In addition, State and local gasoline taxes, like the nondeductible Federal gasoline tax, are in essence charged by the State for the use of its highways. They are in the nature of personal expenses for automobile travel rather than a tax, and therefore, like such expenses, they should not be deductible. Further, their deductibility is inconsistent with the character of the taxes as use charges since they serve to shift part of the cost of the highway user to the general taxpayer.

The gasoline tax deduction is also inconsistent with our current national energy policy. The deduction lowers the price of gasoline to taxpayers who itemize deductions. Repeal of this provision should result in the reduction of gasoline consumption.

Second, we propose to revise the medical expense and casualty loss deductions. Under current law, there is a complex three-tier system for determining allowable medical expense deductions. First, a medical expense deduction is allowed for one-half of medical insurance premiums (up to $150) without regard to a 3-percent floor applicable to other medical expenses. Second, a taxpayer must compute amounts paid for medicine and drugs to the extent they exceed 1 percent of his adjusted gross income. This excess is then added to the remainder of the cost of his medical insurance (which was not deductible in the manner described above) and to general medical expenses not otherwise compensated by insurance. If the total of these items exceeds 3 percent of the taxpayer's adjusted gross income, then that excess is deductible as a medical expense.

Nonbusiness casualty and theft losses are deductible under present law only to the extent that the loss in each case exceeds $100.

We propose to apply a floor of 5 percent of adjusted gross income on medical expenses and casualty losses. Further, we propose repeal of the deduction for one-half of medical insurance premiums (up to $150) allowable without regard to the current 3-percent floor. The 1-percent floor with respect to medicine and drugs would also be eliminated. Expenses for drugs would be covered under the proposed 5-percent floor, but the deduction would apply only to prescription drugs.

Aggregation of medical and casualty deductions is desirable because they are quite similar. Both are based on the theory that they reduce a taxpayer's ability to pay because of unfortunate circumstances generally beyond his control. The 5-percent level is where these expenses become extraordinary and affect substantially a taxpayer's ability to pay taxes.

Third, we propose a $200 floor on the deduction of the following expenses:

- Employee business expenses such as union dues, work clothes, small tools, educational expenses, and home office expenses; and
- Expenses such as tax return preparation expenses, and investment expenses such as the cost of financial newspapers, financial periodicals, investment advisory services, and safe-deposit boxes.

We propose a $200 floor on these expenses because of the considerable difficulty experienced by taxpayers in keeping records of a number of relatively small items. By limiting these deductions to cases where a taxpayer incurs a significant amount of such expenditures, some difficulty in completing tax returns will be eliminated for many taxpayers.

We propose the adoption of a miscellaneous deduction allowance of $400 ($200 in the case of a married individual filing a separate return) for taxpayers who itemize their deductions to replace the itemized deductions eliminated or restructured by our proposal. This deduction would be in addition to a taxpayer's other itemized deductions which are unaffected by this proposal.

Child care provision

The child care provision of H.R. 10612 converts the current treatment of household and dependent care expenses from an itemized deduction to a nonrefundable tax credit. The revenue loss from adoption of a credit is estimated to be $325 million for 1976, $355 million for 1977, and $393 million for 1978, with the amounts projected to increase substantially for the years 1979–81. Such high cost for the child care credit is entirely unjustified in terms of the resultant benefits.

Simplification and expansion of the provision can be provided adequately by retaining the existing deduction without substantial revenue loss. We continue to emphasize that the child care deduction should be made available only to low- and moderate-income taxpayers whose economic situation is such that it compels both spouses to work and who thus have no spouse at home to care for dependents. There can be no justification for allowing the tax system to subsidize high-income taxpayers in discharging a personal obligation to care for dependents and thereby depart from what is the proper basis for the provision.

We generally support the other revisions of the child care deduction made by H.R. 10612. Thus, we support those measures which make it fairer and simpler such as its extension to married couples where the husband or wife, or both, work part time, or where one is a full-time student and the other works. Similarly, we support elimination of the monthly limitation on the deduction in favor of an annual deduction.

We also support elimination of the current distinction between care outside the home and care in the home, making the deduction available to a divorced or separated parent with custody of a child, and to a deserted spouse.

Sick pay exclusion

Another prime candidate for simplification is the sick pay exclusion provisions of the Code. Under present law, sick pay is excluded from gross income and, therefore, not subject to tax. However, these provisions are complicated by special rules turning on the amount of the weekly sick pay, the number of days the employee has been absent from work, the relationship between the sick pay and the employee's regular wages, and whether the taxpayer has been hospitalized.

H.R. 10612 repeals the present sick pay exclusion and the complicated time and percentage rules. A maximum annual exclusion of $5,200 ($100 a week) is provided only for taxpayers under age 65 who are permanently and totally disabled. After age 65, these individuals are eligible for a retirement income credit. The provision requires a reduction of the exclusion on a dollar-for-dollar basis by the amount of the taxpayer's income, including disability income, in excess of $15,000.

While the House modifications of the sick pay provisions are a step in the right direction, we believe that complete repeal of these provisions is essential to the goal of simplification and equity. The sick pay provisions were enacted with worthwhile objectives in mind. However, limitations, conditions, and exceptions had to be grafted onto them to prevent abuses and substantial revenue losses. As a result, these provisions are now incomprehensible to the average taxpayer. More fundamentally, no justification exists for treating sick pay any differently than other wages. Taxpayers who have comparable ability to pay should be taxed in a similar manner.

Retirement income credit

There is a need to redesign the present retirement income credit for several basic reasons:

First, the complexity of the present retirement income credit prevents it from providing the full measure of relief it was intended to grant to elderly people. Individuals who receive little or no social security benefits should be subject to a tax treatment roughly comparable to that accorded those who receive tax-exempt social security benefits. However, difficult compliance burdens have been imposed on large numbers of elderly people, many of whom are not skillful in preparing tax returns. These individuals must now compute their retirement income credit on a separate schedule which involves 19 separate items, some of which require computations in three separate columns. Further, the special provisions for public retirees under age 65 also add substantially to this complexity.

It is these complexities which undoubtedly account for the fact that some of the organizations representing retired people have estimated that as many as one-half of all elderly individuals eligible to use the retirement income credit do not claim this credit on their tax returns.

Second, the credit needs revision because most of its basic features have not been revised since 1962 when the maximum level of income and the current earnings limits were established. Since that time, social security benefits have been substantially liberalized. As a result, the present maximum amount of income eligible for the credit is considerably below the average annual social security primary and supplementary benefits received by retired workers.

Third, the present credit discriminates among individuals with modest incomes, depending on the source of their income. The credit is available only to those with retirement income—that is, some form of investment or pension income in the taxable year. Elderly individuals who must support themselves by earning modest wages, and who have no investment or pension income, are not eligible for any relief under the present credit.

This feature of present law is unfair. Elderly individuals who rely on earned income should be allowed the same retirement income credit as those who live on investment income.

In 1973, we recommended a revision of the retirement income credit. With one exception, H.R. 10612 follows our recommendations. The retirement credit is converted to an age credit, available to all taxpayers age 65 or over regardless of whether they have retirement income or earned income. Further, the maximum amount on which the credit is computed was increased and much of the complexity reduced or eliminated.

One further step is necessary. The separate treatment of the retirement income of public employees under age 65 should be eliminated. The continuation of this treatment perpetuates the extraordinary complexity of this provision. This would be contrary to the goal of simplification and fairness which was the major purpose of amending the existing retirement income credit in the first instance.

Foreign Income Provisions

The House bill has several provisions dealing with the taxation of foreign income. I would like to comment briefly on a few of these provisions.

Foreign tax credit

The United States employs a foreign tax credit to avoid double taxation of income. The basic concept of a foreign tax credit system is that, when an enterprise of one country does business in another country, the country in which the business is carried on has the first right to tax the income of the business. The home country also taxes the income, but only to the extent that the home tax does not duplicate the tax of the country where the income is earned. The duplication is eliminated by the foreign tax credit.

The basic concept of the foreign tax credit is sound, and has the full support of the administration. The foreign tax credit is neither a tax loophole nor an incentive to invest abroad. It is merely part of a system of allocating primary taxing jurisdiction to the country within whose borders the income is earned. U.S. companies are taxable on their worldwide income. Our tax credit system does not reduce the total tax bill of U.S. companies below the amount they would have paid if the income had been earned here. The effect is that the total tax is limited to the higher of the U.S. tax or the foreign tax.

Despite the basic soundness of the foreign tax credit, there are technical problems with our present system. H.R. 10612 contains several provisions which deal with these problems.

At present, taxpayers may compute their foreign tax credit under either the per-country limitation or the overall limitation. Under the per-country limitation, the foreign tax credit is applied to the taxes and the income of each country separately. Where taxes in a given foreign country exceed the U.S. tax on the income from that country, that excess is not creditable. Where another foreign country's taxes are less than the U.S. tax on the foreign income from that other country, the taxpayer will have additional tax to pay to the United States. When there is a loss in a particular country, that loss can reduce U.S. taxes on U.S. income, even if there is income in other countries with respect to which no U.S. tax is payable because of the foreign tax credit.

Under the overall limitation, the taxpayer aggregates all his foreign income and all his foreign taxes. If the foreign taxes do not exceed the U.S. tax on the foreign income, then the entire amount of foreign tax may be taken as a credit. The overall limitation permits the taxpayer to average out high foreign taxes with low foreign taxes, but does not allow foreign losses to reduce U.S. taxes on U.S. income, unless there is an overall foreign loss.

The opportunity that taxpayers now have either to offset foreign losses against domestic income or to average high and low foreign taxes has given rise to demands for revision of our foreign tax credit system. In response to these demands, the House bill eliminates the per-country limitation.

The Ways and Means Committee report explains that the elimination of the per-country limitation is necessary to prevent foreign losses from offsetting domestic income, except in the case of an overall foreign loss. In addition, the per-country limitation creates difficult administrative problems. The primary problem is the difficulty of providing adequate source rules. Because of these problems with the per-country limitation, the administration has not objected to its repeal.

The House bill also includes a foreign loss recapture provision. This provision was proposed by Treasury in slightly different form in 1973, but we support it in its present form. We view this as a technical change to eliminate an unintended benefit. Under present law, a U.S. taxpayer can use foreign startup losses to reduce U.S. tax and then pay no U.S. tax on subsequent foreign gains because of the foreign tax credit. In such a case it is only fair for the United States to recapture the tax lost during the startup period.

The House bill provides a capital gain adjustment to the foreign tax credit. We view this as a technical improvement, and we support it. Capital gains are subject to lower U.S. tax, and it is logical that foreign capital gains should receive a correspondingly lower foreign tax credit limitation. Similarly, we view the full gross-up for less developed country dividends as a desirable simplification, eliminating an inefficient preference in our tax laws.

Domestic international sales corporation (DISC)

The House bill has introduced an incremental export rule for U.S. exporters through DISC and has provided that certain goods are not eligible for DISC benefits. The administration supports DISC and opposes the House cutbacks in the program.

DISC stimulates exports. During the time DISC has been in existence, U.S. exports have grown from $44 billion in 1971 to some $118 billion in 1975. Obviously, all of this growth cannot be attributed to DISC. The growth reflects worldwide trade expansion, exchange rate adjustments, varying inflationary movements, and so on. But part of the growth is due to the incentive of DISC. Most estimates of the DISC part of the growth range between $4 billion and $6 billion per year.

DISC creates jobs. With more goods exported, more goods must be produced, and more people are employed to produce them. DISC tends to neutralize the provisions in foreign tax laws which encourage U.S. businesses to establish plants abroad or encourage foreign export efforts in competition with U.S. exports.

Any curtailment of DISC would be particularly unfortunate at this time, when the economy is in the midst of a recovery. It would increase our present problem of capital formation by raising the taxes on capital at a time when they should be lowered. It would hit hardest those companies who have been doing the most to help our export efforts. We shouldn't alter DISC until there is agreement in the multilateral trade negotiations concerning uniform rules for taxation of exports.

The House moved to restrict DISC benefits in two ways:

First, the bill takes away DISC benefits for the export of certain goods. The Tax Reduction Act of 1975 has already made natural resources ineligible for DISC. The current bill would add to the disqualified list agricultural products not in excess supply and military equipment.

Second, for companies with profits in excess of $100,000, the House bill restricts DISC benefits to income on sales in excess of 75 percent of average sales during a base period.

The first change, the disqualification of certain items from DISC, reflects a desire to remove the export stimulus from the export of goods believed to be undeserving of stimulus. This effort produces hardship for companies exporting those items. The hardship is made particularly difficult by the lack of adequate transitional rules for those companies previously exporting the now-disqualified items.

The second change, the incremental approach, was considered seriously during the development of the DISC legislation in 1971, at a time when income on incremental DISC sales would have been 100 percent deferred, rather than 50 percent deferred. This committee judged an incremental approach unsatisfactory, and the legislation emerged with an alternative of a 50-percent deferral. The reasons valid in 1971 for rejecting an incremental approach remain valid today. The problem is similar to that posed by excess profits tax legislation. Inevitably, any base period will lead to unfairness. The new entrant will have an undue advantage, and the company with declining sales will have no incentive to slow the trend. An already complex statute will be rendered increasingly unworkable to the detriment of U.S. exports and jobs.

DISC has been in place for only a short time. And, it is working. Many companies have made significant investments in reliance on it, but the legislative tinkering with the DISC can only weaken the program. DISC, like the investment credit, should not be turned on and off depending on the whim of the moment. We must resist the temptation to adopt stop-and-go policies, which create a climate of great uncertainty for business planning.

Other foreign income items

The House bill contains a number of other changes in the tax treatment of foreign income. In general, we either support, or do not oppose, these changes. I would like to mention in particular only two of these items.

First, the foreign trust provision: The House bill would end the tax loophole whereby many wealthy individuals avoid U.S. tax through the creation of foreign trusts. We strongly support this provision and, in particular, would oppose any attempt to weaken the provision or to postpone its effective date.

Second, the changes in the ruling requirements with respect to tax-free reorganizations of foreign corporations: These changes are very technical but, in general, would allow taxpayers either to determine the effects of a transaction from the regulations rather than applying for a ruling or to apply for a ruling after the event takes place rather than being required, as under present law, to obtain an advance ruling. We strongly support this provision.

Administrative Provisions

The House bill contains numerous changes affecting the administrative provisions of the Code. Most of these provisions would directly benefit the cause of sound tax administration and the Treasury welcomes their enactment. For example, the provisions dealing with income tax return preparers, declaratory judgments in section 501(c)(3) cases, assessments in the cases of mathematical or clerical errors, and minimum exemptions from levy for wages, et cetera would all have the effect of improving our tax system, and we hope these provisions, with certain minor drafting changes, will be enacted into law.

Jeopardy and termination assessments; administrative summons

We believe, however, that extensive revisions are required in two provisions of the House bill, those dealing with jeopardy and termination assessments and with administrative summons. Whenever the Congress makes changes in the area of the capability of the Service to perform its tax administration responsibilities, great care must be taken to provide that such changes do not diminish the ability of the Service to effectively and fairly carry out these responsibilities. While we share fully the concern underlying the House bill for the protection of taxpayers' rights, we believe these provisions go too far in imposing burdensome administrative procedures on the Service that unduly handicap its ability to collect taxes.

For example, the Internal Revenue Service uses administrative summons to obtain needed information from third parties concerning the tax liability of taxpayers. This important investigatory tool, which has been provided by modern revenue laws since at least 1926, is essential to investigating cases in which there is a substantial probability of serious noncompliance with the revenue laws. Although the Department believes that legislative review of the entire administrative summons procedure is desirable at this time, it opposes the particular amendments passed by the House. If enacted, they would enable a taxpayer, by simple notice, to prevent a third party from giving the IRS information from the third party's records relevant to the liability of the taxpayer and compel the Government to institute a court action (to which the taxpayer will be a party) for the release of that information. This will mean that in every case in which there is a high probability of noncompliance with the tax laws, IRS investigations will, from their inception, be frequently tied up for extended periods of time without any investigatory progress.

As regards jeopardy and termination assessments, the *Laing* case, decided by the Supreme Court after the House bill was passed, will plainly alter procedures which the Service must follow in termination assessment cases, and the effect of this decision should be taken into account when your committee considers these provisions.

Employment taxes

There are two important areas affecting tax administration which are not dealt with in the House bill that we would hope the committee will give its serious consideration. The first deals with the Service's administration of the employment tax area. Despite vigorous actions by the Internal Revenue Service, the tools available under present law are simply not adequate to cope with mounting delinquencies in unpaid employment taxes. Our experience shows that this overall deterioration in compliance requires a thorough revision of the basic definition of the employer-employee relationship and the penalty structure for failures to file, collect, withhold, account for, and pay over employment taxes. Accordingly, we would like to work with your committee in developing clearer and more uniform statutory guidelines with respect to when an employer-employee relationship exists. Such guidelines would have the beneficial effect of making clear the types of relationships that would be subject to the various employment taxes. This would provide greater certainty for taxpayers and eliminate the necessity for the Service to devote a vast amount of administrative time and resources to determining responsibility for payment of employment taxes.

Interest on delinquent taxes

The second area relates to the amount of interest charged and paid by the Service on underpayments and overpayments of tax. Under present law (enacted last year), the rate of interest for tax purposes is to be fixed, not more frequently than every 2 years, at 90 percent of the average predominant prime rate quoted by commercial banks as determined by the Board of Governors of the Federal Reserve System. To make the tax rate of interest more realistic when compared with interest rates in the money markets, we recommend that it be raised from 90 percent to 125 percent of the prime interest rate charged by commercial banks. With this revision, the interest rate on underpayments and overpayments of tax would conform more nearly to the interest rates that the average taxpayer could obtain in the money markets and, thus, make it less attractive for taxpayers to "borrow" from the Government by being delinquent in their tax payments. In addition, we recommend that provision be made for an annual, rather than a biennial, adjustment in the tax interest rate.

I would like to comment, now, on two other administrative provisions in more detail.

Disclosure of private letter rulings

The House bill contains a detailed set of rules providing for public disclosure of the substance of private letter rulings issued by the Internal Revenue Service to taxpayers and of National Office technical advice memoranda issued to District Directors, if disclosed to the taxpayer involved. We enthusiastically endorse this basic concept of making public what has come to be considered a body of "secret law."

While the structure of the section is elaborate in describing what must be disclosed under its terms, it fails to provide sufficient safeguards for the legitimate confidentiality of materials involved. This deficiency results from the fact that the section does not provide that it is the exclusive means of public access to the material encompassed in its scope. Thus, the section leaves unresolved the basic issue as to what information contained in a ruling or a technical advice memorandum, or the related background file, is subject to public disclosure under other provisions of the law, principally the Freedom of Information Act. Nor does the section resolve the issue of what portions of such information are protected from disclosure by the confidentiality principles underlying our self-assessment tax system.

The section also provides that, in general, the identity of the recipient of a private letter ruling will be made public as part of the ruling itself. As a result, it is likely that a complicated and cumbersome procedure will have to be established by the Service to insure that other significant information will be deleted from the public text of the ruling in order to protect the confidential affairs of the taxpayer.

We believe that the "secret law" is best understood when disclosure includes as many of the relevant facts as possible and, moreover, that broad-scale disclosure of the identity of ruling recipients serves no useful public function, particularly when compared to the potential damage it may do to the basic confidentiality of the tax system. We urge the committee, therefore, to attempt to find a method under which identities of ruling recipients would be disclosed when there is compelling cause for the disclosure but under which, as a general rule, such identities would remain confidential. If a successful solution to this problem is found, the need to delete other information from the ruling in order to protect a taxpayer's personal or financial privacy would be reduced.

Certainly it will remain necessary for a procedure to exist to permit the taxpayer and the Internal Revenue Service to agree, before the issuance of a ruling, as to what information may be disclosed. The taxpayer should be entitled to protect trade secrets and other sensitive material, even if his identity will not be disclosed, by withdrawing his ruling request. But so long as his identity will not be disclosed, this agreement procedure should be facilitated, and public disclosure should not interfere with the basic ruling and technical advice issuance programs.

I do want to emphasize, amid these comments, our basic support of many concepts embodied in the House bill. It preserves the confidentiality principles of the Freedom of Information Act; it recognizes the repetitiveness of certain rulings by permitting disclosures of certain rulings in summary form; it acknowledges the need of the Service for judicial uniformity on the scope of disclosure by limiting disclosure and confidentiality actions to the Tax Court and the District Court for the District of Columbia with appeal to the Court of Appeals for the District of Columbia Circuit; and it permits delay of disclosure when premature disclosure would interfere with a pending transaction.

We also believe it critical to have an effective date for disclosure of future rulings to commence upon the expiration of a reasonable time, say 90 days, after enactment of the precise statutory rules governing disclosure. The taxpayer has a right to know, at the time he requests his ruling, the degree of publicity to which his affairs may be subject; and the Internal Revenue Service will have a massive gearing-up task to face.

In addition, consideration should be given as to the best manner in which to make public rulings requested in the past. First, we think that the most recent rulings are likely to be the most informative to the public so that a last-in, first-out (LIFO) order should be used. And, second, we believe that the rulings already designated by the Service for its own internal purposes as important, or reference, rulings will be the most useful and should be disclosed prior to any past routine rulings.

Most important in your consideration of this issue is the preservation of the concept in the House bill that the process of disclosure of past rulings is expensive and should not be required without additional appropriation of funds by Congress for this specific purpose.

Confidentiality of tax returns

As you are well aware, another matter related to the confidentiality of our tax system has been the subject of recent congressional concern; that is, the degree to which tax returns and tax return information are made available to governmental agencies outside the Treasury Department. Several Members of Congress, including Senators Weicker, Bentsen, Montoya, and Dole, have introduced legislation to make section 6103, the section governing tax return confidentiality, more specific and restrictive—replacing the present broad grant of authority to the President to authorize disclosure by Executive order.

In this Congress and the last, the administration sent to the Congress a bill which, in our view, constitutes an appropriate statutory balancing of the need for confidentiality in the self-assessment tax system and privacy for the taxpayer with the legitimate needs of relevant governmental agencies for access to a data source of unparalleled detail and completeness. At the end of January of this year, the General Counsel of the Treasury, Mr. Albrecht, and the Commissioner of Internal Revenue, Mr. Alexander, presented the Treasury Department's and the Service's views on this subject to the House Ways and Means Committee. Such a complete discussion would be inappropriate in the general context of my remarks and this hearing; but we are ready and eager to meet with your committee to review in detail the factors which we believe must be taken into consideration in the legislative resolution of this complex issue.

Let me, nonetheless, raise a few of the most pressing issues for your review.

First, there is substantial similarity among the majority of the proposals presently before the Congress on the basic issues. There must be a comprehensive set of statutory rules to replace the open-ended Executive order system of present law. This system should cover not only the tax return itself but also other tax data concerning a taxpayer gathered by the Service.

There are entities outside the Treasury Department which most proposals agree have legitimate need for access to tax return information. These include the Justice Department when it acts as the Internal Revenue Service's attorney in litigating tax cases; the staff of the Congressional Joint Committee on Internal Revenue Taxation and the tax-writing committees of the Congress, themselves, when considering changes in the tax laws or performing their oversight function; the President and his specifically designated assistants when he is acting in his capacity as the constitutional Chief Executive; and State tax administrators when trying to verify the correctness of income reported on a State income tax return. On most of these issues, there is almost unanimous agreement.

Second, the principal area of contention seems to relate to the use of tax data in nontax law enforcement investigations and court proceedings. We believe that the Internal Revenue Service has all the necessary incentive to protect the confidentiality of returns if given a set of statutory rules permitting it to resist demands for disclosure. The administration's bill requires that the Service be satisfied that the information sought for nontax law enforcement use "cannot reasonably be obtained from another source" and that the disclosure of the information will not "seriously impair the administration of the Federal tax law."

A further requirement that the information have a direct bearing on the investigation or proceeding applies in the case of so-called third party returns. We strongly feel that such a system of administrative control should be tested in use before a cumbersome court order or search warrant procedure is established to govern access by non-Treasury personnel to tax returns.

Third, we believe that analysis of the degree of publicity involved in a disclosure and the relationship of the taxpayer to the matter under investigation or litigation is necessary to determine the standards for disclosure. Thus, a public courtroom disclosure must be justified by a stronger showing of necessity or relevance than must a disclosure within the Federal Government. And the disclosure of a third party's return should be permitted only on a showing of a degree of directness of relevance specified in the statute.

Fourth, we have concluded, based primarily on the absence of past abuse and on convincing claims of need, that the statistical agencies of the Federal Government—specifically the Census Bureau, the Bureau of Economic Affairs, and the Federal Trade Commission's Bureau of Economics—should have access to individualized tax data for statistical purposes under strict confidentiality controls.

Fifth, any amendment should permit the taxpayer to designate agents to inspect his own tax information and to consent to any otherwise unauthorized disclosure of information by the Internal Revenue Service.

Finally, we believe that non-tax-writing congressional committees should have access to returns if authorized by a specific resolution of the appropriate House and that the President, similarly, should not be limited to tax-administration-only access to tax data. There should, however, be a written record of accountability for each disclosure (in the form of the resolution on one hand and a personally signed request on the other), and a specification of the staff assistants who are to be entitled to act as agents for the President and the Congress in carrying out their constitutional functions.

Clearly, there are many detailed provisions to be worked out. But we are optimistic that there is a solid foundation of agreement on which a final and practical structure can be erected which will protect the privacy of taxpayers and enable the Government to function effectively.

Conclusion

In this testimony I have addressed a long and seemingly disparate list of tax provisions. As the members of this committee well know, when we attempt to embody policy in concrete provisions of the law, it is difficult to avoid becoming entangled in a web of complexity. But let us keep before us the long-term objectives of this administration and, I believe, of all of you. The tax system should be fair. The tax system should be simple. The tax system should promote efficient use of resources.

Inevitably we are going to take some steps backward as we take other steps forward and often we are going to move sideways. I believe that the positions I have urged upon you today represent the direction of improvement. However, I must candidly say to you that I see a vast potential for further improvement. As I have said earlier and as I have said many times elsewhere, I believe that the extraordinary complexity of our tax system has begun to threaten public confidence in it, and I do not believe that this complexity is required to serve the objectives of fairness and efficiency. Quite to the contrary.

Let us then, by all means, take the steps I have urged upon you in the direction of a better income tax code, but let us not stop there. Let us have these steps represent a part of a process of continuing true tax reform which will take us eventually to a tax system which looks as though someone had constructed it on purpose, a simple progressive tax on a broad base which adequately reflects individual taxpayer's ability to pay. That is the tax break all Americans are waiting for.

Thank you.

Exhibit 36.—Statement by Secretary Simon, March 22, 1976, before the House Ways and Means Committee, on proposed estate and gift tax revision

I am pleased to be here today to present to you the administration's position on the major issues of estate and gift tax revision you will be addressing during the coming weeks.

Except for the introduction of the marital deduction in 1948, the basic structure of the estate and gift taxes has remained fundamentally unchanged since 1932. The present estate and gift tax rates were adopted in 1941, and the estate and gift tax exemptions were last changed in 1942. A complete reexamination of the estate and gift taxes is, thus, long overdue, and we look forward to cooperating with you in this undertaking.

Objectives of estate and gift taxation

Before discussing specific issues, I would like to set forth some general considerations underlying the estate and gift taxes.

Historically, the estate and gift taxes were prompted primarily by a desire to raise revenue. They were raised in wartime or periods of economic depression when governmental needs for revenue were most intense. Once the immediate emergency was past, estate and gift taxes were lowered again or were eliminated. And even the maximum rates were relatively low by present standards: The top estate tax rate during the 1920's was 25 percent (a 40-percent top rate was enacted in 1924 but was retroactively repealed in 1926).

But the emphasis of estate and gift taxation gradually shifted during the twenties and thirties amid increasing social concern over unreasonable accumulations of wealth. This development culminated in 1941 with the enactment of the present estate tax rate structure that rises from 3 percent on the first $5,000 of taxable estate to 77 percent on taxable estate in excess of $10 million. Since then, a major effect of the estate and gift taxes has been to prevent or moderate the unreasonable accumulation of wealth and its transmission from generation to generation. At the same time, the importance of estate and gift taxes to Federal revenues has progressively diminished, so that these taxes now produce less than 2 percent of Federal revenues.

Until recent years, the estate and gift taxes did not affect a large segment of taxpayers. The limited impact of the taxes was consistent with their role as devices to restrain the undue accumulation of wealth. Thus, the annual number of estate tax returns filed during the period 1923–45 never exceeded 18,000. 1938 was the peak year, with 17,642 returns; and 1932 was the low point, with 8,507 returns. This meant that the percentage of estates filing estate tax returns during the period varied between approximately two-thirds of 1 percent and 1 1/4 percent (0.65–1.25%).

During the 30 years since 1945, the situation has changed dramatically. In 1975, approximately 216,000 estates, or 11.2 percent of all estates, filed estate tax returns. Approximately 150,000 estates, or 7.7 percent of estates, paid estate tax. This development is summarized in the following table:

Year	Deaths in preceding year	Estate tax returns filed	Percentage of estates filing	Taxable returns	Percentage of estates taxable
1945	1,411,338	16,550	1.2	14,521	1.0
1950	1,443,607	27,144	1.9	18,697	1.3
1955	1,481,091	36,595	2.5	25,143	1.7
1959	1,647,886	55,685	3.4	38,515	2.3
1963	1,756,720	78,393	4.5	55,207	3.1
1966	1,828,136	97,339	5.3	67,404	3.7
1970	1,922,000	133,944	7.0	93,424	4.9
1973	1,964,000	174,899	8.9	120,761	6.1
1975*	1,936,000	215,918	11.2	**150,000	7.7

* Fiscal year ending June 30, 1975.
** Estimated.

In brief, the past 30 years have seen a tenfold increase in the impact of the estate tax in terms of the percentage of estates affected. No longer does the tax impact principally on the relatively larger estates. Rather, the estate tax has shifted to a more broadly based tax on the private capital accumulations of more moderate estates. It is, thus, time to reexamine whether the existing estate tax structure is harmonious with the basic objectives of the estate tax.

It should be emphasized that the question is not whether the wealthy should pay taxes. Obviously, an individual should surely count himself fortunate to be among the 8- or 10-percent most wealthy. And such individuals are rightly held accountable by our progressive tax system for defraying a greater share of the costs of government.

Rather, the question is: What combination of income taxes and estate and gift taxes is most appropriate for ensuring the desired degree of progressivity in our tax system? From this standpoint, I would urge the committee to emphasize that the estate tax has the limited function of restraining the undue accumulation of wealth. It should not be viewed as a device to raise revenue nor to achieve progressivity in the tax system, per se. Rather, we should rely primarily on the progressive income tax for the orderly collection of revenues from the income stream as it is generated. It is inappropriate, therefore, to continue down the present path to a broad-based estate tax that imposes heavy burdens on moderate estates at a time when financial demands on the widow and children of a decedent may be most heavy and when the chief revenue producer has been lost to the family.

Estate and gift tax exemptions and rates

As should be evident from the preceding discussion, the most pressing single issue of estate and gift taxation today is whether, and how much, to increase the estate tax exemption.

The estate tax has reached out to more and more estates in part because of an increase in average real family wealth. But the widening impact of the estate tax is also attributable in large part to inflation. Adjusting the $60,000 estate tax exemption for inflation since 1942 would require an estate tax exemption of $210,000. While a person with a $60,000 estate in 1942 could leave it to his family without tax, today an individual must have an estate of $260,000, on which an estate tax of $50,700 will be levied, in order to leave the equivalent amount, $210,000, to his family.

We believe that an increase in the estate tax exemption is clearly warranted. Indeed, such an increase is essential if the estate tax is to be returned to its historic role as an excise on the transfer of relatively larger wealth accumulations. At the same time, we cannot ignore the significant revenue consequences that would result from increasing the estate tax exemption. Thus, we recommend that the estate tax exemption be increased to $150,000 over a 5-year transition period and that the lower bracket estate tax rates on the first $90,000 of taxable estate be eliminated. Limiting the increase of $150,000 (with the proposed rate changes) will permit the revenue loss to be held to an acceptable amount, which can be absorbed gradually during the phase-in period.

We are not recommending any change in the gift tax exemption or rates. In general, it is only those persons with relatively large estates who make substantial lifetime gifts. Individuals with an estate of $250,000 to $500,000 are unlikely to exceed the present $30,000 lifetime exemption and there is less pressing need for an increased gift tax exemption than for an increased estate tax exemption.

While the proposal to eliminate the lower estate tax rate brackets is prompted in part by revenue considerations, it will also achieve a needed simplification and restructuring of the present estate tax rates, which are set out in table I below.

TABLE I.—*Estate tax rates*

Taxable net estate (or taxable gifts)	Present estate tax rates	Taxable net estate (or taxable gifts)	Present estate tax rates
	Percent		Percent
0 to $5,000	3	$1,250,000 to $1,500,000	42
$5,000 to $10,000	7	$1,500,000 to $2,000,000	45
$10,000 to $20,000	11	$2,000,000 to $2,500,000	49
$20,000 to $30,000	14	$2,500,000 to $3,000,000	53
$30,000 to $40,000	18	$3,000,000 to $3,500,000	56
$40,000 to $50,000	22	$3,500,000 to $4,000,000	59
$50,000 to $60,000	25	$4,000,000 to $5,000,000	63
$60,000 to $100,000	28	$5,000,000 to $6,000,000	67
$100,000 to $250,000	30	$6,000,000 to $7,000,000	70
$250,000 to $500,000	32	$7,000,000 to $8,000,000	73
$500,000 to $750,000	35	$8,000,000 to $10,000,000	76
$750,000 to $1,000,000	37	$10,000,000 and over	77
$1,000,000 to $1,250,000	39		

As can readily be observed, the lower estate tax rates are in a sense illusory. Thus, the beginning rate is 3 percent for the first $5,000 of taxable estate, but the lower rate brackets are so narrow that the marginal rate quickly reaches 25 percent at $50–$60,000 of taxable estate. Thereafter, the rate progression slows dramatically. Once an adequate exemption is provided, the lower rate brackets should simply be eliminated. This will mean a higher initial rate but a smoother rate progression. The proposed estate tax rates are set out in table II below. Table III illustrates the effect of the exemption and rate changes on estates of varying sizes.

Liberalized payment provisions for family farms and businesses

An issue on which attention has increasingly focused concerns the provisions for installment payment of estate taxes.

Inflation has had a particularly serious impact upon the family farm or business. Property values have risen dramatically with the result that owners have been faced with higher estate taxes. This has created a greater need for liquidity than is faced by many other taxpayers, because family farms or businesses generally tend to represent a significant portion of the owners' estates in terms of dollar values. Therefore, many families have found it necessary to sell the family farm or business to obtain cash to pay Federal estate taxes.

These liquidity problems will be alleviated by the adoption of the proposed increase in the estate tax exemption, but they will still exist for estates over $150,000.

To meet the specific liquidity problems of family farms and small businesses, the administration has proposed a change in the present provisions for 10-year installment payments of estate tax to make it easier to continue the family ownership of a small farm or business following a substantial owner's death. In summary fashion, the details are as follows:

- At the estate's option, a 5-year moratorium will apply to payment of that portion of the tax liability attributable to an ownership interest in a family farm or other closely held business qualifying for 10-year installment payments under present section 6166 of the Internal Revenue Code. No interest will accrue during the 5-year moratorium period and no principal or interest payments will be required during that period.
- At the end of the 5-year period, the deferred tax will, at the estate's option, be payable in equal annual installments over the next 20 years.
- Interest on the installments will be reduced to 4 percent per annum from the 7-percent rate generally applicable to deferred tax payments.

TABLE II.—*Proposed estate tax rates*

Taxable net estate (or taxable gifts)	Proposed rates	Taxable net estate (or taxable gifts)	Proposed rates
	Percent		Percent
$0 to $100,000	30	$2,500,000 to $3,000,000	54
$100,000 to $250,000	32	$3,000,000 to $3,500,000	57
$250,000 to $500,000	34	$3,500,000 to $4,000,000	60
$500,000 to $750,000	36	$4,000,000 to $5,000,000	64
$750,000 to $1,000,000	38	$5,000,000 to $6,000,000	67
$1,000,000 to $1,250,000	41	$6,000,000 to $7,000,000	70
$1,250,000 to $1,500,000	44	$7,000,000 to $8,000,000	73
$1,500,000 to $2,000,000	47	$8,000,000 to $10,000,000	76
$2,000,000 to $2,500,000	50	$10,000,000 and over	77

TABLE III.—*Estate tax burdens*

[Exemption only; no credits or deductions from adjusted gross estate]

Adjusted gross estate	Current law		Proposed law		Change in tax burden	Percentage change in tax burden
	Taxable estate	Tax burden	Taxable estate	Tax burden		
$60,000	....	....	....	....	....	....
100,000	$40,000	$4,800	....	....	−$4,800	−100.0
250,000	190,000	47,700	$100,000	$30,000	−17,700	− 37.1
500,000	440,000	126,500	350,000	112,000	−14,500	− 11.5
750,000	690,000	212,200	600,000	199,000	−13,200	− 6.2
1,000,000	940,000	303,500	850,000	291,000	−12,500	− 4.1
1,250,000	1,190,000	399,800	1,100,000	389,000	−10,800	− 2.7
1,500,000	1,440,000	503,000	1,350,000	494,500	− 8,500	− 1.7
2,000,000	1,940,000	726,200	1,850,000	725,000	− 1,200	− .2
2,500,000	2,440,000	968,800	2,350,000	970,500	+ 1,700	+ .2
3,000,000	2,940,000	1,231,400	2,850,000	1,234,500	+ 3,100	+ .3
3,500,000	3,440,000	1,509,600	3,350,000	1,515,000	+ 5,400	+ .4
4,000,000	3,940,000	1,802,800	3,850,000	1,810,500	+ 7,700	+ .4
5,000,000	4,940,000	2,430,400	4,850,000	2,444,500	+14,100	+ .6
6,000,000	5,940,000	3,098,000	5,850,000	3,110,000	+12,000	+ .4
7,000,000	6,940,000	3,796,200	6,850,000	3,805,500	+ 9,300	+ .2
8,000,000	7,940,000	4,524,400	7,850,000	4,531,000	+ 6,600	+ .1
10,000,000	9,940,000	6,042,600	9,850,000	6,046,500	+ 3,900	+ .1

- The 5-year moratorium and 20-year extended payment provisions will apply only to the estate tax liability attributable to the first $300,000 in value of the family farm or business. Between $300,000 and $600,000 there will be a dollar-for-dollar reduction in the value of the farm or business qualifying for the moratorium and extended payment provisions. That portion of the tax not qualifying will continue to be subject to 10-year installment payments with the 7-percent interest rate.

We believe that enactment of the administration's proposals would be a positive and essential step toward ensuring the survival of small farms and businesses for future generations.

Marital deduction

Let me turn now to the question of liberalizing the estate and gift tax marital deduction provisions.

The marital deduction was introduced in 1948 to equalize the estate and gift tax treatment of couples in common law property States with that of couples in community property States. The property of community property couples is, in general, split 50–50 between the spouses by operation of law without imposition of estate or gift taxes; and the objective of the marital deduction provisions was to provide equivalent tax treatment for common law property couples.

Under the gift tax, a marital deduction may be claimed for one-half the amount transferred to a spouse. Under the estate tax, a marital deduction may be claimed for up to one-half of the adjusted gross estate (gross estate less administrative expenses of the estate, debts of the decedent, and the value of any community property included in the estate). Under both the estate tax and the gift tax, transfers of certain "terminable interests" are nondeductible; the deduction is generally limited to gifts of outright ownership and gifts that will result in the transferred property being included in the estate of the surviving spouse.

The present marital deduction provisions are subject to criticism on several grounds. *First*, under the existing provisions it is still not possible for couples in common law property States to obtain a tax-free division of their property in all cases. Whereas the community property laws operate automatically to split the spouses' property between two estates, the estate tax marital deduction may be utilized to split a family's wealth accumulation only in the event the wealthier spouse dies first. And the division of property may not be accomplished free of tax during life since the gift tax marital deduction equals only one-half of the property transferred.

Secondly, many families rightfully regard their property as being generated by their combined efforts and, thus, "ours" rather than "his" and "hers" (this is likely to be particularly true of checking and savings accounts, stocks registered in joint names, and the family residence). As a result, they often transfer property from separate ownership, to joint ownership or community ownership without paying much attention to the legal change in ownership. There is a serious question whether it is appropriate to tax such transfers that are basically just incidents in the common management of the family's pooled resources

Finally, the present 50-percent deduction has created complicated administrative problems for many estates. In some estates, tax savings may be achieved through use of a marital gift provision precisely limited to exactly 50 percent of the adjusted gross estate. Since the exact amount of the adjusted gross estate cannot be predicted when a will is drawn, will draftsmen have resorted to formula provisions which have increased the administrative problems of executors and have required fiduciary accounting which is a mystery to widows and children.

We recommend the adoption of a free interspousal transfer rule, or unlimited marital deduction, under which all transfers between spouses would be completely excluded from the estate and gift taxes. Such a rule best comports with the way most couples manage their property and would substantially simplify the estate tax law and the administration of estates.

We estimate that this unlimited marital deduction, when fully effective, will reduce Federal estate and gift tax revenues by $500 million annually, if adopted in combination with the proposed $150,000 estate tax exemption, and $700 million annually if combined with the present $60,000 estate tax exemption. This is obviously a major sum in terms of the total Federal budget, and the loss ought ideally to be phased in gradually over a period of years. In practice, however, such a phase-in is not feasible because the initial steps in liberalizing the deduction produce the greatest portion of the total revenue loss. For example, a minimum marital deduction of $100,000 plus one-half of the adjusted gross estate in excess of $100,000 would reduce revenues about $350 million if adopted together with the $78,000 exemption proposed for the first year under the 5-year phase-in period for the proposed $150,000 exemption. Moreover, a phase-in of the increased marital deduction would create a veritable nightmare for will draftsmen who would have to consider contingent provisions to match each increase in the allowable deduction. We are accordingly recommending that the effective date for the unlimited marital deduction be postponed, so that it would be effective for estates of persons dying after December 31, 1976. The first estate tax returns to which the provision would apply would, thus, not be due until October 1, 1977; and there would be no significant revenue impact until fiscal year 1978.

Tax on unrealized appreciation

Another major issue before your committee concerns the treatment of unrealized appreciation in property transferred at death. Under present law, the heirs receive a new fair market basis in such property, so that any unrealized gain or loss permanently escapes income tax. This rule is sometimes called the stepped-up basis rule. In contrast, if appreciated property is given away during life, the donor's tax basis is carried over to the recipients and any unrealized gain will be taxed on their later sale of the property.

The fact that present law does not tax unrealized appreciation in property transferred at death is said by some critics of the system to create an inequity between taxpayers who accumulate wealth mainly from previously taxed income (e.g., wages and realized appreciation) and those whose accumulated wealth consists largely of unrealized appreciation in the value of their property. Both groups are subject to the estate and gift taxes, but it is argued that the latter group escapes payment of its fair share of income taxes because the unrealized appreciation had not been taxed before death. Moreover, present law is thought to create a "lock-in" effect—a tendency of taxpayers (particularly older taxpayers) to retain highly appreciated property so that they may avoid payment of capital gains tax and pass on a larger estate to their families.

These concerns have led to recurrent, serious proposals to change the rules. The main alternatives that have been suggested at various times are: (1) To impose a capital gains tax on unrealized appreciation in an estate; (2) to extend to property transferred at death the carryover basis provision now applicable to gifts; and (3) an additional estate tax on the amount of unrealized appreciation in an estate.

1. *Capital gains tax.*—Proposals to impose a capital gains tax on unrealized appreciation in an estate would, in effect, treat the estate as if it had been sold at death. If the property in the estate had in fact been sold immediately before death, tax would have been paid by the executor with the decedent's final income tax return, and that tax would have been deductible from the gross estate subject to estate tax. Accordingly, proposals to impose a capital gains tax similarly provide for the deduction of such tax from the gross estate.

The basic assumption of the capital gains tax, which treats the estate as if it was all sold at death, is obviously unrealistic. The concept of a capital gains tax has been to tax realized gains. The event of death hardly qualifies as a tax realization transaction. During his lifetime, a taxpayer has a choice of realizing gain on sale of an asset, paying the tax, and keeping the net proceeds, or of retaining the asset and not realizing a gain on it. The occurrence of his death is hardly a voluntarily chosen event upon which to base the realization of gain. Moreover, the tax will really fall on the heirs in any event. We cannot tax a dead man for a sale he did not make no matter how hard we try. Proposals to impose a capital gains tax at death can, thus, be viewed as proposals to tax some individuals who inherit property differently from others who also inherit property solely because of the decedent's investment decisions during his lifetime. It is by no means self-evident that such a system would be more equitable than present law.

Moreover, because of the deductibility of the capital gains tax against the gross estate, the net effect of a capital gains tax would be more severe for smaller estates than for larger estates. As an example, consider two estates that both have $1,000 of appreciation taxed at a 25-percent capital gains rate but with marginal estate tax rates of 30 percent and 70 percent. For both estates the initial capital gains tax would be $250. But the reduction in estate taxes resulting from the deductibility of that $250 would be $75 for the smaller estate with the 30-percent marginal rate and $175 for the larger estate with the 70-percent marginal rate. The net tax on appreciation would be 17.5 percent for the smaller estate and 7.5 percent for the larger estate. Certainly many people would instinctively question the justice of a proposal that would tax small estates more heavily than large ones.

2. *Carryover basis.*—The second approach that has sometimes been suggested as an alternative to present law is the carryover basis approach, under which the decedent's basis in property transferred at death would be carried over to his heirs. The unrealized appreciation would be taxed when and if the property is sold by the heirs. Your committee tentatively approved the carryover basis provision in 1963 but deleted that provision from the bill reported to the House.

The carryover basis approach is consistent with the tax treatment that would have resulted had the decedent not died but had continued to retain the property. However, the carryover basis approach suffers from a number of major disadvantages.

The first is administrative complexity for both taxpayers and the Internal Revenue Service in determining the decedent's basis in the property, particularly for property that passes to several successive generations. In many cases, records concerning the original basis of the property will have been lost by the time the property is sold. Many of us have undoubtedly had the experience of selling stock or a house and then, at tax return time, having to search through various files, receipts, and check stubs to determine the original cost of the property and the amount of any required adjustments to basis. Often the key to reconstructing the tax basis of property is one's personal recollection of the transactions in question. The carryover basis approach, and to a lesser degree any tax on appreciation transferred at death, will put an even greater premium on careful records, and a greater penalty for carelessness, than normally exists.

Further administrative complexity would be created by carryover basis adjustments. Thus, most carryover basis proposals, such as your committee's tentative decision in 1963 and section 106 of H.R. 1040 (introduced by Mr. Corman), provide for increasing the decedent's basis by the amount of State and Federal death taxes attributable to the unrealized appreciation in an estate. Such a basis adjustment tends to equalize the treatment of estates of persons who realize their gains during life and estates of persons with large unrealized gains. When property is sold and tax paid on the gain, the tax is deductible from that person's estate (or if not formally deducted, is excluded as a practical matter from the estate) and the estate tax is thereby reduced. The basis adjustment for death taxes allocable to unrealized appreciation in an estate has the effect of deducting such taxes from the gain that ultimately will be subject to income tax, with a consequent reduction in income tax liability. While never exactly equivalent, the income tax reduction provided by the basis adjustment for estates with unrealized appreciation roughly corresponds to the estate tax reduction provided to estates with taxed appreciation.

Allowance of an increase in the carryover basis for a portion of death taxes means that the exact amount of gain realized on sales made during administration of the estate cannot be computed until final determination of State inheritance and Federal estate tax liability, including the final calculation of the total value of the estate and the amount of unrealized appreciation. As a result, income tax returns filed prior to such final determination of death tax liability may have to be reopened and the tax recomputed.

Under the carryover basis approach, there would also be a number of thorny questions regarding the allocation among specific assets of the total appreciation in the estate and the increase in basis for a portion of death taxes. For example, the tax basis of property transferred to a charity is ordinarily of little moment, since the charity will be exempt from tax on any gain it realizes upon disposition of the property. Thus, taxes could be minimized by directing highly appreciated property to charity and less highly appreciated property to others. In your committee's 1963 tentative decision, this problem was resolved by requiring a pro rata allocation of the total unrealized appreciation in an estate among all the assets in the estate, obviously a complicating provision. Similarly, questions will be raised concerning whether the increased basis on account of death taxes should be allocated ratably among all estate assets (by value or by amount of unrealized appreciation) or only among assets included in the taxable estate (excluding, that is, deductible marital and charitable transfers). Or it might be questioned whether the basis increase should be allocated to those persons who, because of a specific direction in the will or because of State law, are actually held liable to pay the tax.

Finally, the carryover basis approach does little to eliminate the lock-in of investment resulting from the present law stepped-up basis rule. Rather, it perpetuates that lock-in effect even after a property owner's death.

3. *Additional estate tax.*—The American Bankers Association has developed a third approach, which it calls an additional estate tax, or AET. This would be a flat rate tax; the ABA suggests a 14-percent rate, on the unrealized appreciation in an estate. Unlike a capital gains tax."

The rationale for imposition of a flat rate, nondeductible tax is the phenomenon I discussed earlier, that a capital gains tax falls more heavily on small estates than on large ones. That phenomenon, which is asserted to demonstrate that the capital gains approach is "regressive," is simply a natural consequence of the deductibility of income taxes against the estate. It is equally true of all income taxes paid during life, a fact that can most clearly be observed with respect to the income taxes paid on the decedent's final return. For example, suppose two individuals pay income tax at an average rate of 40 percent in their final returns and that the marginal estate bracket for one is 30 percent and for the other is 70 percent. Allowing for the reduced estate tax due to the deductibility of income taxes, the net tax on the income of the first individual with the smaller estate will be 28 percent, and the net tax for the second individual with the larger estate will be 12 percent. This obviously does not mean that either the income tax or the estate tax is regressive. Nor does it mean that we should deny the estate tax deduction; the funds used to pay the decedent's income taxes are not available for transfer to his heirs and should not be subjected to estate tax.

Nevertheless, the AET proposal is far simpler than either of the other two approaches. Moreover, when viewed in isolation as most changes are viewed by taxpayers, it will not increase effective taxes more for small estates than for large ones. Also, it is a direct excise tax on transfer of unrealized appreciation in an estate and is not an attempt to use income tax concepts in an inappropriate setting. To that extent, therefore, it does not answer the objective of some critics of the present system; namely, redressing the income tax inequity alleged to be created by the stepped-up basis rule.

In short, when the rhetoric is cut away, the AET proposal gives credence to what many of us have long suspected: Proposals to tax capital gains at death are not fundamentally grounded in income tax concerns but are essentially an effort to increase death tax burdens.

That being the case, the threshold question is whether those burdens should be increased. In our view, they should not be increased. Indeed, the extent of the present burden has become so severe that the administration has recommended measures to alleviate the burden by increasing the exemption and providing for a deferral of payment of tax in certain situations.

4. *Exemptions.*—Under all three approaches for taxing unrealized appreciation in an estate, there would be a number of difficult questions respecting the allowance of exemptions and exclusions. For example, most proposals for changing the present stepped-up basis rule would exempt estates that are not required to file an estate tax return (estates of $60,000 or less under present law). We quite agree that such an exemption would be a requisite of any such change. It would be inappropriate to impose on those smaller estates a substantial tax burden (under the capital gains or AET approaches) or the great complexity inherent in the carryover basis approach.

Many proposals to impose a capital gains tax at death would also exempt marital deduction and charitable deduction transfers. Such an attempt to harmonize the principle of taxing unrealized gains with the estate tax policies underlying the estate tax marital and charitable deductions is quite understandable, but it would combine the disadvantages of the capital gains and carryover basis approaches, and would cause the greatest of complexity for the tax system and family estate planning.

5. *Administrative recommendation*—We oppose these proposals to change the present tax treatment of unrealized appreciation in property transferred at death. We are unable to discern any consistent rationale underlying such proposals other than a desire to increase death taxes; and we believe that decisions regarding the proper level of death taxes should be made through a review of estate and gift tax rates and exemptions, rather than through the device of a tax on appreciation in an estate. Moreover, the pressing need today is for estate tax relief rather than an increase in death tax burdens. It would be wholly inappropriate to hold forth the promise of such relief through an increased estate tax exemption and then to make that promise illusory through a tax on unrealized appreciation that will fall particularly heavily on the owners of farms and small businesses.

Miscellaneous changes

In my testimony, I have addressed only the major issues of estate and gift tax reform. There are a number of other issues your committee may want to examine. If so, and if time permits, I will be glad to discuss them with you. I would, however, like to mention one problem in particular because remedial action concerning it could significantly simplify the administration and application of the present gift tax law.

In the Excise, Estate, and Gift Tax Adjustment Act of 1970, Congress accelerated the collection of estate and gift taxes by requiring earlier filing of returns. The principal objective of the legislation was to accelerate the collection of estate taxes. Because the timing of gifts, unlike deathtime transfers, is subject to the volition of the donor, shortening the return period for gifts would not necessarily accelerate collections. Nevertheless, the most recent statistics (1966 returns for 1965 gifts) indicate that $100 million (or more than one-quarter of total gift tax collections in 1966) was collected from 10 donors who each made more than $10 million in gifts. In the expectation that shortening the return period would accelerate collections from such large donors, it was decided to require earlier filing of returns for both gift and estate taxes.

The annual filing system for gift tax returns was therefore changed to a quarterly filing system (under which a return is required for the first calendar quarter in which total gifts for the year exceed $3,000, and for each succeeding calendar quarter of the year).

Two problems have arisen under the quarterly gift tax return provisions. First, although Congress did not intend any changes in the rules regarding the computation of the gift tax, because of the structure of the gift tax provisions a taxpayer may now lose a portion of the gift tax marital deduction. It is clear that this effect of the 1970 changes was unintended. Second, the number of gift tax returns filed annually has increased dramatically, imposing additional administrative burdens on taxpayers and the Internal Revenue Service. During fiscal years 1968–70, the number of gift tax returns filed annually ranged from 139,000 to 151,000; in fiscal 1974, 260,000 gift tax returns were filed.

We recommend that the quarterly gift tax return requirement be amended by adding a $100,000 threshold, so that a quarterly return would be required only when, by the end of a calendar quarter, total gifts for the year exceed $100,000. In other cases, an annual return would be filed, as under prior law. The suggested change would remedy the technical difficulty created under the marital deduction provisions by the 1970 changes, and also would eliminate the quarterly return requirement for most taxpayers, while retaining the intended effect of the 1970 changes of putting donors of very large gifts on a more current basis respecting payment of gift tax.

Thank you for this opportunity to address your committee on these very important estate and gift tax issues.

Trade and Raw Materials Policy

Exhibit 37.—Statement by Secretary Simon, December 11, 1975, before the Senate Committee on Commerce, on American participation in East-West trade

I welcome the opportunity to join in this review of the prospects and problems of American participation in East-West trade and economic relationships during the next 5 years. As Chairman of the East-West Foreign Trade Board, I believe that these hearings will provide an opportunity to assess current policies that affect East-West trade, and to develop more open public discussion and understanding of this important subject, at an appropriate moment.

During the cold war period, U.S. participation in trade with the Communist countries was virtually nonexistent. Our contacts with these countries in the cultural and in other areas were isolated events. No cooperative efforts were undertaken either in the economic and commercial fields or in science and technology. It was difficult to speak of bilateral relationships with these countries in any meaningful way. As a result, there was no inducement toward cooperation and little incentive for restraint.

The era of confrontation during the years of cold war demonstrated that the imposition of economic sanctions against Communist countries neither altered the nature of their systems nor materially improved their policies toward the Western World. In this decade, the U.S. Government has sought to develop a policy in which the attempt to normalize U.S. commercial relationships with the U.S.S.R., Eastern Europe, and the People's Republic of China is a cornerstone.

We have pursued this policy with the firm conviction that accelerated development of strong economic ties between the United States and the Communist countries will give each side a more solid stake in the parallel improvement of our political relations. I believe these ties create a foundation of mutual interest which in turn improves the environment for progress in the relaxation of political tensions.

From its beginning, the new approach to the Communist countries has received broad public support. The flow of goods and an exchange of people between our country and those expanded at an extraordinary rate. The developing momentum in the expansion of our relations with the Soviet Union led to the conclusion, in 1972, of several important agreements with that country- the Trade Agreement, the Lend-Lease Settlement, and the Maritime Agreement. Since 1974, this momentum has slowed. We believe that this slowdown has cost our economy exports and export-related jobs. But it has also impaired U.S. political and humanitarian objectives.

Let me stress at the outset a fact of which this committee is no doubt already aware. Normalizing our relations with the Communist countries in no way implies a grant of special favors not provided to other countries. Quite the contrary. Recognizing that East-West trade is a two-way street which will bring mutual benefits to both sides, we seek to eliminate the aspects of our policy toward the Communist countries that discriminate against them. By extending most-favored-nation treatment to the Communist countries, we would give our imports from them the treatment we now accord to our imports from other countries.

Nor has it ever been our purpose to bargain away the Nation's security simply to see our trade statistics rise. We maintain controls on the export of products and technology of strategic significance, and we would continue to maintain them even under normalized trading conditions.

In addition, the executive branch carefully examines exports that might involve national security considerations through two Cabinet-level boards.

To insure that our national security is not jeopardized, the Export Administration Review Board (EARB), which is chaired by the Secretary of Commerce, reviews particular export license matters involving questions of national security or other policy issues. As Chairman of the East-West Foreign Trade Board, I have attended EARB meetings, and will shortly be formally designated a member of the EARB by Executive order. The Secretaries of State and Defense are also members of this important body. The EARB was established by Executive order in 1970 to assure the highest level of consideration of difficult export license cases, and to obtain agreed action among the departments chiefly concerned with advising the Secretary of Commerce in administering U.S. export controls.

The East-West Foreign Trade Board

But the major East-West economic policy body of the executive branch is the East-West Foreign Trade Board. The Board was created by the Trade Act of 1974 to monitor East-West trade in the national interest. The Board is comprised of the Secretaries of State, Treasury (who is Chairman), Agriculture, Commerce, the Special Representative for Trade Negotiations, the Director of the Office of Management and Budget, the Executive Director of the Council on International Economic Policy, the President of the Export-Import Bank, and the Assistant to the President for Economic Affairs, who is Vice-Chairman of the Board. Recognizing the important role of the Department of Defense in the national security aspects of our trade with the Communist countries, the Board has recently recommended to the President that the Secretary of Defense be added to the Board's membership.

A working group of the East-West Foreign Trade Board, consisting of representatives of the member agencies, usually meets twice monthly to coordinate the development and implementation of East-West trade policies and to refer issues to the Board for decision. The working group also reviews exports of technology to nonmarket economy countries which is essential for the protection of our security, and receives reports from U.S. Government agencies which provide credits, guarantees, or insurance for exports to nonmarket economy countries.

As required by the Trade Act, the East-West Foreign Trade Board publishes a quarterly report on U.S. trade with the nonmarket economy countries. The report reviews (a) the status of negotiations of bilateral trade agreements, (b) activities of joint trade commissions, (c) commercial disputes and problems of market disruption, (d) East-West trade promotion activities, and (e) recommendations for the promotion of East-West trade in our national interest.

Current status of East-West trade

Prior to 1974, the United States was making remarkable progress in developing trade with the East. Secretary Morton will discuss trade flows in more detail, but I would like to mention a few highlights.

In 1971, total U.S. exports to the Communist countries[1] amounted to less than $400 million. In 1974, exports were $2.3 billion, a more than 475-percent increase in 3 years. By contrast, in 1971, U.S. imports were $230 million, and in 1974, they were $1 billion. Thus, our total trade surplus with these countries grew to $1.3 billion in 1974, an increase of 665 percent in only 3 years. The favorable impact of this trade on our balance of payments and on the U.S. economy is obvious.

The expansion of trade with the Soviet Union has been particularly striking, as can be seen in the following table:

U.S. trade with the U.S.S.R.

[Millions of U.S. dollars]

	1971	1972	1973	1974	1975*
U.S. exports	161	547	1,187	607	1,800
Nonagricultural	118	102	265	293	700
U.S. imports	57	95	215	350	250
Total trade turnover	218	642	1,402	957	2,050
Trade balance	+104	+452	+972	+257	+1,550

* Estimated.

Source: U.S. Department of Commerce.

Our estimates indicate that, because of very substantial grain sales, two-way trade with the Soviet Union will reach a new high this year of over $2 billion, with 70 percent of our shipments consisting of grains.

Although most of our exports to the Soviet Union and the other Eastern countries are now agricultural products, our manufactured-goods exports have the greater growth potential in the longer term. Shipments in 1974 of nonagricultural commodities to Eastern Europe totaled nearly $300 million, with almost one-half of these products going to Poland and one-third to Romania.

Manufactured goods and other nonagricultural items accounted for about $300 million of our exports to the Soviet Union in 1974, and are expected to account for about $700 million

[1]For this purpose the Communist countries are defined to include Albania, Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland, Romania, U.S.S.R., People's Republic of China, and Mongolian People's Republic.

in 1975. However, this increase reflects shipments which continue to be made on contracts signed in past years. Projects now underway involving major amounts of U.S. exports include the Kama River truck plant, entailing over $340 million in exports of U.S. goods and services over a period of several years; the Moscow Trade Center, involving an estimated $80 million in U.S. exports; a chemical fertilizer project, involving $400 million in U.S. exports; an acetic acid plant, involving $44 million; and an iron ore pellet plant, involving $36 million. All these and other current projects together totaling over $1 billion are being financed in part by the Export-Import Bank. Eximbank commitments to the U.S.S.R. currently total $469 million.

East-West trade and the Trade Act of 1974

The passage of the Trade Act of 1974 last December was a milestone in the development of our international trade relations. The new trade legislation has given the President, for the first time in 8 years, the authority to participate in the far-reaching multilateral trade talks which began in February of this year. Countries accounting for most of the world's trade are participating in these negotiations which focus on the reduction of all types of tariff and nontariff barriers that affect both agricultural and industrial trade. The mandate given the President by the legislation enables the United States to play a leading role in the expansion of world trade based on clearer ground rules for fair trade practice.

Notwithstanding the importance of the Trade Act for multilateral trade negotiations, this administration has consistently established its objection to the provisions of this act, and the 1974 Eximbank Act amendments, which adversely affect our trade with the Soviet Union, the nonmarket economy countries of Eastern Europe, and the People's Republic of China, and which do not serve our political and humanitarian interests.

During my trip to Moscow in April for the annual meeting of the U.S.-U.S.S.R. Commerical Commission, the President asked me to discuss the recent legislation, and our future trade relations with the Soviets. My talks with Soviet leaders convinced me that it is in our interest to find a way to unblock the impediments to increased trade which now face us.

In the past several months, we have consulted with Members of the Congress on this problem. During the summer, Secretary Kissinger, other members of the Board, and I met with the members of the Senate delegation to the U.S.-U.S.S.R. Parliamentary Conference before and after their visit to Moscow. The Senators had an extremely frank exchange of views with top Soviet officials on the impact of the Trade Act on United States-Soviet relations. I believe their visit was extremely useful as was the visit of the House delegation which took place in August.

Additional consultations with several congressional leaders have been undertaken more recently. I have been encouraged by a common appreciation that we must move ahead. We approach this task with the sure knowledge that it is in our national interest.

The normalization of our commercial relations with the U.S.S.R., Eastern Europe, and the People's Republic of China is an integral part of our policy of expanding our relationships with these countries. The administration continues to believe that improvement in our commercial relations is a necessary element in the improvement in our overall relations with these countries. In an interdependent world in which economics and politics intertwine, commercial relations influence the conditions of the larger political environment. What we do in the economic field could have a significant impact on what we are attempting to achieve in the political sphere.

A solution to the impasse we now face would also materially enhance our business community's efforts to expand trade with the East. We have had many indications that the lack of official credits from the United States is causing the U.S.S.R. and some of the Eastern European countries to direct their purchases elsewhere. Lost U.S. exports mean lost jobs in our export industries, a lost benefit to our balance of payments, and to our competitive position in world markets.

The inability to extend most-favored-nation treatment to imports from the Eastern bloc countries is also holding back major joint projects between our firms and the U.S.S.R. and other countries of Eastern Europe. This is because these projects often involve the eventual export of products to the United States that are now affected by high U.S. non-most-favored-nation tariffs. These projects could eventually supply us with products in limited supply in our own market, such as energy sources and products from energy-consuming projects. Losing these major joint projects is, therefore, a net loss to the United States.

Prospects for East-West trade

The potential for U.S. exports of goods and services, particularly to the U.S.S.R., remains great. The Soviets plan to boost foreign trade with the Western World by 9 percent in 1976 over the level planned for this year. U.S. agricultural exports have been and will continue to be very significant, in part as a result of the U.S.S.R.'s agreement to buy annually a minimum of 6 million metric tons of wheat and corn. But future growth, we believe, will be mainly in manufactured goods. Moreover, the enormous scale on which the Soviet projects are planned makes the United States in many cases a favored trading partner, since few European firms are well equipped for such huge undertakings.

The Soviet Union possesses greater energy reserves than the United States, but faces increasing technological problems as it moves to energy sources deeper in the ground, offshore, and in the Arctic. The U.S.S.R. can obtain much of the necessary technology elsewhere, but in many cases would prefer to deal with U.S. companies. It is manifestly in our interest to participate in the expansion of the world supply of energy. In addition, the cooperative projects that would be undertaken to develop these energy sources could provide additional jobs to our economy, supply us with some energy products, and strengthen our balance of payments. Deputy Secretary Ingersoll in his testimony tomorrow will elaborate on the administration's efforts to negotiate a petroleum agreement with the U.S.S.R.

The potential for trade with the other Eastern European countries not now receiving MFN, and the People's Republic of China, is also significant.

The U.S.S.R. and many of the Eastern European countries are currently signing contracts with our Western competitors that benefit from government-backed credits. The major European countries and Japan have agreements with the U.S.S.R. under which $10 billion of government-backed credits will be available to finance export sales to the Soviet Union. During my April visit to Moscow, the Soviets told me that contracts involving over $700 million in credits which might have been placed in our country had gone to European suppliers because of the lack of Eximbank credits.

Soviet Deputy Minister of Foreign Trade Alkhimov has recently indicated that in the last 9 months, $1.6 billion in contracts which the Soviets were ready to sign with U.S. firms have gone to Western Europe and Japan because of the U.S. restrictions on Eximbank credits. Many of these contracts were negotiated as part of the Soviet 1976–80 plan and therefore represent business opportunities that are not likely to appear again until the next 5-year plan period. Because of the present impasse, U.S. firms have faced the possibility of being virtually excluded from projects in the forthcoming Soviet plan period. The only contracts that they might still win involve projects for which the U.S. companies have no significant competition.

It is my hope, however, that competition among Western industrial nations for exports through government-subsidized credits will end. There was discussion of the problem at Rambouillet, and I am pleased that the six leaders agreed to intensify their efforts to achieve prompt conclusion of the negotiations concerning export credits. Governments should reduce government competition on credit terms offered to all countries. There is simply no point in this subsidized competition.

There is one change in U.S. law that would facilitate the contribution of private financial markets to financing East-West trade. The Johnson Debt Default Act of 1934 is a criminal statute which provides penalties for any individual who, within the United States, purchases or sells bonds or any other financial obligations of any foreign government which is in default in the payment of its obligations to the United States. The act has not served its initial purpose, which was to protect American investors against the purchase of obligations of countries likely to default. Instead, it has had the effect of deterring creative methods of financing East-West trade by the private market. The repeal of the act would, in my opinion, remove an unnecessary barrier to the private financing of East-West trade, and increase our efforts to expand trade and commerce with nonmarket economy countries on commercial credit terms.

Misconceptions about East-West trade

Finally, Mr. Chairman, I would like to respond to some misconceptions about East-West trade. Granting most-favored-nation status to the nonmarket economy countries of Eastern Europe, the U.S.S.R., and the People's Republic of China would give them no special privilege. The Soviets, the East Europeans, and the Chinese nevertheless consider the granting of nondiscriminatory tariff treatment as significant for the improvement of our political and commercial relations. Granting MFN would therefore have a positive impact on the growth of our exports to the East. It is our hope that this expansion would encompass industrial and consumer goods, as well as agricultural commodities.

If we confer most-favored-nation treatment to imports from these countries, ultimately U.S. purchases of a variety of their manufactured products will result. I certainly do not predict a flood of manufactured products to enter our market and displace domestically produced goods, however. In most cases, these countries are not now able to manufacture goods of sufficient quality and consumer appeal to displace products from our domestic industries. A large portion of these imports would, in any case, simply compete with and displace our imports from other foreign sources. In addition, in the Trade Act of 1974, Congress provided adequate safeguards against market disruption to protect our domestic industries, if necessary, and American consumers would benefit from competition for our market and the lower prices it would produce.

With regard to the legislation protecting our domestic industries from dumping, some of our Communist trading partners have expressed their concern that the Antidumping Act, as amended by the Trade Act of 1974, may unfairly hinder their ability to export to the United States. The amendment requires that export prices from a Communist country to the United States be compared with the prices of a manufacturer of a similar product in a market economy country if I, as Secretary of the Treasury, determine that the home market prices in the Communist country cannot reflect actual costs and prices due to the structure of that economy.

Treasury is studying whether alternative methods of comparison are available under the act for conducting investigations and whether revisions to our procedures or to the act would be appropriate. For the present, we have no recommendation in that regard.

There is a second misconception which I would also like to address.

Eximbank credits for exports to the Communist countries do not represent either special treatment or "foreign aid" for these countries. The potential flow of credits from the United States represents only a small fraction of the capital available to the East for East-West trade.

While the potential credit flow may be relatively small, the availability of credits is nonetheless an important factor in the purchasing decisions of the Communist countries. Until we succeed in reducing competition for exports through government-backed credits, Eximbank credits are necessary to put our firms on a competitive footing with their industrial competitors in doing business with Eastern Europe and the Soviet Union, as with other countries.

I would further stress that in making any decision on extending Eximbank loans to the Communist countries, each loan application would be judged on its merits on a case-by-case basis, just as the loans are judged for exports to other countries. Each project must be economically justified according to the criteria enunciated in the Eximbank Act, and must also bring a net economic benefit to the United States in order to be approved.

Thirdly, as I described at the outset, when we trade with the Communist countries, we recognize that the technology that we permit to flow to them might sometimes have limited and indirect uses for military production. Not trading with the Communist countries will frequently not prevent them from acquiring this technology, because it often is and will be available from other Western sources. Excluding ourselves from this trade, therefore, represents foregone economic opportunities and commercial gain for America for no real purpose. Nonetheless, we are always acutely aware of the need to maintain the delicate balance between U.S. economic opportunity on the one hand, and national security on the other. The latter must be given full weight.

Conclusion

Mr. Chairman, I have attempted to be as frank and as candid as I can in expressing the administration's views on the status of East-West trade and our current policies affecting it.

I hope that my testimony, and that of my distinguished colleagues, is responsive to your request in your invitation to testify.

It is an opportunity that I personally have welcomed. I believe that it is very healthy to have an intensive public airing, based on the facts about trade and the issues surrounding it. The current climate is still too much instilled with the emotion surrounding the passage of the Trade Act's provisions relating to MFN and credits. I believe—and indeed I fervently hope—that full public ventilation of the issues will be the basis for reestablishing an atmosphere of credibility and trust.

This committee has always been at the forefront in the development of East-West trade policy. Its concern has been constructive and therefore productive of useful dialog. These hearings demonstrate your continuing leadership. I commend you for this initiative and look forward to working as closely as possible with you and your able staffs, and with other appropriate Senators and Congressmen as our policy evolves.

Exhibit 38.—Joint State/Treasury press release, January 16, 1976, on U.S. commodity policy

We have been asked for a restatement of U.S. commodity policy. Our policy, as set forth in Secretary Kissinger's statement at the Seventh Special Session of the U.N. General Assembly, is based on the following main interests: (1) We seek assured supplies at reasonable prices. This requires not only supply commitments from exporting countries but adequate investment in new production capacity. (2) We are concerned about excessive price fluctuations since, on the one hand, this can impede adequate investment and, on the other hand, can contribute to severe inflationary pressures. (3) We recognize the importance of commodity earnings to producing countries and especially to developing countries who are significantly dependent on raw material exports.

For these reasons we have proposed a number of measures in the commodity field:

(1) We have proposed that the World Bank group, especially the International Finance Corporation, take the lead in bringing together private and public capital as well as technical, managerial, and financial expertise to finance new minerals development.

(2) We are seeking supply access commitments in the multilateral trade negotiations.

(3) Because no one formula will apply to all commodities, we propose to discuss new arrangements for individual commodities on a case-by-case basis.

(4) We have expressed our intention to participate actively in negotiations for new commodity agreements in tin, cocoa, coffee, and sugar.

- We will sign the new Tin Agreement and it will be submitted to the Senate for advice and consent.
- We do not propose to sign the new International Cocoa Agreement in its present form. We consider the agreement to be deficient in a number of respects and have suggested that certain of its provisions be renegotiated. We are awaiting the reaction of other countries.
- We are reviewing the new International Coffee Agreement which contains substantial improvements. An analysis of the new agreement and a recommendation for the President is being prepared.
- Negotiations for a new International Sugar Agreement will commence in September of this year.

(5) We proposed a substantial improvement in the IMF's compensatory finance facility. At the recent IMF meeting in Jamaica a substantial improvement was agreed upon to help stabilize the earnings from commodity trade.

(6) We are supporting in the IMF an improvement of its arrangements for financing buffer stocks.

As this enumeration of measures demonstrates there is no one single approach to commodity trade problems. We reject price-fixing arrangements that distort the market, restrict production, and waste resources. But this should not be the central issue. The main point is that we are prepared to consider measures that will improve the functioning of markets and will directly meet the problems of raw material producers and consumers. In this regard, we seek the establishment of consumer-producer forums for each key commodity to promote efficiency, growth, and stability of particular markets.

Exhibit 39.—Statement by Secretary Simon, January 29, 1976, before the Senate Finance Committee, on a review of the administration of the Trade Act of 1974 and U.S. international trade policy

I welcome the opportunity to join in this review of the administration of the Trade Act of 1974 and U.S. international trade policy, with special emphasis on the multilateral trade negotiations.

During this period of continuing worldwide economic difficulty and change, world trade has taken on even greater importance as a central ingredient in our economic relations with foreign countries. Maintaining and improving an open trade environment is crucial to our efforts to prevent widespread restrictive trade actions that could seriously harm world economic stability and cooperation.

Before turning to a discussion of our trade policy, I would like to say a few words about the world economic outlook, which will play a major role in determining the world trade climate in the months to come.

International economic outlook

The world is now recovering from the most severe economic recession since the 1930's. The recession saw real output in the industrial countries fall sharply and suddenly, a decline of 5 percent in the first half of last year. It saw the first reduction in the volume of world trade since World War II, a reduction of 6 percent in 1975. And it was associated with the most violent inventory-adjustment in more than 50 years.

The outlook for recovery from the worldwide recession of 1974–75 is now good. Solid progress toward recovery has been made particularly here and in Japan and Germany. The outlook for real growth in the major industrial countries is on the order of 5 percent during 1976. During 1976, the United States is expected to experience a rate of real growth in the 6- to 6 1/2-percent range, which is above the average of the last decade. Upturn in the smaller industrial countries, whose economies turned down some 6 months later than the larger countries, will occur more slowly.

At the same time the economies have turned around, progress had been made in curbing inflation. Inflation rates in the industrial countries are forecast to average about 8 percent during 1976. This is too high—but the trend is welcome.

Unemployment levels at the end of 1975 remain too high. The absolute number of workers unemployed is at or near postwar record levels in most of the industrial countries. The relatively modest recovery foreseen during 1976 in some countries will not significantly reduce unemployment rates during 1976—given normal work force growth—although progress is likely during the latter part of the year.

Most less developed countries (LDC's) experienced reduced growth rates later than industrial countries and, while growth rates for nonoil LDC's as a group will probably be lower than in 1975, their balance of payments position will improve in 1976. For many of these poor countries economic growth will not keep up with population growth in 1976.

The pattern of international payments last year was determined by two major factors—the continued massive surpluses of the oil-exporting nations, and the widespread economic recession. A clear pattern of payments balances among three major country groups can be distinguished—

For the oil exporters, the OPEC countries, large *surpluses* of about $40 billion on current account;

For the developed world, the OECD countries, approximate *balance*, with roughly offsetting surpluses and deficits within the group; and

For the rest of the world, large *deficits*, particularly on the part of the less developed countries.

The centrally planned economies of East Europe and Asia also experienced deficits.

As a result of the firmly based recovery now underway in the industrial world, the pattern of payments imbalances will shift importantly this year toward more balance.

The collective current account deficit of the oil-importing countries should be more evenly distributed between developed and developing countries during 1976, representing a partial reversal of the 1975 patterns of current balances which were highly skewed against the nonoil developing countries. The dramatic improvements in the external positions of major industrial countries in 1975 were to a large extent the result of inventory adjustments and recession-induced reductions in import demand. With recovery, the external positions of the industrial countries will adjust accordingly, and this should prove to be an important factor in reducing the external deficits of nonoil LDC's.

During 1975, the recession reduced demands for commodity imports as a result of both inventory adjustments and lower production levels in the industrial countries. Commodity prices declined in the presence of slack demand. The nonoil developing countries faced reductions in both the volume and price of their primary product exports during 1975. This process will be reversed during 1976, with resumption of recovery in the industrial countries. Unfortunately, a sizable portion of this improvement in the nonoil-producing developing countries' positions will be eroded by the higher crude oil prices announced in October.

The continuation of the current solid recovery will depend on continued sound economic policies by all countries. For the industrial countries, sound policies mean policies to assure a continued strong noninflationary recovery in world demand; they mean the avoidance of measures which would frustrate an adjustment in their payments positions, particularly the avoidance of beggar-thy-neighbor trade actions. For the LDC's, sound policies mean realistic investment, growth, and development programs. For the OPEC, sound policies mean reasonable investment policies, without excessive liquidity preference, increased aid to LDC's, and restraint in oil pricing.

But the industrial countries do bear a special responsibility. Simultaneous reflationary measures in 1972–73 led to worldwide inflation. Simultaneous deflationary policies in 1973–74 led to cumulative recession. The major countries must become more aware of the cumulative effects of their policies; economic policy cooperation among them must be improved. Rambouillet made progress toward that goal, particularly in the trade area.

The worldwide recovery, the commitment at Rambouillet to sound economic policies, the comprehensive monetary agreements of Jamaica—all create a positive environment for the multilateral trade negotiations.

Principles of U.S. international economic policy

In approaching the problems of the world economy, the United States has formulated a consistent international economic policy. No nation is more intimately involved in shaping a cooperative international economic system. The core of our international economic policy is dedication to certain fundamental principles, the most important of which is our commitment to a free and open environment for world trade and investment. Within this context it is essential that we seek to achieve certain basic objectives. We must—

- Maintain a sound U.S. economy;
- Eliminate or reduce barriers to and distortions of trade on a reciprocal basis;
- Establish fair trade rules and improve the structure of the General Agreement on Tariffs and Trade;
- Permit the free flow of capital in order to allow its most productive use;
- Assist the developing world to grow and become economically self-sufficient through fair and reasonable access to developed nations' markets; and
- Cooperate with other nations in resolving problems and responding to change in the international economy on a mutually beneficial basis.

Coordination of U.S. policy

The policy guidelines and decisions to implement these principles are coordinated through the Economic Policy Board (EPB) and the Council on International Economic Policy (CIEP).

The President established the Economic Policy Board by Executive order in September 1974. This Board consists of the Secretary of the Treasury, who is Chairman, and 12 other members. The Executive order provides that the Economic Policy Board "shall provide advice to the President concerning all aspects of national and international economic policy, while overseeing the formulation, coordination and implementation of all economic policy of the United States, and will serve as the focal point for economic policy decision making."

The Executive order also provided that the Assistant to the President for Economic Affairs should be a member of the Economic Policy Board and its Executive Director. The Secretary of the Treasury was designated Chairman of the Council on International Economic Policy and the Assistant to the President for Economic Affairs became a member of the Council and its Deputy Chairman.

The membership of the EPB and CIEP differ somewhat. The EPB includes the Secretary of the Interior, the Secretary of Health, Education, and Welfare, the Secretary of Housing and Urban Development, and the Executive Director of the CIEP. EPB does not include the Secretary of Defense, who is a member of the CIEP.

This organizational structure reflects the increasingly close intertwining of domestic and international economic policies which led, first, to the appointment of the Cabinet officer most intimately concerned with these issues, the Secretary of the Treasury, to chair the Council and, second, following the establishment of the Economic Policy Board, led to a very close and intimate relationship between the EPB and the Council.

This relationship is focused in the Executive Committee of the EPB, of which the Executive Director of CIEP is a member, which was established to meet daily to consider issues relating to international and domestic economic policy. The fact that there is a Cabinet-level meeting daily considering these issues is tremendously important. It has given the executive branch the capability to respond rapidly to changing conditions, and it has provided an institutional focus for decisionmaking on matters relating to economic policy. Participation in the Executive Committee has not been limited just to the designated members. Other agencies and departments have participated on a regular basis in areas where it is felt they could contribute to economic policy decisions.

In the international trade area, the Trade Act of 1974 provides the legislative framework for the development and implementation of policy. Responsibility for the multilateral trade negotiations rests with the special trade representative, Ambassador Dent, who is a member of CIEP, and is chairman of the Cabinet-level Trade Policy Committee (TPC). The special trade representative joins the deliberations of the EPB on matters of interest to him and is able to bring to the EPB matters for attention or decision.

In addition to these formal mechanisms, Secretary Kissinger and I meet frequently on an informal basis to discuss economic and foreign policy issues to assure coordination in our approach.

Pursuing our international economic objectives

The principles of our international trade policy are embodied in the Trade Act of 1974, and we are actively pursuing them in the multilateral trade negotiations. Our success in these negotiations will in large measure determine the future of our international trading system. Progress is therefore essential. We are encouraged by the strong impetus which the MTN received from the agreement at Rambouillet in November to accelerate the pace of the negotiations, with the goal of completing them in 1977. Specifically, the Rambouillet Declaration affirmed that we "should aim at achieving substantial tariff cuts, even eliminating tariffs in some areas, at significantly expanding agricultural trade and at reducing non-tariff measures" in order to achieve the maximum possible level of trade liberalization.

A healthy international economic and financial system is, of course, an essential underpinning for trade relations.

Recognizing the close interrelationship between international trade and economic policies, the six participants at Rambouillet agreed to work in the monetary area to create greater stability in the economic and financial conditions underlying the world economy. They also made the fundamental decision to reach specific agreements in the IMF relating to exchange rates. This commitment was implemented in the recent agreements achieved at the Interim Committee meeting in Jamaica. Because these understandings are so important to the future of our international monetary system, and, thereby, to the environment in which international trade will take place, I would like to comment briefly on the Jamaica accords.

The Jamaica agreements

The Jamaica meeting marked the successful conclusion of several years of negotiations, resulting in the first general revision of our international monetary arrangements since the basic framework for the postwar economic system was established at the 1944 Bretton Woods conference. The package that has been developed combines longer term structural reforms with measures to meet current financing needs. They consist of four major elements: New provisions governing exchange rate practices which nations can follow in the future; measures to phase gold out of the monetary system; steps to increase the resources of the IMF and to strengthen the Fund's ability to meet the balance of payments financing problems of member countries; and proposals to amend the IMF Articles, the "constitution" of the monetary system, so as to streamline its operation, and to conform the institution to the different world which has developed since the 1940's and which will evolve in the 1970's and beyond. Together, these agreements lay a foundation of impressive strength on which we may base our efforts in the multilateral trade negotiations.

The agreement to reduce the role of gold in the monetary system removes an important disruptive factor from the system. Its private uses conflict with its monetary uses. Its extreme price volatility can be very destabilizing to a monetary asset. Its relatively fixed supply means that new output cannot be expanded or contracted in line with requirements for more, or less, international liquidity.

Action to update and streamline the IMF Articles, relating to the operations of the General Account and the SDR (special drawing right) account, provides a flexible basis for future evolution of the rules of the system.

In the third area, steps are being taken to enhance the IMF's capacity to provide its members medium-term financing for balance of payments problems while adjustment measures become effective. These actions include an increase in IMF quotas, an immediate increase in members' potential access to IMF credit, the establishment of a trust fund to assist the poorest countries, and a major liberalization of the IMF's compensatory financing facility to assist primary producers. All of these actions demonstrate a commitment to maintaining a payments system which supports the free flow of trade and capital.

A final area where agreement was reached involves exchange rate practices. In sharp contrast to the rigid system of exchange rates established at Bretton Woods, which sought stability by requiring adherence to a specific exchange rate regime—par values—the new provisions focus on achieving the underlying economic stability that is a prerequisite for exchange rate stability. The provisions legalize the various exchange arrangements presently applied by countries; provide a flexible framework for future adaptation of the exchange rate system; and provide wide latitude for countries to adopt specific exchange arrangements of their own choosing so long as they fulfill certain general obligations relating to the maintenance of internationally appropriate economic policies. Of particular importance in this respect for the trade negotiations is the obligation to avoid manipulating exchange rates to gain an unfair competitive advantage.

Those who criticize the present system of semifloating exchange rates state their case in terms of the volatility of the system and the impact exchange rate variability has on international merchants. Such arguments are just not supportable. The floating exchange rate system did not produce exchange rate variability. The variability that characterized the past several years is the result of the violent financial pressures generated by boom and recession, by the sharp rise in inflation rates, and by the increase in the price of oil. Central to the agreement reached in Jamaica was the recognition that instability was not caused by the exchange rate regime but rather by underlying economic and financial conditions.

The agreed new provisions relating to exchange rates provide for a floating system and, upon an 85-percent majority vote, a par value system. In either case, the exchange rate system is not viewed as producing stability. Rather, underlying factors, relative rates of economic expansion, congruent rates of price increases are recognized as the true source of stability. This means that the exchange rate system can facilitate stability but that the basic impetus has to come from domestic economic and financial policies.

Treasury responsibilities under the Trade Act

Let me now turn to the multilateral trade negotiations, where we are attempting to implement our important commitment to an open international trading system under the mandate of the 1974 Trade Act. I would like to devote particular attention to two areas where the Treasury Department has special responsibilities: The enforcement of our antidumping and countervailing duty legislation and our trade relations with nonmarket economy countries. I would then like to discuss an area of special importance: Our commodity policy and our efforts to actively involve the developing nations in the MTN.

As you know, the Trade Act of 1974 made significant changes in both the countervailing duty and antidumping statutes. The act and the congressional hearings which preceded its passage made clear that it was the intent of the Congress that these remedies be vigorously but fairly applied so that international trade could flourish in a freer but fairer environment. At the time of my confirmation as Secretary of the Treasury, I pledged to you that these laws would be efficiently and effectively administered. In the year since passage of the act, the Treasury has carried out that pledge.

Antidumping Act

The act did not substantially amend the Antidumping Act but, for the most part, codified various Treasury practices and policies previously established by administrative action. During 1975, 25 cases were initiated, preliminary actions were taken on 13 cases, and final decisions including referrals to the International Trade Commission (ITC) were made on 12 cases. (I have attached to my statement a summary of all these actions.) The cases initiated include the initiation of an investigation of all imported automobiles from eight foreign countries—the largest inquiry in terms of trade volume ever undertaken by Treasury.

Under new Trade Act procedures, Treasury on three occasions referred antidumping petitions to the ITC at the outset of investigations when it was determined that there was substantial doubt as to the existence of injury. The Commission determined in each instance that it was unable to find "no reasonable indication of injury," and therefore full investigations were or are being conducted in these cases.

I believe the Department has continued to demonstrate its determination to administer effectively the Antidumping Act, and this committee can be assured that these high standards will be maintained.

Countervailing duty law

The Trade Act of 1974 made significant changes in the countervailing duty law with the addition of time limits for completion of investigations and the inclusion of a provision for the temporary waiver of countervailing duties to aid the multilateral trade negotiations. You will recall that section 331 of the act authorizes the Secretary of the Treasury to waive the assessment of countervailing duties otherwise assessable until January 3, 1979, if all of the following three conditions have been met:

(1) Adequate steps have been taken to reduce substantially or eliminate the adverse effect of the bounty or grant;
(2) There is a reasonable prospect that successful trade agreements will be entered into reducing or eliminating distortions of international trade; and
(3) The imposition of additional duties would be likely to seriously jeopardize those negotiations.

Either House of Congress may override a waiver, and the Secretary may revoke it at any time.

There was a dramatic increase in our countervailing duty caseload during 1975 as a result of our stepped-up efforts to resolve all pending and legitimate complaints expeditiously. All the cases outstanding at the time of the passage of the Trade Act have now been resolved. The eight cases still pending were all initiated in 1975. During the year, Treasury initiated 38 countervailing duty investigations—a record number. This included those cases outstanding as of the date of enactment of the Trade Act. Thirteen investigations were terminated at the request of petitioners, 25 preliminary determinations were reached, and 20 final determinations were made, of which 9 were affirmative and 10 were negative. A temporary waiver of countervailing duties as provided in the act was granted in six of those cases. Summaries of these cases are appended to my testimony.

These figures alone do not tell the full story concerning the effectiveness of our efforts to protect U.S. markets. In several of the cases which resulted in negative findings, substantial "countervailable" programs existed at the time the inquiries began. Discussions with Treasury officials during the course of the proceedings or the mere pendency of the actions themselves convinced the responsible officials of the governments concerned to eliminate the subsidies. Furthermore, in each of the six cases where duties were waived the exporting country had taken significant action which in our judgment eliminated or substantially reduced any threat posed by the subsidy programs. In four of the six cases this action involved the elimination of substantial portions of the subsidies. In the other two cases, we believed that while potential existed for adversely affecting the domestic industry concerned, that potential was removed by other price or export policy guarantees obtained from the exporting countries.

As I have indicated, Treasury exercised its authority to waive the imposition of countervailing duties in six instances during 1975. In all cases of substantial subsidization, Treasury worked closely with interested Members of Congress, representatives of the concerned domestic industry, and appropriate executive branch agencies in reaching decisions concerning the exercise of the temporary waiver authority. This process led to decisions reflecting the variety of concerns that must be considered in determining whether the criteria established by the Trade Act have been met. This provision was not designed to be used loosely or indiscriminately but in limited instances where circumstances warrant it. In my opinion, we have by our actions thus far fulfilled the basic purpose for which the waiver provision was added to the law. We have avoided unnecessary friction with our trading partners while negotiations continue in Geneva, while at the same time protecting the interests of our farms, factories, and workers.

Let me now turn to the need for those negotiations to arrive at a new set of international guidelines to limit the use of subsidies in international trade.

Subsidies and countervailing

Section 331 of the Trade Act provides a specific mandate to negotiate on subsidies and countervailing:

> It is the sense of Congress that the President, to the extent practicable and consistent with United States interest, seek through negotiations the establishment of internationally agreed rules and procedures governing the use of subsidies (and other export incentives) and the application of countervailing duties.

Mr. Chairman, as you know, the special trade representative is charged with negotiating a subsidy/countervailing duty code within the multilateral trade negotiations. I am certain Ambassador Dent will wish to address this issue. Treasury has worked very closely with STR and other agencies in carrying out the mandate of the Trade Act in this area. As a result, the U.S. Government has proposed a framework for negotiation of international rules on subsidies and countervailing. We submitted a concepts paper on the elements that should be included in a subsidies and countervailing code. Our proposal is on the negotiating table along with proposals of other countries. Our proposal would establish three categories encompassing all subsidies, and would establish treatment for subsidies in each category. The "prohibited" category would include all blatant export subsidy practices including direct export subsidies and domestic subsidies expressly intended to promote export performance. These would be subject to countervailing without any conditions. The "conditional" category would generally cover programs, the intent and effect of which are to accomplish a country's domestic policy objectives, but which may also affect international trade. These would be subject to countervailing duties only when certain conditions of injury are met. The "permitted" category would consist of practices agreed to have a minimal impact on international trade such as overseas trade fairs. These would be exempt from countervailing action.

The Trade Negotiations Committee meeting in December decided that one of the MTN goals for 1976 would be to reach agreement on an approach to negotiations on subsidies and countervailing.

Effective international rules are needed in this area both to deal with the widespread use of subsidies and to cover the application of countervailing duties against subsidies.

Present GATT rules do not now provide adequate controls on the use of subsidies that distort international trade. The multilateral trade negotiations provide the opportunity for developing clear and effective controls on subsidies and linking subsidy controls with rules on countervailing action.

The thrust of the U.S. approach is to obtain, for the first time, a change in existing international practices which clearly commits both the United States and our trading partners to refrain from the use of export subsidies in international trade, whether or not injury has or will occur. The framework we have proposed for such an agreement provides the possibility for negotiating separate protocols for special problems when we find it necessary and desirable to do so.

In view of the fact that such an agreement will be extremely difficult to negotiate, some might ask why we need it. After all, we can unilaterally offset subsidies in the U.S. market by countervailing action. There are several reasons.

First, we need to prevent subsidized exports from capturing the third country markets for American exports.

Secondly, subsidized products moving in international trade cause diversion of goods produced in third countries and, further, they distort investment decisions.

Finally, the use of unilateral remedies inevitably cause friction between trading partners and are, therefore, subject to appeals on political and other nongermane grounds.

Our objective, then, is to gain agreement on the prohibition of subsidies, the intention and effect of which is to promote exports, whether to the United States or to third countries. To gain this objective we must realistically be willing to accept some limitations on our unilateral use of countervailing duties. What we have proposed is that where the programs complained of are purely domestic in nature—that is, where they apply equally to domestically consumed products and from the evidence available have neither the intent nor effect of stimulating exports—countervailing action by the importing country—i.e., the United States—would be conditioned upon a showing that the imports in question are actually or potentially injurious to domestic industry. I would point out that all countries, including our own, maintain an array of programs for legitimate domestic purposes, which can be judged to be bounties or grants under the broadest interpretation of those words. A typical example is the investment incentive programs maintained by the individual States to attract new industries. Some of those industries inevitably export some of their production.

Our experience has been that programs such as these, maintained for legitimate domestic purposes, generally have only an incidental effect on trade. We need to establish better guidelines for determining when the impact of these programs on trade is significant enough to warrant offsetting action.

This area is one which is in great need of a negotiated solution, and we have accordingly given it high priority in the Geneva negotiations.

I would like to turn now to the second area of special Treasury responsibility under the Trade Act: the operation of the East-West Foreign Trade Board.

The East-West Foreign Trade Board

In accordance with section 411 of the Trade Act of 1974, President Ford established the East-West Foreign Trade Board by Executive order on March 27, 1975. The organization of the Board follows the organization of its predecessor—the President's Committee on East-West Trade Policy.

The President designated me as Chairman of the Board; the Assistant to the President for Economic Affairs, William Seidman, was named Vice Chairman. Other members are the Secretaries of State, Agriculture, and Commerce, the Special Representative for Trade Negotiations, the Director of the Office of Management and Budget, the Executive Director of the Council on International Economic Policy, and the President of the Export-Import Bank. Treasury Assistant Secretary Parsky is Executive Secretary.

In addition, in response to a suggestion by the distinguished chairman of this committee, and recognizing the important role of the Department of Defense in the national security aspects of trade with the Communist countries, the Board unanimously recommended to the President that the Secretary of Defense be added to the Board's membership. On January 3, President Ford, by Executive order, amended the membership of the Board to include the Secretary of Defense.

Among its statutory functions, the East-West Foreign Trade Board is directed in the Trade Act to—

(1) Monitor trade between persons and agencies of the U.S. Government and nonmarket economy countries to ensure that such trade will be in the national interest of the United States;

(2) Receive reports on the nature and terms of transactions from (a) any person who exports technology to a nonmarket country which is vital to the U.S. national interest, and (b) any U.S. Government agency which provides credits, guarantees, or insurance to a nonmarket country in excess of $5 million during any calendar year;

(3) Submit to Congress quarterly reports on trade between the United States and nonmarket countries.

Since its establishment, the Board has functioned as a policy formulating and coordinating body. Its working group, consisting of representatives of the member agencies, usually meets twice monthly to coordinate the development and implementation of East-West trade policies and to refer issues to the Board for decision.

With regard to the Board's responsibility to monitor credits, guarantees, and insurance provided under Government programs, the working group is carrying out its responsibilities through oral and written reports from Eximbank, the Commodity Credit Corporation, and the Overseas Private Investment Corporation on such extensions to the nonmarket economy countries. There is also coordination between the working group and the National Advisory Council (NAC). Data from these agencies are summarized in the Board's quarterly reports.

Control of exports of technology to nonmarket economy countries is maintained by the Commerce Department under the authority of the Export Administration Act. To fulfill the requirement that persons who export technology to nonmarket economy countries report to the Board, the Board decided to use the export control mechanism maintained by the Commerce Department. Notice was given in the Federal Register of July 14, 1975, that the Board had promulgated a regulation concerning the exporting requirements of section 411 relating to the export of technology to a nonmarket economy country. Exporters of such technology will have complied with these requirements by complying with the applicable provisions of the export control regulations of the Department of Commerce.

The Board decided to use Commerce's well-established administrative mechanism, rather than establish a new one, because it did not wish to create yet another bureaucracy to levy additional requirements on businessmen. In order to do this, the Board has interpreted section 411(b) to require that licenses for export of technical data applied for and granted be reported to the Board by the Commerce Department. In addition, the Board and working group have continued the practice of the predecessor Committee by reviewing export license cases of major policy significance.

To date, the Board has submitted to Congress a quarterly report for each of the first three quarters of 1975. The fourth quarterly report will be submitted in February, when detailed 1975 statistics are available.

Notwithstanding the importance of the Trade Act in creating the East-West Foreign Trade Board, this administration has consistently established its objection to the provisions of this act which adversely affect our trade with the Soviet Union and other nonmarket economy countries, and which do not serve our political and humanitarian interest. My contacts with Soviet leaders and with American businessmen during the past year have firmly convinced me that it is in our interest to find a way to unblock these impediments to increased trade.

In consultations with congressional leaders, I have been encouraged by a common appreciation that we must move ahead. Last summer, I met with the members of the Senate delegation to the U.S.-U.S.S.R. Parliamentary Conference before and after their visit to Moscow. The Senators had an extremely frank exchange of views with top Soviet officials on the impact of the Trade Act on United States-Soviet relations. I believe their visit was extremely useful as was the visit of the House delegation which took place in August.

The normalization and improvement of our commercial relations with the U.S.S.R. and other nonmarket economy countries is a necessary element in the improvement of our overall relations with these countries. We believe strong economic ties tend to create a foundation of mutual interest which in turn can improve the environment for progress in the relaxation of political tensions.

A solution to the legislative impasse we now face would materially enhance our business community's efforts to expand trade with the East. We have had many indications that the lack of official credits from the United States is causing the U.S.S.R. and some of the eastern European countries to direct their purchases elsewhere. The major European countries and Japan have agreements with the U.S.S.R. under which $10 billion of government-backed credits will be available to finance export sales to the Soviet Union. This total is in sharp contrast to the $469 million in credits extended by the Eximbank before lending to the U.S.S.R. was suspended in May 1974.

At Treasury's request, the Commerce Department is now conducting an inquiry to determine how much business this country has in fact lost. The Soviets have given us their estimate that for January through October 1975, as much as $1.6 billion in contracts which the Soviets were ready to sign with U.S. firms have gone to Western Europe and Japan because of the U.S. restrictions on Eximbank credits. Many of these contracts are being negotiated as part of the Soviet 1976–80 plan and therefore represent business opportunities that are not likely to appear again until the next 5-year plan period.

I expect that much of the competition among Western industrial nations for exports through government-subsidized credits will soon be constrained through the establishment of guidelines on credit terms to be followed by the larger industrial countries. However, such arrangements will not mean that other countries will not continue to provide large amounts of credit to the East. Our firms will continue to be seriously disadvantaged by not having access to Eximbank credits in trading with these countries.

The developing countries and U.S. commodity policy

I would also like to discuss the related issues of commodity policy, U.S. relations with the developing countries, and the MTN. Commodity policy is a major element of our relationships with the non-oil-producing LDC's. For the foreseeable future many of these countries will largely depend upon commodity trade for their economic well-being and for their hard currency earnings. Our commodity policy decisions are therefore crucial to the ongoing dialog with the developing nations. Moreover, our actions now in setting forth clearly and forcefully our views will play a pivotal role in the evolution of the world's system of commodity trade.

As you are well aware, the worldwide economic boom of 2 years ago created concern in developed countries about the long-range availability and dependability of supplies of raw materials, particularly those from developing countries. At the same time, worldwide inflation and high oil prices played havoc with developing country economics. The success of OPEC led many of these countries to believe that they could resolve their economic problems by emulating OPEC. Several producer associations for other commodities were created in an attempt to raise export prices and export earnings.

These efforts have not been successful. Responding to market signals, prices for most commodities, particularly minerals, have fallen dramatically from the 1974 highs. Yet many developing country spokesmen still pin their hopes for improving their economic lot on mechanisms which would artificially maintain or raise the prices of their commodities. This distracts them from increasing output which could more quickly and surely advance their economies.

Over the next few months the United States will be involved in discussions in several international forums of a variety of such proposals involving export controls, widespread commodity agreements, price indexation, and new international financial institutions.

I believe more fruitful approaches are envisioned in the Trade Act of 1974. I would argue that both our own economic interests and those of the developing countries can best be served, not by putting new controls on the free market for raw materials and their products, but by working to dismantle those that exist.

The United States has put forth its own set of proposals on commodity policy which we believe would constructively and positively come to grips with the basic economic problems faced by the developing countries within the context of our fundamental commitment to free markets. I would like to summarize these proposals for you briefly and then discuss more fully those particular proposals which relate closely to the Trade Act.

The United States has important interests in the raw materials field. As an importer of raw materials, the United States seeks assured supplies at reasonable prices. This will require adequate investment in raw materials production, and supply commitments from exporting countries. As a major exporter of raw materials, we wish to improve our access to other countries' markets for our exports and convince other countries that we are a dependable supplier. Excessively volatile price fluctuations are a matter of concern both to developing and developed countries. They can distort investment patterns and contribute to inflationary pressure. We also recognize the significant dependence of many developing countries on earnings from raw materials exports, and we wish to help increase the security and stability of those earnings.

To accomplish those goals, we have put forward specific proposals.

- To help assure adequate investment, we have proposed that the World Bank group, especially the International Finance Corporation, take the lead in bringing together private and public capital as well as technical, managerial, and financial expertise to finance new minerals development.
- To assure our access to supplies at reasonable prices, and to convince other countries of our dependability as a supplier of raw materials, we are seeking supply access commitments in the multilateral trade negotiations.
- Because no one approach can apply to all commodities, we propose to discuss new arrangements for individual commodities on a case-by-case approach. We have participated actively in negotiations for new commodity arrangements in tin, cocoa, and coffee, and will participate in talks on sugar this fall. We will sign the new Tin Agreement, which will be submitted to the Senate for advice and consent, because it operates with a minimum of market interference and permits full latitude for the operation of our own tin stockpile.
- However, we do not propose to sign the new International Cocoa Agreement in its present form because it sets rigid price ranges, does not adequately protect consumers, and relies excessively on export quotas as a central operational feature. We have suggested that the agreement be renegotiated and are awaiting the reactions of other countries.
- We are currently reviewing the new International Coffee Agreement, which contains substantial improvements. Our review is focusing on the adequacy of the consumer safeguards and the possible future price impacts of the new agreement.
- To help primary producing countries stabilize earnings from commodity trade, the United States proposed a substantial improvement in the IMF's compensatory financing facility. The IMF has now agreed that such countries could draw more freely on the IMF to offset export earnings shortfalls. Under the new rules, members can draw up to 75 percent of quota, and up to 50 percent in any one year.
- We are also supporting an improvement of the IMF's arrangements for national financing of buffer stocks by amending the Articles of Agreement to remove any effect of buffer stock drawings on member-country access to other IMF resources. We have determined that we will support financing for national contributions to buffer stocks from only one of the international financial institutions—the IMF.

- To provide even longer run stability and security of export earnings for the LDC's, we have urged that in the MTN particular attention be paid to the issue of tariff escalation. If LDC's are given improved access to developed country markets for processed forms of their raw materials, they will be able to diversify their economies and decrease dependence on exports of raw materials.

As this enumeration of measures demonstrates, there is no single approach to commodity trade problems. We reject price-fixing arrangements that distort the market, restrict production, and waste resources, and we have made clear we will not join such agreements. On the other hand, we are prepared to consider measures that will improve the functioning of markets and will directly meet the problems of raw material producers and consumers. In this regard, we seek the establishment of consumer-producer forums for each key commodity to promote efficiency, growth, and stability of particular markets.

Two of these issues are particularly related to the Trade Act—supply access and tariff escalation.

Section 108 of the Trade Act specifically directs the U.S. negotiators to work toward agreements which "assure the United States of fair and equitable access at reasonable prices to supplies." Countries may wish to offer or request specific supply access commitments in exchange for similar supply commitments or improved market access for processed products. The feasibility and desirability of such commitments need to be examined. The idea of a general code of conduct on export restraints also would seem to hold promise, in which countries might agree to general principles governing the circumstances and methods under which export restraints would be justified. Finally, we believe that this field offers one area in which developing countries might make some commitments in the MTN in exchange for the benefits they have requested.

The United States has also stated that we wish to examine carefully the issue of tariff escalation and possible remedies. Most countries, including the United States, have tariff systems which favor the imports of raw materials over processed goods. Raw materials producers argue that this is uneconomical and provides them with justification for export restraints on their raw materials in order to protect and stimulate their own processing industries. Thus there is clearly a link between the issues of supply access and tariff escalation.

In general, this administration has consistently argued that we believe all countries benefit from freer trade. We must work to decrease the insecurity caused by unpredictable government intervention in raw materials markets. If countries can be assured that governments will only limit exports of raw materials under clearly defined emergency circumstances, and will not attempt to set prices arbitrarily, importing countries will be less hesitant to become more dependent on imports of those materials and will be more likely to reduce their own barriers to those products. In turn, if importers reduce the levels of tariff escalation so that processing can take place where it is most economical to do so, raw materials producers will be able to increase the value added to products in their countries, further industrialize their economies, and enhance their export earnings without tampering with raw material prices.

I would thus suggest that by using the mandate and authority in the Trade Act of 1974, we can improve our access to needed raw material imports, increase other countries' confidence in us as a supplier of raw materials which we export, and assist the developing countries in their drive to improve export earnings and develop their economies. This can best be done by reducing and restricting Government interference in the free market for raw materials and their products, rather than adding new mechanisms and controls.

Border tax adjustments

I would now like to turn to another section of the Trade Act which raises a subject of immediate interest to the Treasury—tax adjustments made at the border on imports and exports.

The Trade Act directs the President to revise the present GATT rules on border tax adjustments. The rules of the GATT provide, generally, for the adjustment on traded goods of internal indirect taxes—those bearing on consumption such as sales taxes and value-added taxes. Adjustment means the relief of such taxes on exports and their assessment on imports. The GATT does not provide for any such adjustment at the border of direct taxes—those bearing on factor earnings such as corporation and personal income taxes.

The administration is now hard at work on this problem. We are examining how the present rules actually affect trade today. Economic opinion on this point is divided. Some believe that U.S. exports are hurt by the current rules while the exports of others obtain an advantage. On the other hand, it is argued that, taking into account all factors such as more flexible exchange rates, border tax rules have little, if any, lasting effect on trade. We are coming to grips with these separate views and are considering the basic options for improving the current rules. Our work is still in progress but it is becoming very apparent that there are no easy answers.

Antidumping and countervailing duty actions—CY1973-75

	1973	1974	1975
Antidumping:			
Petitions received	20	10	25
Negative decisions	9	2	4
Affirmative decisions	25	5	8
Injury or likelihood of injury	13	3	2
Discontinuances	5	3	0
Countervailing duty:			
Proceedings initiated	1	5	*38
Negative decisions	0	1	*10
Affirmative decisions	0	4	*10
Terminations	0	0	*15
Waivers	N.A.	N.A.	*6

* Includes first week 1976.
N.A. Not available.

We are very aware of the concern of Congress, U.S. businessmen, and labor about this issue, which we will address in the multilateral trade negotiations. I hope the Special Representative for Trade Negotiations will be able to report more progress on this to you soon.

Conclusion

It is my firm belief that progress in negotiating a more open and equitable world trading environment is essential to a world beset with economic difficulty and unprecedented change. The need for meaningful progress in the Geneva negotiations was clearly recognized by the major industrialized nations at Rambouillet. Our agreement there to aim for completion of the MTN during 1977 has won the support of the Trade Negotiations Committee in Geneva, which has set specific concrete tasks for the negotiations this year to enable use to meet that deadline.

In carrying out the mandate of the Trade Act of 1974, our efforts in the multilateral trade negotiations will—

(1) Help move us toward our fundamental goals of freer markets, improved rules and regulations governing the conduct of trade, and a more efficient allocation of world resources for the benefit of producer and consumers alike;
(2) Provide a positive counter to the threat of a potentially hazardous slide into world protectionism; and
(3) Enable us to better meet the justifiable needs of the developing countries, while providing that they gradually assume equivalent responsibilities as their economic situation improves.

The negotiations are a vital element of our international economic policy. Upon the success of our efforts rests in large measure the nature of our future world trading system. I am confident that if we approach these negotiations with the aim of preserving and broadening the freedom of the private sector to conduct international transactions, with a minimum of Government intervention, the future economic system will be one with which we can all live and from which we will all benefit.

Exhibit 40.—Statement by Assistant Secretary Parsky, April 26, 1976, before the Subcommittees on International Resources, Food, and Energy; International Economic Policy; International Organizations; and International Trade and Commerce of the House Committee on International Relations, entitled "UNCTAD IV: The U.S. Approach to Current Economic Issues"

Mr. Chairman, members of the committee, I welcome this opportunity to discuss the range of international economic issues that will be the subject of intense debate and negotiations during the fourth session of the United Nations Conference on Trade and Development (UNCTAD IV).

We approach this meeting sympathetic with the aspirations of the developing countries. We want to work with them in seeking practical, realistic solutions to their problems.

Although each country is different, presenting unique problems which require individual solutions, there are certain needs that are shared and in turn there are certain principles which should apply to all.

All of the developing countries want to improve the economic conditions of their peoples, and they want the help of the developed countries in undertaking this effort. We wish to see the growth and stability of the economies of these countries. It is clear to us all that this world cannot indefinitely endure half rich and half poor. The United States has played and must continue to play a leadership role. We have given significantly of our resources, both financial and human, to help in this process, and we will continue to do so. I believe the basic question is not one of commitment to help, but rather one of process. How can we best get the job done? As such, I believe there are several basic principles that we should bear in mind:

A country's economic growth rate will be determined by the skill with which it utilizes its own resources, not its status as an industrial or less developed country. Foreign aid can make an important contribution to development, but what developing countries do for themselves will determine how they will grow.

Investment is the central propellant behind economic development. While we must be sensitive to the need to provide direct aid to those who face drastic immediate problems, over the long run the best way to assist developing countries significantly is by helping them to create a better climate for increased investment in their country. We must keep this goal in mind when initiating new programs of bilateral and multilateral assistance.

The development of a strong private sector is essential. In the United States and other industrial countries, the private sector has the technology and management expertise to help developing countries. We must not adopt policies that will undermine maximum use of this sector.

The free market may not be perfect but no other system has been devised which will increase production, improve efficiency, and stimulate growth in a better way. Our efforts should be aimed at helping other countries improve conditions for the better operation of the market system by removing government controls. We must resist the erection of additional impediments to market forces.

With these principles in mind, I believe the United States must continue to lead others away from political rhetoric to practical solutions. Simplistic analysis and overstatement, no matter how well intended, will simply not help move us forward. I do not believe that calls for controlled commodity markets, massive transfers of resources, and wholesale debt rescheduling or moratoria are either realistic, or indeed necessary.

As we approach the problems of the developing countries, we must not let the emotions of the international political arena distort the economic realities. For example, some have expressed the view that "all of the developing countries" are facing disastrous balance of payments difficulties requiring blanket solutions by the developed countries. The recent worldwide recession has certainly impacted the developing countries severely, but they are not all teetering on the brink of economic disaster, nor do they all share the same problems. In fact, although a large number of developing countries have been experiencing abnormally large current account deficits as the result of the increased prices of their oil imports and weakened export markets, the deficits have been financed without disrupting existing institutional arrangements. A number of developing countries have proven creditworthy for substantial borrowings of private capital, while other countries have benefited from increased aid flows. There is reason to be optimistic that financing will again be adequate in 1976, particularly in view of lower requirements as a result of increased exports and the new resources provided for by the Jamaica meetings. Some individual developing countries will encounter particularly difficult problems meeting their balance of payments financing requirements, and we must find ways to properly assist them, but we do not believe that this will be a general problem requiring blanket solutions.

This brief discussion of the realities of the LDC balance of payments situation is only meant to illustrate the dangers of oversimplification, and I will more thoroughly discuss this issue later. But I want to make clear that we have attempted to shape our policies and proposals on an objective analysis of the realities of the economic situations of the individual developing countries, not on the basis of misleading generalities that could result in inappropriate, even harmful solutions.

UNCTAD IV in perspective

Before turning to the specific issues which will arise at UNCTAD IV, let me briefly review the events leading up to this Conference. The past 2 years have seen a considerable change in the relations between the developed and developing world. In 1974, elements of confrontation dominated the scene and certain relations became strained, as the LDC's put forward their initial proposals for a "new international economic order," which was elaborated in the Charter of Economic Rights and Duties of States adopted in December 1974, over the strong opposition, and negative votes, of the United States and several other industrial countries.

Such an atmosphere was truly counterproductive for all, and in 1975 there was a major change in our relations with the developing world. At the Seventh Special Session of the United Nations last September, Secretary Kissinger put forth a broad range of positive proposals, and consensus was reached on an approach to a number of major economic issues that will be dealt with at UNCTAD IV. Agreement was also reached last fall to begin a serious dialog between the Western industrial nations, the oil-producing developing countries, and the oil-importing developing countries at the Conference on International Economic Cooperation (CIEC).

The CIEC has resulted in an unparalleled, intense dialog between the developed and developing world. Representatives from 8 industrialized and 19 OPEC (Organization of Petroleum Exporting Countries), and nonoil developing nations are meeting each month in Paris in the 4 commissions on energy, raw materials, development, and financial affairs which form the CIEC.

UNCTAD IV will be another important part of this dialog. This meeting, which brings together almost all countries, including Socialist States, will help determine whether or not the North and South can continue a serious joint effort to identify and solve problems relating to our economic relations and avoid the nonproductive confrontation of the past.

A broad range of vitally important issues will be discussed at UNCTAD IV, including commodities, trade, debt, official development assistance, transfer of technology, and the future role of UNCTAD. A primary focus will certainly be on commodities, where UNCTAD advocates an "integrated program" that includes many features we find unacceptable, and on the financing problems of the developing countries, where UNCTAD seeks generalized relief measures.

I would now like to describe our approach to these two important areas, as well as the other important issues with which UNCTAD IV will be concerned.

Commodities

We expect that the commodities issue will be one of the most important issues at UNCTAD IV.

It's difficult to predict precisely what the developing countries really want, but if we look at the Manila declaration formulated last February and the UNCTAD Secretariat's documentation for UNCTAD IV, I think we can get a pretty good idea. It would appear that they are seeking endorsement of a so-called integrated program—a series of simultaneously negotiated commodity agreements which would use buffer stocks as a price regulating mechanism. The buffer stocks would be financed by a "common fund," which would at the outset command about $3 billion in resources, with $1 billion from governments, of which UNCTAD suggests roughly 10 percent be contributed by the United States. In addition, the LDC's want prices of their raw materials to be indexed to the prices of manufactured goods, they want the availability and concessionality of compensatory finance improved, and they are anxious to improve their access to developed country markets for raw materials and processed and semiprocessed goods.

The most controversial aspect of the UNCTAD commodity program is the integrated program and its central mechanism, the common fund. The UNCTAD Secretariat and many developing countries appear to be seeking at UNCTAD IV an agreement with the developed countries to—

> Hold a series of individual commodity negotiations between producers and consumers which would lead to commodity agreements for those commodities. At a minimum UNCTAD would hope to get such negotiations underway for a "core" of 10 products, including cocoa, copper, cotton, hard fibers, iron ore, jute, rubber, sugar, tea, tin.
>
> Agree in principle to the creation of a common fund and establish a negotiating conference to determine the precise structure and modalities of such a fund.

The common fund is the glue which holds the integrated program together. It is intended to be more than a buffer stock financing mechanism. UNCTAD hopes that such an institution would actively perform the role of a catalytic agent to prod producers and consumers to agree on specific commodity agreements. UNCTAD envisages that producers in particular would be stimulated by the availability of funding for buffer stocks to overcome their own differences and push hard for an agreement.

The United States has made clear in the past that we cannot endorse this aspect of the UNCTAD approach to commodity problems, and we will do so again at UNCTAD IV. We do not believe that a generalized commitment can be made to form commodity agreements, particularly agreements based on a specific market intervention mechanism such as a buffer stock. We believe that each commodity has its own unique characteristics of production, transport, storability, marketing, and consumption, and thus that commodity problems can only be dealt with on a case-by-case basis.

We will also not support the concept of a common fund for buffer stocks, particularly as a new independent international institution which would play an activist role in attempting to form agreements for individual commodities. While we generally believe buffer stocks to be a price stabilization technique that is preferable to alternative market intervention devices such as export controls, which may build rigidities into the market, the applicability of buffer stocks must be determined only on a case-by-case basis. We have carefully reviewed the 10 commodities which UNCTAD has proposed as the core of its integrated program and we are skeptical of the viability or utility of buffer stocks as a stabilizing tool for most of those products.

We also believe that the appropriate method and sources of financing to support the mechanisms of a commodity agreement must vary with the circumstances of each commodity. These methods might include such techniques as commercial borrowing, direct contributions by participants, export taxes, or loans from existing international institutions. If there is sufficient consensus among major producers and consumers of a given commodity that an agreement is necessary, and agreement is also reached that a buffer stock is the appropriate technique to stabilize prices for that commodity, we are willing to support a variety of different avenues of financing the stock; but although we cannot support aspects of the integrated program nor the common fund, we do believe that a positive approach to commodity problems is needed. It's for this reason that over the past year and a half we have conducted an intense review of U.S. commodity policy. We created an interagency Commodity Policy Coordinating Committee, reporting directly to the Economic Policy Board and the National Security Council, to undertake this task. Through this mechanism, the United States has reviewed the UNCTAD proposals and formulated our own comprehensive approach.

In this review, we have found that we could support a number of the objectives the UNCTAD program is intended to achieve. These would include a reduction in excessive fluctuations in prices and supplies; the expansion of efficient processing of primary commodities and diversification of productive capacity in developing countries; increased stability in developing countries' export earnings; and a lowering of trade barriers against processed and semiprocessed forms of raw materials.

We believe the best means to accomplish these goals, however, are different from the UNCTAD approach. It is our firm conviction that the market mechanism is on the whole the most efficient method of assuring that supply and demand of commodities are kept in balance in a dynamic world. Although markets do not always operate efficiently, the appropriate remedy is to strengthen their functioning, not intervene or further impede market operations.

At UNCTAD IV the United States will stress its own proposals in the commodity field:

- We believe that the most fundamental solution to problems of wide swings in export earnings as a result of changes in prices and demand for commodities is to be found in compensatory finance. The recent reform of the IMF compensatory finance facility, in line with U.S. recommendations at the Seventh Special Session, provides very substantial additional balance of payments support to those developing countries that experience fluctuations in their export earnings, while avoiding direct intervention in commodity markets. We have also proposed to broaden the proposed trust fund to include additional compensatory financing to developing countries that are particularly dependent on commodity exports, where there is a balance of payments need. A decision on this proposal depends on the creation of the trust fund and some experience with its operations.
- Commodity problems should be analyzed on a case-by-case basis in forums composed of interested producers and consumers. Where specific problems are identified, we will examine proposed solutions and make suggestions of our own. Those proposed solutions may range from research and development measures to promote consumption and improve market distribution systems and production efficiency, to the creation of buffer stocks to stabilize prices and enhance supply security. In most cases, we believe that commodity problems will best be solved through strengthening the market mechanism, not by circumventing or thwarting it.
- We support the creation of producer-consumer groups for all major traded commodities where these do not now exist. We will seriously study specific commodity problems in such forums in order to improve the operation of markets in those commodities. We are moving toward such a forum for copper and we are willing to look at others such as bauxite or iron ore.
- We continue to be concerned that the investment climate in many developing countries may result in discouraging needed investment altogether or in forcing investment in less productive but safer locations in developed countries. We have

urged that the World Bank group increase its role in raw materials investment by combining its resources and technical expertise with those of the private sector. We are also discussing the possibility of proposing the creation of a new investment institution which could be associated with the World Bank to promote such investment.

In this way, we believe the United States has a positive, comprehensive, and workable program to deal with commodity issues. We believe the solutions we propose meet the real needs of the developing countries. We hope that all participants in UNCTAD IV will maintain a constructive and realistic attitude in the commodity discussions, and that agreement will be reached on a realistic, viable program for further action in this field.

Development issues

Aside from commodity issues, the other major concern at UNCTAD IV will involve problems of developing country finance, particularly debt. Before discussing this issue in depth, however, I would like to make some observations on development issues in general, as debt is only one aspect of the larger question of how developing countries obtain the external resources they need for development purposes. Development is a process requiring the infusion of capital, technology, and management skills on a sustained and substantial scale. While we believe that the developing country itself is the main source for most of these resources and must therefore make the effort necessary to hold down present consumption in the interest of higher living standards in the future, international support is also indispensable.

At UNCTAD IV, the most sensitive issue related to the general question of aid flows is expected to be the demand by developing countries that the industrial countries increase their concessionary aid flows in order to achieve the so-called U.N. second development decade target of 0.7 percent of GNP. This compares with actual aid flows from industrial countries of 0.33 percent of GNP in 1974, the latest year for which such data are available.

The United States supports a substantial increase in such flows to the developing countries and has been increasing its own development assistance. We do not, however, support the 0.7 percent target—which is clearly unrealistic for the United States—since it would require over $11 billion annually in bilateral aid as compared with the $3.4 billion (0.25 percent of GNP) provided in 1974. A number of DAC (Development Assistance Committee) countries have accepted the target in principle but only seven have committed themselves to achieve the target by 1980. Sweden actually achieved 0.7 percent in 1974—the first DAC country to do so.

Concessionary aid flows are important for development of poorer countries but not as important for the other developing countries as export promotion and other types of capital flows. For this reason, the United States made a number of initiatives at the U.N. Seventh Special Session last fall in the areas of capital market access, transfer of technology, and direct investment.

Private capital markets are already a major source of development funds, either directly or through intermediaries. The World Bank and regional development banks borrow extensively to lend to developing countries. We have requests before Congress or will soon be making requests to expand the callable capital of several of these institutions. As you know, such capital serves to guarantee IFI borrowings in the private markets.

The more successful developing countries are the ones that rely heavily on borrowing in private capital markets. It is estimated that the developing countries borrowed roughly $10 billion from private sector sources in 1975, mainly in the form of commercial bank lending. The United States has, therefore—

Contributed actively to the work of the IMF/IBRD Development Committee to explore ways to improve access for developing countries.

Supported a major expansion of the resources of the IFC (International Finance Corporation)—the World Bank affiliated investment broker with the widest experience in supporting private enterprise in developing countries.

Proposed creation of an "international investment trust" to mobilize portfolio capital for investment in local enterprises.

Reviewed our own conditions for LDC access to our capital markets and developed a technical assistance program within AID to facilitate LDC knowledge of and access to the U.S. capital market.

The other two areas of concern—transfer of technology and private investment—are closely related. Technology is vital to development, and international transfer of technology to the developing countries is necessary in view of the cost and skills required to develop it. Private investment is an important source of technology as well as a source of managerial talent and capital.

Among the initiatives we have supported in these areas are—

An international industrialization institute, to sponsor and conduct research on industrial technology.

An international center for the exchange of technological information.

Voluntary and nonbinding guidelines for technology transfer to guide governments and enterprises in this area, including the element of restrictive business practices.

A voluntary and nonbinding code of conduct for multinational corporations to improve the understanding of all parties regarding their mutual obligations.

We believe that the United States is in a position to play a very forthcoming and constructive role at UNCTAD IV in these three areas vital to the development of developing countries—capital market access, technology, and investment.

The financing difficulties of developing countries

Having briefly covered general development issues, including the various proposals the United States has made to deal with the development needs of the developing countries, let me turn to the finance question in greater detail, with particular attention to debt. UNCTAD IV comes at a period after the non-oil-exporting developing countries have experienced 2 years of abnormally large balance of payments deficits as the result of increased oil prices, the accompanying recession in the industrial countries, and worldwide inflation. Deficits on current account, which had averaged $9 billion annually in the early 1970's, jumped to $28 billion in 1974 and an estimated $35–$37 billion in 1975. These increased deficits have been largely financed by borrowings which of course will increase debt service payments in future years.

Because of these circumstances, many of the developing countries have focused all their attention on debt, whereas we believe that the primary issue is really the balance of payments. In this regard, we believe that the balance of payments situation for the developing countries as a whole is beginning to improve. We project that the aggregate deficit of the nonoil developing countries will decline by perhaps $5 billion in 1976, and that as a result new external borrowing will also decline.

Projections of debt-servicing prospects are difficult, particularly in view of the wide diversity of debt situations and the fact that the capacity of individual countries to respond to debt problems varies widely. It should be noted that a relatively small number of countries account for the bulk of the debt and, in particular, of the borrowings on commercial terms. Furthermore, the poorer developing countries most affected by recent economic events cannot resort to private market borrowings to offset the higher prices of oil and other imports and have to depend upon concessional capital. In view of low interest rates and grace periods, such capital has a limited impact on debt servicing, particularly in the short run.

Debt servicing is only one of the elements of the balance of payments problems, but of course any sustained deterioration in a country's balance of payments position makes debt service more difficult. It is encouraging, therefore, that improvement in the current account positions of developing countries is anticipated as the pace of recovery quickens in the industrial world and commodity exports and prices increase. Despite this, many countries see no way to finance their desired development programs without substantial further borrowings over the next several years.

This situation has led the developing countries, with the strong backing of the UNCTAD Secretariat, to set forth a number of sweeping proposals to alleviate their internal debt situation. These proposals are based on the premise that debt rescheduling would provide fast-acting relief for their balance of payments situation and supplement what they consider to be inadequate flows of development assistance. The proposals include:

- For public development credits—waiving debt service payments by the most seriously affected countries for the remainder of the decade; and converting such credits to grants for the least developed countries.
- For private credits—an international fund to refinance service payments over a period of 15–25 years at commercial rates of interest.
- In addition—a conference of major developed creditors and interested debtor countries to be convened in 1976 under UNCTAD auspices; a shift in the forum and chairmanship for debt rescheduling from the traditional creditor club arrangements to the IMF.

The United States is deeply sympathetic with the balance of payments position of the nonoil developing countries and, together with other creditor countries, has taken a number of steps to make available funds supplemental to normal aid flows to meet the financial strain of the developing countries erected by the oil price increase and the onset of worldwide recession. The United States will continue its efforts, in cooperation with other creditor nations, to increase and direct aid flows to those countries in greatest need and to improve the access of developing countries to private capital markets. However, we cannot agree to proposals for generalized debt relief, debt moratorium, and new institutions for refinancing commercial debt and the like for a number of reasons:

The proposals assume there is a debt problem per se for all nonoil developing countries; we believe that focusing on debt alone obscures the overall balance of payments situation, which for many countries is improving.

The proposals assume that all nonoil developing countries or groups of nonoil developing countries are encountering extreme problems in meeting their debt service payments; we believe that debt service problems are limited to very few countries.

The proposals assume that financing through debt rescheduling should be based on the amount of past debt or debt service payments incurred. We believe finance needs must be evaluated on a case-by-case basis, taking into account a country's present circumstances and future prospects.

The proposals assume that commercial credit can be rolled over for extended periods of time; we believe that commercial institutions cannot be relied upon to provide increasing amounts of private capital if the ultimate timing of repayment is continually subject to question.

They assume that proposals for debt relief can be undertaken without any adverse effects on developing country creditworthiness and new capital flows; we believe rescheduling adversely affects developing countries' creditworthiness and new capital flows.

In short, we believe that adoption of these proposals could lead to a severe deterioration in international credit relationships. We strongly believe that these proposals are not in the best interest of the debtor countries because they will destroy their creditworthiness and the ability to borrow from public and private sources in the future.

With regard to institutional arrangements for debt rescheduling, the United States is willing to recommend that the IMF play a greater role analyzing technical issues related to rescheduling exercises than it has in the past. That would be in addition to its traditional task of negotiating standby agreements that give the creditors some assurance that the country requesting debt rescheduling will follow policies that will turn its economic situation around.

However, we firmly believe that actual negotiations to reschedule a country's external debts should remain in the creditor club context. A debt rescheduling is a very delicate process. Debtors want a lenient rescheduling; creditors wish to be repaid as soon as possible. To shift the forum and chair from the creditor club arrangements—which has served both debtor and creditor countries well over the years through a series of extremely difficult debt rescheduling exercises—to the IMF would expose the IMF to the conflicting views of debtor and creditor countries and thereby threaten to undermine the basis of its neutrality which is of paramount importance to the continued success of the Fund. It could also lead to pressures to reschedule IMF drawings, thereby undermining the monetary character of the Fund.

We have recently appraised the nature and extent of the external debt situation of the developing countries, and have found the external debt situation of the great majority of nonoil developing countries to be manageable. The details of these findings were contained in our "Report on Developing Countries External Debt Relief Provided by the United States," submitted by Secretary Simon to this committee on January 30, 1976. Since the report was prepared, the economic situation in several of the countries has improved. Thus, for example, some countries such as Bolivia, Peru, and Uruguay now appear in a more favorable light, due to the rise in economic activity of OECD countries and higher commodity and metal prices. Countries such as Chile and Zambia, which rely heavily on copper exports for foreign exchange earnings, now face a somewhat more manageable situation, as the price of copper has risen from 55 cents a pound in early January of this year to close to 70 cents. As for countries such as Brazil and Mexico, which the report noted have large private sector debts but also have productive and diversified economies, the anticipated strong pickup in their exports to developed countries reinforces our earlier conclusion that they will be able to finance their projected deficits and avoid debt-servicing difficulties in 1976.

As for the most seriously affected (MSA) countries, it is significant to note that two MSA's, India and Pakistan, account for over one-half of the debt service of all MSA's. It is our perception that the economies of both India and Pakistan are performing much better than most people realize.

For example, India is expected to attain a real growth rate on the order of 5 to 6 percent this year and next, and its trade deficit should narrow somewhat next year. India's international reserves have increased from $1.4 billion in December 1975 to over $2 billion in March. This amount is sufficient to cover about 5 months' imports which is quite good for a developing country. Pakistan's growth rate is also projected at about 5 percent, its reserves are sufficient to cover almost 3 months' imports, and Pakistan will continue to benefit through at least 1978 from the debt rescheduling arrangement of 1974.

As for the other MSA's, the picture is mixed. Some countries such as Bangladesh have contracted large amounts of external debt mainly from multilateral and bilateral institutions. Since most of these credits carry extremely low interest rates, the actual debt service payments falling due this year and next are relatively small.

To conclude, U.S. policy has been, and will continue to be, to extend credit on the explicit understanding that it will be repaid according to the schedule agreed upon by the borrower at the time the credit is authorized and signed. The United States does not consider general debt relief to be appropriate for providing official economic assistance to the developing countries.

Our policy on debt rescheduling is to evaluate the merits of each debt reorganization proposal on a case-by-case basis, predicated on the principle of basic adherence to scheduled terms of credit payment. Within this framework, our objective is to encourage countries to undertake appropriate corrective policies in order to minimize the incidence of debt rescheduling and relief operations.

Monetary issues

In view of the comprehensive monetary reform package that was agreed at Jamaica, I would not anticipate extended debate on longstanding proposals by developing countries to restructure the monetary system or an effort to reopen a settled agreement. While some may feel that the reforms do not go far enough, I believe that most recognize that the package as a whole—involving important amendments to the IMF Articles of Agreement, quota increases, and expansion of access to IMF resources—achieves the desired balance and provides substantial benefits for all countries. Without attempting to comment in depth on all the complex provisions of the agreement, I would like to note the most significant elements.

The new more flexible *exchange arrangements* focus on achieving the underlying economic stability that is a prerequisite for true exchange rate stability. Countries are given wide latitude in choosing those particular exchange rate practices best suited to their own needs so long as they fulfill certain obligations calling for, among other things, the promotion of stable underlying economic conditions and nonmanipulation of exchange rates to gain unfair competitive advantage. Past efforts to mandate stability by requiring maintenance of fixed rates provided only the appearance of stability and often required extensive controls and restrictions to sustain them. Such measures disrupted development efforts by impeding trade, limiting investment flows, and forcing cutbacks in aid.

Concrete steps have been initiated to phase *gold* out of a central role in the monetary system. The IMF Articles will be amended to eliminate any important monetary role for gold in the Fund and to provide for the future disposition of IMF gold holdings. In addition, the IMF will begin disposal, under existing authority, of 50 million ounces of gold owned by the Fund (about one-third of its total holdings), 25 million ounces to be sold for the benefit of developing countries—I already mentioned the trust fund—and 25 million ounces to be sold to IMF members in proportion to quotas. The developing countries will clearly obtain substantial benefits from these steps, including the major share of the benefits from the agreed Fund gold sales. I am aware of some concerns of developing countries that abolition of the official price might result in a strengthened role for gold and in increases in liquidity primarily for developed countries. I do not believe these concerns are warranted. The comprehensive actions being taken genuinely place gold on a one-way street out of the monetary system.

The *special drawing right* (*SDR*) will be made a more usable asset under the amendments, thereby increasing its potential to become the principal reserve asset in the system, a long-sought objective of the developing countries. Proposals for an SDR-aid link were dropped from the monetary negotiations at an early stage of the Interim Committee discussions, and the United States will continue to oppose an SDR-aid link should the proposals resurface in UNCTAD. The link would be an inappropriate means of providing aid and is inconsistent with the monetary functions of the SDR.

In addition to amendments, IMF *quotas* will be increased by about one-third, thus ensuring that the Fund is in a position to meet members' future financing needs. The quota share, and thus the voting share, of developing countries has also been increased, thereby enhancing their voice in IMF decisionmaking.

Monetary issues raised at UNCTAD IV may be introduced in the context of the effort to find international financing to meet the balance of payments problems of developing countries. Thus there may be efforts to use the IMF for this purpose.

The Fund is the sole international institution with responsibility for promoting the needed economic adjustments that represent the only lasting solution to a country's payments difficulties. The importance of IMF financing therefore transcends the actual amounts involved, crucial as they may often be, because it is closely linked to adoption of economic policies designed to correct the underlying cause of countries' problems.

The IMF has greatly expanded access to its resources to help meet the enlarged balance of payments financing needs of its members in the present period. In the past year, developing countries have borrowed nearly $2 1/2 billion from the IMF, nearly four times the peak annual drawings prior to the oil price rise. And, with agreement on a comprehensive monetary package in Jamaica in January, the Fund's capacity to deal with members' payments problems has been strengthened importantly.

A *trust fund* managed by the IMF as trustee will be established and begin operations in the very near future to provide balance of payments support on concessional terms for the poorest countries. Resources will be obtained by utilizing part of the gold owned by the IMF, through market sales over a 4-year period. Thus an asset which has not been used in recent years will be mobilized to assist needy countries in meeting their current balance of payments difficulties. Other financial contributions to the trust fund will be welcomed.

A major liberalization of the IMF *compensatory financing facility* has been implemented that will be especially useful in dealing with payments problems in this period of recession-induced falloff in export earnings. It is noteworthy that in the first quarter of this year, the liberalized facility has already provided nearly $500 million in loans, an amount that is more than 40 percent above the previous peak annual level of loans.

Access to the IMF's *regular credit facilities* has been temporarily expanded by 45 percent, pending implementation of the agreed increase in quotas.

The IMF *buffer stock facility* has also been liberalized.

These measures represent a vigorous effort by the IMF to help its members, developed and developing, to deal with their immediate financing problems. They also represent a reasoned response, and we do not feel it is desirable, indeed possible, for the IMF to attempt to do more. It is clear that the IMF cannot meet all the financing needs of the developing countries and that its design, as a monetary institution, is inappropriate to meeting development financing requirements. The resources available to the IMF are finite, and steps to increase access further could seriously impair the Fund's liquidity, to the detriment of developed and developing countries alike.

A major strength of the IMF, and the basis of its international prestige and support, is its unique monetary character. The private markets frequently rely on the Fund's "discipline" to ensure that countries experiencing balance of payments problems adopt the sound domestic policies that are the essential prerequisites for maintenance of creditworthiness. The policy conditions applied by the IMF thus provide an important safeguard for private lenders in that they know IMF involvement will entail the adoption of policies by borrowers that will strengthen their external positions and enable them to repay their loans. Should the market's perception of this role for the IMF be weakened by an erosion of IMF conditionality, it is quite possible that a resulting reduction in private credit availability would more than offset any potential increase in IMF financing. This is one of the basic reasons why we cannot support a further allocation of SDR's according to the principle of an SDR-aid link. A further weakening of conditionality would seriously disrupt the flow of private credit to the developing countries, and make achievement of their development objectives even more difficult.

Trade

Although noncommodity trade issues will not be a central theme at UNCTAD IV, some developing countries may seek greater commitments from the developed countries on special and differential treatment in the multilateral trade negotiations and for improvements on the various systems of tariff preferences now in existence.

The developing countries are impatient over progress in the MTN, and have argued that little progress has been made toward granting them the kind of special trade treatment suggested in the Tokyo Declaration of 1973, which launched the current negotiations in Geneva. They are particularly interested in being exempted from limitations on the use of export subsidies and in receiving special treatment or exemptions in safeguard actions such as the recent U.S. escape clause actions on specialty steel and footwear. They are interested in rapid action on the tropical products negotiations in Geneva.

We are sympathetic with interests of developing countries in securing additional benefits for their international trade, in increasing their foreign exchange earnings, diversifying their exports, and accelerating the growth of their trade. The MTN will provide great benefits to the developing countries. The tariff-cutting formula we have introduced will help the LDC's by increasing their general access to the U.S. market, and by reducing the degree of tariff escalation on semiprocessed and processed products. The United States has made a sound proposal in the tropical products negotiations, and we too hope for rapid progress. We do believe that some kind of special and differential treatment for developing countries will prove feasible in certain areas of the MTN such as negotiation of general rules on subsidies and countervailing. However, we believe that the issue of special and differential treatment for developing countries can only be dealt with in the context of particular codes on other specific areas being negotiated, and cannot be moved at a faster pace than the discussions on these issues.

We will also stress at UNCTAD IV, as we have in the MTN, that the developing countries themselves can and must make contributions to the MTN, consistent with their levels of development. This issue of supply access is a case in point. Furthermore, we believe that special treatment for developing countries must be linked with a phaseout mechanism, so that as a developing country becomes more advanced and competitive on the world market, its special treatment will be phased out and it will begin to assume the same responsibilities as other developed members of the world trade community.

As for generalized systems of preferences, the developing countries would like to see these systems made a permanent part of the world trading system and considerably liberalized. We believe that as preferences are unilateral voluntary actions by the developed countries, they are not subject to negotiations, either in UNCTAD or at the MTN. We believe the new U.S. system is a good one, and as we gain experience with it we will examine possibilities of improving it. While we will certainly listen to the suggestions of others as to what improvements might be useful, actual decisions are strictly an internal U.S. Government affair.

Conclusion

I hope that my testimony has made clear that the U.S. Government has expended a great deal of effort in carefully analyzing the problems identified by UNCTAD and the solutions proposed by the Secretariat and by developing countries. It should be clear that we believe that today's world calls for cooperation among countries. In that regard we feel that we can agree with much of the articulation of the problems and long-range goals identified by UNCTAD and the developing countries. There are differences of opinion with respect to the solutions to these problems. We will not reject any proposed solutions out of hand, but explain why we do not believe certain approaches would be in the interest of the world. Further we have developed proposals of our own which we believe will accomplish the same objectives more effectively. It will be our task at Nairobi to lay these various proposals on the table and begin the process of arriving at a consensus on where to go next. If 1976 can be characterized as a year of dialog, perhaps the work accomplished over the next months will make 1977 the year of consensus.

Exhibit 41.—Statement by Deputy Assistant Secretary Vastine, May 19, 1976, at joint hearings of the Senate Committees on Armed Services, Commerce, and Foreign Relations, on S. 713, the Deep Seabed Hard Minerals Act

The Treasury Department welcomes this opportunity to discuss with you S. 713, the Deep Seabed Hard Minerals Act and its relation to the Law of the Sea negotiations.

The Deep Seabed Hard Minerals Act seeks to encourage the development of the hard mineral resources of the deep seabed, pending adoption of an international seabed regime pursuant to treaty. Before such legislative proposals are acted on, we believe their impact on the following factors must be carefully weighed: (1) The Law of the Sea negotiations, (2) the precedent that this legislation could create for treatment of investment in other sectors of the economy, and (3) the financial obligations it would create for the Federal Government if present negotiations fail.

The bill contains five major provisions: (1) A system for licensing eligible firms that intend to develop mineral resources in the deep seabed, (2) a system of rules and regulations governing eligibility and operations in the seabed and licensing procedures, (3) minimum annual expenditures by firms engaged in exploration and development of resources until commercial recovery begins, (4) U.S. Government guarantees for reduction in value of firms' investments because of a future international agreement, and (5) insurance against damages to a firm's investment for which it has no legal remedy. Treasury is interested in all of these provisions; the first three would affect access to the seabed and the performance of firms which are developing the seabed resources, and the last two could affect the competitive relationship between land-based and seabed minerals and could involve costly Government funding of guarantee and insurance programs. The Department would be directly responsible for maintaining the guaranty and insurance fund, created in section 15. Treasury is also concerned about the customs and tax provisions contained in the legislation.

Treasury concerns

The Department supports the principle that regulations are necessary to ensure orderly access to seabed resources by mining firms. These principles would be embodied in a successfully negotiated Law of the Sea treaty. However, we cannot support S. 713 because it goes far beyond these principles with its guarantee and insurance program, and because now is not the time to install a regulatory licensing and potentially costly guarantee system.

We also believe that the use of investment insurance and guaranty programs could establish an important policy precedent whereby U.S. firms expect the U.S. Government itself to protect them from unforeseen political and institutional changes that affect their operations.

The time is indeed approaching when some firms command the technology to explore and develop seabed mineral resources on a commercial basis. We understand that these firms are concerned about the commercial and political risks of such exploitation. Nonetheless, we believe that these risks can best be addressed through an appropriate and timely international treaty rather than through domestic action by individual countries. And we are determined that no provision of such a treaty will effectively inhibit development of mineral supplies. Treasury is strongly committed to ensuring that new supplies of raw materials come on stream during future decades to meet market demand and to avoid disrupting shortages.

The Federal Government has pursued a policy of equitable treatment of mineral industries, except for the special case of energy. Treasury believes there is no need to change that policy at this time and give special incentives to a limited segment of the nonfuel minerals industry. We depend upon the market to allocate capital resources efficiently. In some cases the market mechanism is frustrated from performing its role. This occurs when threats of expropriation, or adverse political climates in some countries, deter investments that would otherwise be made. We have relied upon general, not selective solutions to this problem. The Overseas Private Investment Corporation is our basic Government insurance program against political risks. It operates virtually worldwide and covers almost all types of investments. And Secretary Kissinger recently proposed at UNCTAD IV a new investment-facilitating mechanism, called the International Resources Bank, which would help reduce political risks of direct foreign investments in all types of mineral and energy projects.

In the case of investment in seabed mining we recognize that there are now substantial commercial and political inhibitions against private investment. We believe these inhibitions should be removed, but that the vehicle for removal should be a Law of the Sea treaty which provides a secure economic and political environment to promote investment which is also consistent with sound environmental practices. Treasury is strongly committed to obtaining a treaty which does provide an environment for successful mining operations. If that treaty is successfully negotiated this year, there will be no need for many of the provisions in S. 713.

If a treaty is not successfully negotiated, we can then consider appropriate action to protect our national interests.

Law of the Sea negotiations

During the last session of Law of the Sea negotiations, I participated in the interagency discussions to obtain an acceptable U.S. position on various deep seabed issues. Some issues are successfully resolved in the single negotiating text but several issues remain for resolution during the intersessional period and at the next session of the Conference in order to secure our economic interests. Proposals for legislation now could affect the momentum of the negotiations, impair the spirit of compromise which we have tried for such a long period to build, and erode the gains that indeed have been made for the U.S. national interest in all three committees of the Law of the Sea Conference.

Secretary Simon has personally followed the developments in these negotiations. If at the end of the summer session their results do not meet U.S. objectives, I can assure you that he will immediately recommend that the administration review its policy and recommend appropriate action to protect these objectives.

Meanwhile the Treasury will continue to monitor the relationship between the negotiations and the uncertainty which now affects investments in seabed mining activity. It is important that the United States pursue policies in the negotiations that preserve our basic commitment to the market as an efficient allocator of resources in minerals development and exploitation. In the long run, provisions that would likely lead to an inefficient allocation of resources and any provisions that would deter the development of seabed resources would benefit no one. They would lead to unnecessarily high prices for the American consumer and to inefficient industrial production, thus retarding economic growth in both industrial and developing countries. The administration believes that the United States must, in the forthcoming negotiations, maintain its determination to resist efforts to restrict access to the seabed or to impose restrictive controls on levels of production of its mineral resources.

U.S. objectives in seabed negotiations

We are determined to obtain certain key objectives in the seabed negotiation. In brief, these are:

A voting system in the Council which adequately reflects the economic interest of producers and consumers of the deep seabed minerals.—In his major address on Law of the Sea issues in April, Secretary Kissinger expressed a policy which has been very strongly supported by the Treasury: He said that the United States was dissatisfied with the previous proposal for the Council voting system, and that "voting machinery must be balanced, and equitable, and must insure that the relative economic interests of countries with activities in the deep seabeds be protected, even though these countries may be a numerical minority." This is now the most important unresolved issue in the deep seabed negotiations.

Open, unobstructed access to deep ocean resources.—A cardinal tenet of the U.S. position has been to insist on nondiscriminatory guaranteed access, with security of tenure, for U.S. and other national firms. In his April speech, Secretary Kissinger emphasized this point when he said, "What the United States cannot accept is that the right of access to seabed minerals be given exclusively to an international authority, or be so severely restricted as effectively to deny access to the firms of any individual nation including our own." The authority should not have any discretionary power with respect to the issuance of contracts, nor should it have the power to deny contracts for political ends. Therefore, we are inalterably opposed to attempts to impose a system which would arbitrarily restrict U.S. access to the seabed, or which would arbitrarily limit the number of sites that firms of any one signatory can exploit. Such attempts appear to be merely an effort by other industrial countries to constrain the U.S. competitive edge in seabed technology and activity.

There are certain other proposals with which we are deeply concerned:

Price and production controls.—Treasury continues to oppose price and production controls that would effectively inhibit development of supplies of seabed minerals. We intend to give continuing close attention to this issue during the remainder of the negotiations.

Revenue sharing with the authority.—The United States can accept revenue sharing with the international authority. However, we are opposed to an onerous burden of payments that would impede deep seabed mining activity.

The enterprise.—The United States has agreed to the creation of an operating arm of the authority, the "enterprise," which can exploit the deep seabeds under the same conditions that would apply to all mining. At issue is how the enterprise will be financed, especially during the initial period. Mandatory contributions on the part of States parties would be an unreasonable burden on the U.S. taxpayers.

Throughout the coming months constant congressional consultations are essential. If both branches work closely together, the United States will be in a better position to negotiate an acceptable treaty, or if necessary, it will be in a better position to take appropriate action to preserve U.S. economic interests in deep-sea mining.

Problems in S. 713

I would like to record some of the Treasury's difficulties with the substance of S. 713.

Our greatest concern is with the potential liability with which the U.S. Government would be faced pursuant to the guarantee and the investment provisions of this bill. No one knows accurately how much investment will be committed by U.S. firms, though there are estimates of several billion dollars for which the United States under the bill could be liable. Neither does anyone know the probability of, or the potential extent of, damages that could occur under section 14.

The provisions for investment guarantees, in section 13, could compromise the U.S. Government's ability to negotiate freely a satisfactory treaty. For example, we may feel it imperative to negotiate a particular economic provision in the treaty, but this same provision could also make the Federal Government liable to claims under the act. The existence of such claims could prevent U.S. agreement to the treaty provision even though all might agree that it is in the best interest of the United States.

We are seriously concerned about the effects of both the guarantee and insurance provisions on the behavior of foreign-based firms and foreign governments. The bill could create a meaningful incentive for foreign firms to set up U.S. subsidiaries simply in order to qualify for potential benefits under U.S. law. Foreign governments, in response to the U.S. initiative, could respond with similar schemes to prevent the loss of prestige and financial benefits associated with pioneering efforts in seabed mining. Thus, by this bill, the United States could initiate an increase of foreign competition with U.S. firms and a possible influx of foreign seabed miners that would have to be regulated, at cost to the United States. The United States has recently been involved in discussions with other industrial nations to limit competitive programs that promote exports through subsidies. It would be ironic, and highly inappropriate, to create another such competition among governments in a new field.

Treasury is greatly concerned about the enactment of any legislation that would establish more than the minimum degree of regulation necessary for deep seabed mining. We believe that further study of the regulatory issues raised by S. 713 is required.

Treasury has objections to the tax and customs provisions contained in the bill. We believe that the customs provisions are difficult to enforce. Moreover, they place traditional Customs Service duties within the Department of the Interior.

We are also concerned about the tax provisions of S. 713. Treating deep-sea recovery as though it were recovery within the United States, as in section 16, does nothing to settle the basic question of whether deep-sea minerals are eligible for the depletion allowance. This is because in order to claim the depletion allowance, the claimant must have an economic interest in the minerals in place. The bill does not confer this interest. Conferring access to seabed resources for purposes of exploitation does not confer an economic interest in the conventional sense.

Because of these important shortcomings and objections, we believe more study of this legislation is required. The administration will consult closely with Congress. After the next session of the Law of the Sea Conference, this summer, we will be in a better position to make the appropriate recommendations.

Mr. Chairman, you requested that we address a number of more detailed questions. Our responses to those questions are attached, which we will be pleased to submit for the record.[1]

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[1]For questions and answers, see full text of statement published in joint hearings, 94th Congress, 1st Session, May 19, 1976, pp. 101-103.

Exhibit 42.—Excerpt of joint statement by Secretary Simon and Minister of Finance Kisiel on the occasion of the Secretary's visit to the Polish People's Republic, June 22–23, 1976, issued by the U.S. Embassy in Warsaw

At the invitation of the Minister of Finance of the Polish People's Republic, Henryk Kisiel, the Secretary of the Treasury of the United States, William E. Simon, and Mrs. Simon visited the Polish People's Republic on June 22–23, 1976.

*   *   *   *   *   *   *

* * * The talks covered economic, financial, and trade issues of mutual interest, with particular attention given to ways of broadening the economic and commercial relationships between the two countries.

During the visit, Secretary Simon and Minister Kisiel participated in the exchange of instruments of ratification of the convention on the avoidance of double taxation. The two officials declared that the convention should facilitate the expansion of bilateral economic relations and contribute to strengthening them.

The Secretary's talks and meetings with First Secretary E. Gierek, Chairman of the Council of Ministers P. Jaroszewicz, and representatives of the Government of the Polish People's Republic were held in a friendly and businesslike atmosphere, and were characterized by a mutual desire to expand and strengthen economic cooperation between the United States and Poland.

Both sides noted with satisfaction the growth in bilateral trade, which reached a level of about $850 million in 1975, and agreed to further develop industrial, technological, and trade cooperation between the two countries. Both sides expressed the conviction that these would serve, among other goals, the achievement of $1 billion in trade turnover in 1976.

They also agreed that the work of the Polish-United States Economic Council, which held its second session in Washington on May 24–25, 1976, is contributing to the development of industrial, technological, and commercial cooperation between the two countries. Both sides expressed their encouragement for the further work of the Economic Council and for other forms of direct cooperation between the businessmen of both countries.

The U.S. side noted that the role of the Export-Import Bank in facilitating the development of trade through the extension of credits reflects a positive assessment by the U.S. Government of the further prospects for economic cooperation with Poland.

A broad and useful exchange of views took place on the subject of the various forms of economic cooperation, including more advanced forms of industrial cooperation. The importance of these for the intensification of economic relations between the two countries was emphasized, and a positive evaluation was given to progress in developing them.

Both sides exchanged information on the prospects for the economic development of both countries and discussed the projects in which the firms and investors of both sides might participate.

In concluding the visit to Poland, Secretary Simon and Minister Kisiel stated that the progress they had made in their discussions should permit a broadening of mutually profitable cooperation between the United States and Poland in the spirit of the understandings which emerged from the visit of the President of the United States, Gerald Ford, to Poland in 1975 and the First Secretary of the Central Committee of the United Polish Workers' Party, E. Gierek, to the United States in 1974.

Exhibit 43.—Excerpt of statement by Assistant Secretary Parsky, July 27, 1976, before the Senate Committee on Foreign Relations, regarding U.S. participation in the renegotiated international coffee and tin agreements and in the extended wheat agreement[1]

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U.S. participation in current commodity agreements

International agreements on coffee, wheat, and tin date back to 1962, 1949, and 1956, respectively. We have participated in the coffee and wheat agreements since their inception. We first signed the tin agreement this year. Our support for U.S. membership in the coffee and tin agreements is based on an extensive study during the last 18 months of our overall commodity policy and these 2 agreements in particular.

We are convinced that the provisions of these agreements are such that they will have no harmful impact on the market for these commodities. The coffee and tin agreements are aimed at short-term price stabilization, rather than the long-term fixing of prices above market levels. And the current wheat agreement serves largely as a forum for the exchange of information and coordination of food aid, rather than as a mechanism to intervene in the market.

I would like to discuss the provisions of these agreements in more detail as examples of commodity agreements structured in a way that is compatible with market conditions.

International Coffee Agreement

The original International Coffee Agreement (ICA) was negotiated in 1962 during a period in which world coffee stocks were large. Production had been in excess of consumption for several years. Coffee prices were below 20 cents a pound (as compared to 50 cents to over 90 cents during the early fifties). The Alliance for Progress was in full swing. Not surprisingly, the focus of the first agreement was on putting a floor under coffee prices while the market adjusted to new levels of supply and demand. Prices were reasonably stable over the remainder of the sixties, ranging from 35 to 45 cents a pound, and stocks were gradually drawn down. Then in 1969 a series of frosts and disease hit Brazil and prices rose sharply.

The ICA, which had been renegotiated with only minor changes in 1968, had functioned reasonably well when coffee was in surplus. The agreement proved unable to cope with the new situation of a tight market, however, and prices rose rapidly to over 50 cents a pound by 1972. The agreement may have actually helped raise prices in 1971–72 because it permitted exporters to continue to limit their exports during a period of short supply. With producers and consumers unable to reach agreement on a price range or quotas, economic provisions of the agreement were suspended in 1972. Prices continued to rise.

By early 1975 coffee prices were on the decline. As prices moved back into the 50-cent range, producers expressed a strong interest in negotiating a new ICA which would again have operative economic provisions. As part of the preparation for entering into such negotiations, an interagency analysis was undertaken of the old agreements. A consensus was reached that the United States should only join a new agreement which incorporated new consumer safeguards. A new agreement would have to clearly be designed to moderate short-term price fluctuations on the upside as well as the downside.

The old agreements used as their basic operative mechanism a set of country export quotas. Each year the International Coffee Council (ICO) set a price range with a median price which reflected current market conditions. A global quota for world coffee exports was set which was thought consistent with the median price. This global quota was distributed to member producer countries based on a percentage share which had been negotiated at the beginning of the agreement. During the coffee year, if prices moved by a predetermined amount above the median price, quotas would be uniformly enlarged by a preset percentage. If prices declined, quotas were tightened.

There were several problems from the consumer country point of view. The country quotas were inflexible and made it impossible for new, more efficient producers to enlarge their share of the market. There were no penalties against a country which did not announce that it would fall short of its quota so that other countries might have their quotas enlarged to fill the void. If prices began to rise rapidly, the mechanism to enlarge quotas was cumbersome and often involved a confrontation between producers and consumers. There was no mechanism to suspend the economic provisions automatically if prices broke through the price range ceiling.

In general we managed to obtain new consumer safeguards in the third ICO which remedy these shortcomings:

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[1] For excerpted material, see testimony to the committee, 94th Congress, 2d session. Available for reading in committee files only.

- The new agreement contains no specific price objectives, and will not operate in such a way as to sustain coffee prices above the long-term market trend.
- The agreement will begin with quotas suspended, so as to assure that during the current shortage period the agreement will not work to maintain high prices.
- When and if quotas come into effect, they can automatically be suspended by certain increases in prices.
- Individual country quotas are assigned on a flexible basis reflecting export performance prior to the imposition of quotas and on levels of stocks held by each country.
- When quotas are in effect, countries which cannot ship their quotas are obliged to notify the Council at least 6 months before the end of the coffee year, so that the export shares of other countries can be increased to cover the deficit, thus assuring that a certain level of supply will enter the market.
- A provision was added whereby after 3 years' operation, countries must affirm their intention to continue their membership for the final 3 years.

Although we believe the new ICA is improved in these aspects, it is by no means perfect. We would have liked a tougher penalty against countries which undership their quotas, whereas the new agreement simply obliges them to do so and provides them with a slightly larger quota the year following an announced shortfall. We would have preferred a penalty for undershipments rather than an inducement to ship.

More fundamentally, we continue to have strong reservations about commodity agreements based on export controls, which generally discriminate against new and efficient producers in favor of the status quo. However, in the case of coffee, a buffer stock system would be both complex, because of the different coffee grades and storage problems, and very expensive. A buffer stock of 10 million bags, equal to less than one-fifth of annual world trade, would cost $800 million with coffee prices at 60 cents a pound. By comparison, when prices took off in 1972, world stocks were around 40 million bags.

It is important to ask at what point economic provisions of the new agreement would come into effect. According to the formula, quotas would be reimposed when prices drop below the average level of 1975, or about 63 cents a pound, or when for 20 market days prices drop by 15 percent below the previous coffee year. The latter provision is operative only if prices are below a price 22.5 percent above the 1975 average, or about 77 cents a pound. We produced a series of price forecasts for coffee in order to ascertain when these conditions might be met. Even making conservative estimates on inflation over the next few years and assuming no new natural or political disruptions to coffee supplies, we concluded that prices will not fall below 77 cents a pound until the 1979–80 coffee year at the earliest.

One new feature of the new agreement which has raised questions is a provision for a coffee promotion fund. Producing countries will be assessed between 10 and 25 cents per exported bag of coffee (the rate depends on how large the exporter is). The approximately $15 million per year raised through the levy will be offered to consuming countries as matching funds for national coffee promotion programs. Countries will most likely obtain this revenue from current or new export taxes on coffee. The idea of taxing coffee exports to entice the consumer to drink more is somewhat disconcerting. However, if the whole tax were to be taken out of new export taxes, it would amount to between 0.07 and 0.1 cents a pound, as compared to current export taxes which are often in excess of 40 cents a pound. Furthermore, we have often encouraged producing countries to concentrate on increasing demand, rather than restricting supply.

An important feature of the new ICA is that any member which fails formally to reaffirm its continued adherence to the ICA after 3 years (by September 30, 1979) will cease to be a member. This will give our Government the opportunity to again review the situation in the coffee market before making such an affirmative declaration.

A final safeguard is the U.S. voting strength in the ICO. Producers and consumers each have 1,000 votes, with the United States holding 397 of the consumer votes. Major decisions by the ICO, such as setting quotas and a price range, or imposing economic provisions even when formula conditions are not met, must be taken with a two-thirds distributed vote. That is, at least two-thirds of the producer and consumer votes must be cast in favor of an action. Though the United States has well over one-third of the consumer votes and would therefore appear to have a veto, the agreement provides that no one country can block an action by the ICO.

To summarize, the new ICA is a better agreement than the previous ones. It has new consumer protections. Its economic provisions are unlikely to come into force until 1979–80 at the earliest. Before then, the U.S. Government will once again have to make a positive determination to stay in the agreement. The United States has near veto power over any ICO action. The risks in joining are thus slight, while the ICO does provide a useful forum for producers and consumers to discuss the world coffee market, and the ICO secretariat does a most professional job of gathering and distributing data on world coffee market conditions.

International Tin Agreement

The first International Tin Agreement (ITA) came into effect on July 1, 1956. The fifth International Tin Agreement came into effect on July 1, 1976, and for the first time the United States was a signatory. With U.S. participation, the ITA membership now comprises virtually all of the world's major consumers and approximately 90 percent of free world production.

The primary objectives of the ITA are to provide for an efficient adjustment between world production and world consumption of tin, and to prevent excessive fluctuations in tin prices. Efficient adjustment between production and consumption is facilitated by the ITA Statistics Committee's extensive data collection operation which reports quarterly on world tin production and consumption, trade, stocks, and other data important to both producers and consumers. The United States has for some time participated in meetings of the ITA Statistics Committee to report on trends of tin consumption in the United States.

To reduce excessive fluctuations in tin prices, the ITA utilizes a tin buffer stock which buys and sells tin on world markets. As opposed to the Coffee Agreement, the Tin Agreement relies primarily on a buffer stock, and secondarily on export quotas. The tin buffer stock is the only operating buffer stock.

The buffer stock manager operates with a three-tiered price range. When tin prices are in the lower tier of the range, he buys tin to support tin prices; when prices are in the middle tier, he stays out of the tin market; and when prices are in the upper tier, he sells tin to put downward pressure on prices. The price range is set by the International Tin Council, the operating body of the ITA. Producers and consumers each have 1,000 of the 2,000 votes in the ITC and the United States has 259 votes.

The tin in the buffer stock is contributed by producers whose contributions are mandatory and by consumers whose contributions are voluntary. Voluntary consumer contributions accounted for only a small fraction of the tin in the fourth ITA with France and the Netherlands being the only contributors. However, consumer voluntary contributions are expected to increase significantly in the fifth ITA because three additional countries, the United Kingdom, Canada, and Belgium, have already pledged contributions. * * *

We have informed the ITC that we do not intend to make a voluntary contribution to the buffer stock. However, the fifth ITA does provide that at the end of 30 months the Tin Council can review the amount of voluntary contributions and after such a review can decide by a simple distributed majority—i.e., more than half of the producer votes and more than half of the consumer votes—to renegotiate the agreement. Should such a renegotiation result in required consumer contributions, and should our policy remain opposed to such contributions, we would have the option of not ratifying the renegotiated agreement and would simply drop out of the ITA.

In August 1975, prior to deciding to sign the ITA and seeking ratification, the executive branch undertook an extensive review which considered the previous tin agreements, U.S. tin consumption patterns, the implications of joining the ITA for sales from our surplus strategic stockpiles, and whether our participation would have a negative or a positive economic impact. The forum for the review was a special EPB/NSC Commodities Task Force cochaired by Treasury and State. As part of this effort, Treasury staff reviewed the first four tin agreements and concluded that they had had only a minor impact on tin prices and that there was no evidence that the first four agreements had increased the long-term price of tin. This review did demonstrate the positive role the ITA could play in improving the efficiency of the world tin market by its extensive data collection and distribution function.

A review of U.S. consumption of tin indicated an actual decline in consumption from 1968 to 1972. While apparent consumption increased in 1973, this was thought to be largely due to stocking in anticipation of price increases. The decline in tin consumption reflected technological developments which enabled tin plate producers to use 50 percent less tin in tinplate production. It also reflected competition from other materials—mainly aluminum, glass, and chemically treated steel—for use by the container industry, which accounts for over a third of total U.S. consumption and is the largest market for tin. This leveling off of tin consumption is also related to the low income elasticity of tin, indicating that tin consumption responds only slowly to income growth.

There has been some fear that our joining the ITA will restrict our freedom of action in sales of surplus tin from our own strategic stockpiles. But the only constraint placed on our tin disposals by the ITA is to consult with the Tin Council before making sales. We have done this even before the fifth agreement and would expect to do so in the future even if we are not members of the agreement. Such consultations are consistent with legislation requiring that sales of surplus strategic materials should not disrupt markets. Therefore, consistent with our policy and with our stockpile law, we have made it clear that in joining the ITA we reserve the right to continue our own stockpile sales.

Finally there is the question whether U.S. participation would have a negative or a positive economic impact. In considering this matter it is important to realize that there can be no doubt that the ITA will continue, with or without U.S. participation. Participation, however, will give the United States an important role in the operation of the economic provisions of the agreement including the determination of the price range to be defended by the buffer stock, the operation of the buffer stock, contributions to the buffer stock account, and decisions on export controls. With more than 25 percent of the consumer country votes we are assured of a prominent voice in these decisions. I might add that at the first session of the fifth ITA held in London earlier this month, the United States, with the support of West Germany and Japan, was successful in fending off producer efforts to increase the floor and ceiling price of the buffer stock price range, a move we judged to be unwarranted by current market conditions. We would expect that decisions on the price range will continue to reflect our views.

In summary, the Treasury Department has carefully reviewed the ITA and has concluded that there are no significant economic costs to American consumers implied by U.S. membership in the agreement. We also conclude that to the degree that our participation insures that the interests of U.S. industrial consumers are represented in Tin Council decisions, U.S. membership can have a positive impact on the way in which the Tin Agreement operates in the international tin market.

International Wheat Agreement

In contrast to the coffee and tin agreements, we are seeking simply to extend the existing International Wheat Agreement which has had no price provisions since 1971. International wheat agreements of one form or another have been in operation longer than either coffee or tin agreements. Formal international agreements on wheat were first initiated in the 1930's, but the participating countries were unable to achieve full cooperation so their economic provisions were never really effective. The first successful agreement went into effect in 1949 and there have been agreements continuously in effect since then.

The major economic provision in past agreements has been a set of minimum and maximum export prices. Until the late 1960's, market prices stayed within the price range. The 1968 agreement, which was called the International Grain Arrangement, was developed in the Kennedy round trade negotiations. It had been conceived as an instrument to deal with grain shortages, but grain surpluses instead proved to be the major problem. These surpluses, coupled with severe competition among exporters, resulted in prices dropping below the price floor. The 1971 agreement, which is the basis of the agreement currently in effect, dropped the minimum and maximum price provisions. As a result, there are no price provisions in the agreement which we are seeking to extend, and it has little economic effect.

The International Wheat Agreement consists of two instruments, a Wheat Trade Convention and a Food Aid Convention.

The Wheat Trade Convention has four objectives: (1) To increase cooperation among countries with respect to wheat problems, (2) to promote expansion of wheat trade, (3) to contribute to stability in the international wheat market, and (4) to provide a framework for negotiation of provisions relating to wheat prices. The convention provides several vehicles for accomplishing these objectives, including periodic meetings to exchange information on the world wheat situation and a system of consultations when instability threatens the market or when disputes and complaints need to be addressed. In addition, guidelines have been agreed relating to concessional transactions in world wheat trade.

The Wheat Trade Convention is administered by the International Wheat Council which is composed of exporters and importers. Decisions of the Council are made by a majority of votes of exporting members and of importing members. The United States has 28 percent of the total 1,000 exporting member votes. Canada also has 28 percent of this total, and the Soviet Union has 10 percent.

The Food Aid Convention is aimed at carrying out a program of food aid with the help of contributions from members. This instrument provides for sharing by developed country grain exporters and importers, the obligation of furnishing food aid.

The major points of interest in this convention include the following: (1) The United States is one of nine countries which are committed to annual contributions; (2) the U.S. commitment is 1.9 million metric tons out of a total of 4.2 million tons; and (3) contributions can be in the form of wheat, coarse grain for food, or cash. The Food Aid Convention has been a very useful means for obtaining a specific commitment from other countries in a manner which ensures a sharing of the food aid burden.

Thirteen major exporting countries, representing 85 percent of world exports during the 1974–75 crop year, and nearly 50 importing countries are members of the International Wheat Agreement and its 2 component conventions. To date more than enough countries have signed the extension of the agreement to make it effective.

We believe that the International Wheat Council is a useful and desirable forum which should be maintained. The continuing exchange of information on the world supply-demand situation that has taken place in the Council has been particularly useful in providing early warning of crop shortfalls or major surges in world import demands. This information has helped reduce spurious volatility in wheat markets and has led to more orderly supply and demand adjustments.

The Council recently has been engaged in discussions concerning the terms of a new wheat agreement. The major focus has been on the question of a nationally held, internationally coordinated grains reserve. The United States has put forth a proposal on grain reserves that would deal both with short supplies and surpluses. Other countries have expressed more interest in price stabilization measures requiring price floors and ceilings.

We oppose price stabilization arrangements in wheat markets as an objective per se because we think they are unworkable. We have argued that our objective is world food security and that the introduction of a workable system of grain reserves such as proposed by the United States would indirectly provide an element of price stability as it also operated to provide world food security.

Some countries have proposed that the discussions of price stabilization and grain reserves should be carried out in the context of the multilateral trade negotiations (MTN) in Geneva. The United States favors continuation of the grain reserves discussions in the Wheat Council in London, where all the major wheat exporters and importers, including the Soviet Union, can participate. After those discussions are completed, we believe the results can be taken account of in the MTN.

In summary, we strongly recommend the ratification of the extension of the International Wheat Agreement until June 30, 1978, so that the discussions on wheat trade arrangements and reserves can continue and so that the valuable and desirable commitments of the Food Aid Convention are retained.

* * * * * * *

Conclusion

Mr. Chairman, I hope that the preceding discussion has accomplished at least the following objectives. I hope that it has shown that the U.S. response to these specific negotiations is closely integrated into a broader international economic policy framework; that our decisions to sign and seek ratification of these agreements are the result of careful analyses of the effects of each agreement, sufficient to convince us that they are useful responses to the problems of the trade and markets in each commodity, and that they will have no harmful impact on the U.S. consumer; and finally that our commodity policy is the result of an effective coordination process. Individual agencies, Treasury and others, have individual points of view. The policy process would be weak and ineffectual without these differences. But we also have a means of resolving differences of view, and once resolved, we stand by agreed positions.

I believe the three agreements before the committee are worthy of positive action by the Senate. They reflect a strong consensus within the executive branch, and they are well founded upon the underlying principles of U.S. commodity policy. They demonstrate, moreover, that in pledging itself in international forums to a meaningful case-by-case approach to commodities the United States means what it says, and implements its promises.

Investment and Energy Policy

Exhibit 44.—Communique of the Conference on International Economic Cooperation, December 16–19, 1975, Paris, France

1. The Conference on International Economic Cooperation met in Paris, at ministerial level, from December 16 to December 19. Representatives of the following 27 members of the Conference took part: Algeria, Argentina, Australia, Brazil, Cameroon, Canada, EEC, Egypt, India, Indonesia, Iran, Iraq, Jamaica, Japan, Mexico, Nigeria, Pakistan, Peru, Saudi Arabia, Spain, Sweden, Switzerland, United States, Venezuela, Yugoslavia, Zaire, Zambia. The ministerial representatives who attended the Conference welcomed the presence of the Secretary-General of the United Nations.

2. The work of the Conference was opened by H.E. the President of the French Republic, Mr. Valery Giscard d'Estaing.

3. The Hon. Allan J. Maceachen, Secretary of State for External Affairs of Canada, and Dr. Manuel Perez-Guerrero, Minister of State for International Economic Affairs of Venezuela, Co-Chairmen of the Conference on International Economic Cooperation, presided at the ministerial meeting.

4. The ministerial representatives at the Conference expressed their views with regard to the international economic situation. They made suggestions as to how the problems which they had identified might be resolved. Attention was drawn to the plight of the most seriously

affected countries. They recognized that the Conference on International Economic Cooperation provides a unique opportunity to address these problems and to further international economic cooperation for the benefit of all countries and peoples.

5. The Conference decided to initiate an intensified international dialogue. To this end, it established four commissions (on energy, raw materials, development, and financial affairs) which will meet periodically through the coming year. It was agreed that each of the four commissions would consist of 15 members, ten of them representing developing countries, five of them representing industrialized countries.

6. The commissions shall start their work on February 11, 1976. Preparation for the work of the four commissions shall be reviewed at a meeting of the Co-Chairmen of the Conference and of the four commissions after consultation with the other participants in the Conference. This meeting will take place on January 26, 1976 within the framework of the general guidelines contained in paragraphs 10–14 of the final declaration of the second preparatory meeting which are approved by the Conference.

7. The Conference agreed that the following participants should serve on the commissions:

Energy: Algeria, Brazil, Canada, Egypt, EEC, India, Iran, Iraq, Jamaica, Japan, Saudi Arabia, Switzerland, United States, Venezuela, Zaire

Raw Materials: Argentina, Australia, Cameroon, EEC, Indonesia, Japan, Mexico, Nigeria, Peru, Spain, United States, Venezuela, Yugoslavia, Zaire, Zambia

Development: Algeria, Argentina, Cameroon, Canada, EEC, India, Jamaica, Japan, Nigeria, Pakistan, Peru, Sweden, United States, Yugoslavia, Zaire

Finance: Brazil, EEC, Egypt, India, Indonesia, Iran, Iraq, Japan, Mexico, Pakistan, Saudi Arabia, Sweden, Switzerland, United States, Zambia

The Co-Chairmen of the commissions will be:

Energy: Saudi Arabia and United States
Raw Materials: Japan and Peru
Development: Algeria and the EEC
Finance: EEC and Iran

Joint meetings of the Co-Chairmen of the Conference and of the commissions may be held if the need arises.

8. It was agreed that members of the Conference who wish to follow the work of a commission to which they do not belong should be entitled to appoint a representative in the capacity of auditor without the right to speak.

9. The Conference decided that a number of intergovernmental functional organizations which are directly concerned with the problems to be considered would be able to make a useful contribution to their consideration. It therefore invited these organizations (United Nations Secretariat, OPEC, IEA, UNCTAD, OECD, FAO, GATT, UNDP, UNIDO, IMF, IBRD, SELA) to be represented on a permanent basis in the relevant commissions. Their observers will have the right to speak but not the right to vote and hence will not participate in the formation of a consensus. Each commission may, in addition, invite appropriate intergovernmental functional organizations to participate as observers ad hoc (underline two) in the examination of specific questions.

10. The Conference decided to establish an international secretariat with an exclusively administrative and technical function on the basis of proposals put forward by the two Co-Chairmen. It named Mr. Bernard Guitton as head of the secretariat and approved plans for its organization and operational procedures. The financial costs arising from the establishment of the secretariat and from future meetings of the Conference will be borne by members of the Conference on the basis of a formula agreed by the Conference.

11. It was agreed that the four commissions should meet in Paris. Subsequent meetings of the commissions will be convened by their Co-Chairmen.

12. One or several meetings of the Conference at the level of government officials may be held at least six months after this ministerial meeting. The Ministerial Conference agreed to meet again at ministerial level in about twelve months time.

13. The Conference adopted the rules of procedure recommended by the preparatory meeting which are based on the principle of consensus, according to which decisions and recommendations are adopted when the chair has established that no member delegation had made any objection. English, Arabic, Spanish and French are the official and working languages of the Conference. The rules of procedure apply to all the bodies of the Conference.

14. The Conference took note of the Resolution of the General Assembly entitled "Conference on International Economic Cooperation" (Resolution 3515 (XXX)) and agreed to make reports available to the 31st Session of the U.N. General Assembly.

15. The members of the Conference paid special tribute to President Giscard d'Estaing for the action he had taken to bring about the dialogue which is now engaged and expressed

their warm appreciation to the Government of France for its hospitality and for the efforts and obligations it had undertaken in order to make the Ministerial Conference a success.

Exhibit 45.— Statement by Assistant Secretary Parsky, February 17, 1976, before the Senate Committee on Interior and Insular Affairs and the Senate Commerce Committee, regarding financing an Alaskan natural gas transportation system

I am pleased to testify before you today concerning the proposed Alaskan natural gas transportation systems. I will concentrate my remarks on the questions of the feasibility of financing this large project in the private capital markets.

At the outset, I should note that we believe that it is possible to arrange a financing without Federal financial assistance. Although the unprecedented size and the risks of the project make private financing a difficult task, we are convinced that with the proper regulatory actions as well as participation by the various parties benefiting directly from the project, a private financing could be accomplished.

Federal financial assistance should not be used as a substitute for proper regulatory action as this would surely result in inefficiencies and unnecessary increases in the already excessive role of the Federal Government in our economy. The actions that are needed involve taking steps to require the major beneficiaries of the project to pay the cost and bear the risk, on an equitable basis, of delivering this gas. Decisions to bring this about may not be easy but are needed if the Alaska Gas Transportation System is to be financed in the most efficient and, in the long run, least costly way.

As you are aware, for the Interior Department's December 1975 report to Congress on "Alaskan Natural Gas Transportation Systems," the Treasury Department prepared a section dealing with "Financing Problems and Issues." I am submitting for the record a copy of that section.[1]

In my testimony today, I would like to highlight a few of the major conclusions we reached in this analysis and, in particular, point out areas where we feel proper regulatory actions will facilitate a private financing of the project. After discussing the overall capacity of the capital markets to handle a project of this size, I would like to outline the major financial risks perceived by potential investors in the project and point out the ways such risks can be handled if appropriate regulatory actions are taken. Finally, I will consider the general question of Federal financial assistance.

Capacity of the capital markets to finance such a large project

The Interior Department has estimated that construction costs for a 2.5-billion-cubic-feet-per-day (BCFD) gas flow range from $9 to $11 billion for the Alaska-LNG System and from $10 to $12 billion for the Alaska-Canada System, depending on such variables as interest on debt during construction and cost overrun contingencies as well as estimates for inflation. If financed by private capital, this project would be the largest single project so financed. By comparison, the cost of the trans-Alaska oil pipeline is now estimated to be in excess of $7 billion- excluding field development costs and the tanker fleet.

Despite the unprecedented size of this project, we believe that the U.S. capital markets have the capacity to finance this gas transportation system and that private capital markets, including the international markets, will finance it if it is shown to be a viable and creditworthy project. Let us look at what this will entail.

Nature of the financial risks

The sponsors of both projects propose to finance them through what is commonly called project financing. This type of financing involves creation of a separate project entity which issues securities structured so that the debt service and equity returns are provided by the revenues generated by the project. The preliminary financing plans involve capitalization of 25 percent equity and 75 percent debt.

Before they will provide funds to either of the proposed projects, both equity and debt investors must be satisfied that the project is creditworthy and that the level and certainty of their expected return on investment is adequate to compensate them for the risks they assume. The bulk of the equity will be provided by the project sponsors, and the debt will be sought mainly from financial institutions.

Although debt investors generally assume some amount of risk in return for higher interest rates, the large amounts of capital required for this project probably cannot be raised if there is any substantial perceived risk to the timely repayment of principal and interest. Thus, a prerequisite to financing this project is to establish that payment of debt service could be

[1]Not included in this exhibit.

expected regardless of what other events occur. The two major financial risks faced by investors are (1) the risk of noncompletion of the project and (2) the risk that, once completed, revenues will be insufficient to cover all project costs—including debt service. Noncompletion could result from unforeseen construction difficulties, excessive cost overruns that make the project uneconomic, environmental suits, and other legal or political difficulties. Insufficient revenues could result from (a) the failure of regulatory agencies to allow tariffs which recover the full project costs or (b) interruption of gas flow due to natural disaster, mechanical failure, or other force majeure events.

The noncompletion risk

In the event of noncompletion, the fundamental concept of project financing (i.e., service of debt through project revenues) is frustrated and, in the absence of other protection, the lender loses his investment. Therefore, before committing funds to an Alaskan gas transportation system, lenders will seek (a) assurances that there are adequate funds to finance completion and (b) protection in the event of noncompletion for reasons other than lack of funds.

The first noncompletion risk of major concern to investors involves large cost overruns which could result from such things as delays in the construction schedule or errors in engineering estimates. In addition, construction delays would add to debt-interest costs.

The second major noncompletion risk of concern to potential lenders is the fact that their debt might not be repaid if the project never goes into operation to generate the revenues they are looking to as the primary source of their debt service. As in the case of cost overruns, investors must have adequate assurances that their debt will be repaid in the event of noncompletion before they will advance funds to the project.

Thus, the key question is: Who will finance cost overruns and bear the other risks of noncompletion of the project? At this point in time, the question remains unanswered. If a private financing is to be arranged, these risks must be borne by one or more of the various parties standing to benefit directly from the project, including:

Equity investors,
Other gas pipeline and distribution companies receiving gas,
Gas consumers receiving gas,
Owners of Alaskan gas reserves, or
State of Alaska.

We believe that these potential project beneficiaries collectively have the capacity to provide lenders the necessary assurances against noncompletion risks. The financing capabilities of these main project beneficiaries are discussed at some length in our contribution to the Interior Department report. I refer you to that report for our detailed analysis, but I would like to summarize for you briefly our analysis of the various categories of beneficiaries.

Equity investors.—As discussed in the Interior report, it appears that, considering both internally generated cash flow and external financing possibilities, the current group of project sponsors could provide the requisite equity capital—although this would clearly be a large undertaking for a group of companies of this size, and some problems could arise for particular companies.

However, the lenders will also be looking to the project sponsors to provide part of any cost overrun financing that might be required or possibly assist in repaying debt in the event of noncompletion. While such commitments do not require the immediate generation of cash, they do result in a contingent liability of an indeterminate and conceivably quite large amount. As they themselves have indicated, the current sponsors apparently do not have the capacity to assume fully the risk of repayment of the project's debt.

Gas pipeline and utility companies.—There are a number of interstate gas pipeline and distribution companies, other than El Paso and those in the Arctic Gas group, who could be considered as potential project sponsors. For example, the 10 largest of these other interstate gas pipeline companies (in terms of natural gas sales) had a combined internal net cash flow of about $1.5 billion in fiscal year 1974. Were the 1974 cash flow levels to continue, the combined internal cash flow of these companies over a 6-year period would be around $9 billion. Thus, they could make a substantial contribution toward financing and bearing the cost overrun and noncompletion risks of this project.

Owners of Alaskan gas.—Another potential source of financing would be the owners of the gas reserves. They recognize that without a transportation system the large proven gas reserves and potential future gas discoveries are virtually worthless. However, it must be recognized that any decision by the producers to help finance the project would have to take into account other competing demands for funds, the rates of return on alternative projects, and the fact that they are already committed to provide substantial additional amounts of capital in order to produce North Slope oil and gas. One action which could affect the willingness and ability of these companies to participate in the financing would be the deregulation of wellhead price for Alaskan gas.

Gas consumers.—A third additional source of financing is gas consumers. The large benefits that are expected to accrue to consumers of Alaskan gas would appear to justify the adoption of regulatory procedures which would involve them more directly in financing and bearing the risks of this project. With respect to the cost overrun and noncompletion risks, a surcharge on current gas consumption might be used to help finance cost overruns and/or repay project debt in the case of noncompletion.

Very large amounts of capital could be raised in this way. One form of surcharge would be a direct add-on to the current utility bill which would be used to finance cost overruns. Another, somewhat more indirect form would be the inclusion of work in progress in the rate base so that consumers would pay the interest charges on project debt and return on equity investment while the project is under construction. A consumer surcharge mechanism, in effect, increases the current cost of gas to consumers but reduces future costs to a level lower than would prevail if consumers did not help finance the project. This reduction in future costs comes about because the amount of debt service (i.e., principal and interest payments) that would have to be recovered through transportation tariff charges would be reduced.

State of Alaska.—The State of Alaska is another potential source of financing. Alaska would receive significant benefits if production of Alaskan gas were assured by the building of a transportation system since it would receive a 12 1/2-percent royalty and approximately a 4-percent production tax. Thus, the State of Alaska, as a direct beneficiary of a transportation system for gas, might decide to finance a portion of the pipeline or help finance cost overruns or guarantee a portion of the debt to insure its repayment in the event of noncompletion.

Other.—Other potential project beneficiaries who might bear some of the cost overrun and noncompletion risks include (1) large industrial gas customers who could provide substantial amounts of capital through advance payments in exchange for an assured supply of gas and (2) the financial institutions providing debt capital who might be willing to commit to finance some level of cost overruns.

As this summary indicates, there are direct beneficiaries of the project who together have the capacity to finance substantial cost overruns or repay the project's debt in the case of noncompletion.

The risk of insufficient project revenues

Even if the various project beneficiaries were able to provide adequate assurances to the prospective lenders with respect to noncompletion risks, the difficult question of who would bear the risks of inadequate project revenues would remain. With projects of this size and complexity, even a low risk of interruption or diminution of revenues is of concern to lenders. As in the case of noncompletion, if a private financing is to be arranged, this risk must be borne by the various parties standing to benefit directly from the project.

There are two major ways of satisfying the lender's need to have some mechanism to insure debt repayment in the unlikely event of a long-term service interruption. First, the lender might be satisfied by a clearly creditworthy party, or parties, agreeing to guarantee repayments of the project's debt. In many projects, this type of guarantee is provided by the project sponsors. However, in the present case, the proposed projects are so large that the current group of gas pipeline and utility sponsors have indicated that they do not have sufficient aggregate credit to satisfy the lenders. Therefore, if a private financing is to be achieved, it may be necessary to strengthen the combined credit of the sponsoring group by adding new members (for example, additional gas pipelines and utilities, and/or the State of Alaska and/or the gas producers). As I noted earlier, this could also assist in covering the risks of project overruns or noncompletion.

Second, users of the project's output or service might enter into what are called all events full cost of service contracts. Under such a contract, the purchaser is obligated to pay a minimum amount sufficient to service the project's debt and cover certain other project costs even if he does not receive output from the project. In short, he pays regardless of what other events may occur. Thus, lenders might be satisfied with an all events full cost of service contract which would require gas shippers to pay the full cost of operating the transportation system (including debt service), regardless of whether gas was flowing or not. In theory, this type of tariff would assure lenders that, once the project is completed, revenues would always be adequate to cover the project's expenses. Under such a contract, the costs could be passed on to the local gas utilities, who in turn, assuming approval by relevant State regulatory authorities, would pass on the cost to gas consumers.

Such a tariff would be essentially an insurance program underwritten by consumers to cover whatever risks commercial insurance companies will not underwrite, or do not choose to underwrite, at reasonable costs. By accepting these risks, consumers would not only assist in arranging a private financing, but would also benefit from lower gas transportation charges from two sources: *First*, the insurance premiums associated with an unconventional commercial insurance program would be avoided. *Second*, the debt-interest costs would be lower, reflecting the increased creditworthiness of the project.

Thus, an all events full cost of service tariff could provide substantial assurances to lenders with regard to the adequacy of revenues to repay the project's debt. If, in addition, there were a wide distribution of Alaskan gas, this could minimize any contingent price increase which consumers might face under such a tariff were there to be a service interruption. Taken together, a clearly enforceable all events full cost of service tariff and a wide distribution of Alaskan gas do offer one way of handling the risk of insufficient project revenues.

Nevertheless, it should be clearly recognized that an all events full cost of service tariff implies that gas consumers would bear much of the project's postcompletion risks, including force majeure service interruptions or even costs resulting from management error. Whether it is reasonable to ask certain gas consumers to bear this level of risk must be judged in relation to the benefits those gas consumers could expect to receive, and whether such risk bearing is required in order to get the project financed. Apparently, the gas consumers receiving Alaskan gas could expect to receive substantial economic benefits. I believe that under the present system of regulated wellhead natural gas prices, gas consumers are in a favored position and could receive the bulk of the net economic benefits made available by a gas transportation system.

From the standpoint of arranging private financing, I believe that an all events full cost of service tariff could be needed. Nevertheless, it would be premature to rule out the possibility that the level of risk which gas consumers would bear under an all events tariff could be reduced by adopting something less than the full cost of service feature. This might be accomplished by carefully defining in the tariff which categories of costs are allowed to be passed on in all events. In addition, provision might even be made for a reduction in the return on, or a partial loss of, stockholders' equity in the case of management error. Through specially designed tariff formulas, we believe the risks associated with an Alaskan gas transportation system can be equitably shared between project sponsors and consumers.

In any event, such a tariff would have to be approved by the Federal Power Commission—a decision that has not yet been made. If approval does occur, it may be necessary to consider ways of assuring both the gas pipeline and gas distribution companies and the lenders who are relying on this tariff that the tariff will be maintained and enforced over the life of the project.

Feasibility of a private financing

On the basis of this analysis, we believe that the various private parties standing to benefit directly have the *capacity* to finance the project and bear its risks. Since the project seems to be economic on current price/cost estimates, there is sufficient incentive for these parties to arrange a private financing *provided* the needed regulatory actions are taken, including steps to involve gas consumers in sharing the risk of the project. Certainly the extent of involvement of gas pipeline and distribution companies, as well as the extent of participation of the owners of the reserves, will be important. However, the regulatory conditions under which the project will operate will be critical to determining whether the project will be financed privately.

Government financial assistance

Whether a totally private financing is achievable will remain a matter of speculation until one of the projects is selected and its sponsors are able to determine further the capabilities and intentions of the potential financial participants and to determine the regulatory conditions under which the project would be constructed and operated. If the needed regulatory actions are not taken and a private financing cannot be arranged, then we believe that the economics and risks of the project raise serious questions as to whether it should be undertaken at the present time. On that basis, I think it would be premature to consider legislation providing Federal financial assistance to the project.

Despite this, if the Congress eventually determines that some form of Federal financial assistance to the project is both necessary and desirable, then the following important considerations should be kept in mind. *First*, any Federal financial assistance granted should be kept to the absolute minimum needed to achieve the desired result: Construction of the gas transportation system. Federal assistance should supplement and facilitate the maximum feasible amount of private financing for the project; it should not substitute for available private financing or for appropriate regulatory actions.

Second, any legislation providing such assistance should give the administrator of this assistance adequate flexibility to tailor the form of financial assistance to the needs of the project. At this time, we, of course, do not know which of the particular financial risks of this project which I have discussed may prove insurmountable without Federal assistance and it would seem desirable to defer legislation until the problems of the project are sufficiently well understood to allow identification of why the private market cannot respond. However, possible forms of such assistance would include Federal guarantees of the project's debt against certain specific risks such as noncompletion of the project or long-term service interruptions, Federal insurance against the service interruption risk, or the financing of cost overruns above some determined level. The exact type, amount, and terms of any Federal assistance would have to be worked out through detailed negotiations with the project's sponsors.

Third, it is important to minimize the impact on our capital markets and on the management of the Federal debt of any Federal financial assistance program. Any type of Federal financial assistance resulting in the undertaking of investments that would not otherwise have been made leads to some redirection of resources in our capital markets. Such incentives increase the demand for capital while having little or no effect on the overall supply of capital and thus tend to cause interest rates to rise. Accordingly, we believe it is essential that the Secretary of the Treasury have the authority to approve the timing, terms, and conditions of any Federal guaranteed securities that might be issued.

Conclusion

In conclusion, I would like to stress again our belief that if appropriate regulatory and administrative actions are taken, Federal financial assistance to an Alaskan gas transportation system will not be necessary and, therefore, I would urge that no such Federal assistance be provided at this time. Instead, I would recommend that one or more of the following actions be taken:

1. Prompt selection of a specific gas transportation system;
2. Grant of all necessary governmental authorizations including timely resolution of all environmental and legal questions regarding the project;
3. Approval of all events tariffs which permit shippers to pass on a substantial portion of the costs, if not the full costs, of the project to the ultimate consumer coupled with strong assurances that they will be maintained in effect and enforced over the life of the project;
4. Approval of a mechanism (such as inclusion of work in progress in the rate base) by which the principal and interest payments on some part, if not all, of the debt funds used during construction could be passed on to gas consumers even in the remote contingency of noncompletion of the project;
5. Approval of a consumer surcharge mechanism which would provide funds to help finance the project;
6. Decontrol of natural gas prices or setting the wellhead price of Alaskan gas at a level high enough to attract the financial participation in the project of the owners of the gas.

These actions would clarify the present regulatory and administrative uncertainties that are now holding up this project and would provide equitable means whereby the private beneficiaries of the project can assist in its financing and a sharing of the risks without the unnecessary and undesirable financial involvement of the Federal Government. In my view, there are great longrun dangers if we continue to substitute Government financial assistance for difficult regulatory decisions which equitably apportion the costs and risks of large energy projects. I believe that this project affords us an opportunity to show that, through innovative governmental action, we can create the conditions necessary for the private capital markets to finance this project.

Thank you, Mr. Chairmen, and I would be happy to answer any questions you and the committees may have at this time.

Exhibit 46.—Statement by Assistant Secretary Parsky, March 31, 1976, before the House Committee on Science and Technology, concerning Federal financial incentives to encourage synthetic fuels production

I am pleased to appear before you today to discuss H.R. 12112 and, in particular, the question of Federal financial incentives to encourage the commercial demonstration of various types of energy facilities. Although the proposed bill would provide Federal guarantees for synthetic fuels production, energy conservation, renewable energy resources, and geothermal development, I would like to focus my remarks today on the synthetic fuels area. I will concentrate on (1) an assessment of the reasons for Federal assistance, (2) the proper structure of such assistance, and (3) the impact of Federal incentives on the capital markets.

The administration program

In his January 15, 1975, state of the Union message the President proposed a number of measures designed to help achieve energy independence and reduce our vulnerability to the OPEC (Organization of Petroleum Exporting Countries) cartel. A key measure was a program accelerating the advent of synthetic fuels. In proposing this program the President specifically endorsed the use of Federal financial incentives where necessary to encourage commercialization. The President reaffirmed the importance of this activity in his February 26 energy message of this year.

An interagency Task Force on Synthetic Fuels last year undertook a comprehensive study of how best to assure early initiation of the commercial demonstration program. One of the major tasks of the task force was to identify and evaluate the need for various types of financial assistance to assure commercial development of synthetic fuels. The draft report of the task force concluded:

> In the absence of Federally provided economic incentives or other policies creating a stable and favorable investment environment, significant amounts of synthetic fuels are not likely to be produced by 1985.

We believe that it is important to proceed with a significant commercial demonstration program as part of a national effort aimed at reducing our vulnerability to a cutoff in imports of oil. Further, we concur in the task force conclusion that incentives are needed to accomplish the basic objectives of this program.

However, in carrying out the incentives program, we believe that special care should be taken to (1) keep the use of Federal assistance for commercial demonstration facilities to a minimum level necessary, (2) ensure that the impact of Federal incentives on the capital markets is minimized, and (3) ensure that the adoption of a Federal incentives program does not impede movement toward the fundamental actions needed to improve the climate for private investment in the energy sector—that is, regulatory reform, continued emphasis on research and development, and decontrol of energy prices. We believe that these more basic actions are the most cost-effective longrun solutions to the problem of attracting private capital to develop synthetic fuels. In order to understand how a proper balance can be achieved between providing needed incentives now and ensuring that longer term actions are taken, I would like to explore each of those areas.

Type of Federal assistance needed

First, let's look at the type of Federal assistance that is needed. The exact type of financial incentive needed to achieve the President's goals will vary from situation to situation depending on the technology, the regulatory environment, the nature of the companies involved, and competitive market considerations. For example, in the case of projects which would provide fuel to a nonregulated sector of the energy industry, the major uncertainty is the future course of prices of competitive fuels. In such cases, some form of price guarantee may be needed to protect the large capital investment should market prices of competitive fuels fall to a low level. In contrast, for projects which will operate in a regulated environment, price guarantees may not be needed but loan guarantees may be necessary to secure financing for the first commercial-size plants to overcome the technological risk, concerns over the large size of the projects in relation to the net worth of the participating companies, and the regulatory uncertainties involved. The Energy Research and Development Administration (ERDA) should, therefore, have a number of incentives available to it and should also have administrative flexibility to choose the appropriate incentive based on specific situations. Different technologies or industries might require different incentives at different times, and it cannot now be predicted with certainty which form of incentive will be best. Accordingly, a range of incentives, including loan guarantees, are necessary to achieve the early commercialization of synthetic fuels.

We continue to believe, however, that every effort must be made to minimize the cost of such a program to the American people. Therefore, it is important that whatever financial incentives are deemed necessary be granted by competitive bidding to the extent possible. By using competitively bid loan and price guarantees wherever possible, the Government will be able to minimize the amount of Federal subsidy involved.

Minimizing the impact on capital markets

Furthermore, as the proposed program is implemented, we must minimize the impact on our capital markets. Any type of Federal financial assistance resulting in the undertaking of energy projects which would not otherwise have been undertaken will lead to some redirection of resources in our capital markets. Such incentives increase the demand for capital while having little or no effect on the overall supply of capital. They tend to cause interest rates to rise and channel capital away from more economic to less economic uses.

In short, the proposed program of Federal incentives will direct capital from other areas of our economy into synthetic fuels production.

This diversion, however, is the intended objective of the incentives program which is specifically designed to attract capital into projects for the commercial demonstration of synthetic fuel technologies. The magnitude of the impact of such diversion will, of course, depend on the amount of money involved and the length of time over which such money is raised. Between $8 and $9 billion in investment may be neeeded to develop the President's recommended 350,000-barrel-per-day oil equivalent synthetic fuels capacity. This amount would be on a phased basis over 5 to 10 years as plants are constructed. The incentives program designed to induce such investment should, therefore, not cause a great disruption in the capital markets. Given the fact that the annual U.S. investment rate in 1975 was over $200 billion, the program is not likely to have a major impact on the general cost or availability of capital. In addition, the Federal Energy Administration estimates that as much as $600 to $800 billion will be invested in the energy sector over the next 10 years. When viewed in relation to this amount, the capital investment expected to be induced into the initial phase of the synfuels program is not large.

However, almost 50 percent of the $200 billion net flow of funds in U.S. credit markets is already being taken to finance existing Federal, State, and local programs. These heavy government borrowing pressures will continue. Therefore, in order to help minimize the impact of ERDA guarantees and price supports in our capital markets, we believe that it is essential that the Secretary of the Treasury have the authority to approve the timing and substantial terms and conditions of each loan and price guarantee and any other financial incentive that would have a similar impact. Loan and price guarantees result in new issues of bonds, notes, or other Government-backed obligations in the capital markets which impinge upon Treasury and other Federal agency financings and which can have significant market impact. Prior approval of the timing and terms by the Treasury will ensure effective coordination with the management of the Federal debt and will help minimize the impact of such incentives on the capital markets. H.R. 12112 contains the necessary authority with respect to guarantees for synthetic fuels, conservation equipment, and impact assistance. However, H.R. 12112 is incomplete in its treatment of the Treasury role with respect to geothermal energy projects. We strongly urge an amendment making the geothermal loan program conform to the remainder of the loan guarantee programs by requiring Treasury approval of the issuance of guarantees and by making the interest on guaranteed obligations of public bodies taxable. The amendment was submitted last year by ERDA but evidently not adopted during your final conference deliberations.

Treatment of foreign investors

In addition, we are concerned by the fact that, with some exceptions, the legislation prevents non-U.S. citizens from obtaining guarantees under the program. This prohibition is contrary to our traditional policy of nondiscrimination against foreign investors. We follow an open-door policy towards foreign investment, and once foreign investors are established here they are afforded national treatment—that is, treated equally with domestic investors. This policy is based on the premise that the benefits of investments are not dependent on the nationality of investors. We should maximize our opportunity for obtaining capital and technology from whatever source rather than making discriminations on the basis of nationality which serve no economic purpose.

This is especially true in the present case where the purpose is to encourage the development of plants to demonstrate the commercial viability of new energy technologies at the least cost to the U.S. taxpayers. It follows that we should seek the most promising technology from those firms most capable of undertaking such projects. To completely prohibit foreign investors from taking advantage of the program would deny the United States the benefits of their technologies without obtaining any compensating benefits and with possible additional costs for American taxpayers.

We do recognize that the legislation gives the Administrator of ERDA the discretion to grant guarantees for investments by citizens from countries who are participants in the International Energy Agreement. While this is an improvement over a blanket prohibition on foreign investment, it is still contrary to our basic policy of national treatment for foreign investors. Therefore, we suggest that the restrictions with respect to the nationality of program participants be eliminated and that all foreign investors who otherwise meet the qualifications established by ERDA be eligible for guarantees under the program.

Necessity for regulatory reform

The proposed incentives program, Mr. Chairman, is important but should not be seen as a substitute for needed regulatory reform. The level of Federal financial assistance that will be required to bring about certain types of first-generation synthetic fuels plants and, more importantly, the ability of the synthetic fuels industry to free itself from Federal financial assistance will be determined to a great extent by how rapidly we develop a more favorable regulatory climate. Energy prices should reflect the real costs of producing energy if we are to achieve the needed increases in supplies of energy and to discourage the wasteful uses of energy. With respect to synthetic fuels in particular, the difficult problem of arranging private financing for high BTU coal gasification plants has been handicapped because of regulatory commission policies which refuse to allow an all events full cost of service tariff for first-generation synthetic fuels plants. I would hope this barrier will be removed so that once demonstration plants are proven to operate satisfactorily, the financing of future plants can be handled completely by the private markets.

Likewise, the interagency Synthetic Fuels Task Force report indicated that a major barrier to electric utilities undertaking medium BTU coal gasification projects is the inability of these companies to attract capital due to their low level of profitability resulting from regulatory policies. Again, the best longrun answer is regulatory reform. In addition, expediting various environmental and other regulatory procedures would significantly assist the private capital market in responding to our Nation's energy needs. The faster we can move on these needed improvements in the regulatory environment, the less will be the need for Federal Government financial assistance. We do, however, recognize that these improvements will take time and that there is currently a clear need for carefully chosen and implemented incentives in order to assure the private financing of demonstration facilities in the interim. Therefore, we urge enactment of H.R. 12112 so ERDA can proceed in this important effort.

Mr. Chairman, that concludes my prepared statement, and I will be gald to respond to any questions you might have.

Exhibit 47.—Statement by Assistant Secretary Parsky, May 3, 1976, before the Subcommittee on Foreign Commerce and Tourism of the Senate Committee on Commerce, regarding the Treasury study of foreign portfolio investment in the United States

It is a pleasure for me to be here to present to you the findings of the Treasury Department's study of foreign portfolio investment in the United States. It is certainly fitting, Mr. Chairman, that the results of this study be presented to your subcommittee, for this represents the culmination of a process of consultation and cooperation between the Treasury and you and your staff that has extended over a period of more than 2 years- beginning with your introduction of the Foreign Investment Study Act of 1974, which provided the authority for us to undertake the study.

The idea for this study originated in 1973, at a time when concern was being expressed over the possible implications of the rise in investments here by European and Japanese interests. Later, the accumulations of funds by the oil-producing countries added to this concern and a number of bills were introduced in the Congress which would impose restrictions on investments from abroad.

The President has resisted these proposals and we have opposed new restrictions on foreign investment in the United States. We continue to believe that the operation of market forces will direct worldwide investment flows in the most productive way. Thus, we have sought to maintain our traditional policy of freedom for investments here by foreigners. At the same time, we did share the view of this committee and others in Congress that adequate information on international investment should be available to all branches of Government and to the public. Consequently, we strongly supported the Foreign Investment Study Act of 1974 which called upon the Commerce and Treasury Departments to undertake comprehensive overall studies of foreign direct and portfolio investments in the United States and to report their findings within 18 months. We did not view such legislation as in any way weakening our commitment to the free flow of investment capital. Rather, we saw it as a desire to ensure that the necessary facts were available so that sound policy could be developed.

As you are well aware, the act was passed in October of 1974. Before that, however, in anticipation of its passage, the Treasury had begun laying the groundwork. First, we had to design a questionnaire form for business firms which would supply us with all the statistical data required. We then had to consult with representatives of the reporting community to assure that the information called for could be supplied at a reasonable cost and in time to allow us to assimilate it and analyze it within the time frame of the act. This process was completed in late 1974, and in January 1975 forms were mailed out to business firms.

For the research on some of the nonquantitative parts of the study- why and by what means foreigners invest in the United States and the legal aspects involved- we decided to contract for the services of a private research firm. After reviewing the numerous responses to our solicitation for bids, we awarded the contract to R. Shriver and Associates on the basis of its qualifications, work plan, and price.

The collection, review, and analysis of all the information we have gathered has been a substantial undertaking. We have received some 10,000 completed forms from business firms. In addition, Shriver and Associates has submitted to us reports on its interviews with over 100 persons in this country and abroad who are involved in foreign portfolio investment, and very extensive material on the purpose and effect of U.S. and foreign laws relating to foreign portfolio investment.

A completely thorough review and analysis of this wealth of information takes much longer than the few months which have passed since it became available to us and we will continue to review it for some time to come. However, the Congress, quite understandably, wanted a timely report on our findings which I am happy to submit at this time. Attached to my statement is a summary of our findings.[1] Later this month we will print and distribute to the Congress and the public a more detailed report.[2] I would now like to give you the highlights of our findings and our major conclusions and recommendations.

Highlights of the Treasury study

The comprehensive benchmark survey which we undertook under the study shows that foreign portfolio investment in the United States was approximately $67 billion as of the end of 1974. This consisted of about $25 billion in stocks, $16 billion in corporate bonds and other private debt, and $26 billion in government bonds and notes.

The total derived from the benchmark survey was about $10 billion higher than our previous estimate; most of this difference, nearly $7 billion, was in the stock figure. This is not surprising since our previous estimate was based on a survey done for 1941 and both the composition and the value of this portfolio obviously could have changed substantially over a period of 33 years.

Special factors, not directly related to market forces, accounted for most of the foreign holdings of debt instruments in 1974. First, practically all of the holdings of U.S. Government securities were held by foreign official institutions such as central banks because of their policies of holding a major part of their international reserves in dollars. Secondly, nearly all of the recorded foreign holdings of U.S. corporate bonds are the result of the U.S. Government balance of payments programs in previous years when U.S. companies were encouraged to finance their overseas investments through Eurobonds, even if they had to pay a higher interest rate than on borrowings in the United States.

When these special factors are taken into account, it becomes apparent that market-related foreign portfolio investment in this country is primarily in the form of corporate stocks. This is seen more clearly if we examine the estimates of foreign portfolio holdings as of the end of 1975, which are based on the 1974 survey and our monthly data on foreign portfolio transactions plus estimates of the changes in market values of foreign-held securities. These estimates indicate that the total foreign portfolio as of end-1975 was $86 billion, of which $37 billion, or 43 percent, consisted of stocks. Since stocks play such a dominant role in foreign portfolio investment in this country, I think it is important to comment in a little more detail about these holdings.

The survey showed that virtually every country in the world held some U.S. stocks but the holdings were heavily concentrated in a few countries. Switzerland, the United Kingdom, and Canada alone accounted for nearly 60 percent of the total and when the Netherlands and France are added, these five countries represented nearly 75 percent of total foreign holdings.

Slightly over half of the total was in the names of foreign banks, brokers, and nominees who were holding these securities in part on behalf of other persons. This was particularly true in the case of Switzerland where nearly 90 percent of the holdings were in this category, a considerable proportion of which represented holdings for beneficial owners in other countries.

The other categories of major holders were: Individuals, holding $4.5 billion, about half of which was held by U.S. nationals residing overseas; institutional investors such as investment trusts with $3.7 billion; other private institutions, $2.5 billion; and foreign official institutions, $1 billion.

The distribution of these holdings by industry was fairly widely diversified and did not differ significantly from that of American investors. Foreign holdings of U.S. stocks were equal to about 5 percent of the value of all publicly traded stocks.

Through interviews with foreign portfolio managers here and abroad, we assessed the reasons for foreign portfolio investment activities in the United States. The principal motivations include:

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[1]Not included in this exhibit.

[2]Copies of the "Report to the Congress on Foreign Portfolio Investment in the United States" are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20420.

1. Expectations of long-term capital gains.
2. The relative economic and political stability of the United States. Many European investors, for instance, see the United States as offering more profit potential and less risk of nationalization than other major countries.
3. The large size and liquidity of U.S. capital markets. The lack of depth and liquidity associated with smaller capital markets elsewhere make it difficult to place large amounts of funds in a relatively short period of time.
4. Close regulation and organization of U.S. securities markets. This serves as a desirable safeguard.
5. Great range of investment choices.
6. Sales efforts of U.S. securities dealers.
7. Greater efficiency of U.S. markets.

In addition to seeking to determine the reasons behind investment activity, we also attempted to identify the processes and mechanisms through which investment is made in the United States. We found that foreign portfolio investors use the same investment channels as U.S. investors for the most part, i.e., the New York and American Exchanges, the regional exchanges, and the over-the-counter market. Many of the major U.S. companies are also listed on foreign exchanges. Foreigners rely heavily on U.S. brokers and dealers for placing orders and obtaining information on U.S. securities.

The heterogeneous nature of the numerous foreign investors in U.S. securities makes it difficult to isolate the effects they have on our financial markets and on our economy. Nevertheless, it is true that any additional demand for securities in any segment of a capital market tends to raise prices and reduce yields on the type of securities demanded. Thus, foreign purchases of U.S. stocks and bonds have a tendency to reduce yields and therefore make raising of capital relatively easier for domestic borrowers. This in turn will tend to stimulate real investment and increase the output and productivity of the economy. We did find that foreign holdings of U.S. stocks are turned over somewhat more frequently than U.S. holdings. On the other hand, foreigners as a whole have been net purchasers of U.S. stocks in every year since 1959 except for the years 1964–66; thus they have on balance tended to strengthen stock prices. Generally, our conclusion is that more participation in our markets tends to make them deeper and more efficient. Thus, foreign participation is beneficial.

The Treasury study also involved comprehensive research into the legal aspects of foreign portfolio investment. While the U.S. legal structure is generally viewed favorably by foreign investors, particularly our securities laws, some aspects are viewed as a deterrent to investments here. The U.S. withholding tax on dividends and interest payments and the fact that the U.S. estate tax is levied on the U.S. securities holdings of foreign investors are two illustrations of such negative factors.

OPEC investments

Mr. Chairman, that provides you with the general outlines of our study. Since one of the major reasons for undertaking this study was the concern expressed by some over the potential of the oil-producing countries to acquire large amounts of assets in this country, before concluding, I would like to make some observations about these investors in particular.

In the early period of the large accumulations by the OPEC (Organization of Petroleum Exporting Countries) countries, almost all of their investments in the United States were in the form of short-term assets such as Treasury bills and short-term bank C.D.'s. Being cautious and conservative investors it was natural for them to confine their investments to the safest and most liquid forms at the outset. This is one of the reasons why our benchmark survey, which was taken as of the end of 1974, shows relatively small holdings for these countries—$2.4 billion, which was less than 4 percent of total foreign portfolio investment in this country.

In 1975 and early 1976, these countries shifted substantial amounts into longer term assets, primarily Treasury and other Federal agency bonds and notes and corporate stocks; lesser, but not insignificant, amounts were also invested in long-term bank C.D.'s and corporate bonds. In 1975, OPEC countries made portfolio investments in the United States of about $5.7 billion, and in January and February of this year they purchased another $1 billion.

Looking ahead, we believe that the oil-producing countries will place an increasing proportion of their investments in longer term debt and equity instruments. Although investments will continue to be placed in the United States, we must recognize the fact that the rate of new investment by many of the oil producers outside their own countries will decline as they are able to absorb more internally.

With respect to the policies these countries are pursuing, enough time has now passed for us to have a clear picture of their approach to investment.

First, they are cautious and conservative investors. I have spoken to the managers of funds in most of the OPEC countries and in particular in those countries that are now accounting for the great bulk of the oil surpluses; namely, Saudi Arabia, Kuwait, and the United Arab Emirates. Although their internal development objectives differ, they all are following diversified investment objectives similar to any institutional investor.

Secondly, they are almost entirely portfolio investors and none of them has a desire to acquire and/or control major U.S. companies. The Saudi Arabian Government, for instance, has told me that it will not invest more than 5 percent in any particular company, and recently indicated to us that it currently does not own more than 1 percent of any company. Further, a country like Kuwait has participated in our markets for years and has always been a most responsible investor.

These characteristics come through quite clearly both in the record of OPEC investments in the United States and in the numerous discussions which I have personally had with their leaders. I do not believe that these countries would consider investments here which would be against our national interest. I am also confident that they would consult with us before undertaking any significant direct investments. In sum, they have been and will continue to be good, sound investors; and I think we should continue to welcome their investments just as we do those of other countries.

Conclusions and recommendations

Our final tasks under the act were to study the adequacy of our information and reporting programs on foreign portfolio investment and to recommend means whereby this information can be kept current.

The benchmark survey which we have just completed gives us a comprehensive and detailed inventory of foreign portfolio investment as of the end of 1974. The magnitude and composition of this inventory will, of course, change as foreigners continue to buy and sell U.S. securities in the years after 1974. We will be able to update the major categories of this inventory reasonably accurately for some time to come by adding (or subtracting) our monthly data on transactions to the 1974 benchmark figures and applying estimated changes in the market values of foreign holdings.

The results of the survey suggest that there is some underreporting bias in these monthly data. This was not unexpected and the differences between the totals reported by the survey and those which had previously been estimated do not appear unduly large, in view of the long period of time that has elapsed since the previous benchmark in 1941 and the significance of the nontransaction factors affecting the investment position totals. It is noteworthy that the difference is substantially larger in the figures on equity holdings, where the valuation adjustment problem is greatest, than it is for holdings of debt instruments.

The survey results, therefore, do not appear to raise major questions about the current reporting system and we believe that the conceptual and institutional structure of this system is adequate. Nevertheless, it will be necessary to constantly monitor the reports and to maintain close communication with the reporting firms to ensure that there are no major gaps in our reporting network.

Although it might be desirable to undertake another benchmark survey at some time in the future, I think that this decision should be left for the future. The desirability of another survey can then be determined on the basis of how much the increased accuracy of the data would be worth as compared to the costs involved to both the Government and the private sector in undertaking a survey.

One important step toward improving our data-gathering capability has already been taken by you, Mr. Chairman, in introducing the International Investment Survey Act of 1975, S. 2839. Thus far, we have been relying on a patchwork of laws to collect data on foreign portfolio investment, laws which are either clearly lacking in some respects or ambiguous as to our authority to collect such data. S. 2839 would give us broad and permanent authority to collect data on all forms of international investment, and we again strongly support its passage with the amendments I proposed in my testimony of February 23, 1976.

My final observations go to the basic question which gave rise to this study over 2 years ago: Is the magnitude and nature of foreign investment in this country such that a change in our basic policy toward this investment should be made?

As you know, this country has traditionally had an open-door policy toward foreign investment. We do not impose special barriers to such investment, except for a few longstanding and internationally recognized restrictions, nor do we offer special incentives for such investment. Furthermore, foreign investors are generally treated equally with domestic investors once they are established here; that is, they are accorded "national treatment." This policy is based on the premise that investment in this country from foreign sources is generally beneficial to our economy just as is investment from domestic sources, and that the allocation of investment capital will be most productive if decisions on investment are left to the marketplace.

There is nothing in the findings of our study to indicate that this policy should be changed in any way. On the contrary, the study has reinforced our view that foreign investment is beneficial to our economy and that we should continue to welcome it. As long as our national security is protected, and as long as the company is willing to abide by our laws and compete in our marketplace, we should not object as to whether its owner is from the United States, or France, or Abu Dhabi.

The benefits of foreign investment are readily apparent when they are made directly in the form of new plants and equipment—so-called "bricks and mortar" investment. In the case of portfolio investments by foreigners, however, it is sometimes thought that we get nothing of substance, that only "paper transfers" are involved since foreigners are merely converting their holdings of liquid dollars into other forms of paper assets such as stocks and bonds.

This notion overlooks the fact that in the capital investment process there are many different kinds of investors and all of them play a vital role. Portfolio investors, domestic and foreign, broaden the market for U.S. securities, and thereby the opportunities for American firms to acquire the financing needed for new investments in "bricks and mortar." Even if foreigners never injected capital directly into U.S. firms by buying new security issues, their role would be no less beneficial since the market for new issues is directly dependent on a broad and lively secondary market.

The more participation we have in our capital market, the more efficient it is in serving the needs of our economy for investment capital. The participation of foreign investors serves this purpose just as that of American investors does, and distinctions made on the basis of the nationality of investors have no economic rationale.

The American capital market is the largest and most efficient capital market in the world. Unrestricted access of foreigners to our market—both as lenders and borrowers of portfolio capital—is beneficial to this market. It is also beneficial to the interchange of goods, services, and capital between nations, which is vital to the growth of the United States and the world economy.

Rather than contemplating new restrictions on foreign capital inflows, we should seek to assure that impediments to these healthy additions to our economy are minimized. The administration's proposal to remove the withholding tax on dividend and interest payments to foreigners is an important step in this direction. We should continue to look for other measures we can take to assure that our capital market continues to grow as the world's major international financial center.

Exhibit 48.—Statement by Assistant Secretary Parsky, submitted for the record to the Senate Judiciary Committee in connection with S. 2387, June 9, 1976, entitled "Oil Company Divestiture"

Due to the cancellation of the June 8, 1976, hearings on the Petroleum Industry Competition Act of 1976 (S. 2387), I am, pursuant to the committee's request, submitting this written statement for the record.

My statement is concentrated on the financial aspects of divestiture- with particular emphasis on the effects on capital formation in the energy industry. However, in order to determine whether divestiture is in our national interest, we also examined the probable effects on the supply and price of energy, the effect on overall industry efficiency, the impact on our ability to deal with the OPEC (Organization of Petroleum Exporting Countries) cartel, and the legal aspects of divestiture. All of these factors are important because in one way or another, they enable us to answer what should be our ultimate question: whether oil company divestiture will enhance or impede our energy objectives.

A. **Basic reasons for opposing divestiture legislation**

At the outset, I should make it clear that the Treasury Department has concluded that divestiture would be contrary to U.S. national interests and severely handicap the achievement of our national energy goals. Our reasons include the following:

First, divestiture would create uncertainties, inefficiencies, and new entry barriers, which would seriously hamper the development of additional energy supplies and in all likelihood put upward pressure on energy prices. The uncertainty which would be inevitable in the transition period and the eventual loss of economic efficiencies which now exist in integrated oil operations will reduce the ability and efforts of the energy industry to develop additional sources of supply. Given the fact that one of the critical parts of our national energy program must be to increase domestic energy supplies, it would be contrary to our national interest to embark on a course which will, in all likelihood, lead to lesser supply and greater imports.

Second, the financial uncertainties resulting from divestiture will increase the cost of capital to affected firms and reduce their ability to raise external capital for investment in alternative energy supply sources.

Third, divestiture would in all probability increase OPEC's influence in the international oil market, thus increasing our vulnerability to a cutoff in supply by OPEC. Divested U.S. firms would probably be less able to develop non-OPEC foreign sources of supply, and a divested U.S. international energy industry would complicate the operation of the International Energy Agency (IEA) emergency oil sharing program—one of our main lines of defense in case of another embargo.

The proponents of divestiture claim that it will increase competition, lead to lower energy prices, greater energy supplies, and a reduced influence and dominance of the oil-producing countries. Our analysis shows why we believe the opposite effects would take place, and I believe that the burden of proof should be on those who are calling for this costly restructuring of the energy industry to establish the benefits that would result. The proponents of divestiture have simply not demonstrated that there will be substantial benefits from divestiture. They have produced no convincing evidence that it will lead to lower prices and increased or more secure supplies of energy.

By enacting a divestiture bill, Congress would be circumventing normal antitrust procedure and substituting its judgment for the judgment of the judicial system. The preambles of most of the recently introduced energy divestiture bills imply (1) that our antitrust agencies have been dilatory and ineffective because they have not found sufficient evidence of monopoly power in the oil industry to support a national antitrust complaint under existing law, and (2) that Congress needs to take independent action. As such, by enacting divestiture legislation, Congress would be legislating a guilty verdict and a harsh penalty without a trial based on carefully accumulated evidence.

Our antitrust laws are sufficient to cure any of the alleged problems resulting from the present structure and operation of the petroleum industry, and, in our view, we should rely on them rather than rushing into the broad restructuring implied by divestiture legislation.

These are the fundamental reasons why we strongly oppose divestiture. In the balance of my testimony, I will outline in more detail the basis for our position.

B. Uncertainty created by implementation of divestiture

Clearly, one of the significant effects of divestiture will be the uncertainty created by the administrative and legal problems associated with the actual implementation of divestiture. This uncertainty will, in our view, have a major impact on the ability and incentive of the industry to develop new energy supplies.

Method of implementation.—Divestiture has been used as an antitrust remedy in the past, and the resulting legal and administrative problems, while complex, have been manageable. What is different in this case is the scope of the undertaking, the nature and structure of the affected industry, and the critical time at which divestiture of this vital industry would be ordered.

Under vertical divestiture, 18 affected companies would be allowed to continue operating in only one of the following sectors of the petroleum industry: Production, transportation (by domestic pipeline), or refining/marketing. Analysis of the breakdown in investment by these companies in each area indicates that typically 40 percent to 60 percent of their assets would have to be divested.

Divestiture could be implemented by outright sales of assets. However, it is doubtful that the sale of assets alternative would be used extensively because of (1) the large volume of assets to be divested ($70–$80 billion), which may drive down the values received upon sale, and (2) questions about the availability of buyers capable of purchasing the assets for cash and their acceptability from an antitrust and national interest standpoint. Divestiture could also be implemented by spinoffs—the transfer of assets to a new corporate entity owned by existing stockholders. However, spinoffs, because they dispose of assets without direct return of value, reduce the asset and earning power backing for the divesting company's outstanding debt.

Legal problems.—Although S. 2387 calls for a transition period of 5 years, legal challenges to the constitutionality of the legislation and to the fairness of specific divestiture plans could suspend or impede full implementation of divestiture until due process is given and the legal issues resolved. Thus, it is possible that the transition period would extend for 10 or more years.

In addition, the question of whether existing loan covenants and indenture agreements are actually violated by divestiture plans is likely to lead to litigation and add to the uncertainty of the transition period. Lenders who are relying on a company's overall creditworthiness as security for investments may believe that their interests are adversely affected under divestiture and might litigate or attempt to enforce their rights under existing loan agreements which generally place restrictions on the sale or spinoff of assets. While negotiated solutions to such problems with lenders will eventually be arranged in most cases, the results which are achieved may entail shorter repayment schedules, security against some of the corporation assets and higher interest rates.

In some situations, negotiations with lenders might solve such problems by allocating the outstanding debt among the divested companies. In other situations, negotiated solutions might be achieved by use of cross guarantees, under which each entity created from the former corporation would guarantee the full amount of the outstanding debt. However, that approach poses several legal and practical problems with respect to enforceability of such guarantees and may even be prohibited as constituting a form of "control" impermissible under the legislation.

Lastly, there are particularly difficult problems relating to foreign entities and the treatment of the foreign assets and liabilities of U.S. companies. For example, foreign government or entities whose interests are harmed by divestiture might bring legal proceedings under their own laws and courts and thus enjoy the possibility of enforcing their claims and executing judgments against assets located outside the United States before divestiture is actually implemented. Laws in countries requiring the government's approval of foreign investments may operate to prevent certain planned dispositions of foreign assets or, by limiting potential purchasers, to deny U.S. sellers the highest market value for the assets being sold. Analysis of the location of the assets and liabilities of the major international petroleum companies indicates that these problems are potentially very significant for some firms.

Substantial differences from previous divestiture experience.—The foregoing discussion indicates a number of significant legal and administrative problems in implementing divestiture. The types of problems encountered have, of course, been faced before in other divestitures, both judicial and legislative, as well as in voluntary corporate spinoffs. However, there are substantial differences in the proposed vertical divestiture and previous divestiture experiences.

First, much judicially ordered prior divestiture experience has been in connection with Clayton Act antimerger cases, making divestiture easier since the divested components are already *relatively* independent. This is also true for the legislated divestitures involving the banking and the public utility industry (i.e., the Glass-Steagall Act, mandating separation of commercial and investment banking; the Bank Holding Company Act of 1956, requiring bank holding companies to divest nonbanking operations; and the Public Utility Holding Company Act of 1935, which broke up utility holding companies). Vertical divestiture of the functional components of an integrated company is substantially different and more difficult.

Second, as contrasted to the proposed vertical divestiture, the amount of assets divested in other situations has frequently been quite small relative to the assets of the ongoing corporations, thus reducing the problems in negotiating satisfactory agreements with existing lenders and attracting new external financing during the transition period.

Third, in no previous divestiture case have the problems involved in the treatment of foreign assets and liabilities even approached the ones created by the proposed vertical divestiture.

Fourth, the absolute size of the undertaking in terms of the amount of assets to be divested ($70–$80 billion) substantially exceeds that of previous divestitures, including the Public Utility Holding Company Act. This act required the divestiture of assets valued, in current dollars, at about one-half that involved in the proposed divestiture. The simultaneous divestment of such a large amount of similar assets may create significant problems in finding acceptable buyers at reasonable prices.

Clearly, the combination of these problems and the high probability of extended litigation will create substantial uncertainty in the minds of existing and potential investors.

C. Financial implications of uncertainty

Capital needs.—This uncertainty will, in turn, create significant financial and capital formation problems for the domestic petroleum industry as it tries to meet its substantial capital investment and external financing requirements. Forecasted capital requirements for the U.S. domestic petroleum industry for the 1976–85 period approach $250 billion (in 1974 dollars). It is clear that substantial amounts of external financing will be required if that overall level of capital investment is to be achieved. For example, between 1965 and 1974, a group of 30 large petroleum companies producing oil and gas in the United States raised external financing of $38.3 billion (of which $35.1 billion was long-term debt). This external financing represents approximately 28 percent of those companies' $139 billion in worldwide capital expenditures, investment, and increases in working capital. The impact of vertical divestiture on the ability of affected petroleum companies to raise new external capital is thus of critical concern, especially since the industry's future proportion of external financing is expected to rise even higher than the historical level due to the need for sharply higher amounts of capital investment.

Raising external capital.—When assessing the ability of the affected companies to raise external financing during the transition period, three important factors must be weighted and balanced. *First*, many, although not all, of the affected companies rank among the largest and most creditworthy firms in the Nation. Such firms must be assumed to have a considerable capacity to adjust to and cope with the problems created by divestiture. *Second*, both existing and potential investors face a situation where the company in which they have an interest will undergo a radical alteration; and they would, in many cases, end up with smaller investments in several new companies. *Third*, the great bulk of external financing is debt financing provided by financial institutions such as commercial banks, life insurance companies, and pension funds, which, as a matter of policy and/or as required by law, generally follow conservative investment practices.

In the normal course of business operations, both equity and debt investors are accustomed to assuming certain risks. However, with vertical divestiture—particularly in the early stages of the transition period—investors will be faced with a multitude of uncertainties for which the ultimate resolution is essentially unpredictable. For example, there will be a lengthy period of uncertainty about the structure of the new firms, their relationships with existing creditors and equity owners, their future creditworthiness, and the treatment of foreign assets and liabilities. All of these factors will have a detrimental effect on the availability of external capital to these firms. With a significant increase in uncertainty, it can be expected that the cost of new external financing would rise, and in certain cases, supplies of capital would discontinue making investments until the divestiture uncertainties are resolved.

More specifically, we believe that the financial effects of divestiture upon the affected companies during the transition would include the following:

The sale of new *unsecured long-term debt issues*, including the refinancing of maturing issues, would probably not be possible until lenders could ascertain what corporate entity would be responsible for debt repayment. Under current bills, this hiatus could run 1–1 1/2 years or longer if delays are encountered. In addition, should the FTC or some other body be given the power to rewrite loan covenants, problems in attracting significant amounts of new debt investments could persist for many years unless such investments are exempted from FTC reformation, and thus possibly given a preferred position over existing creditors' rights.

Some amount of *secured long-term debt*, such as mortgages on specific buildings, may be possible since the basic security of the loans would be the asset rather than the creditworthiness of the parent company. However, the potential volume of such financing, with the possible exception of loans secured by future oil production, may be limited by the specialized nature of many of the oil companies' assets.

It is unclear what the impact on the availability of *unsecured short-term* seasonal loans would be. However, such short-term lenders would have many of the same concerns as long-term lenders if it appeared that their loans might not be repaid prior to actual divestiture. Some amount of *short-term credit* secured by accounts receivables and/or inventories probably could be arranged during the transition period.

Judgments about the availability of new *equity capital* during the transition period are particularly speculative. However, it is likely that the huge uncertainties prevailing during that period will have a temporary freezing effect on equity investors.

Conclusion.—The financial problems associated with divestiture will clearly vary from firm to firm and will depend not only on the availability of external capital but also on the company's ability to generate and use internal funds. However, it is clear that as long as the uncertainties associated with implementing divestiture exist, the cost of capital for most companies would rise and the ability of some to attract external capital and finance energy investments would be adversely affected. In addition, the firm's incentive to make such new investments would be adversely affected by such uncertainties.

Although it is difficult to forecast with precision the exact size of the shortfall in investment, given all the above factors, we believe that the magnitude could be substantial.

D. Long-term financial effects

These transition period effects on investment and the development of new energy supplies are particularly significant. This transition period, which I would emphasize could extend for the next 10 years or more, is the same period during which the domestic energy industry must make massive investments if the Nation is to reduce its dependence on foreign oil. However, in addition to these transition effects, there may also be adverse post-transition-period financial effects of divestiture.

First, the existing integrated companies would, in all probability, have a greater debt capacity than the aggregate debt capacity of the divested component companies since an integrated company has greater stability in its level of cash flow and is viewed as offering a greater likelihood for principal and interest payments on debt to be met. *Second*, in the case of vertical divestiture, the required levels of working capital probably would also rise. *Finally*, the size and output thresholds imposed by divestiture would effectively place growth ceiling on firms approaching those limits and dampen incentives to invest in those firms.

E. Supply and price implications of divestiture

A major expectation of divestiture proponents is that it would increase competition, thus resulting in increased supplies and lower prices. Even if we ignore OPEC market dominance in the near term, no evidence has been presented to support such a conclusion. In fact, we believe the reverse is far more likely: that divestiture will lead to a rise in domestic prices and a decline in domestic supplies.

We believe that this result will occur because of a number of factors, including the following:

First, in response to short-term uncertainties, firms will be reluctant to commit internally generated funds to new projects and external financing will, as I noted previously, be more difficult and/or more costly to raise. Moreover, corporate management will have to direct a significant amount of its effort and attention to preserving or realizing the value of existing assets rather than expanding energy supplies. As a result, priorities for the vigorous expansion of domestic oil and gas resources will be downgraded, which will delay the development of these resources and result in domestic supply being less than it would have been in the absence of divestiture. The gap would, of course, be made up by increased imports from OPEC. Lower investment in new supplies would, therefore, result in upward pressure on price and tend to strengthen OPEC market power.

Second, divestiture introduces new barriers to the flow of investment resources. For example, entry barriers in crude production, and refining-marketing will be raised by vertical divestiture, since divested firms would be prohibited from reentering divested segments. Hence, new entry by firms that otherwise would rank among the most likely potential entrants and have both the capability and incentives to enter would be prohibited by law. Moreoever, since divestiture specifies a minimum-size operation that would be subject to the divestiture law, firms not currently affected by this legislation could not grow beyond that specified limit. As markets and technology change over time, the legislated limitations on size could lead to some companies being trapped in relatively inefficient operating modes. Introduction of barriers to the flow of resources usually results in decreased efficiency of production and consumption of goods and services.

Third, we have found no evidence to suggest that divestiture would produce an increase in operating efficiency and, consequently, place downward pressure on prices. On the contrary, there appear to be logistical, managerial, and risk-avoidance efficiencies associated especially with vertical integration which would be lost under divestiture. As a minimum, inefficiencies attributable to the need to build more flexibility into refineries and transportation systems, maintain larger inventories, and duplicate managerial and administrative functions will result. The added costs associated with these new inefficiencies would tend to create upward pressure on price.

On balance, the uncertainties, new entry barriers, and potential inefficiencies introduced by divestiture would most likely result in greater costs and lower production.

F. Effects on relations with OPEC

Proponents of divestiture also argue that it will lead to lower world oil prices and a weakening of the market power of OPEC over our petroleum imports. We have reached different conclusions. We believe that the proposed divestiture legislation (1) would not reduce our vulnerability to continued OPEC price fixing, (2) would likely seriously impact on U.S. control of delivery of our essential petroleum imports, and (3) seriously complicate our efforts to minimize the impact of any future oil embargo by means of the emergency sharing program of the International Energy Agency. In addition, we believe that the divestiture of the foreign portion of the activities of our U.S. oil companies implied by the legislation under consideration could seriously retard development of non-OPEC foreign sources of oil. Clearly, this would have an adverse impact on our efforts, and those of our IEA partners, to reduce our dangerous overdependence on OPEC oil.

While recognizing that the impact of divestiture on the international operations of U.S. oil companies will depend on the specific language of the legislation and the course of action elected by each company, it appears that they must either divorce their international operations from their U.S. operations or fragment their international operations along the same lines as they elect domestically.

Clearly, fragmentation of the existing U.S. oil companies into many independent units will offer the OPEC the advantage of dealing with an increase in the number of companies who must compete with each other for whatever crude oil OPEC chooses to make available.

Confronting a cartel with an increase in the number of alternative purchasers of its oil will certainly not weaken its market power. In fact, by fragmenting whatever bargaining power and flexibility our integrated companies now have vis-a-vis the OPEC, the reverse is clearly much more likely to be the case.

As I have already pointed out in discussing the financial implications of divestiture, a likely consequence will be an increase in costs of capital. In addition, we have pointed out that fragmentation of companies could not only eliminate existing efficiencies but introduce inefficiencies. We believe that these factors could significantly raise the cost of development of non-OPEC foreign sources of oil, thus reducing the likelihood that such investments will be made. In addition, we believe that divestiture, by creating barriers to investment activities of U.S. energy companies, is likely to eliminate one of the strongest motives for worldwide exploration and development of new sources of oil by our companies—the assurance of secure supplies of crude oil for their downstream activities.

In short, we have concluded that divestiture appears likely to retard significantly our progress toward elimination of the dangerous vulnerability to price increase and embargo which results from our overreliance on OPEC oil.

Conclusion

I have concentrated my statement today on a rather technical analysis of the effects of divestiture. However, in order to appreciate fully the consequences of divestiture, it is important to view the proposed legislative actions as part of a general policy choice that faces us today. Although legislated divestiture of the oil industry is not a new idea, I believe the present level of support for this proposal is part of a growing willingness by many people to inject the Government into the activities in our private sector in a counterproductive and inappropriate manner.

We seem tempted to turn more and more to superficial political solutions to complex economic problems. Not enough people seem to have recognized that more often than not, Government "solutions" lead to further problems and yet more Government involvement to undo the effects of earlier "solutions." For example, the expected shortfall in the level of capital investment during the transition period could create substantial pressure for increased Federal financial assistance to the petroleum industry. Unfortunately, we have not yet learned that the appealing solution politically often yields poor economic results. The divestiture proposals now before Congress are an extraordinary example of this unfortunate situation, and for the reasons I have outlined for you today, the Treasury Department strongly opposes enactment of S. 2387.

International Monetary Affairs

Exhibit 49.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, issued after its fourth meeting, Washington, D.C., August 31, 1975

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its fourth meeting in Washington, D.C. on August 31, 1975 under the chairmanship of Mr. John N. Turner, Minister of Finance of Canada. Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, participated in the meeting. The following observers attended during the Committee's discussions: Mr. Henri Konan Bedie, Chairman, Bank-Fund Development Committee, Mr. Gamani Corea, Secretary General, UNCTAD, Mr. Wilhelm Haferkamp, Vice President, EC Commission, Mr. Rene Larre, General Manager, BIS, Mr. Emile van Lennep, Secretary General, OECD, Mr. F. Leutwiler, President, National Bank of Switzerland, Mr. Robert S. McNamara, President, IBRD, and Mr. Gardner Patterson, Deputy Director General, GATT.

2. The Committee had a discussion of the world economic situation and outlook, and expressed its concern about the current severe problems of recession and unemployment, balance of payments disequilibria, and inflation. The Committee felt that industrial countries which have slack domestic demand conditions and relatively strong balance of payments positions, and which have made progress in reducing inflation, should lead in the promotion of a satisfactory rate of expansion in world trade and activity. The Committee believed that, on the basis of such a coordinated policy approach, a resumption of economic growth might be expected for the industrial world during the latter part of 1975 or the first half of 1976. Although rates of price increase in industrial countries have generally been subsiding, the Committee noted the disturbing fact that economic recovery in the industrial world will get under way with rates of inflation still unacceptably high.

Throughout the Committee's discussion, particular concern was expressed for the many primary producing countries, and especially the developing countries, whose current account deficits have been greatly enlarged by the increase in import costs and the downturn in global demand. Resumption of growth in world trade is urgently needed to alleviate the plight of such countries. Moreover, the Committee feared that, unless they were able to obtain adequate financing, many primary producing countries might have difficulty in fending off pressures to restrain imports, either through deflationary demand measures that would undermine their development efforts or through resort to trade restrictions. In view of these dangers, the Committee expressed the hope that the Executive Board would consider various steps that might be taken by the Fund to meet the present urgent need for a greater volume of financing.

3. The Committee noted the improvements in the 1975 Oil Facility introduced as a result of the July review by the Executive Directors and endorsed the efforts now in progress to raise the amount of resources that the Fund would be able to borrow for the financing of purchases under that facility to the total of SDR 5 billion that was agreed at the meeting of the Committee in January 1975. The Committee also endorsed the intention of the Executive Directors to have another review of the 1975 Oil Facility at an early date, one purpose of which would be to determine what action needs to be taken in the best interests of the international community, and also to undertake at about the same time a broader examination of the Fund's policies on the use of its resources.

4. The Committee welcomed the establishment of a Subsidy Account to assist those members that have been most seriously affected by the current situation to meet the cost of using the Oil Facility and commended those members that have already stated their willingness to make contributions to that account. At the same time, the Committee expressed concern at the fact that the total amount of the contributions by members that have already stated their willingness to contribute is substantially short of the total support that was contemplated and urged those members that have not yet pledged their support to make every effort to do so as soon as possible.

5. The Committee noted the progress made by the Executive Directors on the Sixth General Review of quotas within the framework of the understandings reached at previous meetings of the Committee. The Committee noted the agreement on increases in the quotas of almost all members. In particular, the increases for the industrial countries and for the major oil exporting members have been agreed. The differences that remain among the other members are few and are expected to be resolved soon. The Committee asked the Executive Directors to prepare and submit to the Board of Governors a resolution on increases in the quotas of individual members. The Committee also asked the Executive Directors to complete their work on the mode of payment of the increases in quotas on the basis of the understandings already reached in the Committee so that appropriate recommendations can be submitted to the Board of Governors at the same time as the resolution on increases in quotas. The Committee reiterated its view that all of the Fund's holdings of currency should be usable in its transactions. The Committee agreed that on the question of majorities for the adoption of decisions of the Fund on important matters, a majority of eighty-five per cent should be required under the amended Articles for those decisions that can now be taken by an eighty per cent majority. It also agreed that amendments of the Articles should become effective when accepted by three-fifths of the members having eighty-five per cent of the total voting power.

6. The Committee discussed the problem of gold, including the disposition of the gold holdings of the Fund. The elements of the consensus reached are described in this paragraph.

At the meeting of the Interim Committee on January 16, 1975, it was decided to move "toward a complete set of agreed amendments on gold, including the abolition of the official price and freedom for national monetary authorities to enter into gold transactions under certain specific arrangements, outside the Articles of the Fund, entered into between national monetary authorities in order to ensure that the role of gold in the international monetary system would be gradually reduced."

To implement this general undertaking, provision should be made for:

1. Abolition of an official price for gold.
2. Elimination of the obligation to use gold in transactions with the Fund, and elimination of the Fund's authority to accept gold in transactions unless the Fund so decides by an 85 per cent majority. This understanding would be without prejudice to the study of a Gold Substitution Account.
3. Sale of 1/6 of the Fund's gold (25 million ounces) for the benefit of developing countries without resulting in a reduction of other resources for their benefit, and restitution of 1/6 of the Fund's gold to members. The proportion of any profits or surplus value of the gold sold for the benefit of developing countries that would correspond to the share of quotas of these countries would be transferred directly

to each developing country in proportion to its quota. The rest of the Fund's gold would be subject to provisions in an amendment of the Articles that would create enabling powers exercisable by an 85 per cent majority of the total voting power.

The Committee noted that, in order to give effect to the understandings arrived at in this Committee, the countries in the Group of Ten have agreed to observe during the period referred to below the following arrangements, which could be subscribed to by any other member country of the Fund that wishes to do so. Other members might adhere to these arrangements, and on such occasions the necessary modifications in them would be made:

1. That there be no action to peg the price of gold.
2. That the total stock of gold now in the hands of the Fund and the monetary authorities of the Group of Ten will not be increased.
3. That the parties to these arrangements agree that they will respect any further condition governing gold trading that may be agreed to by their central bank representatives at regular meetings.
4. That each party to these arrangements will report semi-annually to the Fund and to the BIS the total amount of gold that has been bought or sold.
5. That each party agree that these arrangements will be reviewed by the participants at the end of two years and then continued, modified or terminated. Any party to these arrangements may terminate adherence to them after the initial two-year period.

Many members from developing countries expressed concern that the proposed arrangements for gold would give rise to a highly arbitrary distribution of new liquidity, with the bulk of gains accruing to developed countries. This would greatly reduce the chances of further allocations of SDRs, thereby detracting from the agreed objective of making the SDR the principal reserve asset and phasing out the monetary role of gold. This aspect should be studied, and measures explored to avoid these distortions.

7. The Committee noted the work done so far by the Executive Directors on the subject of the establishment of a trust fund and the possible sources of its financing in response to the request of the Development Committee. It was agreed to ask the Executive Directors to pursue their work with a view to completing it at an early date, taking into account the understandings reached in the Committee with regard to the use of profits from the sale of part of the Fund's gold for the benefit of developing countries, without neglecting the consideration of other possible sources of financing.

8. It was agreed that acceptable solutions must be found on the subject of the exchange rate system under the amended Articles, so that these agreed solutions can be combined with those on quotas and gold. The Executive Directors were requested to continue their work in order to arrive at acceptable solutions and to prepare for submission to the Board of Governors, after examination by the Committee at its next meeting, appropriate proposals for amendment of the Fund's Articles on all aspects that have been under consideration.

9. The Committee noted that the Executive Directors are in the process of conducting a review of the Fund's facility on compensatory financing with a view to improving a number of its aspects. It was agreed to urge the Executive Directors to complete their work on this subject as soon as possible, taking into account the various proposals that have been made by members of the Committee.

Exhibit 50.—Statement by Secretary Simon as Governor for the United States, September 2, 1975, at the joint annual meetings of the Boards of Governors of the International Bank for Reconstruction and Development and its affiliates and the International Monetary Fund, Washington, D.C.

It is a privilege to address this distinguished audience once again and to share with you today the views of the United States on the major economic issues facing the world.

In general, the outlook for the international economy is now more hopeful than it was earlier this year. Most of the major industrial countries have adopted vigorous expansionary policies. Several nations, including the United States, have begun the process of recovery. Despite serious strains, the level of international cooperation remains undiminished. Few countries have resorted to policies which might yield domestic gains at the expense of their neighbors. And the more affluent nations are strengthening their efforts to assist those who are less fortunate.

Yet there can be no doubt that the pattern of progress is highly uneven. In a number of countries, the downward economic spiral continues still, becoming more prolonged and severe than once expected. The hardships created by an inflation of unparalleled strength, brutally sharp and unanticipated increases in the cost of energy, and a harsh recession—all of these remain a painful, living reality in too many parts of the world. Thus, the urgent task still before us is to work together in restoring a broadly based, forward momentum to the world economy which will provide the foundation for sustained, noninflationary growth in every nation.

As we press forward, it is essential that we maintain our bearings:

We must carefully support and encourage the forces of recovery without yielding to the temptations of excessive stimulation.

We must persevere in our efforts to control inflation without disrupting the process of recovery. A durable recovery will be possible only if we master the causes of inflation.

We must reach a better accommodation on the problems of energy while continuing to support the oil-exporting nations in their quest for economic advancement.

We must encourage economic development among poorer nations.

We must ensure that we have a smoothly functioning monetary system.

Let me turn now to a more detailed consideration of each of these issues.

Prospects for economic growth

The United States is acutely aware that its own economic policies bear heavily not only upon the livelihoods of our own citizens but upon those in other nations as well. While our economy is no longer as predominant in the world economy as it once was, our gross national product still amounts to over one-quarter of the world total and we represent the world's largest import market. Therefore, the single most important contribution we can make to the health of the world economy is to achieve durable, noninflationary growth within our own borders.

Fortunately, there is now abundant evidence that an economic recovery is well underway in the United States. My Government is determined to sustain this recovery while also bringing inflation under control and adopting those policy measures necessary for lasting growth. We need not, and we should not, seek to choose among these objectives. We have learned from hard experience that all of our economic goals must be pursued simultaneously. We will not provide excessive stimulation that would only intensify inflationary pressures, preempt the capital that is needed to sustain the recovery, and run the risk of setting off another vicious cycle of inflation and recession. Nor will we allow our concern with inflation to prevent us from actively supporting the natural forces of recovery or taking additional expansionary measures if they should be needed. We are not ready to acquiesce in either stagnation or inflation as a way of life.

Some have suggested that in order to help other nations out of recession, the United States should embark upon much more stimulative fiscal and monetary policies. We respectfully disagree. Too many of our current domestic troubles are rooted in such excesses in the past. Since 1965, the average U.S. Federal budget deficit and the average annual growth in our money supply have been about three times as large as in the preceding decade. It is no accident that during the earlier period our country enjoyed reasonable price stability while in recent years we have had increasing difficulty in containing inflation. And inflationary expectations are now so deeply embedded in our society that they will not disappear quickly. The financial sins of a decade cannot be forgiven by a day of penance. Our policies in the United States must be designed to attack the causes of inflation, not their results. In the long run, that will bring the most lasting benefits to us all.

While the revival of the U.S. economy will help to bolster both the economic prospects and the confidence of other nations, it would be unrealistic to expect that any single country could lead the rest of the world out of recession. Expanded world trade should not be regarded as the source but as the product of recovery. Indeed, let us recognize that the process of solving our economic troubles must begin at home with each country acting on its own to make the tough decisions that are essential for sound, durable growth. As that process spreads from one nation to the next, it will become mutually reinforcing and all nations will realize greater benefits. In addition to the expansionary efforts undertaken by the United States earlier this year, several other major industrialized nations have now adopted more stimulative policies. Taken together, these actions should provide a forward thrust to the world economy.

As our policies of expansion gradually take effect, we ask ourselves: Have we done enough? Should we do more to speed up the effects? To the extent that some of our people believe we are not moving rapidly enough to create jobs and to restore our standard of living, there may be adverse social and political pressures. Yet it is equally clear that if we overheat our economies, we will reignite the fires of inflation and create another recession with more serious economic and social consequences. Our highest responsibility as Finance Ministers, I would respectfully suggest, is to pursue sound, balanced policies which promote economic growth without encouraging renewed inflation. That often proves to be politically unpopular in the short run, but in the long run it will do far more to create jobs and serve the best interests of our people than the palliatives so often urged upon us. History is littered with the wreckage of governments that have refused to face up to the ravages of inflation, and none of us can afford, either through shortsightedness or lack of determination, to yield to these temptations.

Beyond the problems of determining fiscal and monetary policies, nations must also deal with the difficulties created by high oil prices.

Almost 2 years after the first oil price shock, it is evident that we are only beginning to understand the full impact as well as the threat to our future which is posed by escalating oil prices. It is now obvious that the most serious consequences are not financial but political and economic. While we must and will continue to devote special attention to the problems of the financial system in adjusting to new realities, we can be confident of our capacity to manage such problems. But the economic consequences of these oil policies—the higher costs that have come not just in energy but in many other vital commodities such as food, the structural adjustments that have been necessary, the loss of jobs, and the obstacles to economic growth—cannot be so easily managed.

In our view, current price levels for international oil can be justified on neither economic nor financial grounds. The present pricing policies of the OPEC (Organization of Petroleum Exporting Countries) countries mean that cheap energy remains in the ground and that the prosperity of all nations is diminished. Moreover, high oil prices lie at the root of much of the world's recent inflation and the recession that followed. Yet now the possibility of another increase in oil prices looms on the horizon. Let there be no misunderstanding about the result of another major price increase: it would seriously jeopardize the balance upon which global economic recovery now depends.

We urge the OPEC nations to recognize, as others have done in the past, that the prosperity of each nation is deeply intertwined with the prosperity of all nations.

Another price increase seems especially inappropriate in light of our efforts to address the legitimate problems facing the oil-exporting nations as well as other developing countries. We have taken significant steps to bring about a dialog between producers and consumers. We have proposed the establishment of commissions to deal with critical problems in the areas of energy, raw materials, development, and related financial questions. Special bilateral programs have been set up with the oil-exporting countries and considerable progress has been recorded. All of these measures reflect our sincere desire to work cooperatively with the oil exporters as they strive for higher standards of living and more diversified economies. In turn, we urge that they work cooperatively with us and with other nations to enhance the prospects for a world economic recovery.

Let me add that the substantial financing requirements of industrial countries in this period of OPEC surpluses dictate that we continue to keep the adequacy of international financing arrangements under review. I am confident that in the future, as in the past 2 years, private financing mechanisms will continue to play the dominant role in channeling OPEC funds to various borrowers. At the same time, we welcome the prospective establishment of the Financial Support Fund agreed upon among the member countries of the Organization for Economic Cooperation and Development. That fund will supplement IMF resources and provide needed insurance in an uncertain period. Particularly important in present circumstances is the assurance thereby provided that, if needed, financing will be available to facilitate the pursuit of sound expansionary policies by the industrial countries.

Problems of the developing countries

Those who have suffered the most from higher oil prices and the deterioration in world economic conditions have been those who least deserve to suffer and are least able to protect themselves—the poor and the needy of the developing countries. In the industrialized nations, the problems of inflation, exorbitant energy prices, and the resulting recession have often meant hardships, but they have not brought large numbers of people to the edge of desperation. Hopes for the future may have been dampened but they have not been crushed. Sadly, the same cannot be said of the less fortunate nations of the world, where hunger and illness are the immediate result of reduced incomes. In these circumstances, the United States and other industrial nations are determined to make special efforts to assist developing nations in their efforts to sustain the momentum of their economic and social progress. We do so from a sense of compassion, and out of a realization that the prosperity of the developing world also serves to support our own continued prosperity.

The World Bank and the International Monetary Fund have already proven that they are highly effective instruments for working with developing countries in devising the most promising plans for economic growth. But we believe that more must now be done within the framework of those institutions to assist the developing countries.

Yesterday, in a speech read on his behalf at the United Nations, Secretary Kissinger set forth a range of proposals that he and I, under the leadership of President Ford, have developed together. Three of those proposals are of particular importance for the Fund and the Bank.

First, the United States proposes as a matter of high priority that a development security facility be created in the IMF to meet the needs of those developing nations suffering from sharp fluctuations in export earnings. It would replace the existing compensatory finance facility. We fully recognize that excessive fluctuations in export earnings can disrupt development efforts and that many producing nations lack sufficient financial reserves to cushion themselves against sharp drops in their earnings. We believe that compensatory facilities to finance shortfalls in export earnings would be both more effective and more efficient in reducing such disruptions than commodity pricing arrangements. Shortly after the completion of these meetings, we will submit detailed proposals to the Executive Board of the IMF calling for the creation of the facility. They will also call for broadening the purposes of the proposed trust fund, enabling it to provide grants to the poorest countries experiencing export shortfalls and allowing some use of the trust fund resources to supplement the proposed facility.

Secondly, we pledge our support to a major expansion of the International Finance Corporation (IFC), permitting that organization to serve as a more effective catalyst for growth of the private sector in developing countries. We agree with Mr. McNamara that the role of the IFC in mobilizing additional private investment is now more important than ever. There can be little doubt that much of the increase in living standards within developing countries must come from increased private sector production of goods and services. Arrangements should be made in the next few months to give the IFC better tools to assist the domestic private sector and to make the IFC a full partner in the Bank group. Moreover, the IFC should play an active part in bringing together foreign and domestic investors. It should act aggressively to arrange financing for mineral production in developing countries where, as an impartial international party, it can help to smooth relationships between international companies with technology and markets and national authorities who understandably wish to strike the best bargain for their countries. The IFC should also develop imaginative financial arrangements, including a new investment trust, so that equity shares in joint ventures can gradually be purchased by private individuals and firms in developing countries. All of these activities will complement the ongoing work of the World Bank, which must continue to assist in financing related infrastructure such as ports and roads and will, we expect, give higher priority to the most important aspect of identifying obstacles to private savings and domestic private investment in developing countries.

Thirdly, the United States once again urges that agreement be promptly reached on the establishment of a trust fund managed by the IMF in order to provide highly concessional balance of payments financing for the poorest developing countries. Nearly a year has passed since my Government first proposed the trust fund and urged that a portion of the IMF gold be sold to help finance this worthy cause. We are pleased that there has been increasing recognition that the trust fund concept represents the most effective means of providing fast-disbursing financial support. This is one way we can move ahead immediately to respond to the severe financing needs faced by the developing countries; we can agree now to see a portion of IMF gold used without waiting for time-consuming amendments of the Articles. Even as we have delayed in establishing this fund, the need for it has grown. Let us resolve to act promptly.

In addition to these major initiatives, other steps should be taken so that the Bank and the Fund can more adequately meet today's needs. As the oil facility of the IMF phases out this year, we should take action to assure the immediate usability of all currencies held by the IMF. We also need to direct early attention to a review of the tranche policies of the Fund and to consider whether changes should be introduced in these policies in order to provide increased access to the Fund's regular drawing facilities. This would enable the Fund to play the expanded and more active role required of it in today's world.

The World Bank is by far the largest and most influential development lending institution and as such has a major role to play in assisting developing nations achieve their development goals. It is of the greatest importance that the quality of this work and the soundness of its financial position be sustained. Since the lending program now being implemented by the Bank carries with it demanding assumptions about the Bank's long-term ability to borrow funds, it is important that the management and Executive Directors of the Bank work together to assess carefully the role the Bank should play in the development process in the next decade and to examine the implications of this for the capital of the Bank and the nature of its programs. With capital an increasingly scarce resource, critical for the growth of the developed as well as the developing countries, it is essential that we have a clear understanding of the priorities which should govern the lending of an institution whose borrowing now approaches $5 billion per year. The United States will continue to provide strong support to the Bank, and we will assist in helping it maintain a sound financial position.

As I said last year, we support a substantial increase in World Bank share ownership and voting power for countries newly able to make a major contribution to development through the Bank group. Such an increase should be determined country-by-country and increases in capital should be accompanied by commensurate contributions to the International

Development Association (IDA) to help the poorest countries as well as the middle-level countries.

I stress the importance of IDA contributions because of the association's central role in meeting the needs of the poorest and least developed countries. They have the least ability to deal with the impact of economic events on their development, and only a combined effort of present members and nations newly able to contribute will enable IDA to assist those countries adequately in the future. Mr. McNamara has announced that negotiations for the next replenishment of IDA will commence in November. A satisfactory agreement on extending IDA's resources will be possible only with the full collaboration of all countries in a position to contribute.

Beyond these measures, developed nations must also support the longstanding development efforts such as the regional development banks and our bilateral assistance programs. These programs have shown their effectiveness over the years and deserve to be strongly supported. It is also important for all countries to open their capital markets to the borrowing of the Bank and of the developing countries themselves.

In setting forth these proposals today and reviewing the activities of the World Bank and the International Monetary Fund, I would be less than candid if I did not add that in and of themselves, the measures I have outlined will not be sufficient to ensure economic development. We must not mislead ourselves on this matter. Far more important to the developing nations than the financial assistance that industrialized countries may provide to them is the restoration of stable, noninflationary growth around the world. And, in the long run, the policies and efforts of the developing countries themselves will be the most decisive. History has shown that no matter how generous others may be, those who have been helped the most are those who have helped themselves.

While the developed nations must provide financing and open up their markets, the effectiveness of such assistance depends heavily upon the ability of the developing countries themselves to assure the best use of all resources, domestic as well as foreign. Development assistance should be thought of not as an international welfare program to redistribute the world's wealth but as an important element of an international investment program to increase the rate of economic growth in developing nations and to provide higher living standards for people of every nation. The effectiveness of international investment, private and public, depends fundamentally on the policies and efforts of each developing country.

I am particularly struck by the impressive economic and social progress made by countries which participate fully in the world market, which rely on market forces to provide incentives for efficient use of resources, and which maintain a favorable climate for foreign and domestic private investment.

In short, the process of economic development requires the cooperation and full efforts of each of us in pursuing economic policies to maximize production, income, and trade for all countries.

International monetary arrangements

Let me turn now to a discussion of international monetary issues.

We have achieved a significant breakthrough in our meetings this week in resolving many of the most difficult international monetary issues before us and in paving the way for a final comprehensive agreement in January. The technically complex—and politically sensitive—question of arranging a major quota increase and allocating national shares is substantially resolved. We have also succeeded in settling the thorny issues involved in phasing gold out of the international monetary system. Both of these agreements required concessions by many, but the result provides concrete evidence of the continuing spirit of cooperation and good will on which these institutions are founded. Once again we have demonstrated that through patient negotiation it is possible to arrive at an accommodation of conflicting views which is acceptable to each of us and beneficial to all of us.

Let us now proceed to the final component of our negotiations—an agreement on amendment of the exchange rate provisions of the Articles—which will enable us to put into practice the accords reached here this week. Amended provisions are needed which give legal recognition to the realities of today's world and reflect the evolution of the system that has occurred in recent years.

Two and a half years ago the par value system gave way to a voluntary system of exchange rate practices under which some countries float independently, some float jointly, and some use pegged rates. We are fortunate that this system was actually in place before the oil crisis hit, and its flexibility has served us well in difficult circumstances.

Let those who see stability in par values review again the chaos and disorder of the closing years of the Bretton Woods system. Think back to those days of market closures which disrupted trade and commerce. Recall that the only sure winners were the speculators, who could be assured that with time and persistence they would inevitably carry the day. Remember, too, the hurried international conferences to try to patch together some solution so that markets might open again. Think back to the duration and difficulty of the

Smithsonian negotiations and the tensions associated with those negotiations. Those were the days when our political cohesion was threatened by monetary difficulties.

The basic logic of the par value system implies a world which does not now exist—one in which prices are reasonably stable, and in which current account balances adjust to capital flows that are relatively slow to change. But the world has changed and we need a system that is adaptable and is appropriate for the world as it is today, not as it once was or as we might like it to be.

Today we have a system which is flexible and resilient. It has enabled exchange markets to remain open and viable in the face of pressures that would have previously been overwhelming. Even the massive accumulations by the OPEC countries and occasional significant fluctuations in particular exchange rates have not unsettled the system. It has been possible to relax or eliminate many of the extensive restrictions on capital movements and to find viable alternatives to restrictive current account measures. The large payments deficits of today have provoked fewer import restrictions by major countries than did the comparatively minor payments difficulties of earlier years. Although rates of inflation have varied enormously, from 6 percent in some countries to 25 percent in others, the flexibility of our system has allowed exchange rates to move so as to reflect these divergences in costs and prices. Attempts to maintain fixed exchange rates under these circumstances would have quickly and inevitably collapsed under the strain.

Some contend that the abandonment of par values is one of the causes of the tidal wave of inflation which has swept the world and that the voluntary system fails to provide the discipline needed to induce countries to restrain their inflation. I cannot agree. It was inflation which made floating necessary. Of course, floating does not prevent home-grown inflation or protect a country from drastic real changes from abroad such as the sudden jump in oil prices. It can, however, shield a country from imported inflation that results from overly expansive fiscal and monetary policies abroad. As for floating as an instrument of discipline, I believe that when a depreciating exchange rate in a free market directly increases the costs of imported goods, that has more meaning to the general public and political leaders than the level of central bank reserves or official borrowing.

U.S. policy is to have our own exchange rate determined essentially by market forces, and not by arbitrary official actions. We do not propose to object if foreign countries elect to establish fixed exchange rates among themselves—the essence of a voluntary system is to permit a free choice—so long as our own desire for essential freedom of the dollar exchange rate is respected. We are prepared to intervene whenever necessary to maintain orderly exchange market conditions. However, sizable movements in exchange rates over a period of several months are not necessarily indicators of disorderly markets—and the fact that such movements are sometimes reversed does not demonstrate that it would have been possible for governments to prevent the initial movement in rates, nor desirable to try.

When the pressures of inflation subside and economies recover, when periods of calm between unexpected shocks become longer, then the behavior of exchange rates will become more stable. The greater exchange stability we all would like to see can only be achieved through sound economic policies which result in greater domestic stability in all of our economies.

We believe strongly that countries must be free to choose their own exchange rate system and that all countries, whatever choice they make, must be subject to the same agreed-upon principles of international behavior. The right to float must be clear and unencumbered. In view of the great diversity in political systems, institutional arrangements, size of national economies, and degree of dependence on foreign trade and investment, our present world requires an open mind about the future.

I do not pretend to have the wisdom or the clairvoyance to predict the precise exchange arrangements the world may desire or require far in the future. Experience with the present Articles provides clear evidence of the difficulty of specifying in rigid detail an exchange rate system that can be expected to last forever. We must deal with the world as it is today, and that now requires a system that can easily adapt to rapid change. I know this can be done. Our agreements this week on gold and quotas show that we can find answers to difficult problems—and that a mutually acceptable accommodation on exchange rates can be achieved. The United States will approach the search for a resolution of this problem with imagination and an appreciation of others' views. We know that others will do the same.

Conclusion

Ladies and gentlemen, it is apparent that the agenda for the future is formidable:

To achieve lasting, noninflationary growth;
To reach an accommodation on energy;
To encourage economic development; and
To maintain a monetary system adapted to today's needs.

Each of these demands our full attention. The agreements we have reached this week demonstrate that through cooperation and perseverance, we can succeed. It is in that spirit that we must continue to move forward. I pledge to you that the United States will remain a reliable partner in this journey.

Exhibit 51.—Text of the "Declaration of Rambouillet" following meeting of heads of states and governments of France, Federal Republic of Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States of America, November 17, 1975

The Heads of States and Governments of France, Federal Republic of Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America, met in the Chateau de Rambouillet from 15th to 17th of November, 1975, and agreed to declare as follows:

1. In these three days we held a searching and productive exchange of views on the world economic situation, on economic problems common to our countries, on their human, social and political implications, and on plans for resolving them.

2. We came together because of shared beliefs and shared responsibilities. We are each responsible for the government of an open, democratic society, dedicated to individual liberty and social advancement. Our success will strengthen, indeed is essential to democratic societies everywhere. We are each responsible for assuring the prosperity of a major industrial economy. The growth and stability of our economies will help the entire industrial world and developing countries to prosper.

3. To assure in a world of growing interdependence the success of the objectives set out in this declaration, we intend to play our own full part and strengthen our efforts for closer international cooperation and constructive dialogue among all countries, transcending differences in stages of economic development, degrees of resource endowment and political and social systems.

4. The industrial democracies are determined to overcome high unemployment, continuing inflation and serious energy problems. The purpose of our meeting was to review our progress, identify more clearly the problems that we must overcome in the future, and to set a course that we will follow in the period ahead.

5. The most urgent task is to assure the recovery of our economies and to reduce the waste of human resources involved in unemployment. In consolidating the recovery it is essential to avoid unleashing additional inflationary forces which would threaten its success. The objective must be growth that is steady and lasting. In this way, consumer and business confidence will be restored.

6. We are confident that our present policies are compatible and complementary and that recovery is under way. Nevertheless, we recognize the need for vigilance and adaptability in our policies. We will not allow the recovery to falter. We will not accept another outburst of inflation.

7. We also concentrated on the need for new efforts in the areas of world trade, monetary matters and raw materials, including energy.

8. As domestic recovery and economic expansion proceed, we must seek to restore growth in the volume of world trade. Growth and price stability will be fostered by maintenance of an open trading system. In a period where pressures are developing for a return to protectionism, it is essential for the main trading nations to confirm their commitment to the principles of the OECD pledge and to avoid resorting to measures by which they could try to solve their problems at the expense of others, with damaging consequences in the economic, social and political fields. There is a responsibility on all countries, especially those with strong balance of payments positions and on those with current deficits to pursue policies which will permit the expansion of world trade to their mutual advantage.

9. We believe that the multilateral trade negotiations should be accelerated. In accordance with the principles laid down in the Tokyo declaration, they should aim at substantial tariff cuts, even eliminating tariffs in some areas, at significantly expanding agricultural trade and at reducing nontariff measures. They should aim at achieving the maximum possible level of trade liberalization therefrom. We propose as our goal completion of the negotiations in 1977.

10. We look to an orderly and fruitful increase in our economic relations with socialist countries as an important element in progress in detente, and in world economic growth.

We will also intensify our efforts to achieve a prompt conclusion of the negotiations now underway concerning export credits.

11. With regard to monetary problems, we affirm our intention to work for greater stability. This involves efforts to restore greater stability in underlying economic and financial conditions in the world economy. At the same time, our monetary authorities will act to

counter disorderly market conditions, or erratic fluctuations, in exchange rates. We welcome the rapprochement, reached at the request of many other countries, between the views of the U.S. and France on the need for stability that the reform of the international monetary system must promote. This rapprochement will facilitate agreement through the IMF at the next session of the Interim Committee in Jamaica on the outstanding issues of international monetary reform.

12. A cooperative relationship and improved understanding between the developing nations and the industrial world is fundamental to the prosperity of each. Sustained growth in our economies is necessary to growth in developing countries: and their growth contributes significantly to health in our own economies.

The present large deficits in the current accounts of the developing countries represent a critical problem for them and also for the rest of the world. This must be dealt with in a number of complementary ways. Recent proposals in several international meetings have already improved the atmosphere of the discussion between developed and developing countries. But early practical action is needed to assist the developing countries. Accordingly, we will play our part, through the IMF and other appropriate international fora, in making urgent improvements in international arrangements for the stabilization of the export earnings of developing countries and in measures to assist them in financing their deficits. In this context, priority should be given to the poorest developing countries.

13. World economic growth is clearly linked to the increasing availability of energy sources. We are determined to secure for our economies the energy sources needed for their growth. Our common interests require that we continue to cooperate in order to reduce our dependence on imported energy through conservation and the development of alternative sources. Through these measures as well as international cooperation between producer and consumer countries responding to the long-term interest of both, we shall spare no effort in order to ensure more balanced conditions and a harmonious and steady development in the world energy market.

14. We welcome the convening of the conference on international economic cooperation scheduled for December 16. We will conduct this dialogue in a positive spirit to assure that the interests of all concerned are protected and advanced. We believe that industrialized and developing countries alike have a critical stake in the future success of the world economy and in the cooperative political relationships on which it must be based.

15. We intend to intensify our cooperation on all these problems in the framework of existing institutions as well as in all the relevant international organizations.

Exhibit 52.—Communique of the Ministerial Meeting of the Group of Ten, December 19, 1975, Paris, France

1. The Ministers and Central Bank Governors of the ten countries participating in the General Arrangements to Borrow met in Paris on December 19, 1975 under the chairmanship of Mr. W. F. Duisenberg, Minister of Finance of the Netherlands.

The Managing Director of the International Monetary Fund, Mr. H. J. Witteveen, took part in the meeting, which was also attended by the President of the Swiss National Bank, Mr. F. Leutwiler, the Secretary-General of the OECD, Mr. E. Van Lennep, the General Manager of the Bank for International Settlements, Mr. R. Larre, and Mr. U. Mosca, representing the President of the Commission of the European Communities, Mr. F.-X. Ortoli.

2. After hearing a report from the Chairman of their Deputies, Mr. R. Ossola, on the Deputies' preparatory discussions, the Ministers and Governors agreed as follows:

Exchange Rate Regime

3. The Ministers and Governors examined the amendments to Article IV proposed by the United States and French Ministers. They agreed on these proposals which they will support at the Interim Committee Meeting in Jamaica. They noted the statement of the Managing Director of the IMF that the Board of Executive Directors will examine these amendments in the coming week.

4. The Ministers and Governors discussed the United States-French proposals to intensify consultation procedures on exchange rate movements and underlying factors. They noted that their central banks were in the process of deepening and broadening their consultations and considered that these consultations will make an important contribution toward countering erratic fluctuations in exchange rates. They agreed that the organization of consultation procedures among Finance Ministers and their Deputies should be conducted on a pragmatic basis. They have also agreed to keep in close consultation with the Managing Director of the IMF.

Arrangements Concerning Gold

5. The Ministers and Governors agreed on the need for simultaneity in the implementation of the various elements in the arrangements concerning gold referred to in paragraph 6 of the press communique of the meeting of the Interim Committee on August 31, 1975.

6. The amended Articles of Agreement should include a clause by which the members of the IMF undertake to collaborate with the Fund and with other members in order to ensure that their policies with respect to reserve assets shall be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system.

Relations with Developing Countries

7. The Ministers discussed questions related to the need of the members of the Fund, and in particular the developing countries, for additional access to the Fund's resources. They agreed to consider these matters further before the meeting of the Interim Committee at Jamaica. In this connection the Ministers and Governors noted with satisfaction that the Executive Board of the IMF had reached agreement on an important liberalization of the compensatory financing facility. They also confirmed their agreement on the urgent need to establish a trust fund for the benefit of the low income countries.

Exhibit 53.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, issued after its fifth meeting, Kingston, Jamaica, January 7–8, 1976

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its fifth meeting in Kingston, Jamaica on January 7–8, 1976 under the chairmanship of Mr. Willy de Clercq, Minister of Finance of Belgium, who was selected by the Committee to succeed Mr. John Turner of Canada as Chairman. Mr. H. Johannes Witteveen, Managing Director of the Fund, participated in the meeting. The following observers attended during the Committee's discussions: Mr. Henri Konan Bedie, Chairman, Bank-Fund Development Committee, Mr. G. D. Arsenis representing the Secretary-General, UNCTAD, Mr. Wilhelm Haferkamp, Vice-President, EC Commission, Mr. Mahjoob A. Hassanain, Chief, Economics Department, OPEC, Mr. Rene Larre, General Manager, BIS, Mr. Emile Van Lennep, Secretary-General, OECD, Mr. F. Leutwiler, President, National Bank of Switzerland, Mr. Olivier Long, Director General, GATT, and Mr. Robert S. McNamara, President, IBRD.

2. The Committee endorsed the recommendations contained in the report of the Executive Directors on the Sixth General Review of Quotas and the proposed resolution on increases in the quotas of individual members to be submitted to the Board of Governors for its approval. In this connection, the Committee reaffirmed its view that the Fund's holdings of each currency should be usable in the Fund's operations and transactions in accordance with its policies. Appropriate provisions for this purpose will be included in the draft amendments of the Fund's Articles. To give effect to the Committee's view in the period before the amendments become effective, it was agreed that, within six months after the date of the adoption of this resolution, each member shall make arrangements satisfactory to the Fund for the use of the member's currency in the operations and transactions of the Fund in accordance with its policies, provided that the Executive Directors may extend the period within which such arrangements shall be made.

3. The Committee considered the question of the implementation of the agreement reached at its fourth meeting regarding the disposition of a part of the Fund's holdings of gold. It was agreed that action should be taken to start without delay the simultaneous implementation of the arrangements referred to in paragraph 6 of the press communique issued by the Committee on August 31, 1975. The sales of gold by the Fund should be made in public auctions according to an appropriate timetable over a four-year period. It is understood that the Bank for International Settlements would be able to bid in these auctions.

4. In its discussion of the world economic situation and outlook, the Committee noted that recovery from the severe international recession of 1974–75 was now under way in much of the industrial world. Nevertheless, current rates of both unemployment and inflation were still unacceptably high. The Committee called on the industrial countries, especially those in relatively strong balance of payments positions, to conduct their policies so as to ensure a satisfactory and sustained rate of economic expansion in the period ahead while continuing to combat inflation.

A special source of concern to the Committee was the deterioration in the external position of the primary producing countries, especially the developing ones. The general picture for the developing countries in 1975 was again one of large balance of payments deficits on current account, financed through heavy external borrowing and through the use of reserves already eroded by the inflation in recent years. With large current account deficits still in prospect this year, the Committee felt that the ability of many developing countries to maintain an adequate flow of imports in 1976, and to follow appropriate adjustment policies, would also depend on the availability of adequate credit from the Fund.

5. The Committee welcomed the recent decision of the Executive Directors liberalizing the Compensatory Financing Facility. Under the new decision the Fund will be prepared to authorize drawings up to 75 per cent of a member's quota, as against 50 per cent under the 1966 decision. Maximum drawings in any one year are raised from 25 per cent to 50 per cent of quota. Moreover, the decision enables the Fund to render assistance under the facility at an earlier stage of the development of a shortfall.

6. The Committee noted the report of the Executive Directors on their review of the Fund's policies on the use of its resources, and also on the Trust Fund for the benefit of the low income members. After consideration of the issues involved, the Committee reached the following conclusions:

(a) It was agreed that the necessary steps should be taken to establish the Trust Fund without delay. Its resources would be derived from the profits of the sales of the Fund's gold, which should be augmented by voluntary national contributions. It was agreed that the amount of gold available for sale in accordance with the agreement reached by the Committee at its fourth meeting should be disposed of over a four-year period. The resources of the Trust Fund should be used to provide balance of payments assistance on concessionary terms to members with low per capita incomes. Initially, eligible members would be those with per capita incomes in 1973 not in excess of SDR 300.

(b) It was further agreed that, until the effective date of the amendment of the Articles, the size of each credit tranche should be increased by 45 per cent, which would mean that total access under the credit tranches would be increased from 100 per cent to 145 per cent of quota, with the possibility of further assistance in exceptional circumstances. The present kinds of conditionality for the tranches would remain unchanged. The Fund will in due course consider again the question of access to the Fund's resources if it becomes evident that the needs of members make it advisable to re-examine this question.

7. The Committee noted the report of the Executive Directors on amendment, welcomed the progress made toward the solution of the outstanding issues, and commended them for the voluminous and successful work that they had done in order to achieve a major revision of the Articles. In particular, it welcomed the agreement that has been reached on provisions concerning the important problem of exchange rates. In this respect, it has endorsed a new Article IV of the Articles of Agreement which establishes a system of exchange arrangements. The new system recognizes an objective of stability and relates it to achievement of greater underlying stability in economic and financial factors. The Committee considered the remaining issues on which its guidance has been requested by the Executive Directors and agreed as follows:

(a) The amended Articles of Agreement should include a provision by which the members of the Fund would undertake to collaborate with the Fund and with other members in order to ensure that their policies with respect to reserve assets would be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system.

(b) The amended Articles would contain an enabling provision under which the Fund would be able to sell any part of the gold left after the distribution of 50 million ounces in accordance with the arrangements referred to in paragraph 3 above, and use the profits (1) to augment the general resources of the Fund for immediate use in its ordinary operations and transactions, or (2) to make balance of payments assistance available on special terms to developing members in difficult circumstances. On the occasion of such sales the Fund would have the power to distribute to developing members a portion of the profits on the basis of their quotas or to make a similar distribution by the direct sale of gold to them at the present official price. Any decision on such a distribution should be taken by an 85 per cent majority of the total voting power. These powers of the Fund would be in addition to the power that the Fund would have under another enabling provision to restitute to all members, on the basis of present quotas and at the present official price, any part of the gold left after the disposition of the 50 million ounces referred to above.

(c) Decisions of the Fund on the use of the profits from the sale of its gold in the regular operations and transactions of the Fund should be taken by a 70 per cent majority of the total voting power and on decisions on use of the profits in other operations and transactions by an 85 per cent majority of the total voting power.

(d) The Executive Directors are urged to review, during the final stage of their work on the draft amendments, the majorities for operational decisions that do not reflect compromises of a political character with a view to considering the reduction, if possible, of the number and size of the special majorities that would be required under the amended

Articles for such operational decisions. Such a review should be completed within the coming weeks and should not delay the completion of the comprehensive draft amendment.

(e) The majority required for the adoption of decisions on the method of valuation of the SDR under the amended Articles should be 70 per cent of the total voting power, with the exception of decisions involving a change in the principle of valuation or a fundamental change in the application of the principle in effect, which should be taken by an 85 per cent majority of the total voting power.

(f) The Executive Directors should continue their consideration of the subject of a substitution account without delaying completion of the comprehensive draft amendment.

(g) With respect to the obligation of participants in the Special Drawing Account to reconstitute their holdings of special drawing rights, it was agreed that the amended Articles should authorize the Fund to review the rules for reconstitution at any time and to adopt, modify, or abrogate these rules by a 70 per cent majority of the total voting power.

8. The Committee requested the Executive Directors to complete their work on amendment in the light of the guidance given by the Committee, and expects that the Executive Directors will be able to submit a comprehensive draft amendment for the approval of the Board of Governors, together with a report, within the coming weeks.

Exhibit 54.— Address by Under Secretary for Monetary Affairs Yeo, January 24, 1976, to the 10th Annual Conference on "Wall Street and the Economy" at the New School for Social Research, New York, N.Y., regarding the effect of world economic recovery on international payments

The world is now recovering from the most severe economic recession since the 1930's. The recession saw real output in the industrial countries fall sharply and suddenly, a decline of 5 percent in the first half of last year. It saw the first reduction in the volume of world trade since World War II, a reduction of 6 percent in 1975. And it was associated with the most violent inventory adjustment in more than 50 years.

Broadly speaking, the pattern of international payments last year was determined by two major factors- the continued massive surpluses of the oil-exporting nations and the widespread economic recession. A clear pattern of payments balances among three major country groups can be distinguished: For the oil exporters, the OPEC (Organization of Petroleum Exporting Countries) countries, large surpluses of nearly $40 billion on current account; for the developed world, the OECD countries, approximate balance, with surpluses and deficits within the group roughly offsetting; and for the rest of the world, large deficits, particularly on the part of the less developed countries (LDC's), but also on the part of the centrally planned economies of East Europe and Asia.

In looking at the pattern of international payments for 1975, the effects of the high oil prices and the recession can be seen. The high oil prices resulted in a large deficit for the oil-importing countries as a group. With recession in the industrial countries, a very large share of the total deficit of the oil-importing countries fell on the less developed countries. Thus the OECD countries as a group were in approximate balance, while the nonoil less developed countries ran deficits totaling $23 billion, even after receiving official transfers of $11 billion.

Why was the balance of payments impact of the recession so uneven, and why was so much of the deficit shifted away from the developed countries of OECD and borne by the less developed countries? The answer lies in understanding the nature of the recession we experienced, and in understanding the ways in which individual nations responded to that recession.

The recession of 1975 was not only severe and pervasive. It was characterized by the most pronounced inventory cycle since 1921. The stage for this acute inventory shift was set in the boom years leading up to 1973 and early 1974. Once again for the first time in decades, simultaneous boom converged in all the major industrial countries and was coupled with unprecedented inflationary pressures. In those conditions- strong worldwide boom, most economies operating at close to capacity, pervasive and virulent inflation, fears of shortages of goods, commodity speculation- there was a powerful incentive to build up inventories. With a strong desire to accumulate inventories superimposed on a vigorous worldwide boom, the resulting demand led to pressures on both volume and prices. As typically happens, this process amplifies as it works back through the production process, with the result that the most extreme pressures in an inventory buildup of this character are seen in the commodity markets and on commodity prices- including the primary commodities which account for a large share of the exports of the less developed countries.

The force of such an inventory cycle cannot be measured simply by changes in output, or statistics on stocks, though the movement of stocks has indeed been dramatic. But to a large extent, the incidence of the adjustment is on new orders and unfilled orders. Just as the pressure on an exchange rate is not simply a function of the momentary spot market, but also reflects the forward book, so do other markets, including commodity markets, reflect the pressures of new orders and unfilled orders in the pipeline. There is evidence that new and unfilled orders were extremely high during the last days of the 1973–74 boom, before the recession came.

But when the economic situation turns, when world boom swings into recession, the exaggerated upward pressure on inventories reverses into exaggerated downward pressures on inventories. Initially, order books collapse. A sellers' market becomes a buyers' market. Businessmen who were trying to stock up on goods to be sure they could meet any requests begin to worry about what to do with amounts they have already ordered. Manufacturers of those goods cut back on orders of their own components, and the process works back to the producers of primary commodities, where the swings and the oscillations in demand tend to be greatest.

As the inventory cycle, in the larger sense of the term, moves into the building phase, its impact will again be felt abroad. It is very difficult to measure statistically the force of a major inventory adjustment because so much of the impact is reflected in the order books, and information on orders is sparse in most countries. Nonetheless, there is evidence that the recent inventory adjustment has been an extreme one and that we are now moving into a recovery phase that should go far in correcting the skewed pattern of payments imbalances experienced in 1975. To illustrate, let me cite a few figures for the United States and Germany.

First, the United States. The change in the book value of manufacturing and trading inventories, at an annual rate, reached a peak positive figure of $57 billion in the summer of 1974, and swung to a negative figure of about $15 billion a year in the second quarter of 1975, when smoothed by a 6-month moving average. By the end of October, the figure had recovered to a positive change of about $20 billion—that is, about half of the abrupt recession-induced fall in the rate of change had been reversed. There was still further rebound to be expected.

Over the same period, new orders in durable goods manufacturing industries reached a peak of nearly $50 billion a month in the third quarter of 1974, or an annual rate of $600 billion. They then fell quite sharply to about $35 billion a month at the low point in the first quarter of 1975, or an annual rate of about $420 billion. Again, the recovery phase since then has raised the figure part way up the scale to the previous peak, at about $41 billion a month (annual rate of about $490 billion). Thus the swing in new orders for durable goods alone, on an annual basis, amounted to a multiple of about 2 1/2 times the swing in the book value of the larger category of inventories per se that I cited earlier.

It is worth noting that both the U.S. inventory and new orders data are all measured in dollar terms. Given the upward trend in prices, the physical volume, if data were available, would show a much more severe decline from the cyclical peak than the value data record. With inflation now diminishing, the recovery in orders, in real physical terms, should be less affected than in the past by such price adjustments.

German data on the physical volume of new orders (domestic and foreign) in manufacturing industries show a sharp fall in the recession. From its peak, the index for new orders fell 18 percent by the last quarter of 1974, and was still 25 percent below the peak in the third quarter of 1975. In value terms, however, the decline is much less sharp; by the third quarter of 1975 the value of new orders was only 6 percent below the peak level achieved in the second quarter of 1974.

If I have labored this discussion of the worldwide inventory adjustment, it is because that factor has played such a major role in influencing the world balance of payments patterns in 1975—and because, with recovery, a change in the inventory cycle will lead to a greatly different balance of payments pattern in 1975 and beyond.

With the effects of the recession last year, compounded by the inventory adjustment, the developed countries recorded a massive improvement in their current account balance, shifting from large deficit to approximate balance. This was accomplished in larger part by a very sharp reduction in the imports of these developed countries, resulting from the recession. Not every developed country recorded a smaller deficit (or larger surplus) last year, but many registered major shifts in that direction—in particular, the United States, the United Kingdom, France, Japan, and Italy.

The less developed countries, on the other hand, showed larger deficits in 1975. These countries were, in many cases primary producers, at the end of the line in terms of the inventory cycle and absorbing through their exports a major part of its impact. In many cases, their imports were maintained at high levels—as high rates of economic growth and development were maintained despite the loss of export earnings. In some cases, patterns of consumption and economic development plans which were established during the immediately preceding period of high commodity prices and favorable terms of trade were not adjusted when economic conditions became less favorable.

Thus, while there were major differences among individual countries, for the nonoil less developed countries as a group, the pattern was one of large deficits—in a sense maintaining growth rates despite recession in the industrial countries—and financing consequent deficits primarily by borrowing.

The large deficits which the nonoil less developed countries recorded last year were financed in a number of ways. Direct investment provided a part of the financing, and long-term loans (both private and official) represented a major source. The remaining shortfall was covered by use of reserves (about $3 billion), IMF credit (about $2 billion), and other short-term borrowing (about $5 billion). Questions have been raised as to whether this pattern of financing—and particularly the reliance on short-term borrowing—is sustainable for the future.

It was of course not only the less developed countries which maintained and financed their deficits rather than adjusting. A number of the developed countries in the OECD—again, particularly the primary producers—also ran substantial deficits and borrowed, although the OECD as a whole was in approximate balance. While the oil-importing countries as a whole had to absorb the large deficit which was the reciprocal of the OPEC surplus, decisions of individual countries as to the extent to which to finance deficits and the extent to which to adjust influenced the sizes and distribution of that deficit among the oil-importing countries. A different pattern of relative emphasis in deficit countries on measures for adjusting rather than financing deficits would have led to different distribution of deficits among the non-OPEC countries. Some nations did not let exchange rates move enough to play their full part. Nonetheless, if there was perhaps inadequate attention paid to adjustment and to allowing exchange rates to move, the world can take credit that moves toward increased import restrictions and excessive competition in export credits were generally avoided. All in all, nations behaved in a responsible manner.

Some analysts have made dark and ominous predictions about the financial position of the less developed countries in the period ahead. They have projected continued very large payments deficits on the part of the less developed nations, on the assumption of a weak recovery in the industrial world, and a continuation of high LDC growth rates. Accordingly, they see a need for large LDC financing resources, and, given high debts in some countries had limits in private credit facilities, call for vast new resources for public financing—for example, by freer access to IMF resources, a large expansion of public credits, or allocations of reserve assets.

I disagree with the assumption of weak recovery in the industrial world; I believe that projections based on a continuation of boom-level growth rates in the LDC's are unsupportable. I am convinced that the recent agreements in Jamaica—including the establishment of a trust fund to provide balance of payments assistance to the poorest countries, an increase in potential access to IMF resources, and a major liberalization of the compensatory finance facility—represent an appropriate and adequate response to the financing needs of the foreseeable future.

In my view, to assume a need for much larger financing would be a serious mistake, one which could lead in the end to serious adjustment problems and distortion of the world economic structure. A large part of the current account deficit of the developing countries in 1975 occurred because they attempted to maintain high domestic growth rates in the face of a softening of export markets that had been unsustainably strong at the crest of the boom. Caught between falling export revenues and rising import levels, these countries experienced rising current account deficits financed in large part by heavy borrowing from private capital markets—much of which took the form of short-term trade credit.

But the pattern of imbalances will shift and shift importantly this year. A firmly based economic recovery is presently underway in the industrial world. Just as last year's recession and inventory adjustment had an amplified adverse impact on primary producers and less developed countries, this year's recovery and inventory adjustment will have an amplified beneficial impact on those same countries. We can only add to inflationary pressure and displace private markets if we panic and try to respond to present and future conditions by throwing official money at yesterday's problem. Perhaps more fundamentally, the developing countries cannot continue indefinitely to base their growth program and expectations on the artificial prosperity and unsustainable terms of trade that they experienced in the crest of the commodity boom. Their development programs must be adapted to their financial realities. Adjustment must be begun.

Attempts to avoid this adjustment by establishing commodity pacts that seek to restore the inflated prices of the commodity boom despite changed economic conditions will not work. Efforts by commodity producers to maintain uneconomic prices will lead to shifts to new sources of supply and (stimulate a spur to) production of substitutes.

Thus a more balanced payments structure is in prospect. To pump more money into the system would simply sustain an artificial situation for a time—exacerbating world inflation and making the ultimate adjustment more difficult politically and economically. OPEC will continue in large surplus—in fact larger in 1976 than in 1975 because of cyclical changes.

These oil surpluses will, by definition, be financed as long as they last, but the payments structure among the oil-importing countries can be improved and maintained on a sustainable basis.

In my view, we have an important choice to make. If nations fail to perceive developments in the world payments structure, or to follow appropriate economic policies, there will be strains in the private credit markets or pressure for excessive and irresponsible measures to expand official credit.

But there is an alternative. The hope is that nations will perceive and take full account of the changing structure of international payments—most importantly the shift back to the industrial countries of a major share of the oil deficit as the inventory cycle turns—and that all nations will pursue sensible policies. For the industrial countries, sensible policies means policies to assure a continued strong noninflationary recovery in world demand, the avoidance of measures which would frustrate an adjustment in their payments positions, and thus a shift back to the industrial countries of a larger share of the deficit. For the LDC's, sensible policies means realistic growth and development programs and progress toward payments adjustment. For the OPEC, sensible policies means reasonable investment policies, without excessive liquidity preference, increased aid, and continuing progress toward adjustment and elimination of large surpluses.

Even with sound policies generally, there may be financing problems—difficult financing problems—for individual countries, both developed and less developed. But we can hope to avoid severe problems for whole categories of countries—such as the nonoil less developed countries—and we can hope to avoid excessive strains on our private credit markets and public credit institutions. We can expect a reasonable and sustainable distribution of payments deficits.

Let me close by mentioning one other reason for optimism that we will in the future see a more balanced pattern of world payments. That reason is that, with the agreements recently reached in Jamaica, we are taking steps to assure that we have a monetary system that will facilitate this development. Without commenting in detail about the Jamaica agreements, let me note some of the important steps that have been agreed:

There is now a shared analysis of the problem of instability in the world economy, and agreement that that problem must be dealt with not by the form of exchange rate system but by creating underlying conditions of stability in the world economy.

There is recognition that present flexible exchange rate arrangements represent a sensible and effective system for dealing with the economic realities which the world now faces and will face in the future.

There is acceptance of the need for firm surveillance of the policies which nations follow to assure compatibility with the needs of responsible international behavior.

Such steps, and the additional measures which have been agreed to, improve the ability of the International Monetary Fund to meet members' financing needs in the period ahead, reinforce the ability of nations, following sound and sensible policies, to pass through an admittedly difficult period.

Exhibit 55.—Remarks by Secretary Simon, March 10, 1976, for the Distinguished Lecture Series, Mainz, Federal Republic of Germany, on economic policy in a changing world economy

As America celebrates its Bicentennial this year, it is interesting to note that Mainz had already been a famous university city for 300 years when the United States declared its independence in 1776. The proud traditions of both America and Mainz certainly deserve recognition, but my comments this evening will concentrate on the challenges of the future, particularly the need for continued creativity and efficiency in our economic systems which must provide the foundation for stable societies.

The United States and the Federal Republic of Germany have experienced remarkable economic development. The severe recession of 1974–75 has ended and both nations are once again expanding real output. But despite the impressive record of economic gains and the current progress of the cyclical recovery, many people remain pessimistic about current events and the future. There is a national tendency for public opinion to swing from euphoric optimism to abject pessimism while missing the middle-ground of moderate judgments and realistic expectations. If we are to overcome this widespread skepticism, government policies in the future must be increasingly based on realism. Over the years government leaders have tended to make exaggerated claims about the potential benefits of new policies to gain current political favor. When government officials promise more than can be delivered, general disillusionment and resentment eventually develop. Decisions about the allocation of national resources and distributions of the output of goods and services are the most basic of all economic issues and greater realism is required in determining national priorities.

Longer term planning horizons and economic policies that would give increased attention to longer term goals which extend beyond the solution of current problems are needed. Government policies are too often simply individual responses to special interest pressures rather than a carefully integrated set of goals for the future.

The repetition of excessive fiscal and monetary stimulus followed by extreme restraint has caused a volatile pattern of economic development. The difficulty of predicting economic activity and the lagged impact of frequent policy adjustments have frustrated the fine-tuning efforts of government planners and exaggerated the extremes of economic booms and recessions.

To achieve the desired improvement in economic decisions based on realism, longer term perspectives, and stability, the United States has established the following goals: Sustained responsible fiscal and monetary policies which will contribute to domestic and economic progress; continue the liberalization of world trade and investment based on the principles of open and competitive markets; assist developing nations to grow toward economic self-sufficiency; and maximize the benefits from the world's resources.

These basic objectives are shared by many other nations, including the Federal Republic of Germany. This is a union based on a realistic recognition that we share mutual national interests in promoting economic development and stability. A strong American domestic economy is vital to your interests. Similarly, your impressive economic development is important to us. Nevertheless, each country has specific national interests and this desirable diversity will occasionally cause disagreements about the technical details and procedures of international trade and finance. While it would be naive to expect consensus on every policy issue, serious discord need not occur. As long as we approach these specific problems with a cooperative attitude based on mutual respect and the underlying strength provided by healthy domestic economies we will find workable solutions. Also, meaningful alliances do not require that all differences be eliminated but it does mean that our independent policies be directed toward the mutual goals of: (1) Sustaining responsible fiscal and monetary policies within our domestic economies as the necessary foundation of real strength; and (2) continuing progress toward a more open and efficient international economic environment.

I. Domestic economic policies

It is increasingly recognized that the pace of domestic economic activity, including employment and inflation, is directly affected by international economic developments. Although issues of national concern continue to dominate economic policies, advanced nations have a definite responsibility to manage their domestic monetary and fiscal affairs with regard to international obligations. The most significant contribution the United States can make to international economic progress is to strive to keep the pattern of growth in our domestic economy more balanced so that it does not disrupt the world economy. Unfortunately, U.S. economic policies have not provided the desired stability over the past decade. One result has been alternating booms and recessions. Another result involved the loss of price stability which characterized the American economy for almost 200 years.

Fortunately, the recession of 1974–75 apparently ended by April 1975 and a relatively strong cyclical recovery has occurred since then which has improved employment conditions in general and specifically reduced the unemployment rate without causing an acceleration of price increases as inflation has remained in the 6-percent zone for several months. Looking ahead, our GNP forecast indicates that 1976 will be a good year with real output gains of more than 6 percent. Personal consumption expenditures will provide a solid base for continued growth, and business spending for plant and equipment should improve as the year progresses, which will provide the necessary thrust to sustain the recovery beyond 1976. Of particular interest to other nations is our expectation that U.S. imports will increase in 1976 following a 4-percent decline in 1975. This acceleration of imports by the United States will contribute to the general recovery in other nations. This basic turnaround in the U.S. economy and relatively strong recovery over the past year is the direct result of three fundamental adjustments: (1) The unwanted accumulation of inventories was eliminated and new orders stimulated industrial output gains; (2) the "real incomes" of consumers were restored by reducing the double-digit level of inflation and initiating tax reductions and rebates to increase personal disposable incomes; and (3) employment conditions improved rapidly enough to reduce unemployment and strengthen consumer confidence.

The near-term prospects for economic growth in the United States are encouraging. However, there are still several important policy issues which must be resolved to successfully sustain the recovery well beyond 1976. This policy debate will undoubtedly continue during the coming months and the ultimate decisions will likely determine the course of the U.S. economy for many years to come.

The basic issue concerns the proper amount of stimulus needed to achieve the interdependent goals of sustaining the economic recovery and reducing unemployment without creating a new surge of inflation which would lead to another sequence of boom and recession. This same issue confronts other industrial nations as they attempt to achieve stable economic recoveries during the coming months. In the United States, the administration has proposed a set of policies which we believe will lead to output gains well above the long-term sustainable pace of the U.S. economy in order to reduce the unacceptable level of unemployment. Critics contend that this goal is inadequate and that added stimulus is necessary to sustain the current recovery and reduce unemployment. Those who argue for increased stimulus apparently believe that the Government can directly accelerate the pace of the entire economy by adjusting its policies and that such stimulus can be effectively eliminated when the private sector recovers. They represent the remnants of the fine-tuning school who believed, at least until recently, that fiscal stimulus was amenable to precise adjustments. Incredible as it seems, in the context of the unfortunate events of 1970–74 there are still some who believe in this concept.

Then there are some who have not believed that the American economy would recover or that if it did it would be an extremely lethargic, almost imperceptible advance. Fortunately, the record to date reveals a vigorous though nonetheless orderly cyclical revival.

There is a third group, small but still vocal. For them it is an issue of the public sector vs. the private sector; Government direction vs. the market economy. In short, the debate is between those who believe in the basic superiority of the private enterprise system, when it is allowed to function properly without overbearing Government interference, and those who believe that the Government must fill a permanent and increasing role if the economy is to progress.

My own conclusion is that, within recognized limits, the market system is the most efficient and creative approach since it is more flexible in responding to changing economic conditions. This does not mean that the Government does not have an important role in economic affairs. Nor does it mean that the existing institutional arrangements will always exist. The market system will continue to evolve and this flexibility will enable it to remain creative and productive.

It should also be emphasized that the administration believes that its recommendations will lead to a more sustainable durable recovery as opposed to the disappointing results of the past decade when cyclical booms and recessions have dominated the economy. Considerable stimulus has already been injected into the U.S. economy. The Federal budget has increased 40 percent from $268 billion in fiscal year 1974 to approximately $374 billion in fiscal year 1976 and a large additional stimulus would create risks of once again overheating the U.S. economy. Businessmen and consumers would react negatively to the prospects of accelerating inflation if that stimulus were to occur because the anticipation of inflation is now deeply ingrained in our society. It should also be recognized that more stable economic policies are required to avoid the unnecessary distortions of the past decade. Increased Government spending programs have proven to be a cumbersome tool for short-term economic stabilization purposes. Moreover, experience has shown that programs initiated in a period of economic slack tend to become a permanent part of the budget. It is extremely difficult to reduce or eliminate even the obviously ineffective or obsolete programs and to scale down existing programs for countercyclical purposes has been, for all practical purposes, impossible. This is particularly true when the sizable outlays of the many State and local governments are added to the total.

This implies that we must avoid abrupt and excessive changes in government expenditures. No matter how well intentioned, such sharp swings in spending tend to accentuate rather than stabilize the business cycle and serve to increase the uncertainty of developing policies to meet future needs. In turn, this uncertainty is felt in the consumer markets.

II. International economic policy

As we strive to improve the domestic economy, it is equally important to recognize the significance of international monetary, trade, and investment relations.

International monetary issues.—The patterns of exports and imports, the location of production facilities, and international capital flows are directly influenced by currency exchange rates. Under the Bretton Woods system created in 1944, exchange rate stability was expected to be based on a comprehensive set of rules which would specify a fixed rate for each national currency. However, that system could not adapt to extreme variations in domestic economic policies, sharply differing rates of inflation, wide variance in interest rates, and the resultant large capital flows which became characteristic of this period. Disruptive currency devaluations occurred, typically under crisis conditions. The familiar postwar monetary system based on fixed exchange rates finally collapsed in 1971 and multilateral exchange rate adjustments were agreed to at the Smithsonian meetings at yearend, but the dollar had to be devalued again in February 1973 and a period of floating exchange rates was initiated in March 1973. Since then a series of reform efforts, under the direction of the International Monetary Fund (IMF), has moved steadily ahead leading up to the Interim Committee agreements in Jamaica last January.

In participating in the reform efforts since 1973, the United States has emphasized the following basic goals:

1. The monetary system should be flexible.
2. Each nation should retain authority to select its own preferred solutions to economic disequilibrium, including changes in fiscal and monetary policies.
3. Competitive currency devaluations should be prevented.
4. The new system should provide a meaningful surveillance authority to enforce the rules adopted.
5. The basic goal of international monetary reform is to restore stability to the system.

At meetings 2 months ago in Jamaica, the world's Finance Ministers agreed on a series of far-reaching structural reforms in the international monetary system. That agreement represented the first general revision of our international monetary arrangements since the basic framework for the postwar economic system was created at the 1944 Bretton Woods.

We live in a different world from that which existed at the time of Bretton Woods. The Jamaica compact reflects fundamental shifts in thinking from the ideas which underlay the Bretton Woods system. It is widely acknowledged that the change in thinking—which focuses attention on underlying economic factors—calls for a new and different attitude with respect to exchange rates, gold, and other aspects of the monetary system. It is perhaps less generally noted that it calls also for a new perspective on the question of international liquidity.

The new monetary system agreed to at Jamaica differs fundamentally from the Bretton Woods system in the provisions setting forth exchange rate rules, and in the provisions on gold—two of the basic components of the Bretton Woods system. Both changes stem from a common idea: The view that monetary stability cannot be imposed on a heterogeneous world by imposing a rigid monetary system—that monetary stability can be achieved only by developing underlying conditions of stability in the major economies. That is to say the new reforms recognize that lasting stability cannot be superimposed on the world economy by forcing countries into the mold of a rigid system, but must develop and grow through the maintenance of proper policies in the national economies making up the system.

First, consider the reform dealing with exchange rates. The Bretton Woods system recognized as legitimate only one exchange rate regime—par values. It assumed that exchange stability could be achieved by requiring adherence to a more or less fixed structure of exchange rates. On the one hand, the threat of reserve loss or the eventual share of a forced devaluation was the leverage to influence domestic policies in deficit countries. For surplus countries, it was imagined that they would act, in terms of policies, to maintain the symmetry of the system. These assumptions proved wrong. Countries did not respond as expected.

The assumptions of the framers of Bretton Woods proved mistaken in another respect. They had assumed a world in which relative price stability and equilibrium would be the norm—disequilibrium and inflation abnormal. In the first half of this decade exactly the opposite has been the case and the tensions resulting from pervasive inflation resulted in overriding distortions which could not be accommodated within the par value system.

A final note about their assumptions and the realities of today. As a logical corrollary of their views, they tended to assume minimal capital flows. Surely they would be surprised at the circumstances of today when billions of dollars can move across the exchanges in a matter of a few days.

The exchange rate arrangements agreed upon at Jamaica take a different approach, and have a different focus. The new provisions focus on underlying economic and financial conditions and acknowledge that exchange stability can prevail only if nations achieve stability in those underlying economic conditions.

A second important step involves the continued phasing out of gold from the international monetary system and an increased reserve asset and unit of account role for the special drawing right (SDR). The official price of gold will be terminated, and gold will no longer be used by the IMF for official transactions. One-sixth of the IMF's gold stock will be sold with the proceeds of the sale, including any profit resulting from the transaction price being above the official price, to be used by the new trust fund for assisting developing nations experiencing balance of payments difficulties. It is anticipated that the trust fund will handle the sale through periodic auctions, spread out over 4 years. Another one-sixth of the IMF's gold holdings will be sold to member governments in proportion to their quota subscriptions. In addition, members of the Group of Ten have agreed among themselves that (1) they will not engage in efforts to peg the price of gold; (2) that the total stock of gold held by the IMF and Group of Ten countries will not increase; and (3) that G-10 countries will respect the conditions on gold trading agreed to by central banks.

The third action agreed to will increase the current quotas for members of the IMF by approximately one-third from 29 billion SDR's to 39 billion SDR's ($35 to $47 billion). The quotas for OPEC (Organization of Petroleum Exporting Countries) members will rise even more so that their total share of IMF voting power will jump from 5 to 10 percent. Other developing nations will maintain their existing proportionate shares and the relative voting position of industrial nations will decline. For example, the U.S. quota will rise from $8 to $10 billion but our relative share of total voting rights will decline from 22.1 to 21.5 percent.

The increase in IMF quotas and amendments to the Articles will require formal ratification by member governments once the Executive Board clears up the remaining details. This ratification process is expected to take 18 to 24 months. The United States strongly supports the agreements and anticipates a rapid response from Congress.

Another important development associated with the exchange rate agreements involves the creation of an improved consultation process to monitor currency fluctuations. The arrangements will evolve over time but it is a fact that Finance Ministers and their deputies and central banks have been in frequent contact to review underlying economic and financial conditions and circumstances in the exchange markets. The United States does not envision this continuous consultation process as a means of creating specific targets for exchange rate relationships involving the dollar nor will central bank intervention be used except when necessary to correct disorderly market conditions.

The attention which all nations are now committed to giving to underlying economic conditions augurs well for the future management of our economic affairs and the control of inflation. If each nation, individually, can manage its affairs soundly and responsibly, and if all nations cooperate in the same vein, we will have made a great stride toward the stability in our economic affairs that we all desire. The Jamaica agreements represent an important benchmark that will enable the broad reform measures to move ahead. The United States supports these agreements as a basis for reducing instability in exchange rates.

International trade issues.—One of the most significant postwar economic developments has been the rapid expansion of trade among market economies from a level of $55 billion in 1950 to over $800 billion in 1975. The United States strongly supports the growth of a free and open world trading and investment order. The case for free trade is based on the general concept of comparative advantage. Trade barriers typically reduce or eliminate the exchange of goods that would benefit all countries. Similarly, trade restrictions which insulate domestic producers from foreign competition reduce the pressures for controlling price increases and for stimulating creative product development. Although foreign trade has historically comprised a relatively small share of total economic activity in the United States, we have remained the world's largest exporter and importer. However, during the 1960's the historical U.S. merchandise trade surplus slowly eroded because of the overvalued dollar, disadvantageous cost developments, and the effective export promotion efforts of other nations. By 1971 a small trade deficit was reported and the shortfall increased in 1972. A small trade surplus was reported in 1973, following our adjustment of currency exchange rates, but record inventory accumulations and the sharp increase in the cost of oil imports resulted in a swing back to deficit in 1974. In 1975 the United States recorded a record trade surplus in excess of $11 billion as exports increased 9.5 percent and imports declined 4.1 percent. During the coming year, we expect the current trade surplus to diminish as the pace of economic recovery in the United States increases and the demand for imports increases more rapidly than the continued growth of our exports.

Looking into the future the European Community represents a major economic power which operates a common external tariff and an expanding network of preferential trading arrangements with other countries in Europe, Africa, and Asia. Fortunately, most of the abrasive problems that have developed in trading relations have been worked out through extended periods of negotiations. However, examples of protectionist agricultural policies, administrative barriers, and discriminatory public procurement practices persist and the expansion of preferential trading arrangements is a serious concern. Since trade issues directly affect the number and quality of jobs in each country, such actions quickly become the basis for domestic protectionist pressures. The benefits of free trade are general for the entire population, but the costs of economic disruptions caused by import competition are very specific and affect individual workers and companies. The continuation of the great benefits from free trade can never be taken for granted, particularly during periods of economic recession when individual nations struggle to avoid current account deficits and further loss of domestic output and jobs.

The United States has strongly supported the new round of GATT (General Agreement on Tariffs and Trade) negotiations which officially began in 1973. Within the general framework of creating a more open world trading system the United States has the following goals:

1. Reducing, harmonizing, or eliminating tariffs on a broad scale.
2. Reducing or harmonizing nontariff barriers. These measures have proliferated in recent years and have often reduced or nullified the benefits of tariff cuts or have completely prevented trading. Because nontariff barriers are difficult to identify and

quantify, they have become a major negotiating problem. Guidelines for controlling export restraints, limiting the use of subsidies, product and safety standards, public procurement, administrative restrictions, and quantitative quotas must be improved.

3. Strengthening the enforcement of international trade rules to minimize conflicts among trading nations.
4. Providing for the special trade needs of developing nations.
5. Preserving equitable access to supplies at reasonable prices. In dealing with commodity issues, the United States continues to believe that a case-by-case approach is essential and that restrictive agreements and pricing formulas are not useful for most commodities.

The United States has been encouraged by the relatively successful OECD trade pledge to avoid discriminatory trading practices during the difficult period of growing current account deficits for most industrial nations resulting from the serious international disruptions caused by the quadrupling of oil prices and the effects of the widespread economic recession. We also support the use of prior consultations within the OECD as a means of avoiding trade measures which violate the terms and spirit of the agreement. Similarly, we have supported the long negotiations attempting to develop limitations on official export credit subsidies. These issues demonstrate the difficulty of preserving an open trading system during periods of unusual economic strain and domestic pressures to protect markets and jobs.

The major thrust of U.S. trade policies was summarized in the important trade legislation finally approved in January 1975 following several years of internal debate. That benchmark legislation was a necessary prerequisite for U.S. participation in the current multilateral trade negotiations and provides the U.S. Government with the necessary flexibility for conducting its trade policies. Basic provisions include:

1. Authority to negotiate for more open access to markets and supplies with emphasis on equity and reciprocity;
2. Increased flexibility in providing escape clause relief and adjustment assistance for American industries, workers, and individual firms suffering injury from import competitions,
3. Provisions for diversifying the types of actions the United States can take in responding to unfair international trade practices;
4. Authority to expand normal commercial relationships with the nonmarket economies; and
5. Authority to fulfull the pledge to establish a plan of generalized tariff preferences for certain trade with developing nations.

We believe that the trade reform legislation is a further step in promoting a more liberal trade policy. However, some critics have described it as being potentially a restrictive measure and there have been expressions of concern in Europe about the possible growth of protectionist sentiment in the United States. This is frankly a puzzling viewpoint which is not supported by actual developments. The Treasury Department is required by law to investigate all formal complaints of alleged "dumping" of foreign products in the U.S. markets and institute countervailing duty investigations when there is a complaint of a bounty or grant on a particular commodity. However, there has been no evidence of any overt effort to tighten the existing restrictions, nor is there any indication of any growing protectionist movement. To the contrary, the protectionist pressures appear to be moderating as the major swing in trade continues. The increase in investigations is due to the fact that all pending cases received over the past few years must be completed in a very short time frame under the Trade Act limit. Major changes are occurring in comparative unit labor costs, energy costs, and other competitive factors to improve significantly the outlook for U.S. exporters. We will continue to strive for the elimination of barriers to trade and the expectations and successful conclusion of the multilateral trade negotiations.

International investment issues.—Member nations of the Atlantic community have fortunately avoided the widespread adoption of capital controls despite the distortions created by economic recession and oil price changes. Foreign direct investment and short-term credit to finance trade have played an important role in the economic development of the entire region during the postwar period. Unfortunately, short-term capital flows can also be disruptive if they are contrary to domestic stabilization goals or create significant balance of payments problems. Most short-term capital flows are temporary and self-reversing. However, it is occasionally necessary to neutralize these flows. For example, a basic role of the IMF is to provide official financing to assist members in overcoming short-term payments deficits. Other examples can be given in which individual countries have adjusted their fiscal and monetary policies. A third approach is to limit capital movements directly. The United States, for balance of payments purposes, instituted three such programs in the 1960's. The interest equalization tax was applied to securities sold in U.S. capital markets by developed countries (except new Canadian issues) and long-term bank loans beginning in 1963. In 1965 the Federal Reserve voluntary credit restraint program created voluntary guidelines for capital flows from banks and other financial institutions. At the same time voluntary restraints on direct investment were established. This program became mandatory in 1968, but unfortunately, such programs also create serious distortions in the efficient allocation of resources. The relaxation of capital controls began in 1969 and they were finally revoked in January 1974. Since then the United States has avoided controls and our financial markets have been open to foreign borrowers.

The U.S. Government has reaffirmed its intention to avoid restrictions on foreign investments in America. There have always been specific requirements that foreign investors conform to U.S. laws, and certain types of investments—such as ownership of communications companies, nuclear energy facilities, mineral resources on Federal properties, certain transportation companies, and a few others—are prohibited but in general, foreign investors receive the same treatment as domestic investors. During the period of concern about the possibility that OPEC funds would flow into America to buy up basic industries, various bills were submitted in the Congress to restrict foreign investment. The administration strongly opposed such actions, and no additional barriers were created. The OPEC nations have given no evidence of any effort to buy up American firms or disrupt the U.S. economy. At the same time, the inflow of investments from Europe continue at a somewhat moderate pace. On the one hand, as of the end of 1974, the total book value of U.S. foreign direct investments totaled $119 billion. Of the total amount $45 billion, or 38 percent, was committed to Western Europe. From the opposite viewpoint, foreign direct investment in the United States was $22 billion, of which $14 billion, or 64 percent, was by European investors.

The near-term economic outlook is favorable and the longer term problems can be overcome if responsible policies are sustained. But our responsibilities are not completed by merely identifying desirable goals. It remains as true today as ever that the economic performance of each nation will depend upon the effectiveness of its domestic fiscal and monetary policies and how well it adjusts to the competitive environment created by the increasing integration of the world's economic system. The United States and the Federal Republic of Germany share mutual goals in seeking stable economic progress. The disruptive experiences of the past, when cooperation failed, provide strong incentives for cooperating in the future to achieve an open and competitive international monetary, trade, and investment system. The specific day-to-day reform efforts will often be slow and occasionally abrasive. However, these temporary frustrations will not cause us to lower our goals but to use more realism and determination in achieving them.

Exhibit 56.—Remarks by Under Secretary for Monetary Affairs Yeo, March 30, 1976, before the Institutional Bond Club of New York at the City Midday Club, New York, N.Y., on international liquidity

Discussions of financial affairs turn frequently to the role international liquidity developments have played in causing the world's economic ills, particularly the virulent inflation of recent years. An inevitable corollary is that collective management or control of international liquidity is necessary if we are to alleviate those ills. The popularity of these themes leads me to devote my remarks this evening to the subject of international liquidity.

Specifically, I would like to respond to three common lines of thought on the subject: That the recently agreed international monetary reforms are somehow incomplete because they do not bring control over international liquidity; that excessive international liquidity has been largely responsible for the severe worldwide surge of inflation; and that excessive international liquidity is permitting countries to avoid adjusting to payments imbalances as rapidly as they should.

These are important issues. But there is a serious danger that excessive attention to the problems of international liquidity will divert our attention from the basic causes of our economic problems, and lead us down the wrong paths in the search for the required solutions. International liquidity developments do influence nations' economic welfare, but they are not major determinants of that welfare. Even if the tightest controls of international liquidity could be devised, they would assure us neither an ideal monetary system, nor success in our efforts against inflation, nor equilibrium in our international payments relationships. I am particularly concerned that our efforts to contain inflation succeed. But to succeed we must concentrate our efforts in the right direction. Control of international liquidity is not the answer.

These issues must, in my judgment, be examined against the background of the profound change which has taken place in thinking about the world's monetary system and the rules governing that system.

At meetings last January in Jamaica of the International Monetary Fund's Interim Committee, the world's Finance Ministers agreed on a series of far-reaching structural reforms in the international monetary system. That agreement represented the first general revision of our international monetary arrangements since the basic framework for the postwar economic system was created at the 1944 Bretton Woods Conference.

There are some who charge that, while the Jamaica agreement has introduced important changes with respect to parts of the monetary system, reform is incomplete in that it does not bring any central control over the aggregate of international liquidity. Such charges reflect, in my view, a failure to perceive the evolution which has taken place in the international monetary system and in the framework within which liquidity issues should be considered.

We live in a different world from that which existed at the time of Bretton Woods. The Jamaica compact reflects fundamental shifts in thinking from the ideas which underlay the Bretton Woods system. It is widely acknowledged that the change in thinking—which focuses attention on underlying economic factors—calls for a new and different attitude with respect to exchange rates, gold, and other aspects of the monetary system. It is less generally recognized that it calls also for a new perspective on the question of international liquidity.

The new monetary system agreed at Jamaica differs fundamentally from the Bretton Woods system in the provisions setting forth exchange rate rules, and in the provisions on gold—two of the basic components of the Bretton Woods system. Both changes stem from a common idea: the view that monetary stability cannot be imposed on a heterogeneous world by imposing a rigid monetary system—that monetary stability can be achieved only by developing underlying conditions of stability in the major economies.

The reform dealing with exchange rates reflects that focus. The Bretton Woods system recognized as legitimate only one exchange rate regime—par values. It assumed that exchange stability could be achieved by requiring adherence to a more or less fixed structure of exchange rates, using the threat of reserve loss or the eventual shame of a forced devaluation as the leverage to influence domestic policies. That assumption proved wrong—particularly in the conditions of the 1960's and 1970's, when extreme variations among nations' economic policies, external shocks, widely disparate inflation rates, and the capacity for massive capital flows ultimately led to collapse of the system.

The exchange rate arrangements agreed upon at Jamaica take a different approach. The new provisions focus on underlying economic and financial conditions and acknowledge that exchange stability can prevail only if nations achieve stability in those underlying economic conditions. The new arrangements do not insist on a particular kind of exchange rate regime such as par values. They provide wide latitude for an individual country to adopt specific exchange arrangements of its choice, including floating, so long as that country fulfills certain general obligations to follow internationally appropriate economic policies. This is the reverse of the Bretton Woods focus.

Similarly, the new provisions for reducing the role of gold in the monetary system reflect a shift in thinking about the effectiveness of that metal in fostering international monetary stability. In placing gold at the center of the system, the founders of Bretton Woods were merely reaffirming gold's traditional role as a disciplinary agent in a world of fixed exchange rates. In practice, gold failed in that role. Instead, it became a contributor to instability—its commodity uses conflicted with monetary needs; its supply limitations did not meet the needs of a vigorous and expanding world economy; and it proved to be an inherently unstable foundation for the international monetary system. Accordingly, nations have agreed to reduce the international monetary role of gold.

It remains for us to adjust our thinking with respect to the role of international liquidity in our economic and financial system. Though the Bretton Woods system has been replaced, the question of international liquidity is still too often addressed in the terms of the past, and we continue to hear widespread calls for international control over liquidity in the manner of the past.

When I hear a call for some form of aggregate control over international liquidity, I wonder what is meant. Is it proposed to substitute decisions of an international bureaucracy for market mechanisms, and give some international group or institution the power to allocate both international public credit and private credit among individual countries on one basis or another? Is it proposed that all international private capital flows be prohibited, except as licensed or authorized by an international control group? Is the intent to impose a system of pure floating among all currencies—which would mean no country's official reserves would change—or would a system of rigid exchange rates be established, with strict rules for settling imbalances in particular assets? I can see many unattractive possibilities.

One thing is certain. Control over official reserves alone does not establish control over the means of international payment. During the 1960's when the par value system of Bretton Woods began to come under severe strain, much of the discussion of the problems of the international monetary system was in terms of the issue of "international liquidity." Such attention was understandable. The stresses of the par value system often showed up as liquidity or reserve pressures on monetary authorities. The problem of deficit countries was to obtain adequate liquidity; the problem of surplus countries was to absorb excessive amounts of liquidity; the problem of the reserve center was to maintain a credible balance between liquid liabilities and assets. And for the monetary system as a whole, there was the serious problem of operating a rapidly expanding world economy with steadily expanding liquidity needs within the constraints of a more or less fixed monetary base—gold.

Even in those days the concept of international liquidity was an elusive one. Traditionally liquidity was measured in terms of countries' official reserves—gold, SDR, IMF reserve positions, and national currencies—and attention was focused on the worldwide aggregate of these official reserves. In today's world, the concept of liquidity, and the means of payment for international transactions, are far broader. There is unprecedented capacity for international credit and capital flows. An imbalance in world payments of $60 billion can emerge over night and be financed virtually without declines in nations' official reserves. A meaningful concept of liquidity almost has to include not only official reserves, but also official borrowing power, private financial assets, and private borrowing power. Admittedly the broader concept of liquidity not only vastly increases the magnitude of the figure to be considered but also is vastly more difficult to measure.

In this context, the traditional measure of international liquidity—gross official reserves—is of limited utility. For some countries—and not only the United States—the level of official reserves has little or no relevance in determining economic policy. The concept of an optimum level of world reserves was tenuous even in a world of par values. In the present environment of flexible exchange rates, it is doubtful that the concept of an appropriate aggregate stock of official liquidity is a useful guide to policy.

What, then, is the proper approach to international liquidity questions in this reformed world, if it is not a focus on governing official reserves? My answer is that we must focus on doing those things called for by the Jamaica agreements. And, I would argue that these reforms in the international monetary system in fact greatly improve the prospects for less violent fluctuations in international liquidity, however one defines it.

Certainly each step away from a central monetary role for gold constitutes a step away from dependence upon that most erratic source of liquidity creation. That process must be continued.

The Jamaica commitments to promote stability by fostering orderly underlying economic conditions and to avoid manipulating exchange rates have perhaps even more important implications for future patterns of liquidity creation. The new system does not focus on aggregate international liquidity. But, by stressing more prompt and effective actions to eliminate the international payments imbalances which have been a major source of liquidity in recent years, the Jamaica system will yield not only greater stability generally but also reduce the fluctuations in levels of international liquidity which have concerned some observers.

Those who seek ways of restraining the growth of international reserves are troubled—as we all are troubled—by the inflationary pressures that still threaten economic and social stability in much of the world. They see a relationship between the relatively high rate of growth in global reserves in 1970–74, and the relative ease with which many countries have financed the large payments deficits that corresponded to the payment surpluses of the oil producers and of other surplus countries. They ask themselves whether such large payments deficits have not contributed to world inflation, and whether some sort of control on international reserve growth or on international credit in the wider sense would have helped the world's financial authorities to restrain the universally unwanted inflation.

The issue is whether financing through borrowing has been preferable to attempted adjustment through policies aimed at eliminating the deficit. The United States has been deeply troubled about inflation and has worked hard to reduce the rate of price increases from the double-digit level of 1974 to the present 6-percent zone. We fully agree that it is essential to reduce inflation in other countries. But there are practical limits on the speed with which adjustment to drastic changes can and should be made. In 1974 decisions to finance the sudden cartel-imposed oil deficits entirely by reserve transfers rather than by reserve creation undoubtedly would have meant a reduction in world demand and in world inflationary pressures. The drawdown of existing reserves would no doubt have caused governments to take more forceful measures to reduce their external deficits than they in fact did. This would just as surely have meant futher major cutbacks in world production and an even more severe recession than the one we have just experienced. It would probably also have led to restrictions on world trade.

In the period after the oil price increases, nations had a choice between financing through borrowing and attempted adjustment through elimination of the deficits—recognizing that collectively the deficit could not have been eliminated without a totally infeasible reduction in imports of oil. Had there been a strict international control over liquidity creation—public and private—during that period, one wonders whether those charged with that control would have had the courage and foresight to provide for expansion of official reserves in the magnitudes needed.

The desire to finance oil deficits was also a key factor in the recent expansion of Eurocurrency markets. Indeed, the bulk of the funds required to finance oil deficits came from the private financial markets—not only in Europe but notably also in the United States. And if there remains any doubt that allowance for financing of these deficits for a time was the desirable thing to do, consider what the implications of a sharp cutback in international credit availability would have meant to the depth and breadth of what was already the deepest world recession in 40 years.

Clearly our banking institutions, whether offshore or onshore, require a proper degree of regulation, to protect the public interest as well as to safeguard depositors. Events in several countries have reemphasized the importance of bank regulation. But I see an important distinction between regulation by individual governments of the national and international banking activities of institutions under their jurisdiction and close international control over the aggregate of nations' official reserves and private financial flows from one nation to another.

While it is worthwhile to try to place international liquidity developments in perspective, I think it is even more important to step back and reflect about the common sense causes of the inflation we have experienced. It is, for example, difficult to exaggerate the impact on inflation of the massive oil price increases over the past 2 years. Another uncomfortably obvious shock was delivered at about the same juncture by crop shortfalls around the world which resulted in sharp increases in food prices. There have been also highly synchronized swings in economic activity among the industrial countries, which sometimes contributed to too rapid expansion, and at others to a deep and widespread recession. But most fundamentally, for a decade or more, too many nations have erred on the side of excessive stimulus in their fiscal and monetary policies. I know that is true of the United States; I suspect others around the world would also consider it true of their countries.

We would be ill-advised to expend our efforts in a misguided and unfruitful attempt to manipulate the aggregate of official reserves—or some broader liquidity concept—as the solution to the problems of worldwide inflation. That inflation had its roots in unwise national fiscal and monetary policies. It will yield only to sound, determined domestic fiscal and monetary policies. These policies are the most powerful and effective tools governments have to manage their economic affairs. The basic key to containment of inflation is for individual governments, by consistent adherence to sound domestic policies, to demonstrate to their people that they do not have to accept inflation as a way of life.

In expressing doubts about undue attention to aggregate world liquidity, and in questioning the wisdom of attempts to impose international administrative control over that aggregate, I do not wish to suggest that liquidity growth and disciplines on liquidity growth are not important. They are very important. What I am challenging is the mistaken presumption that a market not subject to external administrative control is undisciplined. International liquidity, in the present market-oriented world economy, is mainly created in the market, and is mainly disciplined by the market.

It can be argued that in a free world economy, certain countries will not make an adequate effort to adjust to their external imbalances. Indeed, it can be argued that some countries have in recent periods not made such an effort—though this judgment cannot rest simply on the observation that official borrowing has been high, but must reflect persistent maintenance of exchange rates not in line with underlying economic and financial conditions. In such cases, when a country is failing to adjust adequately to its external circumstances, the remedy is not to impose administrative barriers to that country's official and private borrowing. It is to seek a prompt implementation of the arrangements for IMF surveillance and collaboration that are an important part of the monetary reform agreed in Jamaica, and to encourge the adoption of the proper policies.

The financial markets impose their own form of liquidity discipline on borrowers where those disciplines are called for. Lenders in the market, the suppliers of liquidity, will impose borrowing limits on deficit countries whose debt problems appear difficult and whose prospects are uncertain. Such discipline is an integral and proper part of adjustment.

We are now hearing charges that the international capital markets will not function adequately in the period immediately ahead, and that private international credit will be cut off abruptly, particularly for the developing countries which have borne a large share of the world payments deficits in recent periods. There are calls for expansion of official credit either in new forms, such as an allocation of SDR's, or through sharp expansion of credit through the International Monetary Fund and the other multilateral lending institutions.

There is no reason to expect a widespread, abrupt decline in foreign private lending, although the flow of market liquidity to some major borrowers, including some of the developing countries, can be expected to shrink. But, more importantly, the time has come for less emphasis on financing and more on adjustment—more domestic action to control inflation and less accumulation of debt. Fortunately, there are indications that more adjustment is in prospect. The need for credit by the developing countries as a group is beginning to decline, as the sharp downward trend in LDC (less developed country) export earnings associated with the world recession and inventory adjustment begins to move in the opposite direction with world recovery. Certain of the developing nations will face financing problems, because of structural difficulties in adjustment, or too weak an adjustment effort. But a limited number of countries fall in this category. We do not foresee major liquidity problems for the developing countries as a group. The measures taken recently in the IMF to expand financing capabilities are fully adequate to meet the needs for official credit of the developing nations. Indiscriminate creation of additional sources of official liquidity would only serve to undermine the viability of the international financing institutions themselves.

For developed and developing countries alike, controls on global levels of international liquidity will have only a limited influence on their prospects for prosperity and stability. Sound management of domestic economies is the key.

In the United States, economic developments are most encouraging. Our domestic economy is experiencing a strong and sustainable recovery. A strong domestic economy is the greatest single contribution the United States can make to international economic progress.

Fortunately, the turning point in the U.S. economy occurred somewhat earlier than anticipated and the pace of recovery during the transition period has been stronger than expected. Economic historians will likely identify last April as the low point for the U.S. recession. Since then, real final sales have increased at an annual rate of 5 percent and industrial output has risen at an annual pace of 11 percent. The aggregate pattern of this recovery has matched the growth rate of earlier cyclical upturns. Significant progress has also been made in reducing the rate of inflation, in expanding employment opportunities, and in significantly reducing the overall unemployment rate.

The forecast for real economic growth calls for continued expansion in the U.S. economy throughout this year and into 1977. Real output will rise more than 6 percent as most of the basic sectors of the economy experience solid gains. The major strength of the U.S. economy will continue to be personal spending which represents approximately two-thirds of the gross national product. As personal consumption expenditures provide the necessary foundation for the economic recovery, the incremental thrust for growth will be provided by accelerated private domestic investment. Business spending for new plant and equipment tends to lag behind other sectors during an economic recovery, but the drop in such outlays bottomed out during the fourth quarter of 1975 and new reports indicate that capital investment appropriations have increased sharply. The quarterly pattern of business spending is expected to accelerate throughout the year as rising corporate profits provide additional incentive and improved corporate financial positions increase business confidence. Added strength from inventory investment and the strengthing of construction activity will also contribute to the strong economic growth expected in 1976. Finally, the cyclical expansion in the United States will contribute to worldwide recovery as our demands for imports accelerate throughout the year.

The sustainability of economic recovery around the world depends upon sound fiscal and monetary policies. It also depends heavily on correction of the distortions in financial structures which have been associated with the sharp cyclical changes and the strong inflationary pressures that have occurred during the past 5 years. This is the real liquidity problem which should concern us—the domestic liquidity problem in individual countries arising from the recent cycle.

In the early part of that period, inflationary pressures developed as a result of the rapid and, by most standards, unsustainable expansion in real economic activity together with too rapid an expansion of money. These phenomena, strengthened by the quadrupling of oil prices and sharp rises in food prices, culminated in the deepest recession in a generation. In turn the severe recession led to a massive inventory adjustment. Expressed in nominal or money terms, these swings in economic activity have been more pronounced.

A large portion of the monetary expansion that characterized those years was financed in short-term financial markets. This led to a large buildup in short-term assets and liabilities, and was further reflected in the reduced availability of funds in the long-term markets. Inflation reduced the willingness of savers to commit their funds at long-term. As short-term debts increased, business firms became more vulnerable to cyclical fluctuations because of the fixed interest charges and the frequency of principal repayments.

A precondition for a more balanced market situation is a full return to conditions of underlying economic stability which would facilitate the funding out of the maturities of a large part of the short-term assets and liabilities. In the United States, there is evidence that we are making real progress in this effort. In 1973 and 1974, U.S. corporate financing had shifted heavily toward increasing dependence on short-term debt, and our commercial banking system, drawn upon extensively in meeting corporate requirements, drew down its own liquidity and borrowed extensively in the money market, in the form of certificates of deposit. But last year, a recovery in operating profits and the inventory runoff allowed corporations to reduce their dependence on outside financing and on short-term indebtedness, while increasing long-term borrowing. The improved corporate position was reflected in reduced demands upon the banking system, which allowed the volume of its certificates of deposit to decline, while rebuilding its own liquidity. With the end in the United States of an era of undue dependence upon short-term borrowing, the task now is to assure that financing patterns around the world are similarly healthy.

Ladies and gentlemen, I will conclude on an optimistic note. The attention of all nations appears to be properly turning to the fundamental importance of longer term economic stability. This shift augurs well for the future management of our domestic and international economic affairs, particularly the control of inflation. If each nation will individually manage its affairs responsibly, and if we all remain firm in our commitment to international cooperation in monetary and trade matters, we can look forward to future progress without concern about excessive international liquidity. The Jamaica agreement provides the necessary framework for an improved monetary system. Our challenge is to make it work.

Exhibit 57.—Remarks by Deputy Assistant Secretary Widman, May 24, 1976, at the World Trade Institute, World Trade Center, New York, N.Y., on U.S. balance of payments policy

It is quite a privilege to open the World Trade Institute seminar on "Operating in an Environment of Variable Exchange Rates." I see from the program that you plan to move swiftly into some of the very specific practical problems with which a corporation engaged in international trade or financial transactions must deal. I hope that my remarks will provide a useful setting for your examination of these important questions and assist you in arriving at conclusions.

You are meeting just at the close of what has been designated as "World Trade Week," a time when there is special emphasis on the transactions that cross national political boundaries and necessitate the pricing of one currency in terms of another. With U.S. international transactions in goods and services alone running at more than $300 billion a year, there is ample reason for such emphasis.

You asked me, as a representative of the Treasury Department, to talk about the balance of payments policy of the United States. I want to interpret that phrasing rather broadly because balance of payments policy is inextricably linked with international monetary policy which, in turn, is inextricably linked to domestic economic policy. Actually, the key to an understanding of current balance of payments policy is an understanding of agreements concluded at Rambouillet, France, last November and at Kingston, Jamaica, in January 1976 which provide for a new international monetary system. Thus I think it may be best to begin with a bit of history and a brief explanation of the Rambouillet and Jamaica agreements.

Thirty-two years ago, in 1944, most of the world's trading nations met in a monetary conference at Bretton Woods, N.H., and agreed on a set of rules to serve as the basis of the postwar international monetary system. Their basic objectives were to promote international monetary cooperation, to promote international exchange stability, to eliminate restrictions on foreign exchange transactions, and to encourage the growth of world trade. They established the International Monetary Fund as the institutional focus for the operation of the system, gave it financial resources with which to provide medium-term balance of payments support and induce balance of payments adjustment, and they wrote out a very detailed operational charter which became known as the Articles of Agreement of the IMF.

The fundamental approach incorporated in the Bretton Woods system was one of seeking to promote stability through the maintenance of relatively fixed rates of exchange among the currencies of member countries. All countries were expected to designate par values for their currencies, expressed in terms of gold and U.S. dollars- which were presumed to be related at the immutable figure of $35 per fine troy ounce. Monetary authorities were to keep the exchange rates within 1 percent of the par value by buying or selling their currencies against gold or a currency such as the dollar which was convertible into gold. Countries were expected to pursue domestic policies that would facilitate the maintenance of these par values, borrowing from the IMF where necessary in order to provide time to reap the lagged benefits of changes in policy. The par value itself was not altered unless and until it became abundantly clear that a fundamental change in economic relationships had occurred and it was clearly impractical to restore the original relationship.

For many years the world economy was sufficiently stable to allow this system to work reasonably well. The world experienced an unprecedented period of growth and progress; trade and payments restrictions were materially reduced; the volume of world trade jumped dramatically and world financial markets underwent a simultaneous process of expansion and integration.

But other changes occurred as well. The economies of Europe and Japan rose up from the ashes of war while we ourselves were drawn into wars. Both the magnitude and the pace of change quickened. The goals of preserving official par values for currencies were overshadowed by more powerful political and economic forces, by governmental mismanagement, or by sheer political weakness. The par value system was not flexible enough to adapt to these pressures. In particular, currency adjustments were primarily on the downside—often agonizingly and belatedly, countries with payments surpluses felt no incentive to appreciate their currencies, the world became dependent on U.S. payments deficits, and the United States could no longer afford to maintain an overvalued currency at the expense of its own economic welfare. In 1971 the par value system, which had in fact already failed, came to an end when the United States officially suspended the convertibility of the dollar into gold.

After the breakdown of Bretton Woods, it took the world 4 years to build a consensus around a new system. Not until the Rambouillet conference of the heads of state of 6 major nations was there agreement among the large industrial nations, and it was at the Kingston, Jamaica, meeting of the Interim Committee of the IMF last January that this consensus was broadened to include all of the 127 countries which are members of the IMF.

The Governors of the IMF have now approved major changes in the original Articles. These changes are currently being put before the parliaments of the world for formal ratification. They will come into effect when that process has been completed. The proposals were formally put before the Congress on May 15, and we expect the first hearings to be held next week. Our goal is to achieve complete and final action at this session of the Congress.

The new system does not alter or weaken the basic objectives of Bretton Woods, but it differs fundamentally on the method of achieving those objectives. It is this conceptual difference which is particularly significant. Under the old system, the monetary authorities of a country set a par value for their currency, accepting an implied obligation to pursue whatever domestic policies might be needed to maintain that rate, whatever happened at home or abroad. The new system does not focus on exchange rates directly, but on the achievement of stability in underlying economic and financial conditions in individual countries. It is based on the recognition that you cannot—indeed, should not try to—maintain an unchanged exchange rate relationship between two currencies if the basic trends in the two domestic economies are moving in different directions. Thus it reflects the conclusion that the way to stabilize exchange rates—the only way to stabilize exchange rates—is to stabilize underlying economic and financial conditions.

This becomes very explicit when one looks at the policies for intervention by monetary authorities. The potential for a contribution to exchange rate stability by monetary authorities is expressly recognized. But the purpose of such intervention is limited to transactions designed to counter disorderly market conditions—conditions which would be likely to cause erratic fluctuations in rates of exchange. Intervention to affect trends in exchange rates which result from changes in underlying conditions would not meet this standard.

This approach—this concept—is fundamental to our understanding of current balance of payments policy. Under the par value system, any imbalance in a country's international transactions which tended to cause its exchange rate to fall led instead to a loss of official reserves. When market pressure brought the exchange rate to the edge of the accepted margin around the par value the monetary authorities were obliged to step in and use their reserves to buy a sufficient quantity of their currency to prevent the rate from falling further.

In balance of payments statistical presentations great emphasis was placed on what was called the official settlements or official reserve transactions balance. This balance indicated the gain or loss in official reserves and thus in the resources available to defend the exchange rate. Much attention was focused on this balance. When it signaled trouble, governments looked for ways to alter their international transactions so as to change that balance.

Sometimes governments recognized that the proper response was a change in domestic fiscal and monetary policies; sometimes they did not. Sometimes the primary cause lay not in the policies of the country in deficit, but in the levels at which its trading partners had set their par values. Sometimes efforts were made to correct the balance through solutions or specific balance of payments policies which were in basic conflict both with the objectives of an open trade and payments system and with long-range progress in the domestic economy.

In the 1960's, for instance, the United States, in an effort to reduce a balance of payments "deficit," (1) imposed restrictions on investments abroad by Americans, (2) put limits on bank lending to foreigners, (3) expanded subsidized export credit, (4) reduced duty-free allowances for tourists, (5) deliberately "twisted" the yield curve on debt instruments, (6) increased preferences accorded domestic suppliers in Government procurement, and (7) took a number of other specific actions in an effort to maintain a fixed exchange rate which was not consistent with the underlying economic and financial factors prevailing in the American economy and in those of our major trading partners. Yet many countries were reluctant to face up to the need for change. It was not until the failure of this policy became obvious, when the unsustainability of the rate became so apparent that companies found it essential to hedge all their foreign currency liabilities and speculators moved in for the easy kill that the United States was able to insist on basic modifications.

The new system obviates the necessity for this type of balance of payments policy. We do not want limitations on capital transactions any more than on transactions in merchandise trade. The subsidization of export credit has no defense beyond a plea to match the subsidy of a competitor; domestic preferences for government procurement can be justified, if at all, only by the argument that other nations do the same or by the contention that there is inequity in too abrupt a change of rules. Balance of payments policies under today's system can be expressed quite simply: pursue fiscal and monetary policies which will lead to sustainable economic expansion with reasonable stability of prices and accept the balance of payments results.

You may have noted that just last week the Office of Management and Budget announced a major change in the statistical presentation of the U.S. balance of payments designed to reflect the new monetary system. The tables in the Survey of Current Business will no longer contain any balances. Memorandum items will be shown which give several partial balances: On merchandise trade, on goods and services, on goods, services, and remittances, and on current account. Nowhere, however, will the tables show the previous overall balances on current and long-term capital account, net liquidity, or official reserve assets transactions. These balances have no particular meaning under the new system, and it is wrong to try to characterize the strength or weakness of the U.S. payments position by referring to any of them.

As the Advisory Committee on the Presentation of the Balance of Payments Statistics concludes in its report, "A meaningful picture of U.S. international transactions can be obtained only from an analysis of information on several if not all of the categories of transactions, rather than by concentrating on one or more of several overall balances." Though the partial balances which will continue to be shown as memorandum items are valid and significant for particular purposes, it is important that they not be misused.

There are those who feel that the United States might appropriately have objectives or aims as to the structure of its payments positions even if there is no meaningful overall balance. Some have contended that the United States should seek a surplus on current account—attempt to be a net exporter of goods and services—in the belief that such a surplus will mean more jobs for Americans and less unemployment.

On the other hand, some have contended that the United States should attempt to alleviate the shortage of domestic capital by importing funds from abroad.

Obviously we cannot do both at the same time. When we have a surplus on current account we are exporting capital, net. We are providing goods currently in exchange for a financial claim which can only be paid off at some future date by a net import of goods and services to the United States. Thus those who advocate the net borrowing of funds from abroad to alleviate a domestic capital shortage are arguing for a deficit on current account—an excess of imports over exports. They are saying that the United States should seek to receive a net inflow of goods currently, giving in exchange an I O U to be paid in goods at some later date.

Who is to say which of these situations would best serve the economy at any particular moment in time? The economic advantage could shift with changing circumstances. And so we say, "Let the marketplace decide." Let the outcome be the net result of the millions of individual transactions in goods, services, and financial assets, responding to price and other normal commercial considerations and without official interference on the exchange rate. The price of the currency will rise or fall until a balance is struck between supply and demand, and the striking of that balance will not turn on whether the funds are sought to pay for goods or to pay for a financial asset. If the balance is struck at a level which involves an excess of exports of goods and services with a net export of capital, so be it; or if an excess of imports of goods and services with an inflow of capital, so be it.

This policy—this system—has significant implications for individual firms—and for the individuals within firms who must make decisions about procurement and sales and investments. Later in your seminar you will examine the factors which influence exchange rates and discuss forecasting techniques. Let me say quite frankly that the U.S. Government does not believe it possible to calculate in advance the exchange rates which would reflect underlying economic and financial sectors in any particular situation. We do not believe it possible to quantify and relate all of the many factors which influence rates day to day, week to week, and month to month. The techniques are not even available to measure competitiveness of goods, let alone services and capital transactions. We are not able to measure and incorporate in a rate determination exercise all the effects of income elasticities, of expectations with respect to inflation rates and interest rate differentials, of the market appraisal of the prospect of changes in governmental policy in an important country, or the impact of unexpected political developments.

This impossibility of determining the "right rate" is being recognized increasingly by monetary authorities, although some are still reluctant to abandon the attempt. Occasionally we still see some government attempting to maintain through central bank intervention what it believes to be an appropriate rate. Sooner or later, however, these attempts fail. There have been occasions when efforts to maintain a particular rate actually disrupted the market and cost the government involved a pretty sum of cash.

The United States holds no illusions whatsoever about the capability to determine the right rate. The Treasury has given clear and firm assurance that the United States will intervene only when it appears necessary to counter disorderly conditions in the foreign exchange markets or to acquire foreign exchange to repay debts. Under this policy, we will not attempt to keep the exchange rate at any particular figure or within any particular zone or range. We will leave the exchange risk where it belongs: with the employer of venture capital.

I should qualify this statement by noting that if the structure of our payments position were being sharply affected as a result of the manipulation of the system by one of our trading partners, we would be very much concerned. We would be concerned by any form of either active or passive resistance to needed payments adjustment. An interdependent world will only prosper in an open trade and payments framework, not with myriad restrictions and controls on trade or investment. This is why we are pressing strongly for further liberalization of trade in the multilateral trade negotiations and why we are working for a consensus or "code of conduct" on investment.

It is also why there is a specific prohibition in the proposed new text of the IMF Articles of Agreement against manipulation of the monetary system. One of the principal responsibilities of the IMF under the new system will be to monitor the operation of the system so as to ensure that there is no manipulation. We ourselves will be on the lookout constantly to ensure that this does not happen.

A second point I would add is that if the oil cartel succeeds in maintaining an artificially high price level, it is likely that several of the major oil producers with relatively small populations will, for several years, continue to receive foreign exchange income far beyond their needs—or, indeed, their physical capacity to absorb imported goods. For them there is no practical alternative to a surplus on current account. In 1976 the surplus of these few countries could total as much as $45 billion. That means that for the rest of the world collectively there must be current account deficits totaling an equal sum.

When a country has a current account deficit the excess of imports is paid for by borrowing. The surplus oil producers will be lending—somewhere in the world—even if some of that lending is no more than unspent bank deposits in foreign banks. The countries in current account deficit will have to borrow externally, not necessarily directly from the oil producers but from someone, somewhere. An increasing number of countries are approaching the limits of the amounts which they can afford to borrow—or which creditors will lend to them. These countries are thus faced with the necessity of pursuing policies which will eliminate their current account deficits.

If the system is to work, if there are not to be breakdowns or the spread of restrictions on trade and payments, those countries which have the strength to attract foreign capital must be prepared to accept substantial current account deficits. They must not resist or counter the efforts of the weaker nations to adjust. The United States is one of quite a number of countries in that position.

Our current account position has shifted dramatically in the last 2 years. We had a small deficit, $500 million, in 1974, when for most of the year the economy was straining at capacity and there was a huge speculative buildup of inventories. In 1975 we had a current account surplus of nearly $12 billion as our economy wallowed in recession and we went through perhaps the sharpest reduction in inventories in 50 years. Now that pattern has changed again. The U.S. economy is expanding strongly—a few months ahead of its major trading partners. Prices of industrial raw materials are rising. Some rebuilding of inventories may be underway.

In the first 3 months of the year our trade deficit—measured on a balance of payments basis—was $1.6 billion. While the data are not yet available, it is probable that our current account was in deficit during the first quarter by several hundred million dollars. That situation seems likely to continue for some time. If it does, we will be borrowing, net, to supplement the domestic funds available for investment and consumption. We will be making it easier for some of the developing countries and weaker industrial countries to avoid restrictions or further curtailment of their domestic economies. If this happens, it will be through the operation of market forces and a U.S. balance of payments policy which is good for the Nation and good for the world.

There is one very important aspect of the Rambouillet agreement which I have not mentioned; that is, the intensification of cooperation among the finance ministries and central banks of the major nations. The "spirit of Rambouillet" is very much alive. Consultations among the major nations are much more satisfactory now than they have ever been—more frequent, more open and frank, more comprehensive in their coverage than ever. We are learning a great deal about each other's economies, about each other's policies, and about the implications of those policies for the rest of the world. We are learning to understand how the concepts of the new monetary system apply in practice. We are learning that we do not know what the exchange rates ought to be at any particular time and that there is no valid way to calculate in advance a "right exchange rate" on the basis of which a central bank could recognize and counter an "erratic fluctuation."

No one should have been surprised at changes in exchange rates since Rambouillet, and no one should be surprised if other rate changes occur. Rambouillet did not promise instant stability of rates. In fact, it warned that rate stability could not be expected until underlying conditions had been stabilized. At this point underlying economic and financial conditions around the world are not stable—but very unstable. For example, consumer prices in 1975 rose 4 percent in Germany, 9 percent in the United States, 12 percent in France and Japan, 17 percent in Italy, and over 24 percent in the United Kingdom. In most cases the differentials have narrowed somewhat in the past few months, but they remain substantial and it will require all the skill and all the courage which governments can muster to bring inflation rates down to the level needed for sustained economic expansion and stability of rates of exchange. For the United States, that stability is the goal both of domestic policy and of balance of payments policy.

To sum up very briefly: U.S. balance of payments policy is directed toward: (a) Fostering economic and financial stability in our own economy, (b) preserving an open trade and payments system, (c) guarding against the manipulation of the system by other nations, (d) cooperating closely with others in the pursuit of stability in underlying economic and financial conditions, and (e) allowing market forces to determine both the standard of our balance of payments positions and the rate of exchange at which balance is achieved.

We firmly believe that this policy will provide a framework within which international trade and payments can flourish to the benefit of this Nation and the world at large.

Exhibit 58.—Statement of Secretary Simon, June 1, 1976, before the Subcommittee on International Trade, Investment, and Monetary Policy of the House Committee on Banking, Currency and Housing, on amendment of the Articles of Agreement of the International Monetary Fund and an increase in the U.S. quota

Agreement has now been reached on the main elements of a new international monetary system. Since the breakdown of the Bretton Woods par value system 5 years ago, international exchange arrangements have of necessity been operating outside the rule of law. Lengthy international debate, negotiation, and experimentation have brought consensus on a new flexible and resilient system, replacing the exchange rate rigidity and gold emphasis of Bretton Woods.

Throughout the period when the new system was being formed, the Congress- and in particular this subcommittee- have played an active and highly constructive role. My colleagues and I have had profitable and productive discussions with subcommittee members on themes, concepts, and directions the new system should take. Your counsel has been of enormous value in the formation of U.S. policies. I want to acknowledge your contribution and express my thanks.

The foundations of the new system are embodied in the legislation before you. Specifically, that legislation would authorize two related actions: U.S. acceptance of an extensive amendment of the Articles of Agreement of the International Monetary Fund, and U.S. consent to a proposed increase in its quota in the Fund. My purpose today is to discuss the concepts of the new system and the thinking on which it is based; to tell you why I regard its introduction as essential to the interests of the United States; and to urge that you give your strong support to the legislation authorizing its adoption, in order that we can move promptly to restore an effective legal framework that will reduce the risk that nations will be tempted to follow selfish policies which pay too little regard to the effects on others.

Reaffirmation of IMF role and Bretton Woods objectives

The new monetary system, the main lines of which were formulated in Jamaica last January, differs fundamentally, in philosophy and in operation, from the Bretton Woods system it replaces. But the new system will retain and build on two important basic features of the Bretton Woods framework:

First, the central pivotal role of the International Monetary Fund as the institutional heart and monitor of the system will be continued, and indeed strengthened.

Second, the essential aims of Bretton Woods, which give cohesion and direction to the monetary system, will be reaffirmed. Those aims, identified in article I of the present IMF charter, include: Fostering international monetary cooperation and the balanced growth of trade; promoting exchange stability and the elimination of exchange restrictions; and providing temporary balance of payments financing to allow members an opportunity to correct maladjustments without resorting to measures destructive of national or international prosperity.

Taken as a whole, these purposes represent a solemn commitment to the philosophy of a liberal world monetary order. The decision by the international community in 1944 to dedicate itself to these aims marked a turning point—from the selfishness and destructiveness of the 1930's, when each nation sought to lift itself from the morass of world depression at the expense of its neighbors, to the cooperative approach to international monetary problems which has since prevailed.

That is the guiding spirit of Bretton Woods and a part we must not lose: The commitment to international cooperation and responsible international behavior. The continued validity of, and need for, the Bretton Woods objectives are not questioned, and IMF article I is accordingly being reaffirmed.

Conceptual framework of the new system

But while the new system provides the same aims as the Bretton Woods system and continues to rely primarily on the IMF as the institution for achieving its purposes, it differs in other critical respects.

The Bretton Woods system was created against the backdrop of a different world—the world of the 1930's and 1940's, in which levels of international trade were very low; in which capital flows had virtually dried up and the value of international investment to international prosperity was not recognized; in which reliance on direct controls was widespread; in which interest rate and monetary policy instruments had fallen into relative disuse; in which the attention of policy officials was directed single-mindedly toward jobs and employment goals. Structurally the world of Bretton Woods was very different because the number of sovereign nations participating in the international system was perhaps one-third the present number; and because there was a single strong currency—the dollar—and a dominant economy—the United States—which could absorb the combined impact of adjustment policies and reserve changes of the rest of the world.

It is understandable that features of a monetary system designed to meet the problems of that world could become obsolete and anachronistic in the conditions of today, where the structure of the world economy has changed and the problems have changed—where nations are struggling to get below double-digit inflation and are living with levels of unemployment far in excess of those prevailing in the early postwar years.

The proposed new system differs most importantly on how best to bring stability to the international monetary system. Bretton Woods sought to impose stability on countries from without, through the operation of international monetary mechanisms; the new system seeks to develop stability from within, through attention to responsible management of underlying economic and financial policies in individual member countries.

Bretton Woods was based on the idea that stability could be imposed on a heterogeneous world by a structure of par values, supported by financing from the Fund. That system, developed at a time when the competitive depreciations of the 1930's were fresh in mind, recognized as legitimate only one exchange rate practice—par values. It assumed that if countries were required to adhere to fixed exchange rates, to be altered only after fundamental economic changes had occurred, and were supplied with moderate amounts of Fund credit, that arrangement would provide adequate leverage—at least on deficit members—to encourage stable economic policies. But as this subcommittee well knows, it proved incapable of dealing with the changed world of the 1960's and 1970's, when external shocks of unprecedented magnitude, widely diverging inflation rates, extreme variations among nations' economic policies, and the capacity for massive capital flows relative to limited fund resources led ultimately to breakdown of the par value system.

The new system takes a different approach. It does not rely on the system to force stability on member countries, but looks to the policies of member countries to bring stability to the system. In the exchange markets, the new system does not seek to forestall change by imposing rate rigidity, but recognizes that countries' competitive positions do and will change, and that it is far less destabilizing to permit rates to move in response to market forces than to hold out until the abandonment of costly large financing efforts brings abrupt jumps. It recognizes that the only valid path to international monetary stability is the pursuit of policies in the member countries that converge toward stability rather than diverge into instability. It acknowledges that we can never assure lasting stability in exchange rates between the dollar and yen, or mark, for example, if the underlying trends in the economies of the United States and Japan or Germany are sharply different in pace or direction.

This is much truer today than 30 years ago because of the progress we have made in liberalizing the world economy and the growth of economic interdependence. The move to a liberal and integrated world economy has brought greater prosperity and major benefits to all nations. But allowing wider scope for international commerce also means greater potential for disruption from that commerce. With freedom for expanded trade and capital flows, market responses to changing conditions can be swift and massive. In today's integrated world economy, action to manage or fix exchange rates in contradiction to basic market forces will fail. In recent years, nations have learned this lesson time and again, and those who challange it do so at their peril.

The new monetary system is therefore a more flexible, pragmatic, market-oriented system, better suited to the highly integrated world economy of the present. It recognizes that countries cannot define their obligations in terms of measures to be adopted only after the strains occur. It looks to prevention, whereas the old system applied only cures, often too late and with ineffective doses. It concentrates on the real determinants of monetary stability—stability in underlying economic and financial conditions—rather than on the exchange rate consequences which were the focus of Bretton Woods.

Obligations regarding exchange arrangements

That philosophy underlies the new Article IV: Obligations Regarding Exchange Arrangements. This critical part of the Articles provides the legal framework and nucleus of a new system. The new article IV contains five major provisions:

One, the article provides for specific obligations of each member to promote underlying stability. In the words of the article, each member must, with due regard to its circumstances, "endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability," and "seek to promote stability by fostering orderly underlying economic and financial conditions."

Two, the article provides wide latitude for a member country to adopt specific exchange arrangements of its choice. Each member must collaborate with the Fund and with other members to assure orderly exchange arrangements, but the article does not insist on par values or any particular exchange rate regime. It permits a range of exchange rate practices—including floating; EC "snake-type" arrangements; and pegging to another currency, to a basket of currencies, or to the special drawing right (SDR).

Three, the article requires that members avoid manipulating exchange rates or, more generally, the international monetary system to prevent effective balance of payments adjustment or to gain an unfair competitive advantage. This requirement is aimed at promoting responsible exchange rate behavior, the avoidance of competitive undervaluation, and beggar-thy-neighbor policies. It can, moreover, yield a major improvement over Bretton Woods in providing for *symmetrical* Fund examination of surplus as well as deficit countries—since a surplus country which refused to allow its currency to appreciate and accumulated excessive reserves would be "preventing effective balance of payments adjustment."

Four, the article provides authority for the IMF to oversee the compliance of each member with its obligations—the undertakings to promote stability, to avoid manipulation that prevents adjustment or gives an unfair advantage, and to collaborate with the Fund and with other members to assure orderly exchange arrangements. This authority for Fund surveillance gives the Fund the task of applying a global perspective to actions of those members that cause adjustment or other problems for other members.

Five, the article provides the means with high majority vote, for future evolution of the system, if modification is called for to meet future needs.

In summary, the new article IV contains the essential elements of a balanced, realistic, and workable system, monitored by the IMF. Member countries have freedom to pursue exchange practices of their choice—individual floating, or joint floating, or tied to a currency, or otherwise—but undertake important commitments for responsible international behavior—to follow stable economic and financial policies; and to avoid actions that distort world production, trade, and investment to the harm of others. The IMF for its part will pay less attention to such procedural questions as whether a currency is floating or fixed, but will have broad new authority to oversee the system to promote its effective operation and to oversee the compliance of members with their obligations. These obligations are designed to minimize international tensions in exchange matters, while at the same time giving member countries greater freedom to choose the exchange procedure they wish to utilize.

The IMF is in a very real sense the focal point, the core of the system. Members are obliged to provide the Fund with the information necessary for intelligent surveillance of their exchange rate policies. In addition, the Fund is called upon to adopt "specific principles" for the guidance of members with respect to those exchange rate policies to assure that manipulative practices are avoided. In the Bretton Woods system the Fund's attention was more likely to be directed toward a member in times of crisis, and more narrowly focused toward exchange markets. By contrast, under the new system, Fund consultations with members are likely to be more continuous, more broadly based, more concerned with the real international impact of a country's actions, and directed to all countries, not just those in deficit.

Fund surveillance and oversight of members' exchange rate policies does not mean that the Fund can determine the policies of sovereign countries. This would be totally impractical and unacceptable to the United States and all Fund members. But one member's behavior should not be at the expense of other members' well-being. Within that context, the Fund can develop general principles interacting with a type of common law based on application of these principles to individual cases, aimed at assuring that members' exchange policies promote stability and adjustment and are not designed to gain an unfair competitive advantage.

In developing specific principles, the Fund will need to proceed cautiously. Such principles must have very broad acceptance by Fund members. Their development cannot be forced, but they can be expected to emerge over time in the light of general and specific consultations with members. In this way, the general principles of acceptable behavior will evolve, grounded on the agreed objectives and obligations of article IV.

Fund surveillance of members' policies should not be aimed at trying to calculate a zone, or target, or "right rate" for individual currencies toward which exchange rate policies should be directed. Such an approach is, in my view, inconsistent with the new article IV and is neither conceptually sound nor technically feasible. It suffers from the same basic flaw as the par value system—it assumes that we know, or can determine, what should be at least approximately the equilibrium rate for each currency. It is, in attenuated form, a throwback to Bretton Woods, a fixed-rate psychology, a search for "fundamental equilibrium." Even in theory there is no single right rate in a world of large capital flows in which inflation rates, domestic objectives, monetary and fiscal policies, to name but a few influences, not only differ among countries but can change rather rapidly.

The technical difficulties of calculating a proper exchange rate zone or right rate are so formidable as to render this approach impractical as a guide to policy. The approach assumes that we can compare one country's inflation rate against other countries' and thereby determine what its exchange rate should be. There are problems of obtaining the right indices—knowing what weights and base periods to use; problems of obtaining proper data—which are inadequate in most countries; and problems of measuring price and income elasticities. Perhaps more importantly, these calculations look only at the impact of merchandise trade on exchange rates and pay no account to capital movements, which loom so large in determining the exchange rates of so many currencies. With the present state of the art, such attempts on the part of monetary authorities to calculate the right rate and then use the results as the basis for exchange rate policy are tantamount to a daily renegotiation of a par value system on the basis of limited and inadequate data underpinned by flawed concepts. Moreover, the data used all relate to past periods and are entirely backward looking, whereas exchange rates are partly forward and partly backward looking, anticipating future economic and financial trends as well as recording past developments.

The reaction to the exchange arrangements in the new article IV by the general public, industry, and the academic community has been favorable. Some who may feel that amendment is of little urgency because present de facto exchange arrangements have worked satisfactorily should perhaps reflect on the dangerous consequences for all nations if, in present extra-legal circumstances, there should be substantial moves toward exchange rate manipulation. And those who have expressed concern that the new arrangement lacks the elements of a "system" have perhaps paid inadequate attention to the obligations of article IV and the importance of those obligations to the structure of the new system. Certainly the new arrangements are less of a grand design than Bretton Woods—and appropriately so. The Bretton Woods system was created when war had destroyed all vestiges of an international monetary order, and a universal, complete new structure had to be developed. But much of the Bretton Woods system remains valid—I stressed earlier that the objectives would be reaffirmed—and those parts have been retained as a foundation.

The allowance for possible future evolution of the exchange system is a noteworthy provision. The experience of Bretton Woods shows the difficulty of trying to foresee just what exchange arrangements may be required to meet the needs of a world 15 or 20 years ahead. The new article IV provides that with broad consensus the system can be adapted. The Fund can decide, by 85 percent majority, to establish general exchange arrangements which might be appropriate to evolving circumstances, or to introduce a system based on "stable but adjustable" par values. But any introduction of a general par value system under the amended Articles would require a determination that certain specified conditions existed to assure that such a system would be workable—conditions related to the existence of stability in the world economy, effective balance of payments adjustment arrangements, sources of liquidity, and other factors. It is further provided that if a new par value system were established, it would be more flexible than the Bretton Woods arrangements in certain important respects: Individual countries would not be required to establish par values but could adopt other exchange arrangements; a country having adopted a par value could terminate it and reestablish it under certain conditions; par values could be changed more readily; and provision would be made for wider margins and for decisions to change margins.

Since future adaptation of the system, either to general exchange arrangements or to general par values, requires an 85-percent majority vote, the United States, with nearly 20 percent, will have a controlling vote. In any event, the United States cannot be required to establish or maintain a par value for the dollar.

The amended Articles will terminate for IMF purposes existing par values of all IMF members. The legislation before you would repeal the par value of the dollar. Prior congressional approval would be required to authorize any future establishment of a par value for the dollar in the Fund and to authorize any change in the par value if one were established.

The legal standard for the dollar of $42.22 per fine troy ounce of gold would be retained solely with respect to gold certificates held by the Federal Reserve System—the only domestic purpose for which a value of the dollar in terms of gold is needed. Approximately $11 1/2 billion of these certificates are now outstanding and are being retired by the Treasury as its gold holdings are sold.

This subcommittee knows well the importance to the United States of safeguards with respect to future modification of the international monetary system. You are well aware of the difficulties which arose under the Bretton Woods arrangements when the dollar was pinned down at the center of the system and could not adequately move in response to underlying market forces. The results, in the late 1960's and early 1970's, were severely adverse for the U.S. economy—not just in increased debts, but in the loss of jobs, productive capacity, and the transfer of our industry abroad. We must be able to avoid any such situation in the future. It is not just a matter of academic theory, it is a matter critical to the strength of our economy and prosperity of our citizens.

Rambouillet and recent market developments

Let me comment for a moment on recent market developments, in the light of the proposals for the new monetary system, and the related understandings reached by the United States and other major industrial nations at the Rambouillet summit meeting last November.

At Rambouillet broad understandings were reached on structural reform—these understandings were reflected in the proposed new Article IV, which I have just described. Understandings were also reached on more immediate operational issues to further and to implement the concept that stability of underlying economic conditions is a prerequisite to exchange stability. As a product of the understanding, the United States and others agreed to improved consultations—deepened, broadened, more frequent consultations—among treasuries and among central banks. These consultations are an indispensable element of the understandings. It is only through such consultations, by the responsible senior policy officers in treasuries and central banks, that we can gain the comprehensive knowledge needed for a valid assessment of trends and policy moves and for a better understanding of both the underlying causes of instability and the exchange market manifestations of that instability.

Since Rambouillet there have indeed been large movements in the exchange rates of some of the participants. The mark and the French franc have diverged, and the pound and the lira have from time to time been subject to sharp downward pressures. Some have asked whether that meant we had failed, and that the "spirit of Rambouillet" was dead.

No one should be misled—Rambouillet never promised that stability in exchange rates would come instantly or easily. Quite the contrary. The premise of Rambouillet, fully reflected in the proposed article IV, is that exchange stability depends not on market intervention but on stability of underlying conditions. The market experience of the past months is confirmation of that premise—intervention, sometimes very heavy, has failed to assure rate stability in the absence of stability in underlying economic and financial conditions, and plainly that required underlying stability has not yet been achieved.

I can report that in an institutional as well as substantive sense, the spirit of Rambouillet is not only alive but thriving. Consultations have become far more frequent, more comprehensive, and certainly more candid than before. Analysis has become more thorough. I am convinced that the resulting increased knowledge and improved understanding we have of each other's problems have already proved helpful in that the instabilities which have appeared in recent months would have been far more dangerous. Such consultations undoubtedly facilitate our dealing with these problems in the future. This is one of the most encouraging results of Rambouillet, and the framework on which we must build.

Reducing the role of gold and expanding the role of the SDR

Complementing the move to new exchange arrangements, and the shift away from par values, is a shift away from gold, which was intended to serve as the link for holding together the par value system. In theory, gold was the base of the Bretton Woods monetary system, the ultimate reserve asset, the creator and regulator of international liquidity, the basic unit of account, the linchpin supporting convertibility and enforcing discipline. But, in fact, gold never fully performed these international monetary functions, and over time it became increasingly apparent that gold was unsuitable for them—just as it had earlier proved unsuitable as a base for U.S. and other domestic monetary systems. With new gold production strictly limited and industrial demand growing rapidly, residual supplies available for monetary use were both inadequate for and unrelated to the liquidity needs of an expanding world economy. Pressures and price differences inevitably emerged between the controlled official market and the highly volatile private market, leading to concerted official efforts to alleviate or suppress the pressures by sales of gold on private markets—further reducing monetary stocks—and to widespread speculation and pressures for change in the official price which would have had a capricious and destabilizing effect on the monetary system. With monetary gold stocks so limited, the world became dependent on and promoted U.S. balance of payments deficits to meet increasing liquidity needs. The result was that gold convertibility of the dollar grew less and less credible and in 1971 was suspended.

In recognition of these inadequacies, the new system promotes a reduction in gold's monetary role in three ways:

First, gold's legal position is changed. Under the amended Articles, gold will no longer have an official price. It will no longer be the unit of account for expressing the value of currencies, for determining the value of the SDR, and for calculating rights and obligations in the Fund.

Second, the required use of gold in IMF transactions will be eliminated, for example, in quota subscriptions and in payment of charges. In fact, the Fund will be prohibited from accepting gold except by specific decision, by an 85-percent vote.

Third, the Fund will be empowered to dispose of its remaining gold holdings in a variety of ways and by an 85-percent vote in each case.

Agreement has already been reached—prior to the amendment, under the authority of the existing Articles—for the disposal of one-third of the Fund's gold, or 50 million ounces. Of that amount, 25 million ounces will be "restituted" or sold back to IMF members in proportion to IMF quotas and at the official price of 35 SDR, or approximately $42 per ounce. The other 25 million ounces is to be used for the benefit of developing countries, through gold auctions with the profits accruing to a new trust fund.

This trust fund, recently established at U.S. initiative, meets two objectives: Helping to phase gold out of the system, and using some of the profits on gold sales to help finance the severe balance of payments problems currently facing some of the poorest developing country members of the IMF. This is an appropriate use by the IMF of its gold. The technique used—whereby the IMF exchanges gold to replenish its holdings of usable currencies—is familiar and well precedented in IMF experience. Just how much the trust fund will receive from these gold sales cannot be forecast—that's one of the problems of using gold as a monetary asset. The purpose of the trust fund's gold sales is not to obtain a predetermined sum, or to affect the price of gold one way or another, but rather to dispose of the gold, to convert it into usable currencies for the benefit of developing countries.

Establishment of the trust fund does not mean the IMF is becoming an "aid agency." The trust fund will be an entirely separate entity, in no way subjecting the IMF to liability, but controlled and managed by the IMF, thus taking advantage of the technical expertise and sound practices of the institution. The trust fund will provide the same kind of financing as the IMF—balance of payments loans—though the trust fund's credit terms will be more concessional than those of the IMF, as appropriate to the present needs of the trust fund recipients. Loans will be subject to standard IMF requirements that the recipient has a legitimate need, based on assessment of its balance of payments and reserve position. To qualify, a borrower must also meet conditionality requirements of a first credit tranche drawing in the IMF regular facilities—that is, it must have a program by which the Fund deems the member is making a reasonable effort to resolve its payments difficulties. Thus, there is much that is similar to regular IMF procedures. The trust fund provides an appropriate and sensible way to mobilize what essentially has become a sterile asset of the IMF. It does not represent a subversion of the IMF's monetary character. It represents instead an important and innovative way to meet a critical need on the part of a particular segment of the IMF's membership.

Apart from the 50 million ounces of gold for which disposal has already been agreed, under the amended Articles the Fund will be able, by 85 percent vote, to dispose of any part of its remaining 100 million ounces in any of three ways: Sales at market-related prices, sales at the book value of approximately $42 per ounce to present Fund members in relation to quotas, and sales at the book value to developing country members.

The profits from any sales at market-related prices can be used in any of four ways: They may be transferred back to the Fund's general resources and "capitalized" with members' Fund quotas being increased commensurately; they may be placed in the IMF's investment account; they may be used for operations not expressly authorized by the Articles but consistent with the Fund's purposes, such as the trust fund; or they may be distributed to developing country members.

All but the first of these four uses—transferring the proceeds back to the IMF's general resources—require an 85-percent vote. In all its gold dealings, the Fund is required to avoid the management of the price or establishment of a fixed price for gold.

Views have been expressed in the Congress that the Congress should participate in any U.S. decision to support further disposal of IMF gold. I recognize the Congress' interest in this matter. I agree that there should be full and close consultations with the Congress in this sphere. While it would seem unnecessary and inappropriate to consult if the Fund were merely exchanging its gold at market price for currency to be used in its regular operations, it would seem not only appropriate but desirable to consult about proposals to use the IMF's gold or gold profits in such ways as the trust fund which benefit a particular group of countries. I am certainly prepared to consult in this way, in a complete and timely manner, in order that the Congress has an opportunity to make known its views.

With dismantling of many IMF rules and restraints on official gold transactions, important side arrangements have been agreed among the Group of Ten—the major gold-holding nations—to assure that gold does not reemerge as a major international monetary asset. This understanding, which is not part of the amended Articles, but is consistent with and supportive of the policies of the amended Articles, provides that participating nations will not act to peg the price of gold, will agree not to increase the total stock of monetary gold, will respect any further conditions governing gold trading to which their central banks may agree, and will report regularly on gold sales and purchases.

The arrangement took effect February 1, 1976, and will be reviewed after 2 years and then continued, modified, or terminated. It is, in our view, an important and necessary safeguard during this transitional period, although I am firmly convinced that in any case gold's role in the monetary system will continue progressively to decline.

In parallel with phasing down gold's monetary role, the new system provides an expanded role for the SDR and modifies certain of the rules governing that new asset.

When the SDR was originally created in 1968, its value was established in terms of gold and linked to currencies through their par values, essentially through the par value of the dollar. With the suspension of gold convertibility of the dollar and the widespread move away from par values to floating, it became unrealistic to value the SDR in terms of par values, and difficult to determine the rates to be used in IMF transactions. To overcome this problem, agreement was reached on an interim basis to value the SDR in terms of a weighted basket of the market exchange rates of 16 major currencies, with the dollar representing approximately one-third of the basket. Such a basket valuation technique is particularly well suited to a world of widespread floating of exchange rates, and the Fund has subsequently operated without difficulty.

Under the amended Articles, the link between the SDR and gold is severed. The SDR replaces gold as the common denominator of the system and is the unit for measuring IMF rights and obligations. The SDR's value will continue to be determined by the present basket technique. The possibility is provided for future modification in the valuation technique in the event there is a widespread view that a different technique is needed. A majority of 85 percent is required for a change in the valuation principle or a fundamental change in the application of the valuation principle. Other, nonfundamental or technical changes require a 70-percent vote. Such an ability to modify the SDR valuation technique is needed, because the present basket was introduced on an interim, somewhat experimental basis, and because an evolution in exchange arrangements could make it appropriate to shift to a different valuation technique.

The SDR is expected to take on an increasingly important role, not only as a unit of account used in measurements, but also as an asset used in transactions. With respect to its asset use, there is an obligation on members to collaborate with the Fund toward the objective of making the SDR the principal reserve asset of the international monetary system. Also the SDR takes over from gold the preferred status as asset to be received by the Fund in payment of charges, in meeting repurchase obligations, and to be accepted by members in exchange for currencies replenished by the Fund.

A number of technical steps have been taken to improve the SDR's quality and usability so that it may better fulfill its purposes. Thus countries will have greater freedom to enter into SDR transactions with each other on a voluntary basis; the possible uses have been expanded; and the Fund may broaden the categories of holders—though not beyond official entities—and the operations in which they engage. Also, the decisions for altering certain policies governing SDRs are made easier—such as the terms and conditions governing approved transactions, and the rules that require countries to "reconstitute" or buy back after a certain period some of the SDRs they have spent.

At the same time these rules governing use of the SDRs are being eased, important safeguards have been retained which help assure that the SDR will remain a widely accepted and valued asset. Thus, the limit on members' obligation to accept SDR's is retained, and IMF quotas remain the basis for new SDR allocations.

The reduction in the monetary role of gold in these agreements represents real progress toward an objective held for many years by the United States and many other countries. Gold is a valued commodity, but clearly not a sound basis for an international monetary system. The provisions in the new system reducing gold's role and expanding that of the SDR represent a move toward realism and stability.

IMF quotas and the provision of Fund credit

The legislation before the subcommittee would authorize U.S. consent to an increase equal to SDR 1,705 million in the U.S. quota in the Fund. A member's quota determines its obligation to provide resources to the Fund, its ability to draw resources from the Fund, its share of SDR allocations, and its voting rights. The quota increase proposed for the United States represents our negotiated portion of the general quota increase agreed to in a regular periodic review required under the Articles. The quota increase would take effect after the amended Articles take effect. It will have no effect on the budget: in keeping with the recommendation of the Commission on Budget Concepts, the transaction will be effected through an exchange of assets, and the United States will receive a reserve position in the Fund—an automatic drawing right akin to a bank deposit—for dollars drawn down by the Fund to lend to other members. Congressional approval is required for consent to this change in the U.S. quota—and in fact for any change in the U.S. quota, other than that which might result from a "capitalized" increase in quotas which could result from and be financed by a future sale of IMF gold at market prices, and for which no payment would be required from the United States.

When Bretton Woods was established in the mid-1940's and international banking was at a rudimentary stage of development, the ratio of potential IMF credit to the levels of international trade and investment may have seemed impressive. Today it is far, far less so. As the monetary system has developed, it has become increasingly clear that while IMF resources can finance deficits and help bring about orderly economic adjustment, the Fund cannot be the only device. There has been a much more rapid increase in use of private credit for financing payments deficits, and also a move toward more flexible exchange rates and other means of adjusting for imbalances.

While member countries will and should continue to rely mainly on credit from private capital markets for financing needs, the IMF has a unique and indispensable function. It provides balance of payments credit under clearly specified conditions, whereby borrowing countries undertake sound economic programs of corrective measures—fiscal, monetary, and exchange measures—designed to bring about the necessary adjustments, eliminate the problems which caused the need for borrowing, and enable the debts incurred to be serviced.

IMF credit expands the availability of private credit very significantly. Markets are more willing to lend in the knowledge that in the event of difficulty in a borrowing country the IMF can be counted on not just to provide supplementary resources, but, more importantly, to provide those resources in association with soundly based corrective programs.

The disciplines of the private market can be harsh and abrupt. A country that gets into difficulty, whose creditworthiness becomes suspect, can find that private financing dries up overnight. Such a country will adjust—it must adjust. But the choice may be between an adjustment that is internationally harmful and one that is internationally constructive—that is, an adjustment involving restrictions on others' exports, or exchange and capital controls, versus an adjustment based on Fund financing and an associated Fund program keyed to corrective fiscal and monetary measures. The Fund can encourage those forces in deficit countries which favor adjustment via internationally responsible means, and it can provide a forum where those affected by a country's actions can be heard. In dealing with these cases the Fund can perform a crucial role that no other institution can carry out. It can help to prevent a gradual erosion of the entire payments system through the distortions to world trade and investment that result from restrictions on trade and payments imposed by these deficit countries. Action by the Fund to isolate and assist such countries can help to secure the entire system, by halting the contagion of restrictionism. This aspect of the Fund's responsibilities for the monetary system is a crucial one. The Fund's record in helping to bring about adjustments through its conditional financing is good, and its repayment record is unblemished.

The U.S. quota increase would be part of a proposed increase in overall IMF quotas of 33.6 percent. In assessing this overall increase in quotas of about one-third it is worth noting that since 1970, when IMF quotas were last increased, world trade has approximately trebled, inflation has eroded the real value of Fund resources, and the imbalance in world payments has multiplied as a result of oil price increases and other problems. I think the increase proposed for the United States and for the general IMF membership is fully justified.

Reaching agreement on sharing the quota increase among countries was difficult. It was generally acknowledged that the oil-exporting countries should have a larger share, reflecting their increased role in the world economy, and their combined share was doubled, from almost 5 percent to almost 10 percent. It was also agreed that the nonoil developing members should not suffer a reduction of their combined share. Thus, the full impact of the oil exporters' increase had to be shared by the developed countries. The U.S. quota share will decline from 22.93 to 21.53 percent of total, and our voting share will drop from 20.75 to 19.96 percent of total. Since the U.S. vote is dropping below 20 percent, the United States accepted this reduction within the framework of an increase from 80 to 85 percent in the vote needed for major Fund decisions.

Updating IMF operations and organization

The negotiation of a comprehensive amendment of the IMF Articles provided an opportunity for introducing needed operational changes. The original Articles were heavily focused on the mechanics of the monetary system—on the trappings of convertibility and par values. The Articles were more like a contract than a constitution. They contained detailed rules and regulations—many of which became obsolete with the passage of time—and did not contain either scope for flexibility in day-to-day operations or scope for adaption over time.

In light of these problems, a large number of changes are proposed affecting IMF operations. These modifications are described in the Special Report of the National Advisory Council and the Report of the IMF Executive Directors submitted to the Congress in April. The purpose is to modify obsolete provisions, to simplify operations and introduce needed flexibility to remedy past anomalies, and to adopt structural changes. Among the modifications are the following:

Usability of currencies is assured. The United States has consistently argued that all member countries should permit the IMF to use its holdings of their currencies to provide balance of payments financing to other members, which is a basic purpose of quota subscriptions. But under the present Articles, regardless of the strength of their external positions, countries can effectively prevent the Fund's use of their currencies for loans to others. Agreement to the usability of IMF currency holdings was considered essential, in part because quota subscriptions can be paid in full in national currencies under the amended Articles—and there is no reason for the IMF to accumulate more of a country's currency if it is not permitted to use that currency. Under the amended Articles, there are provisions to ensure that the Fund's holdings of all currencies will be usable by the Fund in accordance with its policies. Similarly, members will be required to provide their currency to other members when that currency has been specified by the Fund for repurchase. This agreement will add substantially to the Fund's usable resources at present and in the future and will strengthen its ability to provide balance of payments assistance to members.

The Fund's *authority to invest* is made explicit. Currencies, not in excess of the Fund's reserves (presently about $800 million), can be invested in income-producing and marketable obligations of international financial organizations or of the members whose currencies are used for investment. Investment can be made only if authorized by 70 percent majority and only with the concurrence of the members whose currency is used for the investment. No maintenance of value obligations would apply to invested funds.

The Fund's policy on *repurchases* is modified. The provisions in the present Articles were obsolete and cumbersome, based on a detailed formula and on a calculation of "monetary reserves" more appropriate to a par value system than to present arrangements. The amendment provides that the Fund be given authority to establish policies on repurchases appropriate to the needs of the system.

In addition to such operational changes, organizational changes are also proposed. Most importantly, there is an enabling provision which would permit, by 85 percent majority vote, the establishment of a Council, with decisionmaking power, to replace the present Interim Committee, which is an advisory body. As in the Interim Committee, the U.S. Governor to the IMF would serve as the U.S. representative. The Council would be charged with supervising the management and adaptation of the international monetary system, including the continuing operation of the adjustment process, and development in global liquidity. These provisions are also described in the special report of the National Advisory Council.

Summary comment

Mr. Chairman, the subcommittee has before it the single most important piece of legislation in the international monetary sphere since the Bretton Woods legislation itself. The world monetary system has been without legal form since the Bretton Woods system fell apart 5 years ago. To many people, international finance has been regarded as an arcane and abstract subject, but with the experience of the past decade, the relevance of a smoothly functioning international monetary system to American jobs, production, and growth is plainly seen. This subcommittee knows the necessity of having an effective legal structure, and knows the importance of having our international rules attuned to the realities of the day. Without agreed rules, the temptations are strong for governments, deluged daily by the demands of interest groups, to follow narrow national interests at the expense of others and to pay inadequate regard, or even to abandon, the broad view of international interdependence which has so successfully guided the world community since World War II. As the world's main trading nation and a prime architect of a liberal world trade and monetary order, we should move promptly to show to the world that we remain committed to the rule of law and reason among nations.

The new international monetary system is sound in structure and right in approach—with firmness in the commitment to policies which promote underlying stability, flexibility in procedures and exchange practices; and careful surveillance by the IMF to assure that obligations are fulfilled. We have sought to retain the good features of Bretton Woods, and to replace the obsolete. Members of this subcommittee have long endorsed two of the main themes in the new arrangements—a reduction in the monetary role of gold, and exchange arrangements that respond to market forces rather than trying to counter those forces. The U.S. approach to the negotiations has been strongly influenced by your views.

I urge, on behalf of the administration, prompt and affirmative action by the subcommittee and by the Congress. It is important, for the United States and for all IMF member countries, that we end the present extra-legal character of our international monetary system and restore the structure of a workable, lawful system. The arrangements before us will accomplish that, in a way which is balanced and fair, and which safeguards the interests of the United States and all countries. The United States has played a leading role in bringing about the acceptance of the new arrangements. Prompt action by the Congress will encourage similar actions by other IMF members, and enable the implementation of these measures with a minimum of delay.

Exhibit 59.—Statement of Secretary Simon, June 22, 1976, at the OECD ministerial meeting in Paris

As we meet today to strengthen the spirit of cooperation and consultation, we do so with heightened confidence. We can reflect with satisfaction on the improved pattern of growth and employment within the industrial world. The strong economic recovery in the United States and other industrial nations is beginning to improve worldwide economic prospects as trade increases. We have also reached agreement on the main elements of a new international monetary system which, when ratified by our parliaments, will provide the legal structure for flexible and resilient arrangements patterned to the needs of today's world.

Yet the tasks before us remain formidable:

First, we must seek to convert the current recovery into sustainable economic expansion. The industrial countries have recovered from the worst recession in 40 years. Our challenge now is to achieve sustained growth through the implementation of prudent economic and financial policies aimed at reducing inflation. Because conditions vary from country to country, different though compatible strategies will be required.

Second, we must achieve a pattern of international payments which reflects the realities of the exchange market. There can be no stability in exchange rates or in international payments patterns until stability has been restored in underlying economic and financial conditions. Substantial and in some cases difficult adjustments are required for both deficit and surplus countries.

Third, we must adopt policies that will assure a free and open world trade and investment order.

Fourth, we must realistically address the legitimate concerns of the developing world. But, we must avoid promising what cannot be delivered and reject policies which would distort the proper functioning of our market-oriented economic system.

We must face these challenges together. History has taught us that no country or group of nations can solve economic problems in isolation. Economic progress and prosperity cannot be achieved if countries seek to exact an exorbitant price from others or export their economic difficulties. Our future depends on our willingness to cooperate and our ability to lead.

Let us examine in more detail the tasks before us.

The prerequisite to sustained expansion

We are in the midst of a healthy and balanced recovery. However, we must exercise caution, for we have left the deepest of postwar recessions with inflation rates that remain high in historical terms and unacceptable over any extended period. Sustained expansion requires a further reduction in inflation.

In the United States the recovery is now well into the second year of a relatively strong and balanced expansion: Real output has increased 7.1 percent over the last four quarters while inflation has declined to an average annual rate of 5.5 percent; employment has risen sharply by 3.6 million workers and the unemployment rate has dropped from almost 9 percent to 7.3 percent in May; and our trade balance has declined from record surplus to deficit as the pace of economic expansion and the end of the inventory adjustment increases our demand for imports. While personal consumption provided the basic thrust for the recovery, more recently business spending for inventories and a gradual turnaround in the housing sector have added momentum. Business spending for plant and equipment which appeared to bottom out late last year is accelerating and it now appears that the improvement now expected to begin by late 1976 and early 1977 will occur on schedule.

There are, of course, problem areas which we are closely monitoring: (1) The behavior of raw material prices which can be expected to rise as the expansion continues; (2) the major labor contract negotiations scheduled for this year; and (3) the perennial concern about the impact of weather on the crop harvests. Fortunately, wholesale industrial commodity price increases have remained relatively moderate to date with such prices rising at an annual rate of 3.7 percent during the last 6 months. Average compensation gains have been rising at an 8-percent annual rate and most contract settlements have continued the process of slowly reducing cost pressures. With productivity gains somewhat above the historical average at this stage of the cycle, the increase in unit labor costs is moderate. Finally, the crop situation looks relatively favorable.

Our economic projections for 1976 have been revised. Our new projections anticipate output near 7 percent, well above the original estimate of 6 percent; the inflation rate near 5 percent, well below the original estimate of 6 percent; and the unemployment rate to decline below 7 percent by yearend. Moreover, we are confident that the expansion can be sustained well beyond 1976.

Virtually all of the economies of the OECD area are either experiencing recovery or, like the United States, have moved beyond the recovery stage to solid expansion. The concern today is no longer one of recovery but of sustaining our growth. Some believe that demand will not be strong enough to support further expansion. I do not see major near-term distortions in the continued expansion from the demand side. To the contrary, the greatest threat to the sustained expansion is the risk of a resurgence of inflation.

On the basis of present policies, the OECD Secretariat expects an average inflation rate in OECD countries of 8.2 percent in 1976. In some countries prices are expected to increase 15 percent or more. Unless these inflation rates are significantly reduced we cannot achieve a lasting worldwide expansion.

The policy errors of the past and our hopes for the future force us to recognize a basic reality: Inflation is the greatest threat to sustained economic development and the ultimate survival of all of our basic institutions. The lessons of history clearly indicate that when inflation distorts the economic system and destroys incentives the people will no longer support that system and society disintegrates. Our uniquely creative and productive societies will be severely damaged if inflation continues to dominate economic affairs. Our recent experience demonstrates the fallibility of the old conventional wisdom that a tradeoff exists between the goals of price stability and low unemployment. To the contrary, the achievement of both goals is interdependent. If we are to sustain the output of goods and services and reduce unemployment, we must first control inflation. Inflation restricts the housing industry by increasing the prices of homes and interest costs on mortgage loans. It is inflation which undermines the purchasing power of our people as they strive—too often in a losing struggle—to provide the basic necessities of food, housing, clothing, transportation, and medical attention. Inflation erodes the pace of new business investment in plant and equipment needed to create additional jobs. Inflation is also the greatest enemy of savings and investment.

We want to avoid the recessions that so cruelly waste human and material resources and the tragic unemployment that leaves serious economic and psychological scars long after economic recovery occurs, but we sometimes forget that it is inflation which leads to those recessions. Inflation should be identified for what it is: The cruelest hoax ever perpetrated for the expedient purposes of a few at the cost of many. There should be no uncertainty about its devastating impact, particularly for low-income families, the elderly dependent upon accumulated financial resources and pensions, and the majority of working people who do not have the political or economic leverage to keep their income rising even more rapidly than prices. When inflation dominates an economy the people suffer. Leaders must recognize this basic fact.

We must do everything possible to build a public understanding of the tragic effects of inflation. We must create widespread support for the sound economic and financial policies which offer the only path to lasting stability. We must establish greater understanding that wage and price controls cannot substitute for sound economic and financial policies in eradicating or controlling inflation. Controls simply do not solve underlying problems and their ultimate effect is to disrupt economic progress.

We all desire high employment and improved personal living standards. But these goals cannot be realized and maintained over time unless there is adequate investment in the plant and equipment needed to create job opportunities and produce the goods and services a higher standard of living requires. Needed investment cannot be achieved in a climate of inflation. Industry must have adequate profitability to make investment worthwhile and to provide resources to finance investment. There is vastly more promise of higher employment and improved living standards for all in the pursuit of increased total production than in a struggle for income redistribution.

The need for balance of payments adjustment

Inflation is also a threat to economic prosperity through its impact on the trade and payments system. We have seen what inflation has done to the currencies of some of our member states and it has become glaringly obvious that there can be no stability in exchange rates without reasonable stability in domestic prices. The failure to control inflation will damage not only the country which inflates, but ultimately its trading partners as well. If there is no confidence in a government's anti-inflation policies, the downward pressures on rates of exchange may reach levels which tempt governments to resort to restrictive actions.

In the effort to avoid—or to postpone—exchange rate changes, countries may look for credits from abroad to help finance their deficit, and pursue a policy of intervention to support their currencies artificially in exchange markets. Lenders will become increasingly reluctant to finance expanding current account deficits unless borrowing nations make fundamental changes in their domestic economic policies.

The lesson we have learned—the fundamental concept which the Jamaica agreement incorporates in the monetary system—is the recognition that we must attack the causes of our problems, instead of the results. When an industrial country encounters difficulty in borrowing from the private markets, it is a clear and unmistakable sign that more fundamental measures are needed that will effectively deal with the underlying economic conditions and that will eliminate the need to rely on special external financing. The IMF and other multilateral balance of payments lending institutions have limited resources. The Financial Support Fund—for which we are strongly urging affirmative congressional action—will hopefully soon be in a position to provide supplemental financing in the present transitional period. But none of these devices either can or should do more than provide a kind of "bridge" financing to tide a country over the period between the initiation of the necessary economic and financial policies and the delayed impact on the payments balance. If the open trade and payments system is to survive, countries in a weak position must recognize the need to adjust and put the necessary policies in place quickly—before they find themselves in a crisis position from which there is no escape other than restrictions. Countries may then be forced to make political decisions which are not consistent with sound economics.

Countries in a relatively strong position have an equally important responsibility—to work toward the elimination of inflation, to promote sustainable economic expansion, to keep their markets open to imports, to allow their exchange rates to appreciate in response to market forces, and to accept the decline in their current account positions without which it is impossible for the weaker countries to adjust. The economic health of the world depends on our abilities to make these adjustments.

A free and fair trading system

Two years ago when faced with the difficult task of adjusting to rapidly increasing oil prices, we demonstrated both courage and foresight by joining together in a cooperative effort to refrain from adopting trade-distorting protectionist measures which would have had disastrous consequences. We have won that battle; but the war remains. Now that economic expansion is well underway, we must renew our commitment to avoid the adoption of any restrictive trade measures. That is why I so strongly support the renewal of the trade pledge we made 2 years ago and continued last year.

But it is not enough to agree on what we will not do—important though this may be to help avoid slipping backward. We should also agree on what positive steps we will take. Only in a fully free and open world trading and investment system can our individual national economies achieve our goal of sustained noninflationary growth. We need an open world market to allocate the raw material and capital resources in order to supply abundant goods and services to our people at noninflationary prices.

We have found that opening our markets to imports has often restored healthy competition at home—to the longrun benefit of consumers and producers alike.

This competition, however, must be fair. There is no inconsistency between free trade and fair trade, and the assurance of the latter is what enables us to progress in achieving the former. Unfair trade practices such as artificial export subsidies are detrimental for several reasons. First, they distort the market forces and interfere with the proper allocation of capital. Second, they are an expensive use of limited government resources which are transferred from the exporting nation to its trading partners in the form of the export subsidy. Finally, the use of export subsidies may force other nations to raise tariffs or create quantitative limits to provide relief.

Let me assure you that the United States is as firm as ever in its commitment to a free and fair trading system. I am proud of our record over the past year—despite fears from abroad that we were drifting towards a policy of protectionism. Although there has been concern about recent determinations of the International Trade Commission in favor of import relief and specific countervailing duty and antidumping investigations, we have maintained, with minor exceptions, an open market for imports from our trading partners. The Treasury Department is required by law to investigate all formal countervailing duty and antidumping complaints. Industries in every nation are protected from injury caused by international dumping of marginal or excess production. Nor should domestic companies be required to compete against government-subsidized imports. The antidumping and countervailing duty laws are designed to prevent such abuses. The current number of investigations is the result of procedural requirements that all pending cases received over the past few years be completed within a very short time frame under the Trade Act. But of the over 80 petitioners whose cases have been processed under the antidumping and countervailing duty laws in 1975, only about 10 percent have been awarded relief. These facts clearly refute any charges that America is turning protectionist.

On behalf of the United States, I renew our pledge to pursue a liberal and fair trade policy. We will continue to work to see that the spirit of free and open markets becomes an integral and more permanent feature of the world trading system.

The fulfillment of these objectives will require the cooperation of both industrial and developing nations. We will strive in the multilateral trade negotiations (MTN) to reduce tariff and nontariff barriers to trade in order to improve the international trading system. We have agreed that these negotiations will be concluded in 1977. Both in this organization and in the General Agreement on Tariffs and Trade the United States will work for the complete liberalization of trade for the benefit of all nations.

Progress on international investment

Just as liberal trade is crucial to world economic progress, so is a hospitable climate for international investment. We must work together to dispel the impression that multinational corporations are harmful. Such corporations, and the investment they bring, should be welcome because of the positive contribution they make to economic prosperity. In that regard, I am particularly pleased by our action yesterday in approving the "National Treatment and Incentives/Disincentives" agreements and the "Guidelines for Multinational Enterprises" that have been negotiated over the past 3 years by the OECD. In approving this package, we have acknowledged our dedication to the maintenance of a liberal climate for international investment and thereby made a significant contribution to its improvement.

Particularly helpful in improving the investment climate is the fact that the package makes it clear that governments have obligations toward investors just as investors have obligations toward the countries in which they operate. In particular, I was encouraged that the package recognizes the fact that member countries should grant national treatment consistent with international law to foreign investors and that the Guidelines for Multinational Enterprises recognize that member countries have the responsibility to treat foreign investors equitably and in accordance with international law and contractual obligations and to cooperate to resolve any conflicting requirements that may be placed on international investors.

Looking beyond this to the broader context of international investment, I think we should also undertake new efforts to liberalize the international flow of capital. Specifically, I propose that the Committee on Financial Markets be charged with identifying the various impediments to international flows of portfolio capital and establishing a procedure for consultations with a view toward reducing such impediments.

Regarding direct investment, I believe that it is particularly important that we stem any erosion of public confidence in multinational enterprises. The Guidelines we have approved are an important step in that direction. Multinational enterprises have mobilized capital on an unprecedented scale and have channeled it together with new technology and management know-how to countries where they operate. Their actions have increased economic output and created employment in these countries while their home countries have benefited directly from increased exports and a return flow of dividend and royalty payments. As a result, the whole international economy has benefited from the greater efficiency with which international resources are utilized. There are many factors that contribute to economic progress, but in the final analysis, capital investment is the source of increased productivity and higher standards of living for all.

As we gain experience with implementation of the Guidelines and with procedures for consultations within the OECD, we should keep in mind that their success depends on their voluntary acceptance by multinational enterprises. Any temptation to turn the consultation procedures into a complaint or quasi-judicial procedure against multinational enterprises must be avoided.

The Guidelines also incorporate a provision relating to bribery and illegal political activities. Bribery is not only ethically abhorrent, but it also distorts the operations of markets, undermines the investment climate, and threatens the free enterprise system. We are confident that the vast majority of American businessmen have conducted themselves properly. Nevertheless, the actions of a few have clouded the conduct of business in general.

The provision on bribery in the Guidelines is an important step in addressing this problem. However, this is not enough. The United States has proposed the establishment of a working group under the auspices of the United Nations Economic and Social Council to develop an international agreement to deal with this problem. I urge that governments join us in building the consensus necessary for the early negotiation of such an agreement.

Progress in developing countries

Finally, let us discuss the subject of relations with developing countries. The dialog between developed and developing countries is now moving from highly political and visible forums such as the Seventh Special Session and UNCTAD IV to what we hope will be technical work in specialized forums and the CIEC commissions. As Secretary Kissinger emphasized yesterday, it is crucial that the Western developed countries maintain unity as we consider concrete issues. I would suggest several basic principles that should guide our work.

First, we must be realistic. It does no good to raise false expectations regarding what can be done. We must make clear to the developing countries that their future ultimately depends on their own efforts. We industrialized nations can, through constructive policies on trade and technical and financial assistance, help them to help themselves. But what will ultimately determine their rate of development is the degree to which they utilize their own human creativity and invest their resources, not one-time transfers of wealth.

Second, we must enlarge the world economic pie. The strongest external stimulus to developing countries will come through the economic resurgence of our own economies. As OECD countries' industrial production rises and as employment and personal incomes improve, our economies will create renewed demand for the mineral, agricultural, and manufactured products of developing countries.

Third, we should not be hesitant about defending the use of free markets to allocate resources, both domestically and internationally. If we look at the developing country economic success stories, Singapore, Brazil, Mexico, Hong Kong, Taiwan, and South Korea, we note that all have emphasized their private sectors in achieving consumption and investment goals. These same countries have also actively engaged in world commerce. In a world of rapid technological change and shifting consumer demand, national economies risk obsolescence and stagnation if they insist on turning all decisionmaking over to government. On the international level, we must resist the temptation to replace free markets by decisionmaking through international bureaucracies or government organizations. We want to help the developing world but there are no instant solutions. Real progress depends on maximizing the use of their human and natural resources, through strengthening their private sector.

Fourth, in addressing the problems of the developing countries, we must avoid simplistic generalizations. Each developing country, each commodity, each industry is unique. Ultimately the debt or balance of payments problem of a developing country, the market structure of a specific commodity, the establishment of a particular industry must be considered on a case-by-case basis.

It is on the basis of these principles that the United States has made specific proposals of our own and responded to the recommendations of others.

In order to improve the stability of export earnings for countries particularly dependent on exports of raw materials, we urged major changes in the IMF compensatory financing facility.

We also recommended a substantial increase in the availability of IMF credit, the establishment of a trust fund for the benefit of the poorest developing countries, and the substantial expansion of the World Bank's International Finance Corporation. Many of these suggestions have already been implemented. For instance, this year, through the end of May, countries have drawn $815 million from the liberalized compensatory finance facility, more than twice drawings in any previous whole year. We are thus attacking the root problem of disruption in development efforts caused by fluctuations in export earnings while allowing markets to continue their function of determining commodity prices.

We also believe that the long-term answer to many of the problems of the developing countries lies in foreign investment. We have put forward proposals to increase such investment, such as the International Resources Bank. We regret that other countries refused to study this proposal because we believe it would be beneficial to all countries. In this regard, there may be some public misunderstanding about the Bank, and it is important to understand what it would do and what it would not do. The Bank is designed to reduce the noncommercial, or political, risks related to investment in some developing countries. The market risk inherent in any investment would remain. As such, it is an insurance vehicle to protect against such occurrences as expropriation or nationalization. It is not a lender of money, and would not be a financing vehicle to substitute for the private sector. Further, it is not intended to become involved in ongoing investments but to encourage additional investment. Seen in this way, we believe it can make an important contribution to the need to increase investment in the developing world, and Secretary Kissinger and I will continue to seek consideration of such a concept.

We have also proposed that there should be producer-consumer forums for all key commodities, so that where problems exist, they can appropriately be addressed on a case-by-case basis. In these forums, we will be proposing and seeking constructive solutions based upon improvement of markets and trade expansion, rather than restrictive arrangements designed to fix prices. As such, we have made clear our rejection of the proposal for a common fund to finance and manage a series of buffer stock arrangements which we believe is unnecessary, unworkable, and not a correct utilization of scarce resources.

We have also pursued policies in the United States and made specific proposals in the trade area which would benefit developing countries. We have adopted a generalized system of preferences that will greatly assist developing countries to expand their exports. In the MTN we have proposed a tariff-cutting formula which would decrease tariff escalation, and urged that special treatment be provided for developing countries in new codes on safeguards and on subsidies and countervailing duties.

In these circumstances, the United States has agreed to give quick and constructive consideration to requests from the developing nations for the discussion of their debt status in a multilateral framework. We have also agreed that common features to be used in debt rescheduling procedures be studied in an international forum.

There has been a good deal of publicity on the debt problems of developing countries. Because of high oil prices and slower activity in the OECD, the rate of debt increase has been higher than in years of high commodity prices and growing markets. This situation, however, is now undergoing change, and we should be sure that the solutions we seek are aimed at the problems that exist today, not those that existed a year or two ago. The economic upturn in the industrialized countries is bringing increased income to the developing countries through greater export volume and firming of export prices. As a result, the debt burdens will diminish. Individual countries will continue to face debt problems, but the answer does not lie in generalized debt rescheduling. Such an approach is unnecessary and would be inequitable, and harmful to the long-term interests of the recipients. It would call into question the creditworthiness of the less developed countries as a group, and would be counterproductive to our efforts to encourage countries to adopt appropriate economic policies. We will continue to evaluate the merits of each debt reorganization proposal, predicated on the principle that countries should adhere to scheduled terms of credit payments.

Finally, mindful of the need to strengthen the technological capacity of developing countries, the United States has made a series of proposals to stimulate the development and transfer of technology needed by developing countries.

Over the next few months the developed countries will be participating in a dialog with developing countries on commodities, debt, transfer of technology, trade, and multinational corporations. We must continue to respond to the legitimate proposals of these countries and make our own proposals as well. But we owe it to the developing countries, as well as to ourselves, to assure that our responses are not geared to short-term political considerations, but rather reflect what we believe is practicable, deliverable, and will enhance the longrun economic interests of all nations.

Conclusion

Mr. Chairman, fellow Ministers, we have in the past year made great strides in coping with the complex of problems we face. If we look forward to as much progress in the year ahead, we can indeed take an optimistic view. But progress will only come if we can build a worldwide framework of cooperation. As such, we need not distort our economic system in order to satisfy one or two interests at home or to appease a few abroad. Instead, we must avail ourselves of a rare opportunity to fight for a policy which is both principled and in the economic interest of the world. Let us renew our commitment to continued vigilance and cooperative effort, which is the road to the maintenance of an equitable, free, and prosperous world economy.

Exhibit 60.—Text of the Joint Declaration following meeting at Dorado Beach, P.R., June 27–28, 1976

The heads of state and government of Canada, France, the Federal Republic of Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America met at Dorado Beach, Puerto Rico, on the 27th and 28th of June, 1976, and agreed to the following declaration:

The interdependence of our destinies makes it necessary for us to approach common economic problems with a sense of common purpose and to work toward mutually consistent economic strategies through better cooperation.

We consider it essential to take into account the interests of other nations. And this is most particularly true with respect to the developing countries of the world.

It was for these purposes that we held a broad and productive exchange of views on a wide range of issues. This meeting provided a welcome opportunity to improve our mutual understanding and to intensify our cooperation in a number of areas. Those among us whose countries are members of the European Economic Community intend to make their efforts within its framework.

At Rambouillet, economic recovery was established as a primary goal and it was agreed that the desired stability depends upon the underlying economic and financial conditions in each of our countries.

Significant progress has been achieved since Rambouillet. During the recession there was widespread concern regarding the longer-run vitality of our economies. These concerns have proved to be unwarranted. Renewed confidence in the future has replaced doubts about the economic and financial outlook. Economic recovery is well under way and in many of our countries there has been substantial progress in combatting inflation and reducing unemployment. This has improved the situation in those countries where economic recovery is still relatively weak.

Our determination in recent months to avoid excessive stimulation of our economies and new impediments to trade and capital movements has contributed to the soundness and breadth of this recovery. As a result, restoration of balanced growth is within our grasp. We do not intend to lose this opportunity.

Our objective now is to manage effectively a transition to expansion which will be sustainable, which will reduce the high level of unemployment which persists in many countries and will not jeopardize our common aim of avoiding a new wave of inflation. That will call for an increase in productive investment and for partnership among all groups within our societies. This will involve acceptance, in accordance with our individual needs and circumstances, of a restoration of better balance in public finance, as well as of disciplined measures in the fiscal area and in the field of monetary policy and in some cases supplementary policies, including incomes policy. The formulation of such policies, in the context of growing interdependence, is not possible without taking into account the course of economic activity in other countries. With the right combination of policies we believe that we can achieve our objectives of orderly and sustained expansion, reducing unemployment and renewed progress toward our common goal of eliminating the problem of inflation. Sustained economic expansion and the resultant increase in individual well-being cannot be achieved in the context of high rates of inflation.

The meeting last November, we resolved differences on structural reform of the international monetary system and agreed to promote a stable system of exchange rates which emphasized the prerequisite of developing stable underlying economic financial conditions.

With those objectives in mind, we reached specific understandings, which made a substantial contribution to the IMF meeting in Jamaica. Early legislative ratification of these agreements by all concerned is desirable. We agreed to improve cooperation in order to further our ability to counter disorderly market conditions and increase our understanding of economic problems and the corrective policies that are needed. We will continue to build on this structure of consultations.

Since November, the relationship between the dollar and most of the main currencies has been remarkably stable. However, some currencies have suffered substantial fluctuations.

The needed stability in underlying economic and financial conditions clearly has not yet been restored. Our commitment to deliberate, orderly and sustained expansion, and to the indispensable companion goal of defeating inflation provides the basis for increased stability.

Our objective of monetary stability must not be undermined by the strains of financing international payments imbalances. We thus recognize the importance of each nation managing its economy and its international monetary affairs so as to correct or avoid persistent or structural international payments imbalances. Accordingly, each of us affirms his intention to work toward a more stable and durable payments structure through the application of appropriate internal and external policies.

Imbalances in world payments may continue in the period ahead. We recognize that problems may arise for a few developed countries which have special needs, which have not yet restored domestic economic stability, and which face major payments deficits. We agree to continue to cooperate with others in the appropriate bodies on further analysis of these problems with a view to their resolution. If assistance in financing transitory balance of payments deficits is necessary to avoid general disruptions in economic growth, then it can best be provided by multilateral means coupled with a firm program for restoring underlying equilibrium.

In the trade area, despite the recent recession, we have been generally successful in maintaining an open trading system. At the OECD we reaffirmed our pledge to avoid the imposition of new trade barriers.

Countries yielding to the temptation to resort to commercial protectionism would leave themselves open to a subsequent deterioration in their competitive standing; the vigor of their economies would be affected while at the same time chain reactions would be set in motion and the volume of world trade would shrink, hurting all countries. Wherever departures from the policy set forth in the recently renewed OECD trade pledge occur, elimination of the restrictions involved is essential and urgent. Also, it is important to avoid deliberate exchange rate policies which would create severe distortions in trade and lead to a resurgence of protectionism.

We have all set ourselves the objective of completing the Multilateral Trade Negotiations by the end of 1977. We hereby reaffirm that objective and commit ourselves to make every effort through the appropriate bodies to achieve it in accordance with the Tokyo Declaration.

Beyond the conclusion of the trade negotiations we recognize the desirability of intensifying and strengthening relationships among the major trading areas with a view to the long-term goal of a maximum expansion of trade.

We discussed East/West economic relations. We welcomed in this context the steady growth of East/West trade, and expressed the hope that economic relations between East and West would develop their full potential on a sound financial and reciprocal commercial basis. We agreed that this process warrants our careful examination, as well as efforts on our part to ensure that these economic ties enhance overall East/West relationships.

We welcome the adoption, by the participating countries, of converging guidelines with regard to export credits. We hope that these guidelines will be adopted as soon as possible by as many countries as possible.

In the pursuit of our goal of sustained expansion, the flow of capital facilitates the efficient allocation of resources and thereby enhances our economic well-being. We, therefore, agree on the importance of a liberal climate for international investment flows. In this regard, we view as a constructive development the declaration which was announced last week when the OECD Council met at the Ministerial level.

In the field of energy, we intend to make efforts to develop, conserve and use rationally the various energy resources and to assist the energy development objectives of developing countries.

We support the aspirations of the developing nations to improve the lives of their peoples. The role of the industrialized democracies is crucial to the success of their efforts. Cooperation between the two groups must be based on mutual respect, take into consideration the interests of all parties and reject unproductive confrontation in favor of sustained and concerted efforts to find constructive solutions to the problems of development.

The industrialized democracies can be most successful in helping the developing countries meet their aspirations by agreeing on, and cooperating to implement, sound solutions to their problems which enhance the efficient operation of the international economy. Close collaboration and better coordination are necessary among the industrialized democracies. Our efforts must be mutually supportive, not competitive. Our efforts for international economic cooperation must be considered as complementary to the policies of the developing countries themselves to achieve sustainable growth and rising standards of living.

At Rambouillet, the importance of a cooperative relationship between the developed and developing nations was affirmed; particular attention was directed to following up the results of the Seventh Special Session of the UN General Assembly, and especially to addressing the balance of payments problems of some developing countries. Since then, substantial progress has been made. We welcome the constructive spirit which prevails in the work carried out in the framework of the Conference on International Economic Cooperation, and also by the positive results achieved in some areas at UNCTAD IV in Nairobi. New measures taken in the IMF have made a substantial contribution to stabilizing the export earnings of the developing countries and to helping them finance their deficits.

We attach the greatest importance to the dialogue between developed and developing nations in the expectation that it will achieve concrete results in areas of mutual interest. And we reaffirm our countries' determination to participate in this process in the competent bodies, with a political will to succeed, looking toward negotiations, in appropriate cases. Our common goal is to find practical solutions which contribute to an equitable and productive relationship among all peoples.

Exhibit 61.—Remarks by Under Secretary for Monetary Affairs Yeo, July 14, 1976, before the German-American Chamber of Commerce, New York, N.Y., entitled "Promoting Growth with Stability"

It is appropriate that we talk about promoting growth with stability in a group that has as its title the German-American Chamber of Commerce. I think that it is appropriate because of the responsibilities that involve both of these countries, because of the record, and finally, the close friendship that we enjoy as two countries and two people and the many shared traditions.

I have participated in two summits, and I don't know how many conferences of one type or another. There is an additional fora called the G–5, made up of the Finance Ministers and their deputies of five countries: The United States, Germany, Japan, France, and the United Kingdom.

I would like to talk to you today about three things. One involves the monetary system as it has developed over the last 6 to 9 months, a period that has been loaded with events, loaded with the development of a new monetary system. I want to talk about the institutional arrangements, strengths and potential weaknesses. Second, I want to talk a little bit about the context, the environment, in which we are operating. And third, I want to talk a little bit about public policy here and elsewhere. I think it is a particularly opportune time to take a look at the developing monetary system and its underpinnings, as we so recently left Puerto Rico, which was an integral part of the development of the system.

We have before us and we can look with a little perspective- not enough- but a little perspective, at what was done at Rambouillet, the G–10 meeting in Paris, Jamaica, the International Monetary Fund meeting, and Puerto Rico. All form an overall system, an overall pattern. At Rambouillet, the outlines were developed, the philosophy was articulated. Bretton Woods was turned on its head. Bretton Woods was a par value system that was designed to impose stability. That stability was supposed to occur because political leaders would react to changes in reserves. If they were adding reserves, if they were earning more, they would reflate, and if they were losing reserves, they would deflate. But the system did not work- everyone inflated.

Rambouillet recognized the priority to be put on stability. But it said that you cannot get stability out of a mechanical system. You can only get stability out of a good public policy in country after country after country. It pointed to the substantial signs of instability that characterized the latter part of the Bretton Woods system, of that par value system.

I think you can all remember, or most of you can remember, those grand currency crises, the old single-winged monsters, with Charlie Coombs at the desk here, and Roy Bridges at the desk over there, and massive single-wing swaps put together. Officialdom would stack our money on the table and glare across and say we have this much money, how much do you have? A premise of Rambouillet, essentially, was that they have more than we have, because the fact of the matter is that we have substantial capital flows. We have the capacity for large and rapid capital movements, which cannot be legislated out of existence. You put exchange controls in the United States, and you facilitate the development of an offshore dollar market.

A premise that was embedded in the original Bretton Woods- put together by Harry Dexter White and John Maynard Keynes- was that of minimal capital movements. The system was attempting to clear transactions essentially in trade, real things, goods and services and not clear transactions where a billion dollars could cross over the transom of a given currency in a matter of an hour or two.

Rambouillet recognized first the priority that ought to be placed on stability. Secondly, it recognized that stability cannot be superimposed, that it had to come from, in the jargon of that agreement, underlying economic and financial factors. Thirdly, it recognized that the world had changed and that the kind of monetary system we had to have was a system that could handle the kinds of capital flows which are an everyday part of your life and my life.

Out of Rambouillet came a design- article IV for the technical people like me. Article IV outlines a type of a monetary system based on the philosophy that I have just described. It is a floating system. But, the agreement at Rambouillet also contained the design of a par value system. The world has a choice between a par value system that is more flexible than the Bretton Woods design, and I think probably better, and the floating system. What we moved to in Jamaica was to adopt the thinking that came out of Rambouillet. One hundred and twenty-eight nations agreed on article IV, which serves as the basis for the present monetary system.

There are several things in article IV that I would like to comment on.

Part 3 of section 1 is known colloquially as the "thou shalt not manipulate" section. Frankly, one of the concerns of the authors of article IV was the possibility of manipulation of the monetary system to gain competitive advantage. And the counter to that is contained in part 3 of section 1. In section 3, the International Monetary Fund is given the authority to supervise the language and maintain firm surveillance over the exchange rate practices of member countries.

So what we have here is a design of a floating system with a structure, with an umpire, if you wish. You could think in terms of Rambouillet and Jamaica as dealing with the exchange rate mechanism, and you can think of the events since then culminating at Puerto Rico as dealing with the adjustment part of the system. There has been a popular misconception that floating-rate systems do not require individual country adjustments. I guess an example of that misconception is what is called the vicious circle, or vicious cycle theory.

What this says is that in a floating-rate system, if country A is experiencing inflation, the price of country A's currency in exchange markets will go down and the cost of imports will go up. It is a type of vicious circle.

The fact that this would even be dignified with the word "theory" reflects the recognition, or lack of it, that adjustment has to proceed in a floating system just as it has to in a par value system.

What do I mean by adjustment? I mean that countries have to conduct their affairs in such a way—if you want to maximize the potential of the system—in such a way that they are tending to counter structural disequilibrium; i.e., structural deficits or structural surpluses.

Put another way, a floating-rate system is like a pair of scissors. One blade is the rate and the other is the old Bretton Woods concept of public policy adjustment. In a par value system you have only one blade, you don't have the rate mechanism.

What was agreed to at Puerto Rico, and what is its significance? In the monetary area, it was agreed that stability was our ultimate objective. It was agreed that in cases of structural disequilibrium there would be financing required or, in the words of the communique which no one ever reads, transitory financing. It was also agreed that such financing would be conditional, and explicitly stated—conditional in terms of the extension of credit related to the adoption of policies.

Finally, it was agreed that the extension of credit would be multilateral, through such institutions as the International Monetary Fund. Putting Rambouillet and Puerto Rico together, you have an exchange rate mechanism, and you have some general precepts under which the system might operate. One premise deals with the original blueprint, the other with operation of the system with a high priority on adjustment. Fortunately, or unfortunately, there is one premise that runs throughout, and this is what I would like to talk about principally—the premise that we have to do a better job of managing our individual economies.

A great deal of the thinking that went into Rambouillet and Puerto Rico came off the backboard of the experience of 1972 through 1975. It comes in a variety of forms, in terms of underlying economic and financial stability, and in terms of an orientation toward price stability and reducing inflation.

What exactly did Puerto Rico say? It has not been read very carefully, I am afraid. Seven leaders are assembled and what do they say? They say that inflation threatens employment. They say that if you want to reduce unemployment, you have to get at inflation. They say that their goal is the elimination of inflation. That is not 3 percent; that is not 5 percent. That is not 9 percent. That is elimination.

They say that in order to reduce inflationary pressures, we need more investment. And they even infer that more investment means more savings, and the availability of savings, savings that are not absorbed by financing large deficits. This is an incredible thing. In this country just 2 1/2 years ago, we had something called the Phillips Curve.

What did the Phillips Curve say? It said, what I read in the New York Times this morning, about a leading contender for the Democratic Presidential nomination, that you have a choice. You can opt for less inflation, or you can opt for more employment, and less unemployment. That is what the Phillips Curve in its politicized form says.

What was said at Puerto Rico? If you want less unemployment, if you want more employment, you have to reduce inflation. Now here is a curious juxtaposition. I was surprised when I read this in the Times. I was surprised that this idea could continue to persist. After all we have been through, after the chasm that we all looked down in 1974 and 1975. After you get seven leaders of the world together in one spot and they say just the opposite, we still have to my absolute amazement people who believe in the fraud of the Phillips Curve.

It is a very dangerous idea. We almost lost our ear once, betting on the Phillips Curve, and we do not have the capacity to try it a second time. Now, not only is the Phillips Curve still around, but national economic planning is still around. It comes today in the form of the Humphrey-Hawkins bill. The Humphrey-Hawkins bill has two ideas. Two old, stale, worn-out, disreputable ideas.

One is that in a country like the United States economic planning is the way to produce more, to produce a more efficient economic system. Look at the record of the last 4 or 5 years. Remember in 1972, when we all thought, or most of us thought, that we had lots of excess capacity? Remember in 1968 and '69 when we thought we had a surplus of steel capacity? Remember the explanations of what would happen to productivity which would serve as an antidote for inflationary pressures?

Remember what we said about the beginnings of the great commodity price boom? Well, that it was just a problem of the weather and agriculture, we all knew that. We cannot even forecast with any degree of precision as a business and financial community. Do we know enough to allocate factors of production, to be able to forecast where the capacity shortages are going to be, the 4 or 5 years out that are required to get them into place, to build the plants and put the facilities there? No. Do we have the capacity to allocate labor, and is it an efficient allocation of labor, good for the people involved as well as good for the overall economy to try and create jobs? I do not think so.

What is the price tag? Who is mentioning the price tag? How much does it cost, and who is going to pay for it? It is very simple. You are going to pay for it.

I think that rather than the Humphrey-Hawkins approach, the sort of rejuvenated Phillips Curve, we ought to recognize that we have an opportunity this time to get it right, that we have made a reasonably good start at getting it right. We have an enormous responsibility to ourselves and to others, because the premise of the monetary system that we are operating with is that countries—like the two countries represented here today—will in the end be able to manage their affairs in such a way as to have the basis for stability. Not a con job stability that you simply lay on, like icing on a cake. But stability that comes from within, and that is the opportunity, that is the responsibility.

I am confident that the American people have looked down the chasm of 1974–75 and come to a very, very wise conclusion, that inflation produces unemployment, and as a result they do not want anything to do with inflation.

The most recent example is the reaction of consumer demand in May, as price expectations rose a little bit. I think we saw how deep the feeling is in terms of a desire to avoid inflation. I think we've got another little insight into the fear that inflation occasions in all of us, whether we are bankers or businessmen or just individuals.

On that basis I am personally optimistic. I think that we will recognize our responsibility in this country to ourselves and to others. I think that the kind of ideas, the kind of philosophy which really is 15 to 25 years old, and finds a sort of reincarnation such as in the Humphrey-Hawkins bill, will be seen to have been a transitory manifestation of the past.

Developing Nations

Exhibit 62.— Communique of the Joint Ministerial Committee of the Boards of Governors of the International Bank for Reconstruction and Development and the International Monetary Fund on the Transfer of Real Resources to Developing Countries (the Development Committee), January 9, 1976, issued at the close of its fifth meeting in Kingston, Jamaica

1. The Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (the Development Committee) held its fifth meeting in Kingston, Jamaica, on January 9, 1976, under the chairmanship of Mr. Henri Konan Bedie, Minister of Economy and Finance for the Ivory Coast. Mr. Robert S. McNamara, President of the World Bank, Mr. H. Johannes Witteveen, Managing Director of the International Monetary Fund, and Mr. Henry J. Costanzo, Executive Secretary, took part in the meeting, which was also attended by representatives from a number of international and regional organizations and Switzerland as observers.

2. The Committee reviewed the current situation and prospects of the developing countries and noted with concern that the non-oil developing countries in 1976 are likely to incur extraordinarily large current account deficits for the third successive year. The Committee also noted with grave concern that the minimum 6 per cent growth target of the Second Development Decade appears not likely to be met for the non-oil developing countries and that substantial amounts of additional external capital are still required if the shortfall from this target is to be held to modest proportions. The Committee also discussed the means of improving the current situation affecting resource transfers, aid targets and their implementation, current under-utilization of productive capacity in industrial countries in relation to their aid effort, and the status of current commodity issues. It was against this background that the Committee considered various measures to increase the flow of resources to the developing countries.

3. The Committee noted the decision of the Interim Committee to establish the Trust Fund to provide balance of payments assistance to low-income countries as well as understandings reached regarding increased access to IMF resources. The Committee discussed the use of Trust Fund resources and indicated various considerations to be taken into account by the Executive Directors of the IMF in completing their work on establishment of the Trust Fund. The Committee noted that the Third Window for loans on intermediate terms by the World Bank had become operational, that contributions received and expected would permit Third Window loans of $600 million and urged those countries which have not already contributed to help to increase its resources.

4. The Committee received an interim progress report from its Working Group on Access to Capital Markets, discussed the proposed work program on the review of regulatory and other constraints on access to capital markets by developing countries, and recommended the completion of studies on other appropriate mechanisms which might improve access to capital markets, including the possible use of multilateral guarantees, the strengthening of secondary markets, and the possible creation of an international investment fund.

5. The Committee noted the progress being made in regard to cofinancing arrangements by international and regional development banks and urged that these arrangements be expanded.

6. The Committee was presented with an initial survey of programs and capital resource situations of major international and regional lending institutions. The Committee expressed its full support for an adequate increase in capital financing of these institutions. In this context, the Committee requested the World Bank's Executive Directors to place before the Board of Governors at an early date a proposal for an increase in the Bank's capital. The Committee also supported an early increase in the capital of the International Finance Corporation. The Committee noted the particularly urgent need for assistance to low-income countries, and in this connection expressed its strong support of a substantially enlarged Fifth Replenishment of the International Development Association, which, in the opinion of many members, should be in real terms. The Committee noted that negotiations were under way to secure agreement in time to permit continuity of operations. The Committee urged timely action to replenish the resources of regional banks, including their soft-loan windows.

7. The Committee gave special attention to the question of commodity price fluctuations and to their consequences on the export earnings of developing countries. The Committee agreed to give priority attention to these questions, including especially possible measures for the financing of buffer stocks, for the stabilization of export earnings, and other efforts to assist the developing countries in the area of trade.

8. The Committee expressed its unanimous appreciation of the excellent arrangements made for the meeting and the hospitality extended by the Government of Jamaica.

Exhibit 63.—Summary of Statement by Acting Assistant Secretary Bushnell, January 28, 1976, before the Subcommittee on Foreign Assistance and Economic Policy of the Senate Foreign Relations Committee, on proposed replenishment and expansion of membership of the Inter-American Development Bank and U.S. membership in the African Development Fund

Mr. Chairman and members of the subcommittee, today you have before you key measures to strengthen and expand the economies of countries in Latin America and Africa and thus help enhance the living standards of millions of the poorest people in the world.

Although complex, this package deserves your prompt action because it will increase substantially U.S. support of multilateral development assistance while at the same time reducing budget outlays, and thus supporting our objective of holding down U.S. Government expenditures. The proposed replenishment of the Inter-American Development Bank (IDB) will be accompanied by an expansion of membership to include at least 12 nonregional donor countries. Because of the entry of these nonregional countries and emerging donor status for several of the more advanced Latin countries, the U.S. share of total new IDB resources will drop to 30 percent under this replenishment from 48 percent under the 1970 replenishment. Moreover, while total U.S. funding would amount to $2.25 billion, actual budgetary outlay would be only $720 million, compared to $1.15 billion in the 1970 IDB replenishment. The rest would be in the form of callable capital—a contingent liability that would entail budgetary outlays only in extremely unlikely circumstances.

U.S. membership in the African Development Fund (AFDF), the concessional loan affiliate of the African Development Bank, which the Senate approved initially in 1974, would be particularly appropriate at this time when nonregional donor countries are joining the IDB. Our contribution would be modest—less than 10 percent of the fund's resources.

U.S. support for development banks

The United States has been an active participant in the international development banks since the establishment of the World Bank just after World War II. We were instrumental in the creation of the Inter-American Development Bank in 1959 and the Asian Development Bank in 1966, and participated in discussions leading to establishment of the African Development Fund in 1973.

We believe these banks provide important extra dimensions to development assistance. Economic development is not primarily a matter of money. While money is needed, the key factors determining the success of development efforts are the policies and priorities followed by each country. The development banks make important contributions in precisely such areas, and in institution building. In recent years the banks have accelerated the process of spreading development benefits to the poorer people by placing greater emphasis on agriculture, the family farm, and cooperatives—an emphasis we have encouraged and supported. The regional banks in particular have an important role to play, because they reflect the desires and needs of their regional members and have an expertise and understanding of local conditions and problems.

From the U.S. national point of view, these banks encourage development along lines compatible with our own economy. They stress the role of market forces in the effective allocation of resources and the development of outward-looking trading economies. Through contact with the international development banks, developing countries are learning to administer large procurement programs effectively and honestly. These programs will result in increased procurement of goods and services in the United States, expanded future markets for our products, and thus increasing employment in our country. Our participation in the international development banks will also provide more assured access to essential raw materials, and a better climate for U.S. private investment in the developing world. Finally, the development banks provide both the developed and developing countries with an established and systematic framework for consultations on economic policies, development needs, and economic performance. They are not debating societies which engage in seemingly endless rhetoric about restructuring of the world economy—they are working institutions that get things done.

Latin America and U.S. interests

Now let me turn to our specific interests in Latin America. Despite differences in levels of development and cultural roots, the Americas have been remarkably free of conflict and have had a truly unique history of cooperation in the management of intraregional relationships. We have a vital interest in preserving this long and close association with the countries of Latin America and the Caribbean.

Our economic interests in Latin America may be viewed at two levels. First are our obvious interests in trade, investment, and access to raw materials. U.S. exports to Latin America were $16 billion in 1975. Our direct investment in Latin America is $15 billion, 60 percent of U.S. direct investment in the development countries and 14 percent of total direct investment abroad. Latin America is also an important source of supply for many commodities essential to the U.S. economy such as petroleum, copper, iron ore, and bauxite.

The Latin American countries are also important to us in a less obvious but, in the long run, perhaps a more significant sense. The existing international economic arrangements are being challenged by radical demands for change from some Third World spokesmen. Many influential Latin leaders have taken moderate and constructive positions on Third World demands, and most Latin countries continue to support open free market arrangements in the areas of international trade, investment, and monetary affairs. The economic success of our Latin American neighbors and their allegiance to market-oriented economies and an open world trading system will, in an important way, affect prospects for our own free market economy. Our economy is likely to prosper most in an international environment of similarly organized economies.

Fortunately, economic development in Latin America is succeeding and the IDB is playing an important role in that success and in orienting that growth in directions compatible with the U.S. economy. Since 1960, installed electrical capacity has tripled, primary school enrollments have quadrupled, and the number of rural families with access to potable water has tripled. Although the GNP in Latin America as a whole was growing at almost 7 percent per annum in real terms before the oil price shock and the ensuing worldwide recession, much of Latin America remains poor. More than a third of the primary school-age population is without education facilities or unable to attend school; 40 percent of urban households lack potable water; and infant mortality in Latin America is 80 per 1,000 live births as compared with 19 in the United States.

I believe Latin America will be able to resume its rapid economic growth in the next few years, but it will require increased capital inflows to approach the growth rates of the early

1970's. The proposed replenishment of the IDB will make a major contribution as it will permit the Bank to increase lending at a rate of 7 percent a year in real terms.

Action requested on IDB

The IDB is the central financial institution of the inter-American system. It has proven in its 15-year history to be a well-managed organization and an innovative lender continually finding new ways to improve its development impact by concentrating on the key development bottlenecks.

The Bank's Ordinary Capital commitment authority was virtually exhausted with the approval of the last loans at the end of 1975, and the loan commitment authority of the concessionary Fund for Special Operations (FSO) will be exhausted by mid-1976. To allow the IDB to continue to play a key role in Latin American development, we are asking the Congress to approve—

An increase in the Bank's capital of $5.3 billion, of which the United States would contribute $1,650 million.

An increase in the Fund for Special Operations, which makes highly concessional loans, of $1,045 million, of which the United States would contribute $600 million.

Membership in the Bank by other donors, consisting initially of 10 European countries, Japan, and Israel, to convert the Bank from a hemispheric institution into an institution with worldwide donor membership.

Technical amendments to the Bank charter to make additional regional countries eligible for membership and permit unrestricted lending to the subregional Caribbean Development Bank.

The Latin Americans are doing more for themselves in the current replenishment. Argentina, Brazil, Mexico, Venezuela, and Trinidad and Tobago are prepared to guarantee the convertibility of part or all of their contributions to the FSO. They have also agreed to refrain from borrowing convertible currencies from the FSO, thus significantly increasing the scarce concessional resources available to the poorest borrowing countries. In addition, Venezuela already has made available to the IDB $500 million as a trust fund to be used for Latin American economic development, and is expected to make convertible an additional $100 million of its local currency now held in the FSO. This shift toward effective donor status by the Latin American countries able to do so was one of our principal objectives in the negotiations. It converts the Bank into a more truly inter-American organization as several Latin American countries become donors in financing economic and social development in the poorer countries.

The entry of our friends from other parts of the world as full members and donors in the Inter-American Development Bank with an initial contribution of $745 million is also most welcome. The increased contributions of the Latins plus the nonregionals' contributions will permit a shift in the composition of the U.S. contribution to a greater emphasis on Ordinary Capital, largely consisting of callable capital subscriptions which do not require actual budgetary outlays. Another result of the burden-sharing is that U.S. voting power in the IDB will decline from 40 percent to 35 percent. This, however, is sufficient to preserve our veto over FSO operations.

Africa and the African Development Fund

I would now like to discuss the implications of U.S. participation in the African Development Fund.

Africa has a growing economic significance for the United States. During the last 10 years, U.S. exports to Africa have grown from $1 billion to more than $5 billion, and U.S. investment in Africa has quadrupled. Investment and trade in minerals and petroleum account for the largest share of U.S. economic activity in Africa. In 1975, we imported a large part of our minerals, coffee, and cocoa from Africa, including one-third of our foreign crude oil supplies.

Africa is the least developed continent. Over half of the 25 poorest, least developed countries in the world are in Africa. About 75 percent of the African population is engaged in subsistence agriculture, and in half of the countries per capita income is less than $100 per year. Many of these African countries cannot afford the 6-percent interest rate which the African Development Bank must charge. The African Development Fund was established in 1973 as a concessional affiliate of the Bank to complement its lending activities by concentrating on the poorest of the African states.

The creation of the fund has involved nonregional countries more intimately in African development. Canada, Japan, Brazil, Saudi Arabia, and 12 European countries are members of the fund along with the AFDB, representing all of its members. The administration believes that the United States should also become a member of the fund and requested authorization of a $15 million contribution to be made available to the fund in fiscal years 1976 through 1978.

Conclusions

In conclusion, I urge your early and full support for this legislative package, which would provide for major restructuring and strengthening of the Inter-American Development Bank and for U.S. membership in the African Development Fund. These measures will provide a substantial part of the external funding for continued rapid economic development in Latin America with programs increasingly directed to improving the abysmal daily living conditions of the poorest people in our hemisphere and will build cooperative economic relations with the African nations that are growing increasingly significant for U.S. foreign trade and investment.

Secretary Simon urges you to support this package of measures because they provide major international benefits without conflicting with our own requirements for budget restraint or infringing on our own very large requirements for investment capital over the next few years.

Action on your part is truly urgent. The IDB can now make new loans from Ordinary Capital only to the extent of repayments on outstanding loans. The new donors cannot join the IDB until this legislation is approved. Also, other donors are close to agreement on the first replenishment of the AFDF, while we have not yet joined. The House of Representatives approved legislation encompassing these proposals in H.R. 9721 on December 9, 1975. Authorization action must be completed quickly if funding for the IDB and AFDF is to be included in final congressional action on fiscal year 1976 appropriations. Lack of fiscal year 1976 appropriations would force the IDB virtually to halt its Ordinary Capital lending during 1976 and delay yet again our entry into the AFDF.

Exhibit 64.—Joint Communique on the Second Session of the United States-Saudi Arabian Joint Commission on Economic Cooperation, February 29, 1976, Riyadh, Saudi Arabia

The United States-Saudi Arabian Joint Commission on Economic Cooperation concluded its second formal session today with major attention given to the ways in which the Joint Commission could be helpful in the realization of Saudi Arabia's economic and social development.

The Joint Commission assessed the progress achieved since the last Commission meeting and concluded agreements and understandings on a number of technical cooperation programs including electrical services, science and technology, and vocational training.

The United States-Saudi Arabian Joint Commission on Economic Cooperation was established in accordance with the joint statement issued by Crown Prince Fahd and Secretary of State Kissinger on June 8, 1974. The Joint Commission meeting, held in Riyadh, February 29, 1976, was chaired by Minister Muhammad al-Ali Aba al-Khail, Minister of Finance and National Economy. Secretary of the Treasury William E. Simon, Chairman of the U.S. side of the Commission, led the American delegation. Prince Muhammad Al-Faisel, Governor of the Saline Water Conversion Corporation, attended the session, as did other high Saudi officials from the Ministries of Finance and National Economy, Labor and Social Affairs, Agriculture and Water, Planning, Industry and Electricity, Commerce, Education, and Higher Education.

The American delegation included William Seidman, Special Assistant to the President for Economic Affairs; Gerald L. Parsky, Treasury Assistant Secretary for International Affairs and U.S. coordinator of the Joint Commission; Charge d'Affaires Hume A. Horan and visiting American officials from the U.S. Departments of Treasury, State, Agriculture, Commerce, Health, Education, and Welfare, Interior, and Labor, and the National Science Foundation.

In reviewing the atmosphere within which economic relations between the two countries have been progressing, the Saudi side reiterated the Saudi Government's position concerning the League of Arab States' boycott of Israel, it reaffirmed that this boycott is a nonviolent economic measure which is a product of the absence of a just and lasting peace in the Middle East; that it is not based on any form of discrimination relating to race, color, religion, national origin, sex, or age; and that ever since it was started in the late 1940's, this boycott was not- and is not today- intended against the United States. The Saudi side further expressed its hope that the existing and potential economic cooperation between the two countries will not be disrupted by any misinterpretation of the Arab boycott of Israel. The American side was pleased with the reaffirmation of this policy of not discriminating on the basis of race, color, religion, sex, and national origin. The American side further noted that President Ford's statement of November 20, 1975, with respect to discrimination and the subsequent executive actions were not directed against any particular country. Both sides agreed to make these policies more widely understood and further agreed that any action based on misinterpretation of this policy could hinder cooperation between both countries.

Secretary Simon and his colleagues also had meetings outside the Commission framework with Minister of Finance and National Economy Aba Al-Khail and Governor of the Saudi Arabian Monetary Agency Abd Al-Aziz Al-Quraishi; Minister of Industry and Electricity

Ghazi Al-Gosaibi; Minister of Commerce Soliman Solaim; Minister of Petroleum and Mineral Resources Zaki Yamani; Minister of Foreign Affairs Prince Saud Ibn Faisel; and representatives of various Saudi Arabian Chambers of Commerce. These meetings provided an opportunity for the United States to reaffirm its commitment to cooperate closely with Saudi Arabia in the realization of its economic and social development plan goals. The United States also reaffirmed its intention to continue its efforts looking toward a just and durable peace in the Middle East and noted the constructive support it has received from the Kingdom in these efforts.

The members of the Commission exchanged views on the development of United States-Saudi Arabian economic cooperation since the last meeting, noting that the administrative and financial mechanisms relating to projects were now in place and will permit more rapid project implementation. Specifically, a trust account has been established in the U.S. Treasury Department, in accordance with the February 13, 1975, Technical Cooperation Agreement (TCA) to fund Joint Commission technical cooperation programs on a reimbursable basis. On the administrative side, the Commission noted that the U.S. representation to the Joint Economic Cooperation Commission office is fully staffed and collaborating on a daily basis with its Saudi Arabian counterpart to develop and implement projects.

A large number of other possibilities for technical and financial cooperation between our two countries were also explored. The United States and Saudi Arabia expressed both a desire to have the United States play a major role in the development of key sectors of the Saudi economy and both also expressed a wish to investigate methods of increasing mutual trade and private business activity.

Industrialization and trade

Saudi development plan.—The Saudi delegation reaffirmed its interest in U.S. private sector participation in the realization of the goals of its 5-year development plan. The U.S. delegation pointed out that it has undertaken a number of initiatives in support of further active participation by private U.S. firms and institutions in the Saudi economic development programs.

Following the promulgation of the plan in Saudi Arabia, the U.S. coordinator for the Joint Commission, Treasury Assistant Secretary Gerald Parsky, held a press conference in Washington, D.C., devoted to the plan. A Treasury-produced condensation of the plan has been distributed to date to more than 5,000 U.S. business firms. The complete text of the 663-page summary of the Saudi development plan is also being made available to the American public at a nominal cost through the U.S. Department of Commerce.

To further increase business cooperation between the two countries in Saudi Arabia's industrial effort, the United States has invited leading Saudi officials and private businessmen to visit the United States to meet with U.S. business firms and groups, especially in the electrical field.

The Saudi Arabian Government outlined its anticipated needs for imported grain, rice, and flour; and the American delegation stated that the United States is committed to satisfy the requirements of its historical customers such as Saudi Arabia.

Electricity

Procurement of electrical equipment.—An agreement was signed between the United States and the Saudi Arabian Governments on November 23, 1975, providing for the procurement of nearly 200 million riyals ($60 million) worth of electrical equipment through the Joint Economic Commission.

The U.S. General Services Administration is responsible for the actual procurement. It is expected that the first items delivered under this procurement will arrive in Saudi Arabia by early summer this year. The equipment is to be part of a stockpile both for projects now being planned and to meet any unexpected power emergencies.

Electrical planning project.—In December 1975, the Saudi Arabian Government formally asked the U.S. Government, through the Joint Economic Commission, for assistance in upgrading the Kingdom's electrical systems and planning for the future. A project agreement signed today provides that the U.S. Treasury, on behalf of the Saudi Arabian Government, will contract with U.S. firms to prepare a comprehensive 25-year electrification plan to include the conduct of a national power survey, and offer advisory assistance to improve the capacity of existing systems to meet Saudi Arabia's rapidly changing demands for power.

Statistics and data processing

The Commission received a report on the status of the project agreement on statistics and data processing which was signed on September 27, 1975. Under the agreement, the U.S. Bureau of Census and its National Computer Center is assisting the Ministry of Finance and

National Economy in achieving an effective statistics and data processing capability. The team leader and two senior specialists are now in Riyadh. The remaining specialists will arrive by June 1976.

Standards system

The Saudi Arabian Government also agreed to consider a U.S. National Bureau of Standards (NBS) proposal for technical cooperation in further developing the capabilities of the Saudi Arabian Standards Organization (SASO), particularly in the areas of food and building materials standards and program informational services. The Saudi request for collaborating follows reports on food and building materials standards and on general requirements for the creation of industrial standards which were prepared by the American Food and Drug Administration and NBS technicians who visited Saudi Arabia in the spring of 1975.

Communications

The United States has agreed to send a three-man team to provide some short- and long-term collaboration with the Ministry of Information with regard to the development of systems for broadcast equipment maintenance, a communications and documentation library, and radio and TV for the entire Kingdom. The United States also agreed to collaborate with the Ministry in the development of a National Information Center.

Agriculture and water resources

The most significant development in this field since the Commission's first meeting in February 1975 was the signing of a project agreement on November 23, 1975, under which the United States will provide 34 agriculture and water specialists to the Saudi Arabian Ministry of Agriculture and Water for collaboration in implementing that Ministry's development plans.

The work of the team leader and senior specialist who have arrived in Riyadh has resulted in (a) agreements on short-term study projects in fruit and vegetable packaging and in park development in the Kingdom; and (b) discussions of long-term projects to develop the Wadi Dawasin area in accordance with the recommendations of a previous U.S. study, and to evaluate the water and agricultural resources of the Arabian Shield.

The Commission reviewed the progress of the six-man U.S. team that is in the process of doing a comparative assessment of alternatives for the future water supply for Riyadh.

Manpower and education

Vocational training.—A project agreement was finalized which looks to further developing the Manpower Training and Development Program under the Saudi Ministry of Labor and Social Affairs. This project will involve a wide range of advisory services to be provided by 20 U.S. Labor Department specialists. The project will also provide labor market analyses, the development and implementation of capital-intensive training methodologies, and the purchase and installation of vocational training equipment.

In a related development, the Saudi and U.S. representatives also finalized a memorandum of agreement which will supplement this project agreement. The memorandum provides that the U.S. Department of Labor will be responsible for making arrangements, on a reimbursable basis, for architectural and engineering services and for the construction of vocational training facilities in the Kingdom on a turnkey basis.

Education and higher education.—As a result of discussions held during the first Joint Commission meeting, a team of U.S. educators traveled to Saudi Arabia to undertake an evaluation of the higher education system and to provide recommendations.

A team of U.S. educational specialists has been proposed to work, on a long-term basis, with the supreme council of universities to develop implementation strategies to further improve the higher education system. Part of this strategy will involve the development of a community college system in the Kingdom. A proposal for U.S. collaboration in this endeavor is under active consideration. The American side agreed to provide Saudi Arabia with evaluative reports respecting the community college system in the United States.

Science and technology

The United States and Saudi Arabia today signed a project agreement under which the U.S. National Science Foundation will provide technical assistance to the Saudi Arabian National Center for Science and Technology. The agreement calls for extensive cooperation between the two countries designed to develop the Kingdom's scientific resources in a manner that is responsive to its economic and social goals.

Work on the project will begin immediately with priority being given to developing an analysis of the Kingdom's scientific resources and undertaking a variety of scientific projects between Saudi Arabian and American counterparts.

The Commission also exchanged views on the current status of a number of possible technical cooperation projects in the fields of housing, ports, desalination, and communications.

Overall assessment

The Commission considered the results of its second session as very useful and noted that the understandings and project agreements entered into are positive and constructive contributions toward strengthening United States-Saudi bilateral economic and trade relationships as intended by his Royal Highness and Crown Prince Fahd and Secretary of State Kissinger in establishing the Commission. The Commission commended all participating departments and agencies on both sides for their efforts to date and directed them to continue exploring possible new areas of cooperation in the economic field.

The cochairmen agreed to hold the next Joint Commission meeting in Washington at the end of this year or early 1977.

Exhibit 65.—Joint Statement of the United States-Israel Joint Committee for Investment and Trade, March 3, 1976, Jerusalem

The United States-Israel Joint Committee for Investment and Trade met in Jerusalem on March 1 and 2 for its second regular meeting. The meeting was chaired jointly by Minister of Finance Yehoshua Rabinowitz and Secretary William Simon. Other senior officials of the two Governments also participated. (A list of senior participants is attached.) During the meeting, the Committee reviewed the implementation of the statement of May 13, 1975, and discussed ways and means to expand economic cooperation between the United States and Israel.

During the meeting, the Israeli members of the Joint Committee briefed the U.S. delegation on the current economic situation in Israel, the measures taken to curb inflation, reduce consumption, increase exports, and slow the drain of foreign exchange reserves, as well as recently enacted tax reforms. Proposals announced by the Government of Israel to encourage investment and increase productivity were also reviewed. The U.S. members reviewed current economic developments in the United States and the administration's economic policy.

The Committee received a report on the implementation of the joint statement of May 13, 1975, and expressed its satisfaction with the achievements and the work performed by the Joint Steering Group, which coordinated the activities and prepared the material that served as a basis for the Committee's deliberations.

At the conclusion of the Committee's session, the Minister of Finance and the Secretary of the Treasury approved a program for further cooperation, intended to expand economic and financial ties between the two countries, and, in particular, to support the economic development of Israel through an increase in investment and trade flows between the two countries. The Committee expressed its desire that this program will contribute, as direct aid does, to a just and lasting peace in the Middle East. The strengthening and stabilizing of the economy of Israel will also aid in decreasing Israel's dependence on direct aid, although such assistance may still be needed in the near future.

To facilitate and expand economic cooperation between the two countries, the cochairmen signed an agreement for the establishment of the Binational United States-Israel Industrial Research and Development Foundation. The Committee noted with satisfaction that the United States-Israel Treaty to Avoid Double Taxation was now before the Senate.

The Committee noted with satisfaction that the United States-Israel Industrial Research and Development Council held its first plenary meeting in Israel on December 7-12, 1975, and that the U.S. section of the Israel-United States Business Council will have its first meeting in Washington on March 17 at the Chamber of Commerce of the United States. Plans are now underway to hold the Business Council's first plenary session in Israel.

Principles and programs agreed upon are:

I. Economic cooperation

The Committee indicated that an important objective of the cooperative efforts between the two countries is to assist Israel in increasing its production and improving its efficiency, so as to enable Israel's economy to progress. The Committee believes that such progress can be achieved by continued reliance upon free economic markets, by promotion of a free, cooperative, and open order of world trade and investment and accordingly by continued resistance to the application of restrictive trade practices in international commerce. Members of the Committee also agreed on the importance of ensuring against discrimination in international economic relations on the basis of race, religion, or national origin. The U.S.

members reaffirmed the U.S. policy of opposition to restrictive trade practices or boycotts fostered or imposed against countries friendly to the United States.

II. Encouragement of investment

The Committee noted the incentives to be introduced in Israel to encourage investment and the additional opportunities for foreign investment resulting from the agreement between Israel and the European Economic Community. The Committee welcomed these steps which would enhance the climate in Israel for foreign investment.

The Committee encouraged U.S. and Israeli business to seek out joint business opportunities as part of their interest in achieving a stronger world economy, peace, and international cooperation. It was agreed that the Israel-United States Joint Business Council could make a major contribution in this area.

Within the general framework of activities to facilitate investment in Israel, the United States expressed its willingness to—

1. Organize this year a mission of high-level U.S. business executives to Israel, under the sponsorship of the Overseas Private Investment Corporation (OPIC). In this connection, OPIC will continue and renew its efforts to identify potential U.S. partners for ventures in Israel.
2. Provide appropriate assistance to Israeli industrialists visiting the United States to seek out ties with U.S. firms.
3. Continue to publicize investment opportunities offered in Israel and assist U.S. businessmen in exploring these opportunities and helping to develop additional ones. Such investment could be a source to Israel for technology to improve industrial efficiency and increase production. This could improve the climate for further investment.
4. Cooperate closely with the Business Council in its efforts to promote investment opportunities in Israel and expand and strengthen the ties between the business communities of the two countries.

In carrying out these activities, the U.S. Government will bring to the attention of the U.S. private sector the fact that the rapid industrial development of Israel creates opportunities that can benefit U.S. business as well as the economy of Israel.

III. Trade development

1. The Committee noted the special effort made by the Government of Israel to increase exports and expressed its satisfaction that trade between Israel and the United States has expanded since its last meeting. The Committee agreed that a further expansion of bilateral trade is an important objective of both countries and a major task to be undertaken under the guidance of the Committee. The United States agreed to—

(a) Disseminate information to trade and business on opportunities in Israel;
(b) Organize trade missions to Israel under the auspices of the Department of Commerce for exploration of business opportunities. In this respect it was noted that missions dealing with electronic data processing and building and construction are presently being organized;
(c) Provide appropriate assistance to Israeli businessmen who visit the United States seeking to expand mutual trade;
(d) Assist Israel by working with trade and business organizations in the United States and to encourage their members to visit Israel and explore the various opportunities offered.

2. The Committee noted with satisfaction that since its last meeting and as a result of discussions held between the two countries, Israel has been declared eligible to receive tariff preferences under GSP (generalized system of preferences), which should enhance the opportunity for increased exports from Israel to the United States.

3. The Committee reviewed the progress achieved in implementing a program to enable Israeli producers to sell their products to DOD suppliers and noted the importance of this effort to Israel. To this end—

(a) Israeli members indicated their intention to appoint a special representative of the Government of Israel to help Israeli suppliers explore business opportunities with DOD and its primary suppliers.
(b) It was agreed that potential Israeli suppliers will visit the United States in the near future to bring to the attention of DOD military department procurement offices and their primary suppliers the range of products that Israeli producers can offer. DOD will facilitate their visits by providing them with appropriate assistance and guidance.

(c) DOD has in the past assisted and will continue to assist Israeli producers in making contacts with DOD purchasing offices and suppliers in order to help Israeli producers ascertain the purchasing requirements of the DOD purchasing offices and suppliers, with the aim of facilitating the special efforts of Israel to expand its exports.

Both sides expressed the hope that these measures will help maximize the opportunities for the sale of Israeli products to DOD and its suppliers.

IV. **Supply and storage of raw materials**

The United States noted that in accordance with the Joint Statement of May 13, 1975, the Government of Israel has submitted to it plans for its grain and raw material purchases in the United States. The U.S. members reaffirm that in the event that it becomes necessary for the U.S. Government to impose short-supply export controls, these purchase plans will enable the United States to give sympathetic consideration to Israel's situation and allow Israel equitable access to U.S. supplies of commodities and raw materials during the period of short supply.

V. **Scientific cooperation**

The Committee noted the resolution of the Board of Governors of the United States-Israel Binational Science Foundation (BSF) passed on February 18, 1976, which states as follows:

> The BSF has been allocating grants since mid-1974. Although most of the research projects supported by the Foundation have not yet reached completion, it can be stated that the projects supported by the Foundation are in areas of interest to both the U.S. and Israeli Governments. These projects were selected on the basis of high scientific and/or technological merit and of potential benefit to both countries. The BSF plays a vital role in encouraging and fostering scientific cooperation between both countries. The aim of the Foundation is to support research which will develop cooperative arrangements such as single programs carried out in each country with full coordination and exchange of scientists.
>
> To a greater extent than in former years, highly rated research proposals worthwhile supporting because of their potential benefit to both countries cannot be activated due to lack of funds. The Board wishes to recommend to both governments that they examine the possibility of increasing the funds available to the BSF to support its activities.

The Committee agreed to follow closely the activities of the Foundation and to determine as soon as possible whether additional funds may be desirable to increase its utilization for the benefit of both nations.

VI. **Future work**

The Committee noted the usefulness of its periodic meetings and of the exchange of information on the economic developments in both countries, and decided to continue them on a regular basis. In the period between the meetings, regular exchanges of information should continue within the Steering Group and through visits of senior officials of each country to the other and meetings with counterparts. Until the next meeting of the Joint Committee, it was agreed that a study should be undertaken under the coordination of the Steering Group of further areas of cooperation as well as the advisability of providing appropriate formal arrangements for the joint cooperation activities, which is on the agenda for the Steering Group.

SENIOR PARTICIPANTS

UNITED STATES-ISRAEL JOINT COMMITTEE FOR INVESTMENT AND TRADE

March 1–2, 1976, Jerusalem

Israel

H. E. Yehoshua Rabinowitz, Minister of Finance, Cochairman
Arnon Gafni, Director-General, Ministry of Finance
Dr. Moshe Mandelbaum, Director-General, Ministry of Trade and Industry
Avraham Agmon, Special Advisor to the Minister of Finance, Ministry of Finance
Haim Stoessel, Accountant General, Ministry of Finance
Moshe Neudorfer, Director, State Revenue Administration
Sar Shalom Shiran, Head, Budget Department, Ministry of Finance
Dov Kantorowitz, Controller of Foreign Exchange, Ministry of Finance
Gen. (Res.) Moshe Goren, Director, Israel Investment Authority

Prof. Yitzhak Yaacov, Chief Scientist, Ministry of Trade and Industry
Ze'ev Sher, Economic Minister, Embassy of Israel, Washington
Gad Elron, Head, Economic Division, Ministry of Foreign Affairs

United States

William E. Simon, Secretary of the Treasury, Cochairman
The Honorable Malcolm Toon, Ambassador
L. William Seidman, Assistant to the President for Economic Affairs
Gerald L. Parsky, Assistant Secretary for International Affairs, Department of the Treasury
Travis E. Reed, Assistant Secretary for Domestic and International Business, Department of Commerce
Joel W. Biller, Deputy Assistant Secretary for Commercial Affairs and Business Activities, Department of State
Roger E. Shields, Deputy Assistant Secretary for International Economic Affairs, Department of Defense
Charles W. Hostler, Deputy Assistant Secretary for International Commerce, Department of Commerce
David Gregg, Executive Vice President, Overseas Private Investment Corporation (OPIC)

Exhibit 66.—Statement by Acting Assistant Secretary Bushnell, March 4, 1976, before the Subcommittee on Legislation and National Security of the House Government Operations Committee, on the payment of foreign debts owed the U.S. Government

Mr. Chairman, I am pleased to be here today to explain how seriously Treasury, other U.S. Government agencies, and the borrower governments consider the prompt, ontime payment of foreign debts owed the U.S. Government. Delinquencies in the payment of debts by foreign obligors is taken very seriously by Treasury, and we have taken a number of steps during the past 2 years to insure that debts are paid on schedule. As I shall explain later, payment on only a small portion of the debt owed to the United States is in arrears and for the great bulk of these arrears there are special circumstances which limit our ability to remedy the situation.

This is the first time I have testified on this important subject. Therefore, I think it would be appropriate to review past congressional and executive action on this matter.

Congressional and executive actions and Treasury responsibilities

As you are aware, the Foreign Operations and Government Information Subcommittee of the House Committee on Government Operations began holding hearings on delinquent debts owed the U.S. Government in 1970. In an effort to improve the Government's performance in collection of debts, and in response to timely and useful suggestions from the subcommittee, the executive branch has developed a complete reporting system on foreign debts owed the U.S. Government and has instituted procedures for the periodic review of outstanding delinquencies.

Under section 634(f) of the Foreign Assistance Act, as amended, Treasury is responsible for compilation of data on foreign debt owed to the U.S. Government and arrearages on such debts. We receive from all U.S. Government agencies semiannual statements of long-term foreign debt owed (those with original maturities of over 1 year), short-term debts (maturities of 90 days to 1 year), and accounts receivable (maturities of less than 90 days).

Information is also compiled on debts in each category which are due and unpaid 90 days or more. This information is used in taking appropriate steps to insure prompt collection, as well as in assisting the Congress in its work.

Treasury also oversees the review of individual debt problems through its chairmanship of the National Advisory Council on International Monetary and Financial Policies (NAC). The NAC in its consideration of new loans to foreign countries reviews the status of those countries' debts to the United States. The NAC has adopted a formal procedure for the deferral or disapproval of loans to countries with delinquent debts.

In all of its activities in the debt collection area, Treasury works closely with the Department of State and the agencies to which the debts are owed. The responsibility for collection lies initially with the creditor agency. In cases where the creditor agency's efforts are unsuccessful, the Department of State is asked to provide its assistance.

The Treasury Department is also responsible for compiling an annual report on the external debt situation of the less developed countries and debt rescheduling. This report, which is required by section 634(g) of the Foreign Assistance Act of 1961, as amended, is comprehensive in nature, containing detailed information on the external debt of developing countries, including debt-servicing problems of major debtor countries and the steps which debtor and creditor countries have taken in dealing with these problems. Copies of the second annual report, dated January 30, 1976, have been provided to members of this subcommittee. I shall comment on this report later in my statement.

Treasury also chairs an NAC working group which is developing an early-warning system to identify in advance those countries which may incur debt-servicing difficulties. Another Treasury-chaired NAC working group, which works closely with the debt early-warning group, examines in detail the debt-servicing problems of countries which may incur debt-servicing difficulties.

Foreign debts owed to the U.S. Government

All foreign debts owed the U.S. Government arise from congressionally mandated programs undertaken in this century. Foreign debt owed the United States falls into two broad categories: Debts contracted for the most part after World War II and debts relating to our activities during and immediately after World War I. Since collections on some debts, particularly those under lend-lease during the Second World War, were deferred until the war had ended, I would prefer, for convenience sake, to refer to these as post-World War II debts.

The total principal outstanding on these post-World War II debts was $35.2 billion on June 30, 1975. Of this total, $34.5 billion was on long-term credits, $93.8 million short-term credits, and $527.9 million accounts receivable. The vast majority of this debt is a result of U.S. Government foreign aid and export credit programs undertaken during the last 30 years. Some $15 billion was contracted under the Foreign Assistance Act, and predecessor legislation, and the Foreign Military Sales Act, $5.6 billion under Public Law 480, and about $9 billion under the Export-Import Bank Act. Another $1.6 billion arose from activities related to World War II, primarily lend-lease and surplus property disposal.

Given the aid and export support objectives of these loans, it is not surprising that most of them, nearly 85 percent by value, are owed by non-oil-exporting developing countries. The largest individual debtors are: India, $3.6 billion; Pakistan, $2.4 billion; Brazil, $2.1 billion; Israel, $1.7 billion; Turkey, $1.5 billion; Indonesia, $1.2 billion; and Korea, $1.2 billion.

In the vast majority of instances, debts due to the United States have been paid on time. During the 18 months December 31, 1973, to June 30, 1975, the United States collected some $3.1 billion in principal due on long-term credits, and the equivalent of about $700 million in principal on foreign currency loans. During this period of time, long-term arrearages declined by about $130 million. While a portion of this reduction in arrearages reflects debt rescheduling agreements, the amount of money actually collected on foreign debts far exceeded new arrearages incurred. Foreign debt arrearages constitute a very small portion of total debts falling due to and being collected by agencies of the United States.

Let me turn now to a discussion of post-World War II debt delinquencies and describe our efforts to deal with these delinquencies.

As I indicated earlier, Treasury compiles information from the U.S. Government agencies on all debts which are overdue and unpaid 90 days or more. As of June 30, 1975, the latest date for which complete data are available, the total principal and interest delinquent was $636 million. This compares with $753 million on December 31, 1973. On the whole, I believe our performance in reducing debt arrearages has been good. With continued effort, I would expect this underlying favorable trend to continue.

However, there are certain cases which are extremely difficult to resolve through normal collection procedures. The table attached to my statement classifies arrearages according to the nature of the problem underlying the arrearage. For example, those arrearages which fall under the heading "extraordinary political arrearages" account for nearly 60 percent of total arrearages as of June 30, 1975. Special problems, particularly problems of a political nature, impede our ability to collect these debts. Mr. Boeker of the State Department will be addressing the nature of the political problems underlying these arrearages with respect to China and Cuba.

By far the largest arrearage in this group, $199 million, relates to military logistical support provided by the United States to other nations during the Korean conflict. While the United States has reached formal agreement with most countries for payment for such assistance, no such agreements have been reached with six developing countries: Colombia, Ethiopia, Greece, the Philippines, Thailand, and Turkey. The policy to be followed in seeking disposition of these matters is under intensive review within the administration. Mr. Boeker will provide background information on this problem. Without going into the details, I would like to note that the 10th report of the Moorhead subcommittee (December 1973) concluded that:

*Arrearages of 90 days or more on foreign credits and loans of U.S. government agencies**

[Dollar amounts in millions]

			Dec. 31, 1973	*June 30, 1975*
I. Extraordinary political arrearages:				
A. Long-term, of which:				
1. China			[1]$ 76.5	[1]$ 79.6
2. Cuba			58.3	64.9
Subtotal			134.8	144.5
B. Short-term and accounts receivable, of which:				
1. China			20.2	20.2
2. Vietnam and Cambodia			2.9	8.4
3. Unresolved Korean War logistical support			199.8	199.8
Subtotal			222.9	228.4
Total political			357.7	372.9
Percent of overall total			47	59
II. Major arrearages—public long-term:				
1. Egypt			$ 50.8	$ 13.2
2. Iran (payments initiated, 1974)			35.3	35.8
3. Pakistan (rescheduling agreed)			4.3	59.5
Total major arrearages			90.4	108.5
Percent of overall total			12	17
III. Other arrearages:				
A. Public:				
1. Long-term			$159.2	$ 34.8
2. Short-term and accounts receivable, of which:				
FMS, MAAG, and Logistical support	39.9	67.7		
Lend-lease	4.9	4.9		
Eximbank	19.1	3.8		
Other	15.1	13.8		
			79.0	90.3
Subtotal			238.2	125.1
B. Private:				
A. Private:				
1. Long-term			57.4	20.7
2. Short-term and accounts receivable, of which:				
Eximbank	8.5	8.9		
Other	1.4	0.6		
			9.9	9.5
Subtotal			67.3	30.1
Total other arrearages			305.5	155.2
Percent of overall total			41	24
IV. Overall Total—groups I, II, III			753.6	636.6

* Excludes World War I Debt.

[1] Excludes $45.1 million of principal and interest due from the Republic of China for assets left on the Asian Continent, for which Export-Import Bank by agreement with that Government has deferred from pressing.

MARCH 19, 1976.

> It is improbable that as less developed nations they (the six nations) ever implied a willingness or ability to pay. There is no reason for continuing to carry these claims as debts on U.S. Treasury records.

The second category, "major arrearages," includes Egypt, Iran, and Pakistan. Together, these arrearages totaled $108 million as of June 30, 1975.

Secretary Simon raised the matter of debt arrearages when he visited Egypt in July 1974. At that time, Egyptian arrearages totaled nearly $60 million, a large portion of which was on local currency loans. Since that time, we were pleased to see that these arrearages were virtually eliminated. Unfortunately, new arrearages have occurred which total $13 million as of June 30, 1975. Subsequently, this amount was reduced by nearly $5 million at yearend 1975.

Secretary Simon is visiting Egypt later this week to discuss a number of economic and financial issues. He will raise the question of the remaining debt arrearages with appropriate Egyptian officials. Given the excellent cooperation which Egyptian officials have demonstrated in the past, we are confident that this arrearage can be cleared up in the near future.

The Pakistan arrearage relates to a debt rescheduling agreement which the United States and Pakistan are signing this morning. This agreement, which will be submitted to Congress for appropriate review, will implement a June 28, 1974, understanding reached between

Pakistan and members of the World Bank Aid-to-Pakistan Consortium. When the debt agreement is implemented, the amounts, which are now carried as arrearages, will be rescheduled, and Pakistan will be current on its obligations to the United States.

For the past 4 years, the United States has been in regular communication with Iran in an effort to collect arrearages of $35 million on several lend-lease and surplus property agreements signed in the period 1945–48. This arrearage is receiving priority attention and some payment has been received. Mr. Boeker will discuss the matter in detail.

The remaining category of other long-term, short-term, and accounts receivable arrearages total just over $155 million as of June 30, 1975. This compares to $306 million for December 31, 1973. During this period, arrearages on long-term debts owed by foreign public sector entities declined about $125 million, while those arrearages from private sector entities fell about $35 million. Many of these arrearages reflect technical and administrative problems, rather than hardcore delinquencies.

Efforts to improve collection of delinquent debts

During the past year, several steps have been taken to improve the debt collection procedures of agencies of the Government. At a meeting of the National Advisory Council on International Monetary and Financial Policies which I chaired on August 7, 1975, agencies reviewed measures they were taking to improve their debt collection procedures. At that time, Eximbank, whose defaults amount to less than 1 percent of Exim's portfolio, reported that the Bank was in the process of establishing a computerized program for automatically billing debtors 45 days prior to due date of payment. This program is in the process of being implemented, and when fully implemented, the end of fiscal year 1976, it will help to limit the level of delinquent accounts on Exim transactions.

The Department of Defense established a task force to develop standardized procedures for all the armed services on foreign military sales program transactions to include uniform billing, cash collection, and delivery reporting. Mr. Welsch will comment on how these measures should help to control delinquent accounts on DOD transactions.

In addition to these technical improvements, Treasury and State have intensified their efforts to reduce the level of delinquencies. Treasury stepped up its efforts in the weekly staff meetings of the National Advisory Council to call attention of creditor agencies to delinquent debts of particular countries and to seek their increased cooperation in collecting these delinquencies. While the results have obviously not eliminated all debt delinquencies, there are several instances where our consideration of loans to these countries was deferred pending a satisfactory response from the debtor country. In most cases prompt payment or at least a schedule for early payment to bring payments up to date have resulted.

World War I debt

The other part of our debt is World War I debt. The question of the delinquent principal and accrued interest on World War I debt owed to this Government by our European allies, and related debts owed by Germany, is extremely complex and has remained unresolved for over 40 years.

U.S. allies during World War I borrowed $12 billion to purchase war material. After taking into account interest charges of $14.6 billion, an amount which exceeds principal, and repayments of $2.8 billion, the outstanding debt totaled approximately $24 billion as of June 30, 1975.

These debts present special problems. Most debtor countries fulfilled their commitments under the debt agreements until the Depression. Aside from a few countries, however, the debtor governments have made no payments since the Depression of 1933–34. The principal debtor governments (except the Soviet Union, which repudiated all foreign debts in January 1918) have never denied the validity of the debts. Despite their clear legal validity, the debts are, as a practical matter, inextricably bound up with the entire question of German war reparations and the intra-European debts generated during the First World War. Many European nations are net creditors on World War I indebtedness, with Germany owing them more than they in turn owe. These nations have since the early 1930's steadfastly maintained that they would only resume payments on their war debts to the United States on the condition that the issue of Germany's World War I reparations was satisfactorily settled.

Resolution of the problem of government claims against Germany arising from World War I was deferred "until a final general settlement of this matter" by the 1953 London agreement on German external debts, to which the United States is a party. This agreement was ratified by the U.S. Senate and has the status of a treaty.

While the United States has never recognized any legal connection between World War I obligations owed to this country and reparation claims on Germany, there is a linkage in reality. A National Advisory Council working group has this complex matter under study but thus far has not found any feasible way to resolve this problem.

LDC debt, debt rescheduling and U.S. policy

The question of increased LDC (less developed country) balance of payments deficits and the concomitant rise in LDC external debt is attracting considerable attention in international fora such as the United Nations Committee on Trade and Development (UNCTAD) and the Organization for Economic Cooperation and Development (OECD). The magnitude of these balance of payments deficits and the pattern of past and projected financing is analyzed in considerable detail in the second annual "Report on Developing Countries' External Debt and Debt Relief Provided by the United States," which was sent to Congress on January 30, 1976.

The sharp jump in oil prices and a combination of other factors such as higher prices for food and fertilizer in 1974 and the worldwide recession of 1974–75 impaired significantly the economic prospects for many of the nonoil LDC's. However, the report concludes that most LDC's will be able to manage the financing of their current account deficits in 1976, even though many countries will continue to borrow beyond normal levels. If there are LDC debt problems in calendar year 1976, it is expected that these problems will be associated with individual countries—perhaps three or four—rather than with the LDC's as a whole.

The report sets forth in unequivocable terms the U.S. position on U.S. participation in a generalized debt rescheduling or debt moratorium as advocated by some countries. The United States opposes a generalized debt rescheduling or moratorium as these are not considered to be appropriate instruments to alleviate the balance of payments financing difficulties of these LDC's. Moreover, proposals which have been advanced along these lines would be inequitable, providing only minor assistance to the poorest countries and windfall benefits to others.

U.S. policy on debt rescheduling is to evaluate the merits of debt reorganization on a case-by-case basis, predicated on the principle of basic adherence to scheduled terms of credit payment. Within this framework, the U.S. objective is to encourage countries to undertake appropriate corrective policies in order to minimize the incidence of debt rescheduling.

In summary, Mr. Chairman, let me repeat that most debts by foreign governments to the United States are being repaid on time. In the fiscal years 1974 and 1975, we have collected over $5.6 billion in principal and interest on Government long-term credits. Collections on short-term credits are also substantial. During the same 2 years, we have reduced the total of delinquent debt. About 60 percent of total debt arrearages on post-World War II debt and almost all arrearages on World War I debt are subject to special political or other factors, which make prompt payment unlikely at this time.

Mr. Chairman, I will be happy to answer any questions which you or members of the committee may have.

Exhibit 67.—Statement of Assistant Secretary Parsky, April 8, 1976, before the Subcommittee on Foreign Operations of the Senate Appropriations Committee, regarding U.S. contributions to the international development banks

Mr. Chairman, last year the four international development banks made commitments for new loans totaling $8.5 billion for 377 projects in 84 countries. This total is far more than the bilateral economic development program of the United States or any other country. For most developing countries outside the Middle East the programs of the international development banks have become the core of their external financing. Most aid donors from both Europe and the Middle East build their bilateral programs around, and in cooperation with, the banks' programs. The U.S. contribution to this truly mammoth development effort requires appropriations of a little over a billion dollars in FY-77. About $300 million of this total is for callable capital which is unlikely to result in any outlays ever from the U.S. Treasury. Callable capital is a guarantee facilitating the sale of bonds by the banks in the capital markets of the world.

Mr. Chairman, Treasury has testified each year about these banks and I would presume not to repeat the basic details on their creation and growth which you and the committee know so well. I shall try to focus on a few of the key reasons why continued support for the banks at the level requested is in the national interest, despite the many competing domestic demands for funds, and review the current funding situation and recent developments in each bank. Detailed statements on the International Development Association (IDA), the International Finance Corporation (IFC), the Inter-American Development Bank (IDB), the Asian Development Bank (ADB), and the African Development Fund (AFDF) are annexes to this statement.[1] I shall do my best to answer questions on any of these institutions as well

[1] Annexes 1 through 5 are not included in this exhibit but are available in subcommittee files.

as any general questions you may have on the banks. Mr. Charles A. Cooper, U.S. Executive Director for the World Bank group, Mr. John M. Porges, U.S. Executive Director at the IDB, and Mr. John A. Bushnell, my deputy at the Treasury for developing nations finance are here with me today and are also available for questions.

We believe that the World Bank group and the three regional banks provide important extra dimensions to development assistance. Economic development is not primarily a matter of external funding. While money is needed, the key factors determining the success of development efforts are the policies and priorities followed by each country. The development banks make important contributions in precisely such areas by encouraging the adoption of sound economic policies, by assisting in institution building, and by supporting successful development efforts made by the countries themselves.

The banks have developed highly competent professional international staffs which help the developing countries with the complex problems of priority setting and institution building. These international staffs bring together outstanding professionals from both developed and developing countries. In both the World Bank and the Inter-American Development Bank there are more Americans than any other nationality; and, overall, Americans make up about 25 percent of the development bank staffs.

The banks are cost efficient institutions. For example, the combined administrative budgets of the banks in 1975 accounted for only 3 percent of the $8.5 billion lent out that year. Moreover, included in the administrative budgets are expenses for technical assistance, training centers, et cetera, which are not directly associated with the cost of making loans.

From the U.S. national point of view, these banks encourage development along lines compatible with our own economy. They stress the role of market forces in the effective allocation of resources and the development of outward-looking trading economies. Through contact with the international development banks, developing countries are learning to administer large procurement programs effectively and honestly. These programs will result in increased procurement of goods and services in the United States, expanded future markets for our products, thus increasing employment in our country. Our participation in the international development banks will also provide more assured access to essential raw materials and a better climate for U.S. private investment in the developing world.

There is clear evidence that in all of the international development banks increasing attention is being given to, and a greater volume of loans are being made for, the direct benefit of the urban and rural poor. Assistance is being directed increasingly to the poorest countries and to low-income groups in all borrowing countries.

About 92 percent of IDA credits are made to countries with per capita incomes below $200, and the ADB makes loans on concessional terms only to member countries with per capita incomes of less than $300. About 50 percent of IDB's concessional loans are being made to the nine poorest countries in Latin America, and this percentage is expected to continue rising steadily in the future.

All of the international development banks are increasing their lending for projects which directly assist the rural and urban poor. In recent years the banks have placed greater emphasis on agriculture, the family farm, and cooperatives—an emphasis we have encouraged and supported. The IDB has been the leader, for example, in lending for integrated rural development, cooperatives, farm-to-market roads, and rural water supply. The World Bank and IDA have made several loans for population projects and for sites and services to improve living conditions for the poorest groups. The IDA, as well as the African Development Fund, have made loans for the drought-stricken Sahel region of Africa. The ADB is taking the lead in loans involving light and intermediate technology which benefit the poor.

I would emphasize that the change in emphasis toward direct assistance to the poor is slower than some of us would like and we continue to press within the banks for a greater concentration to reach directly the poorest groups in each borrowing member. We must also not lose sight of the fact that basic infrastructure projects—roads, ports, electric power, and major irrigation—are still necessary to provide the basis for overall growth of the developing country economies.

The development banks are part of an international structure in which the developed and developing countries work together to solve problems. The development banks are not debating societies which engage in seemingly endless rhetoric about restructuring of the world economy; they are working institutions that get things done. By cooperating with other developed countries in funding these institutions we improve the effectiveness of our own efforts. Other donor countries strongly support this cooperative approach and multilateral institutions are being used for an increasing share of the total development assistance of other industrial donor countries. The United States is no longer the leader in directing assistance through the development banks; the constraints on our support are a principal limitation on their growth as other countries, in general, are prepared to multilateralize a greater part of their assistance.

Bilateral aid remains, of course, of major importance. There are special aspects of economic assistance that require bilateral programs, especially where we have special techniques or products to impart, where we have special interests in individual projects or programs, or where security considerations are heavily involved. But U.S. support for the multilateral institutions is essential if we are to meet today's and tomorrow's challenges of improving the prospects for the millions in developing countries which our bilateral programs do not reach.

In our contributions to the international development banks, we have been trying to reduce U.S. budgetary outlays by making relatively less available to the soft-loan windows of these institutions and relying more on U.S. contributions of callable Ordinary Capital. Callable capital does not involve budgetary outlays; thus, emphasizing callable capital fits in well with the administration's strong efforts to achieve budgetary constraint. Moreover, since our private capital market is a major source of borrowing by the international development banks, it is appropriate that the United States provide an increased proportion of its overall contributions to these banks in the form of callable capital, while other donors with less well-developed capital markets undertake a greater share of funding for the soft-loan windows of the banks. This shift in burden-sharing is illustrated by the recent trends in U.S. contributions to the concessional funds of the banks. Our contribution to the fourth replenishment of IDA is one-third of the total, as compared with 43 percent in our initial contribution in 1961, 42 percent of the first IDA replenishment, and 40 percent of both IDA II and IDA III. In the case of the new IDB replenishment, our contribution to the Bank's concessional resources would be reduced to $600 million, or 57 percent of the total, as compared with $1 billion, or 67 percent of the total in the 1970 replenishment.

In the IFC, our share in the proposed total capital replenishment for FY 1977–79 would fall to about 25 percent as compared with 32 percent in the initial capitalization. And in the Asian Fund the U.S. share will also decline, although we want to maintain our share of the ordinary ADB capital through full appropriation of the amount requested for FY–77.

One of the advantages to the United States of burden-sharing in the international development banks is that it provides us with substantial leverage in the use of our foreign assistance funds. Thus our appropriations request of about $1 billion in FY 1977 will be associated with nearly $10 billion of total lending by these banks.

Because of burden-sharing by the other donor countries, and their consequent sharing of the role in the decisionmaking process as members of these institutions, we do not—as we do in our bilateral aid programs—have complete control over the activities of the banks. These institutions, as you know, are clearly not part of the U.S. Government. What we have to weigh, therefore, is whether, on balance, the international development banks generally perform in ways which meet U.S. objectives even if, for example, they make some loans or lend to some countries that do not meet with our approval. In this connection, most of the total lending by the international development banks is to countries—such as South Korea, the Philippines, Pakistan, Tunisia, Brazil, Egypt, and Colombia—where we have strong interests and where we now have or recently have had substantial bilateral aid programs.

Appropriations requests

To provide for continued U.S. support of the international development banks in FY–77, we are requesting appropriations of $1,030.6 million of which $734.1 million will require Treasury outlays and $296.5 million is callable capital—guarantees unlikely to require expenditures. The administration is seeking—

$375 million for the second U.S. installment of the fourth replenishment of IDA;

$45 million as the first U.S. installment in the first replenishment in 20 years for the International Finance Corporation;

$240 million for the second installment of the fourth replenishment of IDB Ordinary Capital ($40 million of paid-in capital and $200 million of callable capital);

$200 million for the first installment of the replenishment of the resources of the IDB's soft-loan window, the Fund for Special Operations (FSO);

$120.6 million for the third installment of the first capital replenishment of the ADB ($24.1 million paid-in and $96.5 million callable);

$50 million for the initial U.S. contribution to the first replenishment of the resources of the soft-loan window of the ADB, the Asian Development Fund (ADF).

In addition, the President has just transmitted to the Congress a request for supplemental appropriations for FY 1976. In this supplemental request the administration is seeking—

$240 million for the first installment of the fourth replenishment of IDB Ordinary Capital ($40 million of paid-in capital and $200 million of callable capital);

$15 million for the initial U.S. contribution to the African Development Fund (AFDF).

These U.S. contributions are part of the multilateral effort in funding the international development banks in which the United States contributes only a part—and an increasingly smaller part as can be seen in the table attached to this statement (annex 6). If other donors are to continue supporting these banks, we must do our part by delivering on the amounts we agree to contribute.

The administration is not seeking a contribution for the "third window" of the World Bank which lends at an interest roughly halfway between that of the World Bank and that of IDA because we believe priority should be given to IDA and IFC appropriations.

Our participation in the fourth IDA replenishment was authorized by Public Law 93-373 and our participation in the replenishment of the capital resources of the Asian Development Bank in Public Law 93-537. Authorizing legislation for participation in the replenishment of the IDB passed the House of Representatives as H.R. 9721 on December 9, 1975, and the Senate on March 30. A conference, necessitated by differences in the House and Senate versions of the bill, is expected to be held soon. Legislation authorizing U.S. participation in the replenishment of the IFC and ADF was transmitted to the Congress in February.

H.R. 9721 provides for the United States to make three contributions of $400 million per year to the replenishment of the capital resources of the IDB beginning in FY 1976 and $450 million (all callable) in FY 1979. The bill also provides for U.S. membership in the African Development Fund with an appropriation in FY 1976.

In the IDB a new class of shares, known as interregional capital, will be created to facilitate the entry of nonregional members. We are not requesting appropriation of the callable interregional capital because covenants limiting IDB borrowing to the amount of appropriated U.S. ordinary callable capital would not apply to interregional callable capital. This matter is explained in more detail in annex 3 on the IDB.

We signed up for IDA IV in January 1975 without appropriations because we knew that, while other donors had made advanced contributions to allow IDA to continue making commitments, they would contribute no additional funds until the United States formally agreed to the replenishment. Such action by the other donors would have forced IDA to stop lending to the world's poorest countries. By agreeing to contribute one-third of the funds for IDA IV, we assured that others would contribute the other two-thirds of the funds and IDA has continued to make commitments for projects and programs in the poorest countries.

The nature of our current arrangements concerning IDA, frankly, give me a great deal of concern. We should be aware of the implications of the procedure under which we are beginning our contributions 1 year late and spreading our contribution to IDA IV over 4 years while IDA commits the funds in 3 years. Under the present schedule, IDA will have committed all IDA IV resources 3 months before the end of FY-77. Yet we shall have half of our contribution still awaiting appropriation in FY-78 and FY-79.

As you know, the conference committee on April 1 recommended $320 million for the first installment of the U.S. contribution to IDA IV. We will need to have the $55 million appropriated in FY 1977 in addition to the full $375 million requested if we are not to fall further behind other donors in providing funds to IDA.

To complicate matters, negotiations have already started on the next IDA replenishment. IDA hopes that the fifth replenishment will take effect by July 1977 so that there is no period during which IDA commitments must stop. Some of you have suggested that we provide commitment authority to IDA subject to appropriation. This procedure would mean that in FY-78 appropriations would be necessary to meet not only the $375 million third payment for IDA IV but also for the first payment for IDA V. Such appropriations would total more than double the current request even if the U.S. share of IDA V is substantially reduced. Although I would welcome your views on this problem, I do not believe we can resolve it this morning. However, this situation does emphasize the great importance of full appropriation of the $375 million plus any shortfall from FY-76 and FY-77 if the United States is to continue as an active supporter of IDA's key development role in the poorest countries. The administration believes that for the United States to turn its back on IDA is unthinkable.

The need for funds in the other banks is also urgent. The IDB ran out of commitment authority to make new loans in late 1975 and would have had to cease lending except for a change in its regulations that allowed it to make new commitments against loan reflows and certain reserves on a temporary basis until the new replenishment becomes effective. Even after doing this the IDB had only $73 million in remaining commitment authority from Ordinary Capital at the end of 1975; these funds have already been allocated for a couple of pending loans. Thus the IDB is now unable to make new Ordinary Capital loans. The supplemental FY-76 appropriations which are obviously urgently needed will be used in part to reverse this temporary accounting change made last year. Thus the Bank will again have exhausted its commitment authority by about the beginning of FY-77. The FSO will also run out of commitment authority by the beginning of FY-77.

The Asian Development Bank has only $41 million of commitment authority remaining for soft funds, and these funds remain only because it reduced its soft lending in CY-75 to $166 million from $173 million in CY-74. The Bank has made no soft loans so far in 1976. During 1975, the United States participated in negotiations on an ADF replenishment but did not commit itself concerning the specific timing or amount of any U.S. contribution. Last December, the ADB Governors approved a resolution providing for an $830 million replenishment with a suggested U.S. share of $231 million. The United States abstained on the resolution and no final decision has yet been taken on the full amount to be requested from the Congress for a 3-year U.S. contribution. We are, however, requesting $50 million as the U.S. contribution to the ADF for FY-77 to continue the level of U.S. support of the ADF in recent years.

The pipeline of available funds for concessional lending has been reduced below minimum levels by the delays in U.S. contributions. Soft convertible funds of the regional banks available for commitment declined from $285 million at the beginning of 1975 to only $100 million by the end of the year. The inability to make new commitments not only delays the financing of good projects but also weakens the morale and dedication of the banks' staffs.

The $45 million appropriation request for the IFC is part of a $480 million capital increase for the Corporation. The total U.S. share is about $112 million.

We regard the IFC expansion as a major element in our program for aiding the developing countries. IFC, a member of the World Bank group, is the only multilateral agency specifically designed to encourage private sector growth in the developing countries. It is unique among international development institutions in that it purchases equity and operates without government guarantees.

The United States has taken the lead in publicly supporting a major expansion of IFC capital through statements made by Secretary Simon at the annual meeting of the IBRD/IMF in September 1975 and by Secretary Kissinger at the U.N. Seventh Special Session in the same month. The proposal has since received widespread support from other countries and international negotiations are expected to be completed soon.

The United States has always stressed that the development process involves a cooperative effort between the public and private sectors—domestic and foreign. The task is too big and resources too scarce to permit a dependence on one or the other. A high level of private investment has been a common factor behind the growth experience of three of the most successful LDC's—Brazil, South Korea, and Taiwan. Low rates of private investment have tended to be associated with low rates of economic growth. Public investments in infrastructure yield low returns if not followed up by further investment in more directly productive activities. The private sector has proven its effectiveness relative to the public sector, both in seeking out the investment opportunities that are most profitable and in using available resources efficiently.

IFC taps the private sector, both domestic and foreign, for the bulk of the investment capital in its projects while applying a development orientation to the utilization of that capital.

The country shares of IFC's current capital represent the relative economic strength of the members in the 1950's when the Corporation was established. By using an up-to-date formula reflecting conditions in the 1970's the relative share of the U.S. subscription declines while those of Germany and Japan, as well as of the newly rich OPEC countries, rise.

This capital increase is the first since IFC's founding in 1956. The proposed increase is ambitious—more than quadrupling the IFC's small capital base of $108 million. IFC's small capital base has impeded its equity operations, restricted its ability to borrow IBRD funds for relending, and resulted in IFC becoming a much more junior member of the World Bank than was contemplated when it was established 20 years ago. The capital increase will enable the IFC to play a more substantial role in the development process in association with private capital. The United States, as the largest private enterprise economy in the world, is expected to be the leader in support of the IFC. Frankly, I wonder if we have done justice to our strongly held beliefs in the advantages of private enterprise by delaying a replenishment of the IFC in recent years while giving priority to the organizations lending mainly to governments. It is time to put the IFC at the top of our priority list.

Mr. Chairman, I must take note at this point of the actions of the conference committee of the Senate and House on April 1. The committee has reduced our requests by $130 million. I should state for the record that it is present administration thinking that we would amend the FY-77 request to include this $130 million requested but not appropriated in FY-76.

This procedure would also apply to the supplemental requests in FY–76 for the IDB and for the African Development Fund recently submitted to the Congress.

Before closing I would like to address briefly five additional issues which are of interest to the Congress and the administration. First, let me comment on why it is important for the United States to contribute to four international development banks.

Our past experience with the regional banks leads us to believe that smaller institutions with a predominance of local citizens can do a better job of meeting certain requirements than the much larger World Bank group. Countries in the regions—Latin America, Africa, and Asia—concur in this belief since the regional institutions give them more control over the course of their own development. Moreover, the work of these institutions and that of the World Bank group are complementary. The World Bank concentrates on larger, more complex projects utilizing expertise gained from worldwide operations. The regional banks focus on smaller scale projects and call upon the firsthand knowledge and experience of their staffs to meet problems unique to their areas.

Let me now address the effect of the international development banks on our balance of payments. Excluding short-term funds held by the development banks in U.S. financial markets, the total of all inflows and outflows of dollars resulting from transactions from their inception through December 1975 has resulted in a net deficit of only about $200 million for the U.S. balance of payments. Moreover, the banks maintain substantial investments in U.S. short-term financial assets.

The absolute magnitudes of the various types of flows are, of course, much larger; the total net outflow of capital (subscriptions paid-in plus net sales of bonds, loan participations, etc., in the United States) totaled almost $11 billion as of end-1975, while the development banks' purchases of U.S. goods and services, direct expenditures and long-term investments in the United States totaled over $10 billion.

Because of our overall favorable payments situation in 1975 we opened our capital markets freely to the banks for the first time in several years. As a result, they raised $1.8 billion in net long-term capital. Consequently the cumulative effect on U.S. international payments was less favorable at the end of 1975 than at the end of 1974. However, at the end of 1975, the banks held about $5 billion in short-term U.S. financial assets which, if included in the above figure, would make the effect on total inflows and outflows from the United States positive by a large margin.

Let me turn now to procurement. One of the major benefits we derive from our membership in the international development banks is the opportunity it affords U.S. exporters to compete for procurement financed by the banks. The rules of the banks require international competitive bidding and other safeguards which give our exporters a fair chance to compete for business in the developing countries. One of the advantages in joining the African Development Fund is that U.S. companies will become eligible to compete for contracts financed by the AFDF and thus will have a greater incentive to compete for business in Africa, which has not been a traditional market for many U.S. suppliers.

We have increased efforts in the last year to obtain a larger share of procurement in the development banks. During the past 10 months, Treasury has had on loan from the State Department a senior foreign service officer who has concentrated on improving the U.S. procurement record at the banks. This record, I might add, is not bad at all. Although the U.S. share of world exports of goods and services in recent years has been approximately 17 percent, our share of bank-financed procurement has been running at 25 percent. Every $1 billion of procurement in the United States for bank-financed projects generates 47,500 man-years of employment in this country.

I know you are also interested in the foreign assistance activities of the oil-exporting countries as they relate to the international development banks. The vast increase in oil export earnings of the OPEC countries has made it possible for some of them to take on part of the development financing burden and to borrow substantially less from the international development banks thus permitting more lending to the poorer developing countries.

OPEC countries have provided cofinancing totaling some $1 billion to complement 36 IBRD and IDA projects in 16 countries—most of them over the past year or so. These projects are listed in a table attached (annex 8). A substantial amount of IBRD/IDA resources was freed up for other projects and countries by this OPEC cofinancing.

The pattern of lending by the development banks to OPEC countries has changed as a result of the higher incomes of these countries (annex 7). Lending of soft funds from IDA, the FSO, and the Asian Development Fund to these countries has been stopped with the exception of limited amounts of FSO funding for Ecuador. These FSO loans to Ecuador have been financed from sources other than the U.S. contribution, including Ecuador's own contribution to the FSO. Lending to the OPEC countries with the highest incomes such as Venezuela and Iran has stopped. However, lending to the poorer countries such as Indonesia and Nigeria has increased, partly as a result of proceeding with loans on which work had already started before the oil price increase. We have urged the banks to concentrate their limited resources on those countries with the greatest need.

My final point deals with our procedures to examine the work of these banks. We are continuously working at improving our oversight activities in regard to the banks' lending programs and project implementation. Embassy, AID, and Treasury officials make visits to projects as frequently as possible. At every opportunity we encourage and facilitate project visits by Members of Congress.

The primary mechanism through which the administration sets policy on the international development banks, both on general policy questions and on each individual loan, is the National Advisory Council on International Monetary and Financial Policies (NAC). Every loan and borrowing operation and every substantial technical assistance operation is reviewed in detail by the interested U.S. agencies in the NAC before instructions are given to our Executive Directors. Through this process we assist these institutions to do an even better development job by bringing the very considerable expertise found in the Federal Government to bear in reviewing their projects. I would especially like to mention the outstanding technical work of the Department of Agriculture and the Department of Transportation in contributing highly useful inputs to these reviews. AID is one of the most active agencies participating in the NAC and contributes its immense development experience as well as its knowledge of current conditions in developing countries. The Department of Commerce and the Export-Import Bank help us to be continually vigilant that American exporters have the fullest opportunity for business. The Federal Reserve provides extremely useful analysis of the monetary and financial situation in the borrowing countries. The State Department contributes its detailed knowledge of conditions in the borrowing countries and provides the key foreign policy element in NAC deliberations. In addition to chairing the NAC, we in Treasury are particularly concerned with general bank policies such as assurance of adequate self-help, avoiding financing of cost overruns, a consistent approach to maturities and grace periods, and increased efforts to reach the agricultural sector and the poorer people in ways that will increase output. The NAC also reviews such general U.S. concerns as expropriation of U.S. investment and arrears on debts to the United States in connection with each loan.

The annual report of the NAC should be an integral part of the documents you consider in determining appropriations for the development banks. In particular, I would call your attention to chapter IV of the FY–75 report which reviews developments in the banks and includes tables covering such matters as the sectoral breakdown of lending and membership in the regional banks and appendix C which includes the NAC evaluation of all the loans approved during the year. If this appendix were not so long—a hundred fine-print pages—I would suggest you might include it in your report because it brings out the real life benefits for millions of people around the world made possible through the work of the development banks. The purpose and benefits of each loan are given. Let me quote just one example of the sort of information in the NAC report. For a $15 million loan to Kenya, half from the IBRD and half from IDA, the following is part of the analysis of benefits:

> The major quantifiable benefits stemming from the project are substantial increases in marketed production of wheat, maize, milk and coffee estimated at $10.1 million per year after full development. The project should also ensure employment—either permanent or seasonal and depending on the number of group owners involved—for about 13,000 group farm owners, and will benefit farm families comprising 80,000 persons. These families are from the lower income levels of Kenya's rural population, most of which would be landless and unemployed if steps were not taken to protect their investments. At full development, the annual income of each family should have gained—in addition to its subsistence income—$84 on the mixed farms, and $420 on the coffee estates. Currently, the average per capita income of the rural family in Kenya, including subsistence produce, is only about $70 per annum.

I know that some of you have felt the United States, especially the Congress, cannot make a sufficient review of the lending operations of the development banks in advance of loan approval. Unlike the situation for the bilateral aid program, we cannot present you with a list of specific projects that will be financed with the appropriations before you today. This situation is inherent in the nature of these multilateral institutions where the United States provides only one dollar out of every three, four, or five they lend. It would obviously be infeasible for them to present their programs in advance to the governments and parliaments of all their members, or even to the 20 to 25 donor members. However, these institutions do not make sharp changes in the pattern and nature of their lending from year to year. Thus a review of last year's lending program will indicate quite accurately the nature and direction of their lending programs this year and next year.

In conclusion, Mr. Chairman, I would like to apologize for having dealt so much with figures, procedures, and burden-sharing. Underlying all these aspects we must keep in mind that the fundamental purpose of these institutions and of all the funds you appropriate for them is to help the people in developing countries improve their miserable living conditions. Support for the development banks is important in building and maintaining the broad framework of international cooperation that is important to continued U.S. prosperity. But this is an additional benefit. The basic justification for the appropriations has to be that these banks do a good job in using the money to help the developing countries help themselves and that this development reaches the people in these countries in a way that justifies U.S. taxpayer support.

We have not asked for the amounts of money that these institutions could use to accelerate development worldwide. Given the need for budget stringency, which we in Treasury know is so essential in the United States today, we have asked for the minimum amounts necessary to keep these institutions going in a manner consistent with the highest priority needs of the poor countries and contributions being made by others. The decisions you will make on these appropriations may receive much attention in the capitals of the world. But the practical effects of the appropriations will be spread to the poorest villages, slums, and isolated areas where little is known of the United States, burden-sharing, or these institutions, but where improved seed, a well, a visiting health team, availability of credit, or a road to the market can make—at small cost—an immense difference in the quality of life.

ANNEX 6

Trends in share of international development bank resources provided by the United States

[Percent of contributed resources]

			IDB		ADB	
	IBRD	IDA	OC	FSO	OC	SF
Initial contribution	41.4	42.6	43.1	68.5	20.0	28.6
First replenishment	32.9	41.9	43.1	[1] 68.5	18.2	....
Second replenishment	28.0	40.0	43.1	83.3	....	....
Third replenishment	....	39.9	41.2	75.0	....	....
Fourth replenishment	....	33.3	32.4	66.7	....	....
Fifth replenishment	....	....	....	57.4	....	....
Cumulative U.S. share	25.3	37.7	40.4	69.2	18.8	28.6

[1] If the SPTF is included, the United States provides a total of 90.7 percent of IDB concessional resources through the first replenishment.

ANNEX 7

International development bank loans to OPEC countries—FY 1974 through FY 1976

[In millions of dollars]

Country	FY 1974					FY 1975					FY 1976[1]					Grand total
	World Bank		ADB/IDB			World Bank		ADB/IDB			World Bank		ADB/IDB			
	Bank	IDA	OC	SF FSO	Total	Bank	IDA	OC	SF FSO	Total	Bank	IDA	OC	SF FSO	Total	
Abu Dhabi	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Algeria	157.5	—	—	—	157.5	48.0	—	—	—	48.0	46.0	—	—	—	46.0	251.5
Ecuador	23.2	5.5	—	55.7	84.4	4.0	—	35.0	23.5	62.5	—	—	*40.7	—	40.7	187.6
Indonesia	48.0	84.0	11.78	21.54	165.32	332.0	—	77.1	14.2	423.3	68.0	—	66.05	—	134.05	722.67
Iran	265.0	—	—	—	265.0	52.5	—	—	—	52.5	—	—	—	—	—	317.5
Iraq	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Kuwait	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Libya	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Nigeria	75.0	—	—	—	75.0	173.0	—	—	—	173.0	—	—	—	—	—	248.0
Qatar	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Saudi Arabia	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Venezuela	22.0	—	—	—	22.0	—	—	—	—	—	—	—	—	—	—	22.0
Total	590.7	89.5	11.78	77.24	769.22	609.5	—	112.1	37.7	759.3	114.0	—	106.75	—	220.75	1,749.27

* Includes $29.6 million from Venezuelan trust fund.

[1] Through Mar. 1, 1976.

ANNEX 8

Cofinancing operations between Bank/IDA and Arab development banks

[In U.S. $ millions equivalent]

Country and project	FY	IBRD loan	IDA credit	Cofinancing institution	Amount lent	Total project cost
Burundi—coffee improvement	76	....	5.2	Kuwait Fund	1.2	7.5
Rwanda—Highways	70	....	9.3	Saudi Fund	5.0	25.7
	76	....	9.5			
Sudan—Irrigation	73	....	42.0	Kuwait Fund	11.0	96.0
supplemental	75	....	20.0	Kuwait Fund	39.0	148.0
				Arab Fund	14.5	
				Saudi Fund	28.0	
Tanzania—Textiles	75	15.0	....	Kuwait Fund	15.0	44.3
Maize	76	....	18.0	BADEA[1]	5.0	38.0
Zaire—Mining	75	100.0	....	Libyan-Arab Foreign Bank	100.7	435.0
Water supply	76	21.5	....	BADEA[1]	10.0	70.4
Ghana—Cocoa	76	14.0	....	BADEA[1]	5.0	30.0
Mauritania—Ports	76	....	8.0	Kuwait Fund	8.3	27.5
Highways	75	....	3.0	Kuwait Fund	3.8	13.7
Nepal—Hydroelectric	76	....	26.0	Kuwait Fund	17.5	68.0
Algeria—Ports	74	70.0	....	Arab Fund	20.0	293.2
				Kuwait Investment Company	60.0	
Cement	76	46.0	....	Local Algerian Banks	89.8	214.4
Egypt—Fertilizer	74	....	20.0	Arab Fund	22.1	132.4
				Kuwait Fund	23.8	
				Abu Dhabi Fund	10.2	
				Libyan-Arab Foreign Bank	10.1	
				Qatar	3.4	
Cotton ginning	74	....	18.5	Saudi Fund	25.6	40.4
Suez Canal	75	50.0	....	Kuwait Fund	34.5	288.0
				Saudi Fund	50.0	
				Abu Dhabi	34.5	
				Qatar	10.0	
Cement	75	40.0	....	Arab Fund	23.0	84.0
Railways	75	37.0	....	Saudi Fund	65.0	296.3
Telecommunications	75	....	30.0	Saudi Fund	23.0	173.4
Jordan—Thermal power	73	....	10.2	Kuwait Fund	10.2	25.0
Power	76	....	5.0	Arab Fund	13.4	22.0
Syria—Thermal power	74	25.0	....	Kuwait Fund	33.0	62.6
	75	8.6	....	Abu Dhabi Fund	15.0	
Tunisia—						
Gas pipeline	71	7.5	....	Kuwait Fund	2.5	14.3
Phosphate	73	23.3	....	Kuwait Fund	6.9	64.2
Sewerage	75	28.0	....	Saudi Fund	30.0	86.1
Yemen, A. R.—						
Agriculture	73	....	10.9	Kuwait Fund	5.9	17.5
Water supply	74	....	6.25	Abu Dhabi Fund	1.0	6.8
Agriculture	75	....	10.0	Abu Dhabi Fund	10.0	23.2
Highways	75	....	9.0	Kuwait Fund	5.0	15.7
Water and sewerage	75	....	8.1	Arab Fund	21.0	31.2
Yemen, P.D.R.—						
Highways	75	....	15.5	Kuwait Fund	15.3	31.8
Ports	76	....	3.2	Arab Fund	13.6	17.6
Yugoslavia—						
Oil pipeline	76	....	49.0	Kuwait Fund	125.0	377.0
				Libya	70.0	
Totals		485.9	336.65		1,146.8	3,321.2

$240 million for the first installment of the fourth replenishment of IDB ordinary capital ($40 million of paid-in capital and $200 million of callable capital);

$15 million for the initial U.S. contribution to the African Development Fund.

[1] Arab Bank for Economic Development in Africa.

Exhibit 68.—Statement of Deputy Assistant Secretary Bushnell as Temporary Alternate Governor for the United States, April 23, 1976, before the ninth annual meeting of the Asian Development Bank Board of Governors, Jakarta, Indonesia

On behalf of President Ford and Secretary Simon, my delegation wants to stress our continuing deep concern with accelerating development in Asia. We also want to repeat our wholehearted support for the Asian Development Bank—the key regional development finance institution. As a nation of the Pacific as well as the Atlantic, the United States has a vital interest in continued development and improved living standards for all the people of Asia. In our increasingly interdependent world increased peaceful cooperation among nations enhances the welfare of all.

International economic situation

At the eighth annual meeting of the Bank last year Secretary Simon identified three central economic issues facing the world in 1975:

First, to restore economic growth and price stability around the world;

Second, to adapt to the energy shock in ways that will provide more secure sources of energy and will support a pattern for orderly growth; and

Third, to adjust our financial policies to accommodate massive shifts in international flows of funds.

Fortunately, today we can already see substantial progress on each of these economic problems. The pace of economic activity is already picking up rapidly in a number of countries. In the United States our economy has now been growing for nearly a year and we are already seeing the effects of this growth on the demand for the imports of the regional members of the ADB. With the completion of the downward adjustment of inventories in the United States along with similar favorable indications from other countries, we expect the faster growth in the developed countries will have a much more apparent effect on demand for the exports of developing countries.

Most countries have also made substantial progress in reducing price inflation. Some regional members of the ADB have set an example for all of us in bringing price inflation under control. However, for many countries, including the United States, inflation rates are still higher than we would expect during a period when productive capacity is not strained. Clearly continuing progress in reducing inflation rates is one of the greatest challenges we face over the next year as productive capacity is more fully utilized throughout the world.

Considerable progress has been made in many countries in adapting to the energy shock. In the United States we still have much to do to supply our energy needs more fully from domestic sources. As our oil consumption rises and production falls, we expect the increase in our oil import bill in 1976 to be almost as large as our current account surplus in 1975, assuming no change in oil prices.

We welcome the greatly increased emphasis the ADB has given to helping member countries develop indigenous energy sources as a major contribution to their own development and to a better energy balance in the world. Over 20 percent of ADB lending was in the energy field last year and most of this was for domestic energy sources such as the power project in Thailand based on lignite and the Garung hydroelectric project here in Indonesia. Just last month the Bank approved a project to expand Korean coal production. This ADB emphasis should continue.

Finally, private financial markets have done an outstanding job of moving funds from surplus to deficit countries. We expect that the private markets will continue to play this critical role. We tend to look only at the net borrowing or lending of countries. Thus we overlook the fact that many countries have both large inflows and large outflows of long-term capital. Many of the countries which provide support for the Asian Development Bank have been large net borrowers in recent years even while they have been providing capital to the Bank. This year the United States will be in a similar position as it is unlikely that our current account surplus will be nearly as large as our capital outflows to support development in the poorer countries. It should be recognized that this situation makes it harder to build popular support for development assistance. In most cases the interest and other terms on the borrowing of donors are far harder than the terms of our support to the ADB and other development programs.

Despite the many strains of the past year I believe we can all take pride in the fact that most countries have maintained their commitment to open trading arrangements and a relatively free international flow of funds. I am particularly impressed by the fact that developing countries have relied heavily on aggregate monetary, fiscal, and exchange policies in adjusting to recent difficulties. They have also made excellent efforts to maintain relatively open markets for imports. These policies suggest that most developing countries are increasingly understanding the advantages to their development of more intensive participation in an interdependent world connected by increasing links of trade and financial flows.

Moreover, we have made substantial progress in improving the international system to deal with the sort of problems faced in the past couple of years as well as to assist with longer term development problems.

The IMF has agreed on amendments to provide for improved longer term stability in international trade and payments and for a substantial increase in quotas, particularly for developing countries.

The compensatory financing facility of the IMF has been enlarged to assist in financing shortfalls in export earnings for reasons beyond a country's control.

A trust fund is being established in the IMF that will use profits from the sale of a portion of the IMF's gold to provide concessional assistance to overcome temporary balance of payments problems.

Agreement appears to be near on the creation of the International Fund for Agricultural Development to help increase food production in developing countries.

My own country has initiated a system of generalized tariff preferences as part of our efforts to liberalize imports from developing countries.

Negotiations are virtually completed for a World Bank capital increase, and discussions have started on the fifth replenishment of the International Development Association. We expect agreement within the next few days on a fivefold increase in the capitalization of the International Finance Corporation (IFC). This general increase—the first since IFC was founded in 1956—will permit substantial additional capital assistance to private firms in Asia. With an increase in capital, the IFC can play an even more important role than in the past in helping to build a strong private sector which is essential to economic growth in developing countries.

The role of the international development banks

The international development banks remain the primary multilateral source of capital for long-term economic growth. These banks last year made new commitments of $8.5 billion for nearly 400 projects in over 80 countries. However, economic development is not primarily a matter of money. While money is needed, the key factors determining the success of development efforts are the policies and priorities followed by each country. The development banks make important contributions in precisely such areas, and in institution building. In recent years the banks have accelerated the process of spreading development benefits to the poorer people by placing greater emphasis on agriculture, the family farm, and cooperatives—an emphasis we encourage and support. The regional banks in particular have an important role to play because they reflect the desires and needs of their regional members and have an expertise and understanding of local conditions and problems.

Role of ADB

The role of the ADB is to bring its special expertise and local knowledge to the development problems of Asia. The Bank has done this well, due in large part to the leadership of President Inoue. I would like to take this occasion to express my country's appreciation for his dedicated service to the Bank.

The Bank's growing impact on Asian economic progress is reflected in its activities last year:

Lending for agriculture and agro-industry was over 37 percent of total ADB/ADF lending in 1975 compared with 24.5 percent in 1974; we believe the 1975 proportion is about the right emphasis on agriculture.

The Bank has given greater emphasis to the use of intermediate technology in Bank-financed projects. Recognizing that traditional capital-intensive projects are often neither the most cost effective nor the most appropriate, the Bank has focused attention on the basic use of labor, combined with less capital-intensive technology, by supplying labor with appropriate tools—be it a wheelbarrow, a 4- or 5-horsepower hand tiller, or a hand-operated water pump. In this way the Bank is able to make use of idle manpower in its developing member countries and, at the same time, spread its limited resources such that it reaches many more people. We hope the Bank will greatly expand its use of appropriate intermediate technology in the future.

The Bank also deserves credit for its efforts to mobilize cofinancing for development projects. The Bank's cooperation with OPEC (Organization of Petroleum Exporting Countries) nations in financing fertilizer projects is well known. Cofinancing in cooperation with private banks and other private financial institutions has the potential to be a major source of development finance. Such arrangements increase private sector involvement in the development process and stretch the Bank's scarce resources. We congratulate the Bank on opening a new horizon through the recent water supply loan to Singapore in which the ADB arranged cofinancing with a private financial institution. We hope there will soon be many such loans involving cofinancing. Such arrangements also help to introduce developing countries to the international capital market and thereby initiate the process of establishing ongoing financial relations for further access to private financial markets. Through the mechanism of cofinancing, smaller banks and other financial institutions may also begin to lend to developing nations by benefiting from the project appraisals carried out by the development banks.

In order to maximize the development impact of ADB operations, we continue to believe that it should reduce its financing of cost overruns. The Bank should use its financial and human resources to develop new projects, instead of allocating additional scarce resources to projects already underway.

With the rapid growth in lending from $254 million in 1971 to $660 million in 1975 it would be prudent in the period immediately ahead for the Bank to concentrate on improving the quality of new loans and on continuing to seek more effective implementation of loans underway. To further this effort, the Bank must work toward a system of more intensive project supervision. As the Bank becomes stronger it should also become more active in the difficult sectors where innovative lending is needed such as in rural development and other projects to reach lower income groups.

Another area to consider should be equity investments by the Bank in productive, employment-creating enterprises. Such investments could encourage policies and institutions which would further promote and broaden participation in the development process. The Articles of Agreement of the Bank authorize the Bank to make equity investments. I would urge that the Bank activity study how it might make equity investments and that the Board of Directors consider the matter in the near future.

To finance its rapidly rising disbursements on loans, the Bank borrowed more in 1975 than in all previous years combined. In 1976 it has already borrowed more than in all of 1975. However, much of the Bank's borrowing is still relatively short term in comparison with the maturities of its lending. Greater effort may be needed to increase the average maturity of the Bank's borrowing. The confidence the markets are now showing in Bank obligations suggests that longer terms are becoming feasible.

During the past year there appear to have been more interruptions in meeting financial obligations to the ADB and the proportion of Asian Development Fund resources tied up in inactive loans has increased. My Government feels that the Bank should exercise its normal responsibility by taking action to collect amounts due and to assure that funds which are not being used are reprogrammed where appropriate so that the 1976 ADF program can be implemented to the maximum extent possible.

U.S. support for the ADB

Speaking for my Government, I want to emphasize that the administration will continue its strong support for the ADB. Subject to final congressional action we will soon subscribe our second installment of $120.6 million to the first replenishment of the Bank's Ordinary Capital and make a further contribution of $25 million to the initial resource mobilization of the ADF. I hope we will complete this financing commitment to ADF and also subscribe to the remainder of our share of the capital increase by October or November after approval of our FY-77 budget.

The United States supports the replenishment of the ADF. I would hope shortly to be able to announce a U.S. contribution target for the replenishment which will be higher than our previous contribution.

The United States also supports a replenishment of the Bank's Ordinary Capital. We believe that in laying out the criteria for replenishment it is appropriate for the Bank to review its lending, borrowing, and financial policies. The ADB is entering a stage of rapidly increasing loan disbursement and borrowing requirements. It is a period when the ADB must move from financing its loans from paid-in capital to relying primarily on private capital markets.

The increased reliance of the Bank on private capital markets, in turn, makes it all the more important for the Bank to maintain a solid financial position. An improvement in its financial indicators and its general creditworthiness will reduce the cost of money to the Bank and help lengthen the maturities of its issues. The Bank's financial position could be strengthened by some modifications in various ADB financial policies. This is important because bond purchasers will look not only at the degree of governmental support for the Bank, whether through paid-in or callable capital, but also at the financial operations and management of the Bank itself. In this regard I note with concern that the Bank's income in 1975 did not increase from the level in 1974, even though the scale of the Bank's operations increased substantially. The Bank's financial statements for 1975 indicate that this was due to sharply increased borrowing and administrative costs, changes in currency values, and increased funding of grant technical assistance.

Specific policies which we believe are necessary to improve the financial strength of the Bank include: (1) That the Bank's lending rate more fully cover the costs of its borrowings and operations, (2) that the effective commitment fee charged on undisbursed loans more closely parallel the practices in the other international development banks, (3) that the Bank make efforts to find ways other than use of Bank income to fund grant technical assistance, and (4) that the Bank restrain the growth of administrative expenses.

Our goal, and the goal of all friends of the Bank, is a financially viable and strong regional institution that is secure in international capital markets, requiring decreasing amounts of paid-in capital, and building reserves sufficient to set aside portions to help finance ADF operations. It is our hope these can be achieved over the course of the next few years.

Before I close I want to express our great appreciation to the Government of Indonesia for hosting this ninth annual meeting of the Asian Development Bank. We have looked forward to visiting this dynamic and growing city of Jakarta and to this opportunity to discuss the challenges and opportunities facing Asia and the ADB.

In closing, I think it is worth remembering that the fundamental purpose of the ADB, and of all the development lending institutions, is to help the people in developing countries improve their living conditions. The basic justification for U.S. support of the ADB and of the other development banks has to be that they do a good job in using money to help the developing countries help themselves and that this development reaches the people in these countries in a way that justifies U.S. taxpayer support. The practical effects of our contribution will be spread to the poorest villages, slums, and isolated areas in Asia where little is known of the United States or the ADB, but where improved seed, a well, a visiting health team, availability of credit, or a road to the market can make—at small cost—an immense difference in the quality of life.

Exhibit 69.—Statement by Secretary Simon, May 7, 1976, on his visit to Chile

The discussions I have had today with Finance Minister Cauas and other Chilean ministers have been both informative and promising. In our meetings, we discussed a wide range of economic and financial subjects of interest to our two countries. I was impressed by the resolve of the Chilean Government to take forceful steps to reduce its balance of payments deficits, control domestic inflation, and accelerate the rate of growth of the economy. These constitute an impressive list of challenges, but I feel that the Chilean Government has adopted economic policies such as the removal of most price, exchange, and other economic controls, which should greatly enhance the prospects for stability and economic growth. There are already positive signs of improvement. There has been a significant increase in noncopper exports and a substantial increase in agricultural production. Further, the Government has emphasized its desire to meet its responsibilities to its creditors, and this year Chile anticipates repaying over $500 million of foreign debts. These economic developments are most promising, and the United States wants to support these efforts to correct the economic imbalances of the past.

However, increasing restraint is being felt in the United States because of the human rights issue. In order for the United States-Chilean economic and financial relationships to grow and in order for other countries also to support Chile's economic programs, the United States believes that greater understanding has to be reached about what the Chilean Government is doing to ensure that human rights are respected. In our meetings, the Chilean Government described the steps it has taken to ensure the rights of individuals and to prevent abuses, and emphasized its firm commitment to these principles.

In this regard, I am pleased to note that in the past few days a number of individuals have been released from prison and given exit decrees. I have attached to my statement a list of the names of these people.[1] In addition, the Government informed me that it will be announcing shortly amendments to Chile's Constitution and additional measures that will provide further guarantees against human rights violations.

The Government of Chile has agreed to:

1. The Government of Chile will meet shortly with the working group of the United Nations Commission on Human Rights to establish rules of procedure so that a review of the measures underway to ensure human rights can take place in Chile. The desire to have all American countries view what is taking place in Chile was the basis for the Government's invitation to the General Assembly of the Organization of American States.
2. The Government of Chile will continue to process the release of persons under the parole program and under other programs, shortly announcing the release of a number of such persons; and, in the future, the momentum of this program will increase.
3. The Government of Chile has and will continue to vigorously prosecute those officials who inflicted abuses on the persons detained in Chile. It informed me of the prosecution and sentencing of a number of such persons.

I think these steps offer significant promise, and I have encouraged the Government to accelerate the release of individuals and the adoption of necessary legal reforms.

[1]Not included in this exhibit.

With this in mind, the United States is prepared to work closely with Chile in the months ahead. We are prepared to assist Chile in its efforts to establish economic stability and promote economic prosperity but we can only do so within the framework of a system that ensures personal and political freedom. The elimination of public concern in the United States and elsewhere that will result from this process will pave the way for a dynamic joint effort to move Chile's economic development programs to a new level of achievement.

As this process evolves, we will look toward ways of increasing public and private help. In particular, we will look toward a major program of encouraging U.S. private investment in Chile through activation of our OPIC investment insurance program, promotion in the United States of the investment opportunities in Chile, and through an agreement to avoid double taxation in order to provide the security and stability investors require.

The potential for joint cooperation between our two countries is substantial and I personally intend to make sure that every avenue is fully explored and every effort made to ensure that these opportunities are not neglected. I intend to continue the dialog we have opened, for I firmly believe that the adoption of giving stronger constitutional guarantees and the release of persons still under detention for political reasons will ensure the development of strong economic ties between the United States and Chile, in support of Chile's development aspirations and for the benefit of both countries.

Exhibit 70.—Joint communique on May 11, 1976, of Mario Henrique Simonsen, Minister of Finance of Brazil, and Secretary Simon

The Secretary of the Treasury, William E. Simon, concluded today his visit to Brasilia. During his visit, the Secretary met with President Geisel, Finance Minister Simonsen and with Ministers Silveira, Velloso, Paulinelli, Ueki and with the Secretary General for Trade and Commerce Belotti. Secretary Simon's discussions with Brazilian leaders covered a broad range of economic topics of major interest to the two Governments and were marked by a spirit of cordiality.

At the conclusion of their meeting in Brasilia, the Secretary and Minister Simonsen announced a number of specific results which are a practical demonstration of the close ties between the United States and Brazil and open significant opportunities for future collaborative efforts of major benefit to the two countries.

Secretary Simon and Minister Simonsen agreed that a resolution of key bilateral trade issues would provide major impetus to an expansion of trade and investment between the United States and Brazil and deepen the relationship between them. They agreed, therefore, that this goal should be given their personal and priority attention. After a series of meetings they reached agreement on a number of important measures in achievement of this important goal.

Minister Simonsen announced his Government's intention to adjust export incentives in order to avoid barriers to the increase of Brazilian exports.

With respect to footwear, Minister Simonsen welcomed the recent decision taken by the President of the United States not to increase import barriers on footwear from Brazil. The Minister confirmed that no more export incentives on footwear are being provided than there were in 1974 and that the noted adjustments in the export incentives of Brazil assure that the utilization of tax credits is no higher than in 1973. Secretary Simon welcomed these developments and agreed that the present countervailing duties on footwear would not be reevaluated until the last quarter of next year.

Minister Simonsen indicated that the Brazilian Government would also adjust its tax credit program on exports of leather handbags. Secretary Simon indicated that this action would enable the United States to waive countervailing duties imposed on imports of leather handbags from Brazil and agreed to take such action effective July 1, 1976.

Minister Simonsen expressed his concern to Secretary Simon over the possibility of trade restrictions against Brazilian exports to the United States because of tax credits granted by the Brazilian Government on exports of soybean oil. He agreed with Secretary Simon on the importance of avoiding such action.

Toward this objective, Minister Simonsen informed Secretary Simon of the Brazilian Government's decision to adjust export incentives on soybean oil exports. As a result of this action, Secretary Simon indicated he did not believe that a complaint by U.S. producers would be filed under section 301 of the Trade Act and that the issue has been satisfactorily resolved.

Recognizing the importance to relations between the United States and Brazil of avoiding disagreements over incentives and countervailing policy, Minister Simonsen and Secretary Simon agreed to consult fully on incentive-countervail issues. As for any U.S. investigations of countervailing complaints concerning Brazilian exports, Secretary Simon indicated that the United States will consult with the Brazilian Government on all aspects of any such cases.

The Minister and the Secretary also agreed that both Governments should discusss marketing and ways to promote demand and usage of soybeans, soybean meal, and soybean oil.

Minister Simonsen and Secretary Simon agreed that the above measures represent a major contribution toward the development of a sound and dynamic trading relationship between the United States and Brazil. They agreed that a hospitable climate for investment and capital flows was also of great importance. In this connection, the Secretary and the Minister agreed on the importance of a treaty between the two countries to avoid double taxation, and agreed that their tax experts should meet in the near future to discuss the provisions that might be incorporated in such a tax treaty.

Secretary Simon discussed with the Brazilian Ministers Brazil's development plans and prospects, and in particular, capital projects under consideration in Brazil which could be facilitated by U.S. investment. Secretary Simon expressed his belief that U.S. investment in Brazil, which now exceeds over $3 billion, will continue to grow and make a significant contribution to Brazil's development efforts. He agreed to bring key Brazilian projects to the attention of the private sector in the United States.

Secretary Simon noted that the sharp increase in oil prices has shifted the pattern of the world's surplus investment funds. He expressed his belief that this shift has created important opportunities for countries such as Brazil, as it seeks capital to develop a viable rapidly growing industrial/agricultural economy. Secretary Simon and Minister Simonsen agreed on the importance of close collaboration to maximize these opportunities. They agreed to work together to facilitate tripartite investments, joining United States and Brazilian enterprises in partnership with the oil-producing countries for productive investments in Brazil, for the benefit of each of the parties. The Secretary and the Minister agreed that the opportunities for bilateral and tripartite investment in Brazil were extensive.

Minister Simonsen explained to Secretary Simon the programs and policies Brazil has undertaken to consolidate its economic accomplishments and to attain internal and external equilibrium for the long term. The Minister expressed his concern about the existing deficit for Brazil in the trade balance with the United States, and his desire that trade equilibrium be achieved through the increase of Brazilian exports to the U.S. market. Secretary Simon expressed his view that Brazil's economic prospects remained highly favorable. Secretary Simon felt that Brazilian economic policies should be effective in achieving greater price stability and equilibrium in Brazil's balance of payments position, and that these efforts merited the confidence of foreign investors and lending institutions.

During their meetings, Secretary Simon and Minister Simonsen also exchanged views on conditions prevailing in the major foreign exchange markets of the world and on other topics of current interest in the international monetary area. They also discussed the policies and prospects of the international financial institutions.

Secretary Simon and Minister Simonsen agreed on the importance of continuing the dialog between them on issues of major significance in the economic and financial area. Within the framework of the memorandum of understanding signed in Brasilia February 21, 1976, and to underscore the importance of continued consultations and to provide a more formal mechanism in which these discussions can take place, the Ministers agreed to establish and cochair a consultative group on trade, investment, and financial issues within the area of responsibility of the Department of Treasury and of the Ministry of Finance. The Ministers will designate coexecutive secretaries for support of the consultative group.

In concluding his visit to Brasilia, Secretary Simon indicated to Minister Simonsen that in his view the measures that he and Minister Simonsen had agreed upon during his visit represented a significant development in the overall relationship between the two countries, heralding the prospect for broader and more intensive ties between the United States and Brazil that would prove of substantial benefit to the two countries. Secretary Simon expressed his government's determination to build on the impressive framework of the current relationship between the United States and Brazil and to add to the accomplishments which had resulted from his visit and the visit of Secretary Kissinger earlier this year. Minister Simonsen agreed that the economic relationship between the United States and Brazil had been enhanced as a result of Secretary Simon's visit and expressed his conviction that the measures they have announced today will be of major benefit to both countries.

Exhibit 71.—Address by Assistant Secretary Parsky as Temporary Governor for the United States, May 18, 1976, at the Inter-American Development Bank meeting in Cancun, Mexico

The Inter-American Development Bank is about to enter a vital new period in its history. The last 18–24 months have been a period of uncertainty and hesitation for the world economy, for the economies of most member countries, and for the Bank. This period of great uncertainty for both the world economy and the Bank now appears to be over. The economies of most developed countries have been expanding rapidly for several quarters and the effects of this expansion on world trade and developing country exports are already being seen. With exports again growing rapidly, most developing countries should be able to reduce their unusually large payments deficits of the past couple years and at the same time increase growth rates. Nevertheless, as a result of the events of the past 2 years, the world has undergone basic change. With the development of natural resources by some countries and with the transfer of financial resources to others, the world today is truly interdependent. We need not fear this fact. Instead, as the proper response to interdependence, we must build a worldwide framework of cooperation. Development problems remain; but they too can be overcome if we approach them together—seeking realistic solutions that will benefit all countries.

The period of great uncertainty is also over for the Inter-American Bank as final action on replenishment of its resources and the entry of the nonregional members is clearly in sight. I am pleased to say that we expect the Congress of the United States to complete action this week on the bill authorizing a U.S. vote for the replenishment as well as for the amendments permitting nonregional membership. President Ford will then sign the bill into law and Governor Simon will vote promptly. Everyone in the Bank, especially President Ortiz Mena, deserves a great deal of credit for facilitating the agreement on the replenishment in record time. Negotiations were initiated at our annual meeting last year, and only formal steps now remain to place it into effect by the end of this month.

Another major development of great significance to the Bank's future is the expansion of the membership to include countries from outside this hemisphere. We have all worked hard to make it possible for these countries to join the Bank. I hope the nonregional countries which have not yet completed their formal processes will move forward as quickly as possible so that we may be able to welcome them as active participants in this institution. Moreover, I would hope that the nonregional countries which have not yet indicated an interest in joining the Bank will soon do so with contributions appropriate to their economic potential.

This annual meeting gives us a unique opportunity to demonstrate to the representatives of these countries which are about to become full members what the Bank does. We are meeting here in an impressive new city sponsored by the Government of Mexico, with the assistance of loans from the Bank for infrastructure such as water supply, housing, and roads. Thus, we can all see at first hand how the Bank helps member countries even in an area where there was previously virtually no economic activity or population. On behalf of the United States, I want to thank the Government of Mexico for hosting this 17th annual meeting of the Inter-American Development Bank.

International economic outlook

The hopes for rapid economic development of each member country depend in large measure on participation in an international economy which itself is growing rapidly. Fortunately the world is now well on the way to recovering from the most severe economic recession since the 1930's. Industrial production in the major industrial countries has been on the rise for several months. For the larger developed countries as a group the rate of real growth in 1976 seems likely to exceed 5 percent. At the same time, however, inflation and unemployment are still unacceptably high in many countries, including the United States. We must increase our efforts to solve these problems through the pursuit of fiscal and monetary policies aimed at achieving a balanced expansion.

During the past 2 years, the non-oil-exporting developing countries have experienced abnormally large balance of payments deficits as a result of increased oil prices and the accompanying recession in the industrial countries. These deficits on current account were about $28 billion in 1974, and an estimated $35–$37 billion in 1975. Normal long-term financing covered only $20–$25 million of the gaps in 1974 and 1975, and developing countries have increased their short- and medium-term borrowings from commercial banks. A continuation of such borrowing would increase debt service payments in future years in a way which might create major problems. Fortunately, we are beginning to see a turnaround in the payments positions of many of the developing countries. Just as last year's recession and inventory adjustment had an amplified adverse impact on primary products and developing countries, the strong economic recovery underway in the industrial countries will have an amplified beneficial impact. Our latest estimates are that the deficits of the nonoil developing countries will be reduced to about $28 billion in 1976 with further improvement continuing in 1977.

Recognizing that the adjustment process is not as rapid for all countries, the United States has made a series of constructive proposals to assist the developing countries. Agreements reached 4 months ago in Jamaica are specifically aimed at the balance of payments needs of developed and developing countries alike. Already it is clear that there will be increased use of International Monetary Fund resources, especially compensatory financing, in 1976.

Despite the many strains of the past year, I believe we can all take pride in the fact that most countries have maintained their commitment to open trading arrangements and relatively free international flows of funds. I am particularly impressed by the fact that developing countries have relied heavily on aggregate monetary, fiscal, and exchange policies in adjusting to recent difficulties. They have also made excellent efforts to maintain relatively open markets for imports. These policies suggest that most developing countries are increasingly recognizing the advantage to their development of more intensive participation in an interdependent world. We must continue our efforts to increase trade and financial flows directed by market forces.

There's no question that the international economic system can be improved. We in the United States will continue to suggest changes in the monetary, trade, commodities, and technology areas which are aimed at strengthening the functioning of market forces. We do not believe that a new institutional framework to deal with developing countries' economic concerns would be practical or helpful. Instead, we feel that we can bring about effective action within the existing international institutions such as the IMF and the international development banks. We will certainly do our part.

The United States fully recognizes the concerns of Latin American exporters over the wide fluctuations in some commodity export prices and the impact such fluctuations have on their export earnings. We believe progress on raw material problems can be achieved in several ways: Through commodity-by-commodity dialogs between interested producers and consumers, through strengthening the market mechanism, and through adequate investment in raw materials production to assure availability of supplies. We have put forward proposals to accomplish these objectives. Further, as part of our efforts to liberalize access to the U.S. market for developing country exports, the United States introduced a generalized system of preferences on January 1 of this year. This system covers over 2,700 products of which our imports were approximately $2.6 billion from eligible developing countries in 1974.

At the same time, the most significant contribution the United States can make to international economic progress is to sustain rapid growth in our domestic economy while keeping open our markets for growing imports of the products of other countries. Fortunately, the American economy is experiencing a strong recovery. Real output will grow by more than 6 percent in 1976. Given our close trade ties with Latin America and the end of our inventory adjustment, an acceleration of imports by the United States will contribute to general recovery in Latin America.

For the economic recovery to be sustained, world trade must continue to expand. The benefits of expanding trade are familiar: Greater efficiency, more and higher quality jobs, and lower consumer prices. We are hopeful that the new round of multilateral trade negotiations will reduce trade barriers on a broad scale, provide for the special trade needs of the developing nations, and preserve equitable access to supplies at reasonable prices.

U.S. commitment to Latin America

The Americas have had a unique history of cooperation in the peaceful management of intraregional relationships for the mutual benefit of all countries in the hemisphere. We support Latin American economic integration efforts and are ready to consider proposals for strengthening intraregional cooperation.

The United States has a vital national interest in our long and close association with Latin America, and we continue to give high priority to the development of the economies of all IDB member countries. Thus, our support for the work of the Inter-American Development Bank is unwavering.

Joining us here today are several distinguished representatives from the U.S. Congress. Their presence here and in visiting the Bank's projects evidences the continued interest in the economic development of Latin America by the U.S. Government and our people.

Economic development in Latin America is succeeding because of the talent, hard work, and perseverance of people throughout the hemisphere. While external assistance makes an important contribution to development, a country's ultimate achievement depends upon the efforts of the nation itself. Many of the development success stories of the past quarter century are in Latin America. Latin American countries, as a whole, have been growing at a very impressive rate of almost 7 percent per annum in real terms. Since 1960, value added in manufacturing in the region and installed electrical capacity have tripled while primary school enrollments have quadrupled. Adult literacy increased from about 52 percent in 1950 to about 73 percent in 1970, and the number of rural families with access to potable water has tripled. The IDB has been a major factor contributing to most of these accomplishments.

Although the development task in Latin America is well underway, much remains to be done. In particular, Latin America requires an expanded flow of external capital over the next several years to maintain its development momentum.

My fellow delegates will appreciate the fact that, like many Latin American countries, the United States is faced in the next decade with the task of finding enough capital to meet the need for urban renewal, to revitalize our transportation systems, to expand our energy resources, and to modernize our industrial plants. The shortage of capital is a problem in your countries as it is in mine. Capital is an important and scarce resource. Nevertheless, my country is committed to continue to supply substantial amounts of capital to Latin America as long as capital continues to be used efficiently to expand living standards in Latin America.

In connection with the shortage of capital, it seems to me highly appropriate that greater efforts be made to take advantage of light capital or intermediate technologies. The productive use of idle labor with new methods and less costly tools should allow more effective utilization of scarce capital resources. The IDB has begun to take advantage of intermediate technologies in some of its agriculture projects. We hope to see extension of this approach to other projects and other sectors.

IDB's role in Latin America

Turning to the IDB's record and its policies for the future, I want to commend the Bank for its achievements over the past year under the impressive leadership of its President, Mr. Antonio Ortiz Mena:

- Agreement was reached on increasing the Bank's total resources by $6.3 billion—$5.3 billion in capital and $1 billion in the Fund for Special Operations (FSO).
- Arrangements have recently been completed to permit 12 or more countries from outside the region to become donor members.
- The Bank began development lending from the $500 million fund entrusted by the Government of Venezuela.
- The Bank initiated a program of complementary financing to increase the flow of private financial resources to development projects in Latin America.
- The Group of Controllers has continued to make objective and astute evaluation of the Bank's programs and operations. We look forward to the Group's being used more actively to assist the Board of Directors.

In 1975 the IDB authorized $1.4 billion for 70 loans, the highest annual volume of lending in the Bank's 15-year history. New commitments in 1975 were three times the 1968 level. While this is impressive, it is important to remember that the level of new loan commitments is not in itself an adequate measure of the Bank's performance. The key measure of a development bank's success is the extent of development that actually takes place as a result of its efforts.

We believe that the Bank should devote more attention to the implementation aspects of its lending operations. Both management and the Board of Directors should concentrate on improving the quality of loans, improving estimates and control of project costs, and increasing supervision of projects underway. The timelag between approval of loans and their implementation could be reduced if the Board of Directors were to insist that projects be sufficiently well prepared before they are brought forward for approval. The Board should also consider canceling balances in old loans which have not been properly used in order to free up scarce resources.

While more attention to improve procedures and administration is important, we do not believe that more decentralization of the Bank's functions is the answer. Management controls and clear procedures have to be worked out by the management and the Executive Directors. Many important policies, including those detailing procurement, need continuous review, as Minister Beteta properly pointed out yesterday. As we undertake such a review, we should bear in mind that foreign exchange disbursements should be generally for procurement outside the borrowing countries. I also urge the Bank to pursue ex post project evaluation studies to determine where improvement in project implementation can be made.

We continue to believe that the limited resources of the FSO should be reserved for countries that have a genuine pressing need for concessional assistance and have demonstrated by their own self-help efforts that such assistance is justified. It is a sign of basic economic strength that some member countries agreed to discontinue borrowing convertible currencies from the FSO. We applaud their intention to make a portion of their new contributions to the FSO in convertible currencies.

While these are important steps in the right direction, more can be done to concentrate the Bank's concessional resources where they are most needed over the next few years. We believe that the middle-income countries should increasingly switch their borrowing to Ordinary Capital and the Venezuelan trust fund. In addition, more Ordinary Capital loans should be made to the poorest countries for income-generating projects. The use of FSO convertible currencies to meet local costs financing needs in the wealthier countries decline as their ability to mobilize internal resources increases. These measures will free the scarce concessional convertible currencies for the use of the poorest members of the Bank. We strongly support the Bank's efforts to expand its lending for agriculture and commend the Bank for directing the largest share of its 1975 lending to the agricultural sector. It is most gratifying to note that the International Group on Agricultural Development in Latin America, established at the initiative of the Bank, concluded its first formal meeting here in

Cancun this past weekend. We look forward to a very useful role for this group in coordinating efforts to increase agricultural productivity and improve nutrition in the region.

While increased production should remain the chief objective of agricultural loans, we believe the Bank should place special emphasis on projects containing benefits which will be widely shared among rural populations. We are pleased that the Bank has increased its lending to agricultural cooperatives. In addition, the Bank has made significant advances in financing projects for potable water supply, rural electricity, education, and health, of which pre- and post-natal maternal care are key elements. We urge the Bank to continue its efforts in these areas. It is these rural development projects and loans to cooperatives and rural credit unions which tend to have the greatest direct benefit to the quality of life of lower income groups.

The Bank's loan commitments financed by borrowing backed by its capital have increased sharply in recent years and further increases are projected for the replenishment period. These commitments will result in a rise in the annual level of disbursement and borrowing. Thus it is more important now than ever before to assure the Bank's creditworthiness in international capital markets is enhanced. Accordingly, consideration should be given to structuring the Bank's lending rate so that it moves automatically with the cost of capital to the Bank and with a sufficient spread above the borrowing costs to cover administrative and liquidity costs. This would have the added benefit of removing the setting of the Bank's interest rate from the political arena and of providing substantial profits to add to reserves as the Bank grows. Assured income and increasing reserves will make it possible for the Bank to sell its bonds at the most favorable rate and thereby itself lend at the lowest cost to developing countries.

Although we are focusing in this meeting on intergovernmental relations and affairs of an official lending institution, we should not lose sight of the overwhelming importance of the private sector to Latin American development. Most Latin American countries have a dynamic private sector. We believe that market forces are instrumental in effectively allocating resources and producing a climate which favors individual initiative. A healthy private sector is the most effective means of allocating resources, speeding economic development, and distributing the fruits of economic growth among all the people. The International Finance Corporation (IFC), which supports private sector activities in developing countries, lends more in Latin America than any other region. Earlier this month the IFC's Board of Directors approved a major capital increase for the organization. The United States strongly supports this increase because we believe that the IFC is making a notable contribution to the pace of development. For the same reason we believe that the IDB should increase its support to the private sector, through greater lending to productive enterprise outside the public sphere and to domestic development finance companies, which both raise additional domestic capital and relend to local industry, commerce, and agribusiness. The Bank should also support the growth of savings and loan institutions which can be effective in increasing the mobilization of domestic savings.

While we believe the Bank should support the private sector through its lending operations, we do not think it appropriate for the Bank, as a development lending institution, to use a significant part of its new resources to finance exports. Export financing should be left to the marketplace and to private businessmen and bankers.

The private sector is the most important source of external capital for Latin America. Approximately three-fourths of net capital flows to Latin America came from private souces last year. We applaud the Bank for its initiative in launching a complementary financing program to channel resources from private investors and banks to its development projects.

We are all New World countries settled and developed by colonists and refugees, from across the Atlantic and Pacific Oceans, both adventuresome and idealistic. In July the United States will celebrate the 200th anniversary of the declaration of our independence. Since our shores were first settled we've experienced a major socioeconomic transformation from a pioneer society to an industrial nation. We recognize in the development goals of our Latin American neighbors the same historical imperative which directed our own development. We share your hope for a better life for all your people and we pledge to continue to assist the economic development of this region.

Exhibit 72.—Joint statement of Secretary Simon and Secretary of State Kissinger, June 1, 1976, on UNCTAD IV at Nairobi, Kenya

The United States went to UNCTAD IV at Nairobi in a serious and cooperative spirit. In preparation for the Conference, we conducted a thorough review of U.S. international economic policies in which all agencies of the Government participated. There was agreement on a series of proposals of special relevance to the developing countries, which we presented at UNCTAD. We were represented by the most senior delegation in the history of UNCTAD meetings, and, for the first time, the U.S. position was set forth in an opening statement by the Secretary of State. In that statement, the United States put forward its proposals to deal with the problems of the developing world, including proposals directly related to commodities, and at the same time indicated that there were certain proposals that we could not accept. Throughout the 4-week meeting, the United States cooperated with other nations and important progress was made on a number of matters before the Conference.

In our review of international commodity policies in preparation for the UNCTAD meeting, and otherwise, we have tried to find ways of meeting the concerns of the developing countries, within the framework of an efficient international market system. As we have made clear at the U.N. Conference, we are prepared to participate in a case-by-case examination of arrangements to improve the functioning of the international commodity markets through a broad range of measures appropriate to specific commodities, but we have opposed mechanisms to fix prices or limit production by intergovernmental action.

One of the most significant of the U.S. proposals addressed the problem of increasing investment in mineral development. For that reason, the United States, in an effort to meet the interests of the developing countries and the world economy at large, proposed an International Resources Bank to facilitate the continued flow of essential capital, management, and technology for the development of new resources in the less developed countries (LDC's).

As the Conference progressed, a senior interagency group in Washington reviewed all proposals before the Conference with a view to accepting as many as possible of the suggestions being made by the LDC's and other countries consistent with our basic principles.

At the final plenary session an LDC resolution on commodities was adopted by consensus. The interagency group authorized reservations about parts of this resolution, which were read at the Conference. Nevertheless, we joined the consensus because we wanted to contribute to the spirit of harmony in the closing sessions of the Conference and because the resolution contained a number of elements of our own comprehensive approach which had been agreed within the Government and advanced by Secretary Kissinger in his address to the Conference 3 weeks earlier. As our reservations indicated, we did not believe that all aspects of the LDC proposals were practical and feasible. However, we committed ourselves to the search for concrete, practical solutions to commodity problems that will be in the interests of both producers and consumers.

It is all the more regrettable, therefore, that the resolution proposing further study of the International Resources Bank was defeated by 2 votes with 31 votes in favor. Ninety countries at the last minute abstained or absented themselves.

A substantial number of the 33 votes against were the Socialist countries, whose contribution to the development of the poorer countries of the world is negligible.

Forty-four countries cooperated in this effort by abstaining on the International Resources Bank and 46 absented themselves—almost all of which were the developing countries. This does not augur well for the future of the dialog of the worldwide development effort. The United States, whose role is so vital, does not expect when it makes major efforts to cooperate that its proposals will be subject to accidental majorities.

If the dialog between the developing and developed countries, to which we attach great importance, is to succeed, suggestions put forward by the developed nations, such as the IRB at UNCTAD, must be treated on the merits and with serious consideration. The LDC's must not lend themselves to parliamentary manipulation by those states who contribute nothing to the development of the poor nations of the world.

We will be addressing the problems of resource development financing again in later meetings, including the preparatory conferences contemplated by the commodities resolution of UNCTAD IV. We will advance the IRB proposal again, and we expect that it will be considered with the same respect and care which the United States will lend to the study of the proposals which the LDC's will table.

The United States went to Nairobi with a wide range of other proposals aimed at dealing constructively and pragmatically with the urgent problems of the developing world. We are gratified that the Conference embraced a number of these suggestions, dealing with resource and technology transfer and trade expansion. We will continue to elaborate these proposals—as well as the proposal for the Resources Bank—in appropriate fora, because they are right for the profound problems we are addressing.

The reservations and explanations of the U.S. delegation, made at the final plenary meeting of the Conference with respect to the resolution on commodities, is quoted below:

> With regard to section IV of this resolution, our understanding of the request to the Secretary-General to convene preparatory meetings is that the purpose of such meetings is to determine the nature of the problems affecting particular commodities and to

determine, without commitment, the measures which might be appropriate to each product. Such meetings will show us the cases where we could enter into negotiation of agreements or other arrangements which could encompass a broad range of measures to improve trade in commodites.

It is our further understanding that the Secretary-General in convening preparatory meetings will utilize existing commodity bodies. Where there are no such bodies, ad hoc groups will be convened. We interpret this section to mean that preparatory meetings will be convened on individual products and that the preparatory meetings are consultations prior to a decision whether to enter negotiations.

A decision on a financial relationship among buffer stocks will need to be considered in the light of developments on individual funds. However, since there may be advantages in linking the financial resources of individual buffer stocks, we will participate without any commitment in preparatory meetings to examine whether further arrangements for financing of buffer stocks including common funding are desirable. After these preparatory discussions we will decide on participation in any negotiating conference.

We have accepted this resolution on the understanding that its various positions, including those on commodity arrangements and compensatory financing, do not alter our reservations on the concept of indexation.

We should just add two final points. First, we are not indicating in this or other resolutions of this conference any change in our known views on the new international economic order and its basic documents.

Second, we would emphasize the difficulties related to the concept that production of synthetics and substitutes should be harmonized with supplies of natural resources.

We regret that this resolution, which is supposed to deal with commodity problems in an overall sense, does not address the problem of supporting development of resources in developing countries. Failure to adopt the proposed resolutions regarding the International Resources Bank represents a similar lack of attention to this task. We accept this resolution with these reservations and explanations.

Exhibit 73.—Statement by Secretary Simon, June 9, 1976, before the House Committee on International Relations, presenting the views of the administration on H.R. 11463, the proposed amendment to the Export Administration Act that deals with foreign boycotts of countries friendly to the United States

Mr. Chairman, I am pleased to have the opportunity to present the views of the administration on H.R. 11463, proposed amendment to the Export Administration Act that deals with foreign boycotts of countries friendly to the United States, specifically the Arab boycott of Israel. I would also like to take this opportunity to review with you our concerns over other legislative proposals now pending before the Congress.

Mr. Chairman, let me begin by stating unequivocally the administration's opposition to the boycott. We share the concerns underlying H.R. 11463 (the Koch bill) and other proposed legislation. We believe, however, that the approach reflected in these proposals would be counterproductive to the resolution of the boycott problem. In my presentation, I would like to provide you with the administration's reasons for believing that present U.S. legislation and regulations provide a forceful and balanced approach which best serves U.S. interests by meeting the challenge posed by the Arab boycott, while at the same time enabling us to progress toward a Middle East peace settlement.

In so doing, I am aware that some people believe our approach to the problem of the Arab boycott has not been forceful enough and that our belief in the need for measured restraint has not been based on the weight of evidence. In this regard, we clearly have a disagreement; for I believe that we have taken extensive steps in the past year to address the Arab boycott issue and that additional legislation now would be counterproductive to our shared desire to end the boycott.

In this regard, I believe it is important to understand that the policy that underlies the Arab boycott arose out of the state of belligerency that exists between Israel and the Arab nations. According to its governing principles, the Arab boycott of Israel is not based on discrimination against U.S. firms or citizens on ethnic or religious grounds. The primary boycott, which dates from 1946, involves the Arab countries' refusal to do business with Israel. It was designed to prevent entry of certain products into Arab countries from territory now part of Israel. The secondary boycott, introduced in 1951, operates to prevent firms anywhere in the world from doing business in Arab countries or from entering into business undertakings with Arab firms if they have especially close economic ties with Israel, or if they contribute to the Israeli defense capability. It was designed to inhibit third parties from assisting in Israel's economic and military development. Both aspects of the boycott are considered by the Arab League States to be legitimate acts of economic warfare.

U.S. action to deal with discrimination and the Arab boycott

At the outset I would like to review some of the major steps that have been taken to deal both with respect to the boycott and with respect to discrimination.

In February 1975, President Ford issued a clear statement that the United States will not tolerate discriminatory acts based on race, religion, or national origin.

The President followed this in November 1975 with an announcement of a series of specific measures on discrimination:

- He directed the heads of all departments and agencies to forbid any Federal agency in making selections for overseas assignments to take into account exclusionary policies of foreign governments based on race, religion, or national origin.
- He instructed the Secretary of Labor to require Federal contractors and subcontractors not to discriminate in hiring or assignments because of any exclusionary policies of a foreign country and to inform the Department of State of any visa rejections based on such exclusionary policies.
- He instructed the Secretary of Commerce to issue regulations under the Export Administration Act to prohibit U.S. exporters and related service organizations from answering or complying in any way with boycott requests that would cause discrimination against U.S. citizens or firms on the basis of race, color, religion, sex, or national origin.
- Also, in January 1976, the administration submitted legislation to prohibit a business enterprise from using economic means to coerce any person or entity to discriminate against any U.S. person or entity on the basis of race, color, religion, sex, age, or national origin.
- In March 1976, the President signed into law the Equal Credit Opportunity Act, which amended the Consumer Credit Protection Act making it unlawful for any creditor to discriminate against any applicant with respect to a credit transaction on the basis of race, color, religion, national origin, sex, marital status, or age.
- The Comptroller of the Currency, the Securities and Exchange Commission, and the Federal Home Loan Bank Board have all issued statements to the institutions under their jurisdiction against discriminatory practices.

In recent months, the administration has also taken the following actions to make clear that it does not support boycotts of friendly countries.

1. In November 1975, the President instructed the Commerce Department to require U.S. firms to indicate whether or not they supply information on their dealings with Israel to Arab countries.
2. In December 1975, the Commerce Department announced that it would refuse to accept or circulate documents or information on trade opportunities obtained from materials known to contain boycott conditions.
3. The State Department instructed all Foreign Service posts not to forward any documents or information on trade opportunities obtained from documents or other materials which were known to contain such boycott provisions.
4. In December 1975 and January 1976, the Federal Reserve Board issued circulars to member banks warning them against discriminatory practices and reiterating the Board's opposition to adherence to the Arab boycott.
5. In January 1976, the Justice Department instituted the first civil action against a major U.S. firm for violation of antitrust laws arising out of boycott restrictions by Arab countries. The Justice Department has a continuing investigation in this area.

This record indicates clearly that the administration has not ignored the problem of the Arab boycott, but has taken vigorous action to address the issue. But equally important we have done so in a manner that would not be injurious to our broad, fundamental interests in the Middle East, or counterproductive to our objective of bringing about the liberalization and ultimate termination of Arab boycott practices.

Despite our efforts there has been considerable pressure on the administration to mount a confrontational attack on the Arab boycott. Each step we have taken has immediately been met with demands for additional action.

We have strongly opposed such confrontation and intend to continue to do so because we are convinced that such a course would fail to achieve its stated objectives. The ultimate effect of such an approach is to tell Arab nations that either they must eliminate the Arab boycott entirely, irrespective of a settlement in the Middle East, or cease doing business with American firms. We have seen no evidence that such a policy would result in elimination of the boycott. In fact we believe that the effect of such pressure would harden Arab attitudes and potentially destroy the progress we have already made.

The argument is made that the Arab world when faced with such a choice will recognize the importance of continued access to U.S. goods and services and therefore eliminate what they consider one of their principal weapons in the political struggle against the State of Israel. Unfortunately, this argument fails to reflect several basic facts.

The United States alone among industrial countries has a clearly established policy and program of opposition to foreign boycotts of friendly countries, including the boycott of Israel. Other countries already supply a full 80 percent of the goods and services imported by the Arab world. There is no evidence that these nations are prepared to lose that $50 billion-a-year market or to jeopardize their stake in the rapidly expanding economies of the Arab nations. Further, there is precious little that the United States presently supplies to Arab nations that is not available from sources in other countries and they are eager to take our place. The major Arab States have the funds and the will to incur any costs such a switch might entail. They see that the United States has frequently engaged in economic boycotts for political purposes, for example, in Cuba, Rhodesia, North Korea, and Vietnam, so they cannot accept the argument that they are not entitled to do the same.

Mr. Chairman, I believe that we must face an essential and widely recognized fact. The Arab boycott has its roots in the broad Israel-Arab conflict and will best be resolved by dealing with the underlying conditions of that conflict.

Problems with a legislative approach

For these and other reasons which I will mention, it is the position of the administration that no additional legislation is necessary or desirable at this time and that in fact new legislation would be detrimental to the totality of U.S. interests both here and in the Middle East.

Present U.S. policy and antiboycott measures already are quite effective. Further, a number of Arab governments are now negotiating or considering contracts with U.S. firms notwithstanding the public commitment of these firms to maintain investment, licensing, or other special economic relationships with Israel. Other U.S. firms are making some progress in working boycott clauses out of the various stages of their transactions, for example, contracts, letters of credit, and shipping instructions. Although the pattern is not uniform as to company, transaction, or country, this reflects a gradual easing of enforcement practices over the past 6 months.

A number of firms do business with both Israel and the Arab countries. Recently, a prominent U.S. business leader informed me that he had successfully concluded a commercial contract with an Arab country even though he maintains extensive ties with Israel. The Arab countries, in fact, are considering the adoption of a standard policy of exempting from the boycott list any firms which make as significant a contribution to them as to Israel.

New legislation at this time could alter these favorable developments regarding enforcement practices. As you know, boycott rules are not uniformly enforced throughout the Arab world. Each country has the right to maintain its own national boycott legislation and has exercised this right. Some countries have chosen not to follow stringent boycott practices. Other countries are continuously reviewing their policies to ensure that any actions they take with respect to the boycott do not conflict with their own national interests. I am concerned that new legislation could raise the issue to a higher political and emotional plane and thereby become a major negative factor as these countries assess the advantages and disadvantages of applying a boycott as they review individual trade and investment proposals by U.S. firms.

Finally, legislation, as evidenced by the several bills now pending, tends to involve an all-or-nothing approach, and fails to take into account the fact that a broad range of measures to deal with specific aspects of the boycott have already been adopted during the last year and a half.

Opposition to specific legislation before the Congress

Mr. Chairman, I would like to turn to the specific legislation that is now before the Congress. I would like to discuss first the antiboycott amendments contained in the Koch bill (H.R. 11463).

The provisions of these bills would: (1) mandate disclosure of required reports by U.S. firms to the Commerce Department of their responses to boycott-related requests; (2) prohibit U.S. firms from furnishing, pursuant to a boycott request, any information regarding the race, religion, sex, or national origin of their or other firms' directors, officers, employees, or shareholders; and (3) prohibit a refusal by a U.S. firm to deal with other U.S. firms pursuant to foreign boycott requirements or requests.

The administration is concerned about each of these provisions.

With respect to disclosure of reports of U.S. firms, by publicizing information about their compliance with boycott requests, the disclosure provision will also make available information concerning noncompliance. This disclosure would give boycott officials an enforcement tool and make it more difficult for Arab business partners to tolerate de facto noncompliance by U.S. businesses.

In addition, although a firm might disclose that it has indicated to Arab governments, for example, that it does not ship on Israeli vessels, or have other specified business dealings with Israel, such a disclosure would not and could not provide evidence as to whether this was the result of Arab pressures or an autonomous, voluntary business decision. Firms wishing to avoid the risk of adverse domestic reaction to their disclosure might then decide it necessary to cease doing business in the Arab world, even though they would continue to have no business dealings with Israel.

With respect to the provision of these bills barring the furnishing of information on race, religion, sex, or national origin, sought for boycott purposes, we believe that adequate and effective measures have been taken by the President and the respective agencies which make such a provision unnecessary.

With respect to the prohibition of refusal to deal among U.S. firms pursuant to foreign boycott requirements or requests, U.S. antitrust laws already prohibit agreements or conspiracies to engage in anticompetitive, boycott activities and the Justice Department has one suit pending in this area. It is not clear whether the refusal-to-deal provision in H.R. 11463 is intended to go beyond existing antitrust laws. If the bill is intended to cover cases where a firm unilaterally—without any agreement—chose not to do business with another firm, it could, in our view, place the Government and the courts in a very difficult situation of assessing the motives behind the choice of one's business associates or his other business decisions.

Even if the provisions could be altered to make them enforceable, other serious problems would remain. U.S. firms might well be able to meet the new legal requirements by sales and shipments via parties in third countries and thus avoid, for example, having to refuse use of ships or insurance companies which are on boycott lists. The provisions could also have the unintended and undesirable effect of encouraging some firms to make general use of nonboycotted suppliers in their worldwide trade. The reason for this would be a fear that if they used boycotted firms except for projects in boycotting countries, it might be considered prima facie evidence of refusal to deal. Finally, responsible enforcement would require extensive staffing and funding resources going well beyond the requirements for enforcement of existing Export Administration Act provisions directly related to national security interests.

Other legislative proposals

While the Stevenson-Williams and Koch bills do not prohibit the provision of information to Arab governments by U.S. firms on their business dealings with Israel, H.R. 4967, the Bingham bill, does impose this requirement. The administration continues to oppose this bill both because it is inequitable and could well be self-defeating. We do not believe that Arab governments will abandon their policy of not dealing with firms which may be assisting Israel in a significant economic and/or military way simply because of a requirement that prohibits such firms from indicating either the existence or the extent of their relationship with Israel. There are a variety of other sources which Arab governments could use to attempt to develop such information. Many of these sources would probably be unreliable and could thus erroneously place U.S. firms on the Arab boycott list. Moreover, even firms which for reasons that have nothing to do with the boycott have no business or commercial connections with Israel would be prohibited from acknowledging this fact.

Former Under Secretary of Commerce James Baker outlined in great detail the administration's opposition to this bill before your Subcommittee on International Trade and Commerce on December 11, 1975, and I want to reiterate the administration's continued opposition to this bill.

Mr. Chairman, we must proceed in this entire area with great caution not only because existing legislative proposals place us in a confrontational stance with the Arab nations but also because in at least some instances, they could seriously distort major economic forces in this country and around the world. Proposals such as the Ribicoff bill (S. 3138) would go so far as to alter a number of major tax provisions. This bill would restrict use of the foreign tax credit, the DISC (domestic international sales corporation) provisions, and the earned income exclusion of the Internal Revenue Code and tax on a current basis the earnings of foreign subsidiaries of taxpayers who participate in the Arab boycott. Such changes in our tax laws would significantly impact U.S. companies, employees, and investors alike, while imposing new and onerous burdens on the Revenue Service that would impair its capacity to fulfill its basic function as a collector of tax revenue by creating an administrative nightmare.

Complicated and delicate questions of foreign policy are not susceptible to rigid solutions which are prescribed through the Internal Revenue Code. Such actions are contrary to the resolution of the boycott problem, contrary to the efficient administration of the fair laws, and contrary to sound principles of tax policy. For these reasons, Assistant Secretary Walker of the Treasury Department in a letter to Chairman Long of the Senate Finance Committee expounded at some length on the serious problems we have with this type of legislative approach. I would like to include a copy of that letter for the record.[1]

Constructive approach to the boycott question

Mr. Chairman, we are determined to solve this difficult and complex problem. Any approach inherently involves a certain degree of subjective judgment. We believe that peace in the Middle East is the only ultimate answer. In the administration's view, heavyhanded measures which could result in direct confrontation with the Arab world will not work. A far more constructive approach, we believe, is to work through our growing economic and political relations with the Arab States as well as our close relations with Israel and the broad range of contacts which the executive branch and the regulatory agencies maintain with the U.S. business community to achieve progress on the boycott issue.

As administration witnesses have indicated in testimony during the past year, all of the agencies concerned with the boycott and discrimination issues have kept these important questions under continuing review and are prepared to take whatever steps they consider necessary to deal with those problems.

Many of the administration's actions have dealt with discrimination which, as the President said in a statement early last year, is totally contrary to the American tradition and repugnant to American principles. We have wanted to leave no misunderstanding here and abroad of our determination to eliminate discrimination on racial, religious, and other grounds. At the same time, we have taken a number of steps as I have outlined to lessen the impact of boycott practices on American firms. In our contacts with the U.S. business community, we have also found that a number of firms are working on their own to eliminate boycott conditions from their commercial transactions or have announced that they will not comply with boycott requirements.

We consider these to be healthy signs from our business community, and, in my view, we should encourage this kind of movement rather than rush into coercive legislation that would be disruptive and damaging to the business community, cause widespread uncertainty in our commercial relations with the Middle East, and have the other adverse effects I have described.

In addition to these developments, our approaches to the Arab governments have brought a greater awareness of the economic cost to them of the boycott and a better understanding of the obstacle it imposes in the path of better relations with the United States.

I and my colleagues have had a number of conversations with the leaders of Arab governments including Saudi Arabia, Kuwait, Egypt, and Syria to make very clear to them our opposition to the boycott and all discriminatory practices. We have also emphasized that the boycott is a significant impediment to greater U.S. private sector participation in the economic development of these countries. From my own conversations and reports that have come to my attention, I believe that Arab governments are beginning to recognize that this issue is prejudicial to their own economic interests.

The meeting of the United States-Saudi Arabian Joint Commission on Economic Cooperation last February provided an occasion for further discussion of these issues. I was able to make representations at the highest levels of the Saudi Arabian Government on the question of discrimination against Americans on racial, religious, and other grounds, and the joint communique issued on February 29 contains a public affirmation by the Saudi Arabian Government disavowing such discrimination. In fact, many Arab leaders have stated to us that it is against Islamic tenets to engage in such discrimination.

At the same time, Mr. Chairman, I would like to make clear that our opposition to legislation or other confrontation in dealing with the boycott problem in no way suggests a diminution of our concern for Israel's welfare and our desire to help overcome obstacles to more rapid economic development and prosperity in that country. We remain committed to a free and independent State of Israel. As you know, we have been, and will continue to be, generous in our aid to Israel. In addition, we have taken significant steps to assist Israel's economy in other ways. As Cochairman of the United States-Israel Joint Committee for Investment and Trade, I have met on numerous occasions with Israel's economic leadership and have worked out practical means to meet Israeli needs and to cooperate on a wide range of economic and commercial matters.

The Joint Committee has also been instrumental in helping organize the Israel-United States Business Council, which is now holding its inaugural joint session in Israel. We look to the Council to help develop closer relations between the two business communities and to make practical contributions to expansion of direct trade and investment ties. The activities of the Joint Committee and the Business Council are constructive efforts in our continued support of Israel and are part of our broader bilateral economic program to help deal with all of the economic problems of the Middle East.

[1] Not included in this exhibit.

In conclusion, Mr. Chairman, I would note that we have had talks with Arab and Israeli leaders and with leaders of the American Jewish community on boycott issues and on ways to eliminate racial, religious, and other discrimination. We have made the point that our basic goal must be to encourage progress toward peace. It is our considered judgment that confrontational policies will not work to remove the boycott and could undermine the delicate search for peace in that troubled region of the world. The administration sought and continues to seek effective ways to eliminate this divisive policy and simultaneously achieve a just and lasting peace in the Middle East.

I can assure the committee that we will continue these efforts as well as our strong policy of combating any form of racial, religious, and other discrimination against and among Americans. The Congress and the administration share the goals of a just Middle East peace and an end to boycotts and discriminatory practices. I hope we can agree that the legislative proposals now before the Congress are not the best measures to achieve these goals.

Exhibit 74.—Press release, June 17, 1976, announcing meeting between Secretary Simon and Argentine Minister of Economy Martinez de Hoz, for discussion of the new Argentine economic program

Secretary of the Treasury William E. Simon and Argentine Minister of Economy Martinez de Hoz met at the Treasury Department on June 16 for a wide-ranging discussion of the new economic program adopted by the Government of Argentina. They discussed relations between Argentina and U.S. financial institutions. They emphasized the contribution that foreign investment could make to Argentina's economic growth and discussed the policies in both countries that would enhance the climate for such investment. The Minister was accompanied by the president of Argentina's central bank, Adolfo Cesar Diz, Ambassador-Designate to the United States, Arnaldo Tomas Musich, and other senior Argentine officials. Assistant Secretary Gerald L. Parsky and Deputy Assistant Secretary John A. Bushnell also participated for the United States. Minister Martinez de Hoz was also the guest of honor at a luncheon hosted today by Assistant Secretary Parsky at the Treasury Department.

In the meeting with Secretary Simon, Minister Martinez de Hoz reviewed the program Argentina has adopted to restore equilibrium to the Argentine economy, to bring about a major improvement in Argentina's external payments position, and to reduce inflation. He indicated that the program incorporated a broad range of economic policies including measures to increase agricultural production, improve tax collection, establish a realistic exchange rate, reduce excessive liquidity and attract foreign investment. The Minister informed Secretary Simon that the actions the Government instituted beginning in March 1976 have already begun to take effect. He noted that so far this year Argentina's gross foreign exchange reserves have nearly doubled to $1.2 billion. The Minister also noted the rate of inflation which had reached a peak of 38 percent a month in March 1976 and has dropped sharply to 13 percent a month in May. Minister Martinez de Hoz indicated that major progress had also been made in reducing the budget deficit which prior to the stabilization program was equal to 13 percent of Argentina's gross domestic product.

Minister Martinez de Hoz informed Secretary Simon that missions from the IMF and the World Bank have been in Argentina assessing the economic situation and that he was looking forward to meeting with IMF officials in Washington later this week to discuss arrangements with the IMF in support of Argentina's economic program.

Secretary Simon welcomed the major efforts that Minister Martinez de Hoz and the Argentine Government have taken to stabilize and strengthen Argentina's economy. He indicated that this bold program merited support. Although such a major restructuring of an economy takes time, the recent data demonstrate that the program is working. The Secretary and the Minister agreed that their officials will remain in close contact both in Washington and in Buenos Aires to follow the progress under Argentina's stabilization efforts.

TESTIMONY ON INTERNATIONAL MATTERS

Exhibit 75.—Other Treasury testimony in hearings before congressional committees

Secretary Simon

Statement published in hearings before the Committee on Finance, U.S. Senate, 94th Congress, first session, on a comprehensive national energy conservation and conversion program, July 14, 1975, pp. 363–75.

Statement published in hearings before the Subcommittee on International Trade, Investment and Monetary Policy of the Committee on Banking, Currency and Housing, House of Representatives, and the Subcommittee on International Economics, Joint Economic Committee, 94th Congress, first session, on the status of international monetary negotiations and the experience with floating exchange rates, July 21, 1975, pp. 140–94.

Statement published in hearings before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, first session, on proposed replenishment and expansion of membership of the Inter-American Development Bank, July 29, 1975, pp. 9–17.

Statement published in hearings before the Subcommittee on International Finance of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 94th Congress, first session, on S. 1262, a bill to amend sections 208–210 of the International Economic Policy Act of 1972, July 18, 1975, pp. 51–60.

Statement published in hearing before the Committee on Foreign Relations, U.S. Senate, 94th Congress, first session, on U.S. participation in the Financial Support Fund of the Organization for Economic Cooperation and Development, July 30, 1975, pp. 3–11.

Statement published in hearing before the Subcommittee on International Trade, Investment and Monetary Policy of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, first session, on U.S. participation in the Financial Support Fund of the Organization for Economic Cooperation and Development, September 18, 1975, pp. 14–25.

Statement before the Committee on Foreign Relations, U.S. Senate, on international economic policy, October 22, 1975.

Statement published in hearings before the Committee on Foreign Relations, U.S. Senate, 94th Congress, first session, on U.S. participation in the Financial Support Fund of the Organization for Economic Cooperation and Development, March 26, 1976, pp. 119–23.

Statement published in hearings before the Senate Committee on Banking, Housing and Urban Affairs, 94th Congress, 2d session, on questionable foreign payments abroad by U.S. corporations, April 8, 1976, pp. 84–96.

Statement published in hearings before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 94th Congress, 2d session, on U.S. participation in the Financial Support Fund of the Organization for Economic Cooperation and Development, June 4, 1976, pp. 8–12.

Deputy Secretary Dixon

Statement published in hearings before the Subcommittee on Financial Institutions, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 94th Congress, 2d session, on the proposed International Banking Act of 1976 (H.R. 13876), August 31, 1976, pp. 1–3.

Under Secretary for Monetary Affairs Yeo

Statement published in hearing before the Task Force on Tax Expenditures and Off-Budget Agencies of the Committee on the Budget, House of Representatives, 94th Congress, second session, on the Exchange Stabilization Fund, February 18, 1976, pp. 33–7.

Statement published in hearings before the Committee on Foreign Relations, U.S. Senate, 94th Congress, second session, on IMF amendment and quota increase, June 22, 1976, pp. 12–23.

Statement published in hearings before the Subcommittee on International Finance, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 94th Congress, 2d session, on amendment of the IMF Articles of Agreement and increase in IMF quota, August 27, 1976, pp. 131–39.

Assistant Secretary Cooper

Statement published in hearing before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, first session, on U.S. participation in multilateral development lending institutions, July 8, 1975, pp. 97–106.

Statement published in hearing before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, first session, on proposed U.S. contribution to the African Development Fund, July 15, 1975, pp. 74–88.

Assistant Secretary Parsky

Statement published in hearings before the Subcommittee on International Finance of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 94th Congress, first session, on the administration's policy with respect to foreign investment in the United States and the Arab boycott, July 22, 1975, pp. 79–103.

Statement published in a hearing before the Subcommittee on International Trade, Investment and Monetary Policy of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, first session, on U.S. policy with respect to foreign investment and Treasury's role in foreign investments in the United States, September 24, 1975, pp. 161–75.

Statement published in hearings before the Subcommittee on Foreign Commerce and Tourism of the Committee on Commerce, U.S. Senate, 94th Congress, second session, on the International Investment Survey Act of 1975, February 23, 1976, pp. 21–30.

Statement published in hearings before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 94th Congress, second session, on the President's proposal for an Energy Independence Authority, April 14, 1976, pp. 335–40.

Statement before the Foreign Relations Committee, U.S. Senate, on increased participation by the United States in the Asian Development Fund, April 27, 1976. (See Senate Report 94–773.)

Statement before the Subcommittee on International Trade of the Committee on Finance, U.S. Senate, on the United States-Romania Trade Agreement, September 8, 1976.

Statement before the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce, on questionable payments abroad by U.S. corporations, September 21, 1976.

Acting Assistant Secretary Bushnell

Statement published in hearing before the Subcommittee on Foreign Assistance of the Committee on Foreign Relations, U.S. Senate, 94th Congress, first session, on proposed replenishment and expansion of membership of the Inter-American Development Bank and U.S. membership in the African Development Fund, January 28, 1976, pp. 18–37.

Statement published in hearings before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, second session, on increased participation by the United States in the Asian Development Fund, May 12, 1976, pp. 5–17.

Deputy Assistant Secretary Bushnell

Statement published in hearing before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, first session, on proposed replenishment and expansion of membership of the Inter-American Development Bank, and lending to the Caribbean Development Bank, July 29, 1975, pp. 75–95.

Statement published in hearings before the Subcommittee on Foreign Operations and Related Agencies of the Committee on Appropriations, House of Representatives, 94th Congress, second session, on contributions to the international development banks, March 16, 1976, pp. 163–79.

Statement published in hearings before the Subcommittee on Oilseeds and Rice and Subcommittee on Cotton of the Committee on Agriculture, House of Representatives, 94th Congress, second session, on international bank lending for palm-oil projects, March 18, 1976, pp. 29–37.

Deputy Assistant Secretary Niehuss

Statement published in hearings before the Subcommittee on Economic Stabilization of the Committee on Banking, Currency and Housing, House of Representatives, 94th Congress, second session, on financial incentives for synthetic fuels, May 26, 1976, pp. 184–6.

Organization and Procedure

Exhibit 76.—Treasury Department orders relating to organization and procedure

NO. 240, SEPTEMBER 27, 1975.—LIAISON BETWEEN SUBORDINATE ORGANIZATIONAL UNITS OF THE TREASURY AND THE CENTRAL INTELLIGENCE AGENCY

In order to assure proper coordination of arrangements for all Treasury support of the CIA and for any CIA activity in support of one or more operating units of the Treasury Department, I have directed the Special Assistant to the Secretary (National Security) to review in my behalf all such agreements and arrangements now in effect and all proposals for new arrangements, to consult with the General Counsel concerning them, and to report all such arrangements to me on a continuing basis.

Any agreement between Treasury agencies and the CIA dealing with arrangements of a continuing nature shall be reduced to writing, reviewed by the General Counsel and submitted for my review and approval before being adopted.

In each instance in which either the CIA or a Treasury agency wishes to request the other to provide support and there is no current written agreement which is applicable, the request shall be transmitted between the agencies through the Special Assistant to the Secretary (National Security) who shall consult with the General Counsel.

This directive shall apply to similar arrangements for support or assistance with all other intelligence agencies of the Federal Government except the Federal Bureau of Investigation. Coordination of such arrangements with the FBI shall, in the case of the Internal Revenue Service, be the responsibility of the Commissioner of Internal Revenue, and in the case of all other Treasury units, the responsibility of the Assistant Secretary (Enforcement, Operations, and Tariff Affairs) in consultation with the General Counsel.

All arrangements proposed pursuant to this directive shall be submitted to me for my personal review and approval. This directive is intended to assure proper coordination and legal review of all such agreements and arrangements but shall not affect in any way the normal reporting relationships and operational responsibilities of Treasury officials. This directive does not apply to the routine exchange between the intelligence community and Treasury of substantive intelligence information and reports on a continuing basis.

I have sent a copy of this order to the Director of the CIA with the request that he establish appropriate procedures within his agency to assure that this order is observed.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 234-3, OCTOBER 7, 1975.—DIRECTIVE TO SELL GOLD

By virtue of the authority vested in me as Secretary of the Treasury by Section 9 of the Gold Reserve Act of 1934 (31 U.S.C. 733) and Reorganization Plan No. 26 of 1950, I hereby authorize and direct the Under Secretary for Monetary Affairs to take all necessary and proper measures, including direction of other officials of the Department, for the sale of approximately 14,100 fine troy ounces of gold from the United States' gold stocks to the American Revolution Bicentennial Administration from October 1975 through July 1976. Any actions heretofore taken by the Under Secretary for Monetary Affairs in connection with such sales are hereby ratified and confirmed as the actions of the Secretary.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 241, FEBRUARY 1, 1976.—TRANSFER OF FUNCTIONS TO THE OFFICE OF THE ASSISTANT SECRETARY FOR TRADE, ENERGY, AND FINANCIAL RESOURCES POLICY COORDINATION: REDESIGNATION OF OFFICE

By authority vested in me as Secretary of the Treasury, including the authority of Reorganization Plan No. 26 of 1950, it is hereby ordered that:

1. All programs, functions, personnel, records, personal property, and funds, heretofore assigned to the Office of the Assistant Secretary for International Affairs are transferred to the supervision and control of the Assistant Secretary for Trade, Energy, and Financial Resources Policy Coordination.
2. The Assistant Secretary and the Office of Trade, Energy, and Financial Resources Policy Coordination are hereby redesignated the Assistant Secretary and the Office of the Assistant Secretary for International Affairs, respectively.
3. The Assistant Secretary for International Affairs is hereby delegated all the responsibilities and is authorized to perform all the duties previously performed by the Assistant Secretary for Trade, Energy, and Financial Resources Policy Coordination and the Assistant Secretary for International Affairs, pursuant to:
   Treasury Department Order No. 202 (Revision 1), March 26, 1973
   Treasury Department Order No. 232, June 23, 1974
   Treasury Department Order No. 237, April 7, 1975
   However, each of these Orders is modified to the extent inconsistent herewith.
4. The organizations and all internal rules, regulations, and instructions adopted for the administration of the Offices of the Assistant Secretary for International Affairs and the Assistant Secretary for Trade, Energy, and Financial Resources Policy

Coordination, which are in effect on the date of this Order, shall continue in effect until superseded or revised.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 221-3 (REVISION 1), FEBRUARY 21, 1976.—TRANSFER OF FUNCTIONS TO THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

By virtue of the authority vested in me as Secretary of the Treasury, including the authority in Reorganization Plan No. 26 of 1950, it is ordered that:

1. There is hereby transferred, as specified herein, the functions, powers and duties of the Commissioner of Internal Revenue arising under laws relating to wagering to the Director of the Bureau of Alcohol, Tobacco and Firearms (hereinafter referred to as the Director).
2. The Director shall perform the functions, exercise the powers, and carry out the duties of the Secretary under Subtitle F of the Internal Revenue Code of 1954, insofar as the provisions of Subtitle F relate to forfeitures and criminal violations of the provisions of Chapter 35- Taxes on Wagering and Chapter 40- General Provisions Relating to Occupational Taxes. Regulations for the purpose of carrying out the functions, powers and duties specified in this paragraph may be issued by the Director with the approval of the Secretary.
3. All regulations prescribed, all rules and instructions issued, and all forms adopted for carrying out the functions, powers and duties specified in paragraph 2 hereof, which are in effect or in use on the effective date of this Order, shall continue in effect as regulations, rules, instructions and forms of the Bureau until superseded or revised.
4. All activities relating to the discovery of civil liability, determination, assessment, collection, processing, depositing, or accounting for taxes (including penalties and interest), under Chapter 35- Taxes on Wagering shall continue to be performed by the Commissioner of Internal Revenue. The Commissioner may call upon the Director for assistance when it is necessary to exercise any of the enforcement authority described in section 7608 of the Internal Revenue Code.
5. (a) The term "Commissioner of Internal Revenue" wherever used in regulations, rules, instructions and forms, issued or adopted for carrying out the functions, powers and duties specified in paragraph 2 hereof, which are in effect or in use on the effective date of this Order, shall be held to mean the Director.

   (b) The terms "internal revenue officer" and "officer, employee or agent of the internal revenue" wherever used in such regulations, rules, instructions and forms, in any law specified in paragraph 2 above, and in 18 U.S.C § 1114, shall include all officers and employees of the United States engaged in the administration and enforcement of the laws administered by the Bureau, who are appointed or employed by, or pursuant to the authority of, or who are subject to the directions, instructions or orders of, the Secretary.
6. To the extent that any action taken by the Commissioner of Internal Revenue or his delegates or the Director of the Bureau or his delegates under Treasury Department Order 221–3, prior to the effective date of this Order, may require ratification, such action is hereby affirmed and ratified.
7. Each wagering tax case and investigation open or otherwise in process as of the date of this Order shall be pursued to conclusion by the agency processing the same on such date. The Commissioner shall be responsible for issuing rulings and regulations with respect to the administration of the wagering tax laws other than those described in paragraph 2.
8. This Order is effective immediately. Any prior orders or instructions in conflict with the provisions of this Order are hereby amended accordingly.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 242, MARCH 27, 1976.—ESTABLISHMENT OF THE OFFICE OF ASSISTANT SECRETARY (CAPITAL MARKETS AND DEBT MANAGEMENT)

By virtue of the authority vested in me as Secretary of the Treasury, including the authority of Reorganization Plan No. 26 of 1950, it is ordered that:

1. The position of Assistant Secretary (Capital Markets and Debt Management) is hereby established, the incumbent of which shall report to the Secretary through the Under Secretary for Monetary Affairs. Such Assistant Secretary shall serve as principal advisor to the Secretary, Deputy Secretary, and Under Secretary for Monetary Affairs on debt management, federal financing affairs, the financing of non-federal sectors of the economy, and general capital markets policy, and shall exercise policy direction and control over:
   - Treasury operations related to, and the relationship between Treasury and, the Federal Financing Bank;
   - Treasury staff work on the substance of proposed legislation relating to the regulation of, and the lending, investment, and deposit powers of, private financial institutions as well as the operations of other private financial intermediaries;
   - development of legislative and administrative principles and standards for federal credit programs, working closely with federal credit agencies in the design of new credit programs and legislations;
   - determination of interest rates for various federal borrowing, lending, and investment purposes under pertinent statutes;
   - determination of interest rates for the sale of special Treasury issues to foreign central banks; and
   - Treasury operations under the New York City Seasonal Financing Act of 1975 (P.L. 94–143).
2. The Deputy Assistant Secretary (Financial Resources Policy), his immediate office, and his subordinate Office of Capital Markets Policy with assigned positions, personnel, records, and property are transferred from the supervision of the Assistant Secretary (International Affairs) to the supervision of the Assistant Secretary (Capital Markets and Debt Management) and retitled Office of the Deputy Assistant Secretary (Capital Markets Policy). The Office of Financial Resources Policy and its employees remains with the Assistant Secretary (International Affairs).
3. The Office of the Deputy Assistant Secretary (Debt Financing) is hereby created. Supervision of the Office of Debt Analysis, and the functions, personnel, records, and property relating to the operations of the Federal Financing Bank, are transferred from the Special Assistant to the Secretary (Debt Management) to the Office of the Deputy Assistant Secretary (Debt Financing).
4. The Special Assistant to the Secretary (Debt Management) is hereby placed under the supervision of the Assistant Secretary (Capital Markets and Debt Management).
5. The Deputy to the Assistant Secretary for New York City Finances is hereby created to discharge the Secretary's responsibilities under the New York City Seasonal Financing Act of 1975 (P.L. 94–143).
6. The Senior Advisor to the Assistant Secretary for Debt Research is hereby created to conduct long-range research on the economic and financial impact of federal debt operations.

This order amends Treasury Department Order No. 241 (dated February 1, 1976) and supersedes Treasury Department Order No. 170–12 (dated January 15, 1972). Treasury Department Order No. 190–3 (dated January 3, 1975) is hereby rescinded.

WILLIAM E. SIMON,
Secretary of the Treasury.

No. 243, AUGUST 27, 1976.—DELEGATION OF AUTHORITY UNDER TITLE II OF THE PUBLIC WORKS EMPLOYMENT ACT OF 1976

Pursuant to the authority vested in me as Secretary of the Treasury by Reorganization Plan No. 26 of 1950, there is hereby delegated to the Director of the Office of Revenue Sharing in the Office of the Secretary the authority to perform the functions, exercise the powers and carry out the duties vested in the Secretary of the Treasury by the Public Works Employment Act of 1976, Title II, Public Law 94–369. The Director shall perform those functions, powers and duties under the direct supervision of the Under Secretary of the Treasury. The Director may issue regulations for the purposes of carrying out the above functions, powers and duties under the Director's own name and title with the approval of the Under Secretary.

EDWIN H. YEO III,
Acting Secretary of the Treasury.

No. 190 (Revision 12), September 14, 1976.—Supervision of Bureaus and Offices, Delegation of Authority, and Order of Succession in the Treasury Department

1. The following officials shall be under the direct supervision of the Secretary:
   - The Deputy Secretary
   - Adviser to the Secretary
   - The Executive Assistant to the Secretary
   - Staff Assistants to the Secretary

2. The following officials shall be under the supervision of the Secretary, and shall report to him through the Deputy Secretary:
   - Under Secretary for Monetary Affairs
   - Under Secretary
   - General Counsel
   - Assistant Secretary (Tax Policy)
   - Commissioner, Internal Revenue Service
   - Comptroller of the Currency

3. The following officials shall be under the supervision of the Under Secretary for Monetary Affairs, and shall exercise supervision over those organizational entities indicated thereunder:
   - Assistant Secretary (International Affairs)
     - Deputy Assistant Secretary for Trade and Raw Materials Policy
     - Deputy Assistant Secretary for Energy and Investment Policy
     - Deputy Assistant Secretary for International Monetary Affairs
     - Deputy Assistant Secretary for Developing Nations
     - Deputy Assistant Secretary for Research and Planning
     - Deputy to the Assistant Secretary for Saudi Arabian Affairs
     - Inspector General for International Finance
   - Assistant Secretary (Capital Markets and Debt Management)
     - Deputy Assistant Secretary for Capital Markets Policy
     - Deputy Assistant Secretary for Debt Financing
     - Senior Adviser (Debt Research)[1]
     - Special Assistant to the Secretary (Debt Management)
     - Deputy to the Assistant Secretary for New York Finances
   - Assistant Secretary (Economic Policy)
     - Office of Financial Analysis
   - Fiscal Assistant Secretary
     - Bureau of Government Financial Operations
     - Bureau of the Public Debt
   - Treasurer of the United States
   - Special Assistant to the Secretary (National Security)
   - U.S. Savings Bond Division

4. The following officials shall be under the supervision of the Under Secretary, and shall exercise supervision over those organizational entities indicated thereunder:
   - Assistant Secretary (Administration)
     - Office of Administrative Programs
     - Office of Audit
     - Office of Budget and Program Analysis
     - Office of Computer Science
     - Office of Equal Opportunity Program
     - Office of Management and Organization
     - Office of Personnel
   - Assistant Secretary (Legislative Affairs)
   - Assistant Secretary (Enforcement, Operations, and Tariff Affairs)
     - Office of Law Enforcement
     - Office of Operations
     - Office of Tariff Affairs
     - Office of Foreign Assets Control
     - Bureau of Alcohol, Tobacco and Firearms
     - U.S. Customs Service
     - Bureau of Engraving and Printing
     - Bureau of the Mint
     - U.S. Secret Service
     - Federal Law Enforcement Training Center
   - Special Assistant to the Secretary (Public Affairs)
   - Office of Revenue Sharing

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[1]The insertion of this line was the only change from Revision 11, dated May 5, 1976. That revision, therefore, is not included in this exhibit.

5. The following officials shall exercise supervision over those organizational entities indicated thereunder:

General Counsel
- Legal Division
- Office of Director of Practice

Assistant Secretary (Tax Policy)
- Office of Tax Analysis
- Office of Tax Legislative Counsel (also part of Legal Division)
- Office of International Tax Counsel (also part of Legal Division)
- Office of Industrial Economics

Commissioner, Internal Revenue Service
- Assistant Commissioner (Accounts, Collection, and Taxpayer Service)
- Assistant Commissioner (Administration)
- Assistant Commissioner (Compliance)
- Assistant Commissioner (Employee Plans and Exempt Organizations)
- Assistant Commissioner (Inspection)
- Assistant Commissioner (Planning and Research)
- Assistant Commissioner (Technical)

Comptroller of the Currency
- First Deputy Comptrollers
- Deputy Comptrollers

6. The Deputy Secretary, the Under Secretary for Monetary Affairs, the Under Secretary, the General Counsel, and the Assistant Secretaries are authorized to perform any functions the Secretary is authorized to perform. Each of these officials shall perform functions under this authority in his own capacity and under his own title and shall be responsible for referring to the Secretary any matter on which actions should appropriately be taken by the Secretary. Each of these officials will ordinarily perform under this authority only functions which arise out of, relate to, or concern the activities or functions of or the laws administered by or relating to the bureaus, offices, or other organizational units over which he has supervision. Any action heretofore taken by any of these officials in his own capacity and under his own title is hereby affirmed and ratified as the action of the Secretary.

7. The following officers shall, in the order of succession indicated, act as Secretary of the Treasury in case of the death, resignation, absence, or sickness of the Secretary and other officers succeeding him, until a successor is appointed, or until the absence or sickness shall cease:

A. Deputy Secretary
B. Under Secretary for Monetary Affairs
C. Under Secretary
D. General Counsel
E. Commissioner of Internal Revenue
F. Assistant Secretaries, or Deputy Under Secretaries, appointed by the President with Senate confirmation, in the order in which they took the oath of office as Assistant Secretary, or Deputy Under Secretary.

8. Treasury Department Order No. 190 (Revision 11) is rescinded, effective this date.

WILLIAM E. SIMON,
Secretary of the Treasury.

STATISTICAL APPENDIX

TABLES

The statistical tables to this Annual Report will be published in the separate Statistical Appendix.

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