ANNUAL REPORT

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

FISCAL YEAR 1977

DEPARTMENT OF THE TREASURY

DOCUMENT NO. 3273

Secretary

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STOCK 048-000-00309-05

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THE SECRETARY OF THE TREASURY
WASHINGTON

January 3, 1978

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 fiscal year ended September 30, 1977. This submission is in accordance with 31 U.S.C. 1027.

Sincerely yours,

W Michael Blumenthal

W. Michael Blumenthal

President of the Senate

Speaker of the House of Representatives

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International Monetary Affairs

Developing Nations

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

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

Secretary, Deputy Secretaries, Under Secretaries, General Counsel, Assistant Secretaries, and Treasurer of the United States serving in the Department of the Treasury from January 21, 1977, through September 30, 1977[1]

Term of service		
From	To	Officials
		Secretary of the Treasury:
Jan. 23, 1977	....	W. Michael Blumenthal, Michigan.
		Deputy Secretaries:
Mar. 3, 1976	Jan. 23, 1977	George H. Dixon, Minnesota.
May 3, 1977	....	Robert Carswell, New York.
		Under Secretary for Monetary Affairs:
Mar. 30, 1977	....	Anthony M. Solomon, Virginia.
		Under Secretary (Counselor):
Mar. 30, 1977	....	Bette B. Anderson, Georgia.
		General Counsel:
Aug. 4, 1977	....	Robert H. Mundheim, Pennsylvania.
		Assistant Secretaries:
Apr. 11, 1972	Apr. 28, 1977	Warren F. Brecht, Connecticut.
Feb. 28, 1977	....	Laurence N. Woodworth, Maryland.
Mar. 30, 1977	....	Gene E. Godley, District of Columbia.[2]
Mar. 31, 1977	....	C. Fred Bergsten, New York.[2]
Apr. 29, 1977	....	Roger C. Altman, New York.
Apr. 29, 1977	....	William J. Beckham, Jr., Michigan.
Apr. 29, 1977	....	Joseph Laitin, Maryland.
May 16, 1977	....	Daniel H. Brill, Maryland.
		Fiscal Assistant Secretary:
July 29, 1975	....	David Mosso, Virginia.
		Treasurer of the United States:
Aug. 3, 1977	....	Azie T. Morton, Virginia.

[1] For officials from Sept. 11, 1789, to Jan. 20, 1977, see exhibit 62.
[2] Act of May 18, 1972, provided for two Deputy Under Secretaries, to be designated Assistant Secretaries by the President as desired.

PRINCIPAL ADMINISTRATIVE AND STAFF OFFICERS OF THE DEPARTMENT OF THE TREASURY AS OF SEPTEMBER 30, 1977

Secretary of the Treasury	W. Michael Blumenthal
Deputy Secretary of the Treasury	Robert Carswell
Under Secretary for Monetary Affairs	Anthony M. Solomon
Under Secretary	Bette B. Anderson
General Counsel	Robert H. Mundheim
Office, Secretary of the Treasury:	
Executive Assistant to the Secretary	Curtis A. Hessler
Confidential Assistant to the Secretary	Lisa Astudillo
Office, Deputy Secretary of the Treasury:	
Executive Assistant to the Deputy Secretary	David W. Heleniak
Executive Secretary	Peter S. Bridges
Deputy Executive Secretary	Ann M. Morgan (acting)
Special Assistant to the Secretary (National Security)	J. Foster Collins
Office, Under Secretary for Monetary Affairs:	
Assistant Secretary (International Affairs)	C. Fred Bergsten
Deputy Assistant Secretary for Trade and Investment Policy	Gary C. Hufbauer
Deputy Assistant Secretary for Commodities and Natural Resources	Helen B. Junz
Deputy Assistant Secretary for International Monetary Affairs	F. Lisle Widman
Deputy Assistant Secretary for Developing Nations	Arnold Nachmanoff
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
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
Office, Under Secretary:	
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Deputy Assistant Secretary (Administration)	Patricia M. Harvey
Director, Office of Administrative Programs	Robert R. Fredlund
Director, Office of Audit	Wilbur R. DeZerne
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Director, Office of Equal Opportunity Program	David A. Sawyer
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Director, Office of Personnel	Morris A. Simms

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Director, Interpol (National Central Bureau)	Louis B. Sims
Deputy Assistant Secretary (Operations)	(Vacancy)
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Director, Foreign Assets Control	Stanley L. Sommerfield (acting)
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Assistant to the Treasurer of the United States	(Vacancy)
Office, General Counsel:	
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Assistant General Counsel and Chief Counsel, Internal Revenue Service	Stuart E. Seigel
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
Deputy to the General Counsel for Tariff Affairs	Peter D. Ehrenhaft
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Deputy Assistant Secretary (Tax Policy)	Donald C. Lubick
Deputy Assistant Secretary (Tax Policy) (Tax Analysis)	Emil M. Sunley
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Tax Legislative Counsel	Daniel I. Halperin
International Tax Counsel	Charles I. Kingson
Director, Office of Industrial Economics	Karl Ruhe
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Deputy Assistant Secretary (Legislative Affairs)	Colbert I. King
Special Assistant to Assistant Secretary	B. Alexander Kress
Special Assistant to Assistant Secretary	Lawrence F. O'Brien III
Special Assistant to Assistant Secretary	Leslie J. Barr
Assistant Secretary (Economic Policy)	Daniel H. Brill
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Director, Office of Financial Analysis	John H. Auten
Deputy Assistant Secretary for International Economic Analysis	Roger E. Shields
Assistant Secretary (Domestic Finance)	Roger C. Altman
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Director, Office of Capital Markets Legislation	Basil N. Petrou
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Senior Adviser (Debt Research)	Edward P. Snyder
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Director, Office of Market Analysis and Agency Finance	Roland H. Cook
Director, Office of Revenue Sharing	Bernadine N. Denning
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Deputy Assistant Secretary	Everard Munsey

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Assistant Director (Criminal Enforcement)	Marvin O. Shaw (acting)
Assistant Director (Inspection)	Jarvis L. Brewer
Assistant Director (Regulatory Enforcement)	Stephen E. Higgins
Assistant Director (Technical and Scientific Services)	William H. Richardson (acting)
Chief Counsel	Marvin J. Dessler

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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 for Administration	C. Westbrook Murphy
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)	Richard D. Chotard
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Associate Deputy Comptroller (Bank Organization and Structure)	Gail W. Pohn
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Special Assistant to the Comptroller (Congressional Affairs)	Donald A. Melbye
Special Assistant to the Comptroller	Robert A. Baer
Special Assistant to the Comptroller for FDIC Affairs	Joseph M. Ream
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Director, Communications	Caryl Austrian

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Assistant Director (Operations)	Everett J. Prescott
Assistant Director (Research and Engineering)	(Vacancy)

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Associate Director for Administration	David W. McKinley

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Assistant Director (Police Training Division)	Alvin C. Turner
Assistant Director (Special Training Division)	Robert T. Lacey
Assistant Director (Washington Liaison Office)	John C. Dooher

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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

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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	Stuart E. Seigel

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Deputy Director	Frank H. MacDonald
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Assistant Director for Management Planning	(Vacancy)
Assistant Director for Marketing and Statistical Services	Francis B. Frere
Assistant Director for Production	George G. Ambrose
Assistant Director for Technology	Alan J. Goldman

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

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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, Office of Security and Audit	William A. Magee, Jr.
Assistant Commissioner (Enforcement Support)	Alfred R. DeAngelus
Chief Counsel	(Vacancy)

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

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Deputy Director	Lilburn E. Boggs
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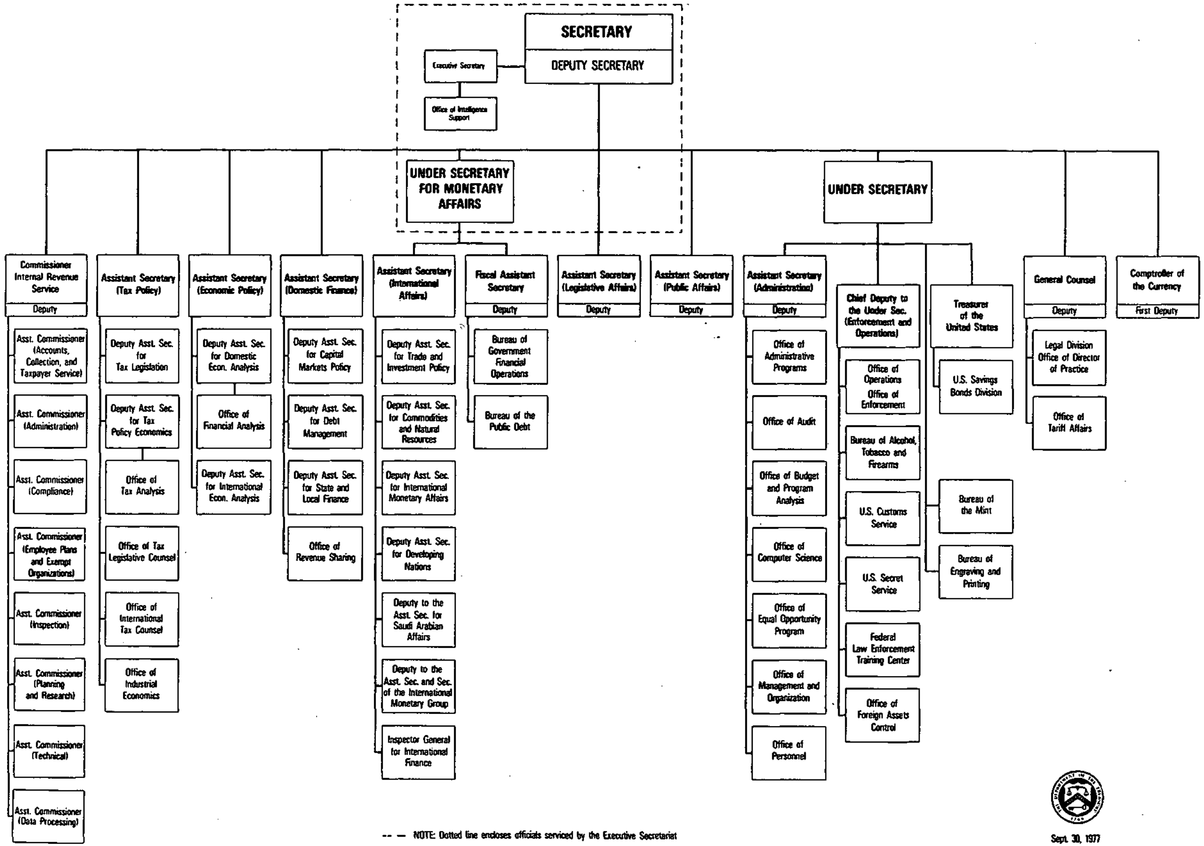
Assistant Director (Investigations)	Burrill A. Peterson
Assistant Director (Protective Forces)	Thomas J. Kelley
Assistant Director (Inspection)	Myron I. Weinstein
Assistant Director (Administration)	Francis A. Long

ORGANIZATION OF THE DEPARTMENT OF THE TREASURY



-- — NOTE: Dotted line encloses officials serviced by the Executive Secretariat

Sept. 30, 1977

INTRODUCTION

This introduction reviews major domestic and international developments which affected areas of Treasury interest and responsibility during fiscal 1977. Detailed information on the operating and administrative activities of the Department is provided in the text of the report and supporting exhibits. Statistical information may be found in the separate Statistical Appendix.

DOMESTIC DEVELOPMENTS

Domestic Economic Recovery

The domestic economic situation continued to improve in fiscal 1977, but the pace was uneven during the year as a minor inventory adjustment ran its course. Real economic growth, which was at a 3.9-percent annual rate of increase during the transition quarter (the third quarter of calendar 1976), slowed to only 1.2 percent during the final quarter of calendar 1976, when growth in GNP was held down by a substantial fall in the rate of inventory accumulation. During the early part of calendar 1977, real growth was checked temporarily by severe winter weather but rebounded vigorously when the weather warmed up. As a result, real GNP rose at nearly a 7-percent annual rate during the first half of calendar 1977. By the third quarter of the calendar year—2 1/2 years after the recovery began—growth eased back to just over 5 percent, still somewhat above the longrun rate of growth in potential output. By the end of the fiscal year, the economy had grown by 15.2 percent from the recession low, and 5.0 percentage points, or about one-third of that growth had occurred during the fiscal year under review.

Employment registered strong gains during the year in conjunction with unusually large increases in the labor force. Total employment increased by 3.3 million persons (3.8 percent) from September to September, somewhat more than the increase of 2.6 million persons (2.8 percent) in the labor force. As a result, the unemployment rate dropped from the 7.8-percent level prevailing at the beginning of the period to 6.9 percent. Most of the improvement in the unemployment rate occurred over a relatively short interval. The rate dropped five-tenths of a percentage point from 7.8 percent in December to 7.3 percent in January and continued to fall to 7 percent by April. After April the rate seesawed back and forth between 7.1 percent and 6.9 percent, indicating a temporary plateau had been reached at a still unacceptably high rate of unemployment.

The improvements in the unemployment picture did not affect all labor force groups equally, however. Because the labor force growth for adult males was generally more modest than that of adult women or teenagers, this group enjoyed the largest improvement in the unemployment rate—a decline from 6.1

percent in September 1976 to 4.9 percent in September 1977. Adult women, whose increased labor force participation accounted for about two-thirds of the total labor force growth over the period, experienced only half as much decline in the unemployment rate, from 7.6 percent to 7 percent. The situation for teenage workers was still less favorable. For this group, the growth in the labor force and employment were approximately equal, with the number of unemployed teenagers remaining virtually unchanged at around 1,670,000 persons and with little improvement in the unemployment rate which fell from 18.8 percent to 18.1 percent. The structural character of the unemployment problem thus became clearer during fiscal 1977, and by the end of the period new policy initiatives dealing with the unemployment of youth were being investigated.

Personal consumption was a major source of economic strength early in the recovery and it continued to be one in fiscal 1977 though some weakness was becoming evident toward the end of the period. After a relatively lackluster performance in the third quarter of calendar 1976, retail sales increased strongly as the holiday season approached, and that strength continued throughout the first quarter of 1977, except for the decline due to the cold weather during January. In mid-1977, the pace of personal consumption again turned weak, and the quarter-to-quarter rates of increase were disappointingly small in the second and third calendar quarters of 1977, although some strength was evident in the monthly data in the third quarter.

Investment continued to play a pivotal role in economic developments during fiscal 1977 and occupies a critical position with respect to the outlook for 1978. Nonresidential fixed investment began the year on a rather poor note, increasing at only a 1.8-percent annual rate as a consequence of weakness in investment spending for both structures and equipment. In the second quarter, however, settlement of a major strike in the motor vehicle industry boosted total spending on equipment by near-record rates. In the subsequent quarters, investment for structures began to exhibit some strength, though the final quarter of the fiscal year once again saw diminishing performances for both categories of nonresidential investment. Residential investment, on the other hand, grew at a rapid 49-percent annual rate in the first quarter, followed by a much smaller gain in the next quarter due to the cold weather, and another gain in excess of a 40-percent annual rate in the third quarter. Having thus reached a high plateau, activity in the final quarter edged off slightly for this sector.

The major developments in business inventories over the course of the fiscal year consisted primarily of a significant inventory retrenchment at the beginning and much smaller adjustments during the final quarters. Overall, relatively tight inventory control appeared to be the order of the day. The events of 1976 and 1977 suggest that businesses are no longer inclined to accumulate inventory stocks significantly in excess of sales growth, and whenever they find this happening, adjustments—occasionally involving production cutbacks—almost surely follow.

On balance, the economic expansion proceeded at a fairly satisfactory pace during fiscal 1977 though the rate of progress was not smooth. For the year as a whole, growth amounted to 5.0 percent in real terms with the individual quarterly rates varying from 1.2 percent to 7.5 percent. The easing which became evident as the year wore on was a function of decreasing gains in personal consumption as well as the absence of further large jumps in inventory accumulation.

Inflation

Substantial progress was made in controlling inflation early in the economic recovery, but in the course of fiscal 1977 very little further moderation was achieved. At the beginning of the period, consumer prices were increasing at an annual rate of about 4 1/2 percent—a rate not greatly different from that which prevailed by the final quarter. In between, however, the pace was driven to almost double the beginning and ending rates of advance as a consequence of sharply higher prices for food and, to a lesser extent, for energy and services. Wholesale prices showed a roughly similar pattern during the period except that absolute declines in food prices during the summer led to small absolute decreases in the total index and generally moderate rates of advance as the year came to a close. For the Wholesale Price Index, as was the case with the Consumer Price Index, the volatility of food prices played a major role in quarter-to-quarter variations.

Early in the fiscal year, food prices jumped as a consequence of the exceedingly cold and dry weather in Florida and California, respectively, and concern about the lack of snow cover over much of the Great Plains. When the effects of these special influences proved to be less severe than expected and favorable harvests became assured, equally strong declines in food prices occurred which served to dampen the pace of the major price indexes.

The recent behavior and outlook for industrial prices is not as favorable, but even here there are few signs that a major resurgence of inflation is imminent. The pace of industrial price increases accelerated somewhat at the very end of the fiscal year, but substantial improvements in the price behavior of crude materials suggest the deterioration may well prove to be transitory.

Productivity growth in the private business sector slowed slightly to a 2.3-percent rate of increase during the fiscal year. Within the year, the quarterly pattern was erratic. Compensation per man-hour continued to increase at relatively rapid rates and rose 8.7 percent during the fiscal year. The net result was that unit labor costs continued to rise fairly strongly, with the increase for the fiscal year slightly in excess of 6 percent, as had been the case in the previous year.

Thus, inflation continues to be a major problem. Further moderation is proving progressively more difficult to achieve, yet the current rates remain far too high and cannot be tolerated indefinitely without running the risk of progressively more serious distortions. Such distortions—in consumption, saving, and investment patterns—would eventually pose a significant threat to the current economic expansion and the longer term stability of the U.S. economy.

The Budget and Fiscal Developments

The budget estimates for fiscal 1977 presented in January 1977 by the outgoing administration called for outlays of $411.2 billion and revenues of $354 billion, leaving a deficit of $57.2 billion. In the early months of the new administration (i.e., during the second quarter of fiscal 1977) budget revisions were submitted to Congress which would have increased outlays to $417.4 billion and reduced revenues to $349.4 billion. As a result, the deficit for the year would have been increased by approximately $10.8 billion, to $68 billion. Before congressional action on the revisions took place, however, the emergence of greater than expected economic strength led to the administration's cancellation of its proposal for a tax rebate, the major item in the 1977 revisions.

Actual outlays totaled $401.9 billion and receipts amounted to $356.9 billion, for a deficit of $45 billion. The major reason for the difference between the expected and realized budgetary outlays was the continued occurrence in fiscal 1977 of outlay underruns. The underruns had first attained noticeable dimensions during fiscal 1976 and the transition quarter, and at that time it was expected that once the fiscal year had been shifted to its new terminal date the phenomenon would largely disappear. The underruns continued throughout fiscal 1977, however, and no single cause could be identified.

Off-budget net outlays for fiscal 1977 were also somewhat lower than had been anticipated. In the revised budget such outlays were expected to amount to $10.8 billion and the midsession review issued on July 1 had lowered that estimate to $10.3 billion. Off-budget net outlays actually amounted to $8.7 billion for the year.

Domestic Finances

The financing of the record volume of funds raised in the financial markets in fiscal 1977 was facilitated by substantial inflows of funds to savings institutions and by a buildup of liquidity by other investors. Money market rates generally declined in the first half of the year and rose in the second as the Federal Reserve tightened credit policy in response to accelerating growth rates of the monetary aggregates. By late September 1977, short-term interest rates were around 6 3/8 percent, about 1 percentage point higher than 12 months earlier. In the bond markets, yields on Government and corporate issues remained remarkably stable through this period, but municipal bond yields fell by 1 percentage point. Even so, long-term interest rates were still high by historical standards.

The volume of financing was large in both the capital and money markets. Strong demands for long-term funds, particularly for mortgage loans and by State and local governments, were accompanied by greater demand for short-term business loans and consumer credit. Nonfinancial corporate businesses continued to restructure their balance sheets, and corporate liquidity stabilized in fiscal 1977. Bank loans to nonfinancial corporations climbed by an estimated $17 billion, and other kinds of short-term borrowings by nonfinancial corporations (namely, commercial paper and finance company loans to business) rose by another $12 billion. At the same time, net new issues of corporate and foreign bonds (including bonds issued by financial companies) amounted to about $34 billion, down from $36 billion the year before, and net new stock issues $10 billion, down from $12 billion.

During fiscal 1977, the rather strong demand by business for bank loans, coupled with rapid expansion in bank real estate and consumer loans, held down bank purchases of Treasury securities. Although total bank credit expanded at a rapid 11 percent during the year, net purchases of Treasury securities by commercial banks accounted for only 12 percent of the net volume of Treasury securities issued to the public.

Public debt securities held by investors other than U.S. Government accounts and Federal Reserve banks rose $46.4 billion in fiscal 1977. Foreign investors were the largest purchasers of Treasury securities followed by State and local governments. The combined net purchases of the two absorbed 77 percent of the net issues of Treasury securities to the public. Individuals increased their purchases of savings bonds but reduced their holdings of marketable securities, as did corporations.

A large segment of the Treasury's security offerings consisted of additional amounts of regular bills and notes with maturities up to 5 years. Also, the Treasury issued longer notes and bonds with a view toward lengthening the average maturity of the marketable debt. In fiscal 1977, notes and bonds increased by $41.3 billion, while Treasury bills decreased by $5.4 billion. Issues to State and local governments (for advance refunding) rose by $8.6 billion and savings bonds by $4.7 billion.

Despite the issuance of a record volume of municipal bonds in fiscal 1977, bond prices rose sharply. The Bond Buyer's index of yields on municipal bonds averaged 6.51 percent in September 1976, but dropped to 5.50 percent in September 1977, a low for the past 3 1/2 years.

Record inflows of funds were set in fiscal 1977 not only by savings institutions but also by credit unions, insurance companies, and private pension funds. In addition, nonfinancial businesses placed some of the proceeds of their security offerings and of their heavy internal flows into credit market instruments. Foreign investment in the U.S. credit markets rose by a record $28 billion.

Taxation Developments

Tax policy developments reflected the need for economic stimulus coupled with tax simplification and permanent tax reductions.

In February 1977, President Carter proposed a $26.4 billion tax package for fiscal 1977 and 1978 which included an $18.5 billion economic stimulus program and a $7.8 billion tax cut in fiscal 1978 through a permanent extension of the temporary tax cuts enacted in the 1976 Tax Reform Act.

The $18.5 billion tax cuts to stimulate the economy consisted of $15.4 billion of personal tax reductions, including $8.2 billion for a per capita tax rebate, and $3.1 billion of business tax cuts to encourage investment in productive facilities.

Taxes would have been reduced by $10.6 billion in fiscal 1977 and $7.9 billion in fiscal 1978 under this proposal.

Extension of the temporary tax cuts provided under the 1976 Tax Reform Act would have lowered individual taxes by $6.8 billion and corporate taxes by $1 billion in fiscal 1978.

Acting on the President's proposals, Congress passed and the President signed on May 23, 1977, a $20.4 billion tax reduction program for fiscal 1977 and 1978 in the Tax Reduction and Simplification Act of 1977. The permanent extension of the temporary tax cuts was enacted with some modification providing $7.9 billion of tax reduction, of which $6.9 billion went to individuals and $1 billion went to business. The basic tax reduction and simplification in the act (excluding the extension provisions) amounted to an aggregate $12.5 billion in fiscal 1977 and 1978, of which $10.5 billion went to individuals and $2 billion went to business.

The act omitted the per capita rebate proposal, which was withdrawn by the President in the light of the performance of the economy, accepted a slightly modified version of the President's standard deduction proposal, and added a new jobs credit. The net reduction in fiscal 1977 and 1978 receipts from all tax changes in the Tax Reduction and Simplification Act of 1977 is $2.6 billion and $17.8 billion, respectively.

The President proposed an energy program containing, in part, tax proposals which would first take effect in fiscal 1978. The objective of the energy program is to conserve energy use and to reduce the annual energy growth to less than 2 percent a year by 1985. At the close of the fiscal year, congressional consideration of alternative approaches was proceeding with the nature of the eventual legislative outcome in doubt.

The President took action to resolve both short- and long-term problems in the social security system. High unemployment in recent years curtailed revenues while benefits rose with inflation. Since 1975, outlays have exceeded income and existing reserves are being seriously depleted. In addition, the current system will have an estimated deficit of 8.2 percent of taxable payroll over the next 75 years. This is attributable in part to a projected higher proportion of elderly persons in the population as life expectancy increases and birth rates drop. It is also attributable in part to a technical flaw in the automatic cost-of-living formula applicable to benefits.

To bring financial stability back into the system, the President proposed that general revenues be used in countercyclical fashion to replace payroll tax receipts lost during recessions. He also proposed increased payroll tax revenues by removing in one action the taxable payroll ceiling for the employer tax and moderately increasing, in several changes by 1985, the ceiling for the employee tax. In addition, the tax rate for self-employed would be increased so that it equaled 1 1/2 times the rate for employees. The 75-year deficit would be reduced to a manageable 1.9 percent under the President's proposals. At the fiscal yearend, social security changes were under consideration by the Congress.

Work continued on the development of tax reform proposals. Final decisions had not been reached by the end of the fiscal year on the exact nature of the legislative package which the President would submit to the Congress.

INTERNATIONAL DEVELOPMENTS

The World Economy

During the past fiscal year, the pace of real growth in world economic output was somewhat slower than in the first year of cyclical recovery, 1975-76, and was stronger outside Western Europe than in that region. Most of the progress made in 1975-76 in restraining global inflation was retained, but the wide differences in national rates of inflation persisted. In many countries, inflation still continued at an unacceptably fast pace, unemployment remained appreciably higher than in the sixties, and global payments deficits continued to require financing on the much higher plateau that has prevailed since the abrupt increase in oil prices in 1973-74.

In May 1977, the Secretary participated in the summit meeting in London, where leaders of seven large industrial democracies committed themselves "to stated economic growth targets or to stabilization policies which, taken as a whole, should provide a basis for sustained non-inflationary growth, in our own countries and world-wide and for reduction of imbalances in international payments."

The seven major industrial economies experienced real growth rates of roughly 4 1/2 percent in the first half of calendar 1977, following 3.2 percent in the last half of 1976. This average rate is somewhat misleading as the economies of Japan and the United States—which account for about 60 percent of the group's GNP—expanded at 7.7 and 5.5 percent rates, respectively, while those of the other five averaged 2.3 percent. Again this year, as in 1976, the summer months produced a "pause" in the expansion. Real growth in the seven industrial countries as a group in calendar 1977 now seems likely to fall significantly short of the 5.2-percent rate posted in 1976.

The smaller industrialized countries, largely as a result of stabilization policies in some countries, are now expected to post gains averaging about 2 1/2 percent per annum in calendar 1977, down slightly from the corresponding rate of about 3 percent in 1976.

As for the oil-importing developing countries, real growth rates for the full year 1977 seem likely to average close to the 5-percent level estimated for 1976.

In 14 industrial countries, the average annual rise in consumer prices at the end of September 1977 was 7.8 percent (latest 12-month period), as compared with 7.3 percent at the end of September 1976. During the final quarter of the fiscal year, the rate of price increases in several countries was perceptibly slower than earlier in the year. At the end of September 1977, the possibility of future improvement depended particularly upon the course of basic commodity prices and future wage settlements.

Within the less developed countries (LDC's), consumer prices in the oil-exporting countries continued to rise at an average rate of about 15 percent per annum. Although some slowdown of extremely rapid price changes was achieved in a few oil-importing developing countries, the average rate of inflation in this large and diverse group of countries continued to hover around 30 percent a year, with a wide range from 9 percent in Asia to 50 percent in the Western Hemisphere.

In most industrial countries other than the United States, rates of unemployment were higher in mid-1977 than in 1976 or 1975, though in Germany and Japan they were about the same as in 1976, and in Switzerland remained very low.

Aggregate payments imbalances, as measured by current account deficits (goods and services, plus those official and private transfers of funds that are not considered capital transfers), appeared to be holding at about the 1976 level of $70 billion in dollar terms. Although they were somewhat reduced in real terms, these imbalances remained nearly twice as high, relative to the aggregate exports of the deficit countries, as in the years 1971-73.

Financing for about three-quarters of the total deficit of about $225 billion in 1974 through 1976 was provided by private market-oriented financing, something less than 20 percent by official development financing, and about 7 percent by the International Monetary Fund.

There were marked changes in the distribution of payments deficits and surpluses. During the first half of 1977, the current account position of the United States moved to a deficit at an annual rate of $17 1/2 billion, seasonally adjusted, as against $1.3 billion in the full calendar year 1976. By contrast, the Japanese and German current account surpluses together were running at an annual rate of $15 billion, up from about $7 billion for the full year 1976. The combined deficit of the United Kingdom, Italy, France, and Canada was down about $2 billion on the same comparison, at the annual rate of $13 1/2 billion. Thus the rest of the world had improved its aggregate position, at midyear, by something like an annual rate of $10 billion.

As of September, it was clear that severe and complex problems remained, but it was also evident that there were important signs of encouraging progress. Stabilization programs in Italy, the United Kingdom, France, Brazil, Mexico, and some other countries had helped to slow the pace of inflation, check the deterioration of payments positions, and restore financial confidence. There continued to be very wide differences, among both industrial and developing countries, in inflationary pressures and in payments positions. Nevertheless, foreign industrial countries, as a group, succeeded in arresting further deterioration and made some progress in coping with inflationary pressures and improving their payments positions. The payments position of non-OPEC developing countries as a group also appears to have strengthened during the fiscal year. During the period October 1976-March 1977, the rise in the dollar value of imports (c.i.f.) over the previous 6 months was only 75 percent of the growth in exports (f.o.b.) during the same period.

International Monetary Cooperation

At the annual meeting of the International Monetary Fund in October 1976, Ministers were concerned primarily with the persistence of high rates of inflation and high levels of unemployment. There was also a general consensus that, nearly 3 years after the abrupt increase in oil prices, it was time to place more emphasis on adjustment of payments imbalances, and thus slow down the rapid growth of debt by some deficit countries. To attack these problems simultaneously and symmetrically, the Interim Committee of IMF Governors agreed on a basic four-point strategy:

- Deficit countries should arrange their domestic policies so as to restrain domestic demand and to permit the shift of resources to the external sector, to the extent necessary to bring the deficit on current account in line with a sustainable flow of capital imports and aid.
- Industrial countries in strong payments positions should ensure continued adequate expansion in domestic demand, within the limits set by effective anti-inflationary policies.
- Exchange rates should be allowed to play their proper role in the adjustment process.
- In the context of the use of the Fund's resources, adjustment by deficit countries can be promoted by a larger use of the credit tranches and the Extended Fund Facility.

Late in 1976, the International Monetary Fund arranged to borrow about \$3.3 billion from a number of Group of Ten countries and Switzerland, including a commitment of \$1.1 billion from the U.S. Treasury, under the General Arrangements to Borrow. These funds were used to provide a standby commitment to the United Kingdom of about \$3.9 billion, associated with the adoption of a stabilization program. Additional support to the United Kingdom was provided in February 1977 by a number of monetary authorities under the aegis of the Bank for International Settlements, in an amount up to \$3 billion, related to potential drawdowns of official sterling balances. The U.S. commitment, provided by the Federal Reserve and the Exchange Stabilization Fund of the Treasury, amounted to \$1 billion, but had not been drawn upon as of September 30, 1977.

In April, supplementary financing (about \$390 million) was committed to the International Monetary Fund under the General Arrangements to Borrow to facilitate a standby arrangement for about \$520 million with the Italian Government, in connection with the Italian stabilization program.

At their meeting in April 1977, the Interim Committee of Fund Governors encouraged the Managing Director of the Fund to proceed with a plan for a Supplementary Financing Facility, designed to provide needed additional resources to the Fund, to help promote orderly adjustment and to provide confidence to private markets that adequate official financing was available. The Managing Director's negotiations resulted in an undertaking by seven industrial countries and seven oil-exporting countries to establish credit lines to the Fund, aggregating slightly over $10 billion. The U.S. share was $1.7 billion. Legislation to authorize U.S. participation was pending before the Congress as of September 30, 1977.

At their meeting in September 1977, the Interim Committee, concerned with the weakness of domestic demand in several foreign countries in relatively strong overall positions, urged such countries to make every effort to ensure adequate growth of domestic demand compatible with containing inflation. In this connection, they welcomed recent announcements of expansionary programs by Germany and Japan. The Committee also noted the importance of structural problems in these and other countries, and the need to develop appropriate energy policies. They expressed the belief that, as the results of adjustment actions became more evident, other countries would become strong enough to contribute to the growth of the world economy; but they also cautioned that policies should at a minimum be directed at avoiding a resurgence of inflation.

The second amendment to the Articles of Agreement of the International Monetary Fund, which would formally establish the reform of the Bretton Woods international monetary system, and the one-third increase in Fund quotas agreed last year have not yet become effective. As of September 30, 1977, the amendment had been accepted by 56 nations with 58.14 percent of the voting power. The amendment will become effective when three-fifths of the members (79 at present) having at least four-fifths of the voting power have formally accepted it. The increase in quotas enters into force when the amendment is effective and members with 75 percent of quotas have consented to their increased quotas. By the end of the fiscal year, members with 52.43 percent of quotas had given their consent. The United States accepted the amendment and the quota increase pursuant to Public Law 94-564, effective October 19, 1976.

In many foreign exchange markets, official intervention, official borrowing, and other actions by national authorities have exerted strong influence on dollar and other exchange rates. Nevertheless, the substantial number of exchange rate changes in the past 2 years in major countries attest to the fact that countries have become more flexible in their attitudes toward such rate movements. Currencies of countries in relatively strong payments positions have appreciated, while currencies of countries in relatively weak positions have depreciated by varying amounts. On a trade-weighted basis, against a basket of Organization for Economic Cooperation and Development (OECD) currencies, the U.S. dollar appreciated by about 2.4 percent during the year ending September 30, 1977. During this period, the Swiss franc, deutsche mark, yen, and pound sterling rose in terms of the U.S. dollar, while the values of the Canadian dollar, the Australian dollar, and the Italian lira fell.

The Treasury and the Federal Reserve continued to maintain very close contact with major foreign monetary authorities in order to discuss current market conditions and official exchange market operations. These consultations have been of great value in avoiding misunderstandings on policies and in ensuring that markets function effectively. From time to time there have been periods of nervous markets in some foreign currencies, often associated with market expectations as to possible changes in official policies and attitudes affecting exchange rates.

The U.S. exchange rate policy is based on the view that the value of the dollar in the exchange markets will tend to reflect the underlying performance of the domestic economy—success in dealing with inflation, ability to expand the economy and to maintain an open, efficient, and attractive capital market. The United States has intervened to counter disorderly conditions in the exchange market. This policy has not, however, merited regular or massive participation in the market.

Financial Relations with Non-OPEC Developing Countries

The aggregate current account deficit of this group of countries is estimated to have improved markedly in calendar 1976, falling from about $37 billion in 1975 to about $26 billion in 1976 (excluding official transfers). The net flow of official financing (including transfers) reached about $22 billion in 1976 and the private money and capital markets and direct investment provided something like $15 billion. As the combined flows exceeded the current account deficit, the international reserves of the group rose by 37 percent in 1976 (to $41 billion at yearend), and another 10 percent in the first half of 1977. In analyzing financial flows to these countries, it is useful to distinguish between those that obtain the bulk of their external capital from private capital markets and those that rely primarily on official flows. In 1974 and 1975, the privately financed group (Brazil, Mexico, Korea, etc.) experienced relatively larger increases in their current account deficits than the officially financed group (Bolivia, India, Zaire, etc.). In 1976 and 1977, the first group accounted for most of the reduction in the aggregate deficit of the nonoil LDC's. As for the officially financed group, their deficits are constrained by the amount of financing available, and in 1977 are on an increasing trend as official flows increase.

The improved payments position since 1975 has resulted from buoyant exports to the industrial countries at improved terms of trade, while imports grew more slowly. This change reflected the higher growth rates in the United States and some other countries, as well as some especially sharp price rises in coffee and cocoa. Moreover, in some major countries exchange rates were permitted to depreciate and domestic stabilization programs were undertaken to slow down the pace of inflation. In one case, that of Mexico, temporary financing was provided by the Treasury's Exchange Stabilization Fund, to meet short-term pressure on the peso during an interval preceding an arrangement with the International Monetary Fund to support the Mexican stabilization program. Thus domestic policy changes as well as external influences contributed to the improved payments position.

The rate of increase in debt of the non-OPEC LDC's has been slowing down, and the size of their aggregate external public debt, relative to their recurring external receipts and level of output, appears to be moving back toward historical levels. This change has been brought about mainly by a reduction of deficits in the dozen or so larger and more advanced countries that have relied primarily on borrowing from private money and capital markets. At the same time, average rates of real growth in the oil-importing developing countries recovered from about 3 percent a year in 1975 to about 5 percent in 1976, a rate likely to be sustained in 1977. Brazil and Mexico instituted major adjustment policies and are likely to record somewhat lower growth rates in 1977. Other countries that adopted stabilization programs earlier are likely to have somewhat higher growth rates in calendar 1977 than in 1976.

During 1977, U.S. policy placed an increasing emphasis on the role of the multilateral development lending institutions, especially the World Bank and the regional development banks, in providing financing for sound projects and programs in developing countries. On a net flow basis financing by multilateral development institutions provided about 15 percent of total private and official capital flows to the nonoil developing countries in 1976. The soft-loan windows of the development banks presently supply about two-thirds of the official capital flows to the poorest countries.

The United States is committed to encouraging growth with equity in the developing world. For this reason, the United States favors increased priority for lending by the development banks for agriculture, nutrition, health, and education to meet the basic human needs of the world's poorest people. Protection of human rights is also an important element of U.S. policy. The United States believes that these rights should be advanced through the multilateral development agencies.

During the year, Congress appropriated $1.9 billion as the U.S. fiscal 1978 contribution to the resources of the international development banks. Of this figure, $800 million represented an appropriation for the full amount of the first installment of the U.S. contribution to the fifth replenishment of the International Development Association. For fiscal 1977, the United States had contributed $1.1 billion to the resources of these institutions. During the year under review, Congress also approved authorizing legislation totaling $5.1 billion for U.S. contributions to the World Bank group, the Asian Development Bank, and the African Development Fund.

During consideration of the appropriations legislation, the House of Representatives proposed certain restrictive amendments barring the use of U.S. funds for loans by the international development banks to certain countries and for certain commodities. A compromise was ultimately worked out under which the restrictive amendments were not enacted, and the President agreed to instruct the U.S. representatives at the respective institutions to oppose and vote against such loans.

Reflecting the importance of the development banks in U.S. relations with developing countries, the Department of the Treasury under the new administration has undertaken a review of the effectiveness of these institutions in achieving U.S. objectives and of how U.S. objectives can best be pursued in them. The study is expected to be completed early in 1978.

The Development Committee brings together a group of Governors of the World Bank and the IMF several times a year. During this year, the Committee endorsed recommendations by a working group aimed at improving developing country access to private capital markets, and it created a second working group to examine certain aspects of official development finance and policy. At its September 1977 meeting, the Committee adopted an ambitious work program including the subjects of coordination among the multilateral development institutions, the stabilization of export earnings, private direct investment, the role of borrowing in development, and a World Bank study of development issues.

The Treasury continued to take part in interagency coordination of the U.S. bilateral financing and aid programs through the National Advisory Council on International Monetary and Financial Policies, the Development Coordination Committee, and the Development Loan Committee of the Agency for International Development.

Treasury also continued to follow developments in international indebtedness. In January 1977, the Treasury submitted to Congress the third annual report on the external debt of developing countries and debt relief provided by the United States. During the fiscal year, the United States participated in only one multilateral rescheduling of official debts, in response to the inability of the Government of Zaire to meet its debt obligations.

New Initiatives in Commodity Policy and Energy

The administration undertook a fourfold approach to international commodity problems in 1977. First, it adopted a positive and open attitude toward the negotiation of individual commodity agreements to stabilize prices around market trends. Second, the U.S. representatives agreed at the North-South conference in May 1977, along with other developed and developing countries, to support the establishment of a common fund, in order to facilitate the financing of buffer stock arrangements. Third, the United States undertook a policy of promoting increased investment in the production of key raw materials through encouraging increased involvement in such activities by the World Bank group, the regional development banks, and the U.S. Overseas Private Investment Corporation. Finally, it was decided to continue to review the adequacy of existing mechanisms to assure adequate support for the stabilization of export earnings of developing countries, although it was concluded that the IMF compensatory financing facility, following its extensive liberalization in 1975, was functioning well and was capable of meeting export earnings stabilization needs, as and when they arose, for the foreseeable future.

Much of the attention of the administration in the commodities area focused on the type of buffer stock arrangement which would be most economically rational and in the U.S. interest as a major producer and consumer of a number of important raw materials. It was concluded, for example, that the United States should seek to provide sufficient financial resources to agreements it joined and to accumulate buffer stocks large enough to be effective in protecting against price surges as well as price declines. It was also decided to limit the use of export quotas in support of buffer stocks to extreme situations, and to oppose production controls in any buffer stock arrangement.

Where international buffer stock agreements were not feasible, but greater price stabilization appeared desirable, the United States could consider export quota arrangements which would promote national stocking to protect against high prices and encourage investment through a flexible quota reallocation system. It was also decided that the United States could consider internationally coordinated national stocks in cases where international buffer stocks were not feasible.

When a sufficient number of commodity agreements with operating buffer stocks had been negotiated, the funds allocated for such agreements could be pooled in a common fund in order to facilitate the financing of buffer stocks. This purpose would be achieved by making unused funds from some agreements available to others which were in a buying phase and by providing such agreements with supplementary financing through common fund borrowings on commercial markets.

A new commodity agreement for sugar, requiring stockholding, seemed certain to enter into force. Negotiations for a new International Sugar Agreement were successfully concluded and the agreement was scheduled to become effective on January 1, 1978. The new agreement, through the combined use of stock and quota mechanisms, was designed to stabilize prices within a 10-cent-per-pound price band (11-21 cents). Market forces would be allowed to operate freely over a substantial segment at the center of this band. The United States actively participated in negotiating the new agreement because it believed the pact would serve the interests of the United States as both a major sugar-producing nation and as the world's leading sugar importer.

In the energy area, the key issues revolved around price, supply, and technical and financial cooperation. There was also the question of establishing an appropriate means to continue an energy dialog, following the conclusion of the Conference on International Economic Cooperation. The key demands of developing countries included indexation of oil export revenues and increased resource transfers to the oil-importing developing countries, particularly those deficient in energy resources, to help in meeting their oil bills and to assist in developing any existing indigenous energy resources. Increased financial, scientific, and technological cooperation in conventional and nonconventional energy areas continued to receive considerable attention.

The United States called for international cooperation to effectuate an orderly and smooth transition to the period of global energy use when there would be increased reliance on sources other than oil and gas. The industrialized nations indicated they recognized the importance of oil prices to all nations and continued to seek to achieve energy prices that were fair to both producers and consumers. The OPEC countries continued to seek to maintain the purchasing power of their oil export earnings, calling for indexation of oil prices, transfers of real resources to LDC's, and substantial revisions of pricing policies.

The developed nations proposed specific initiatives to intensify cooperation in energy research and development programs with special attention given to technologies appropriate for developing nations. The United States developed an energy investment proposal which recognized the importance of capital in energy development in the oil-importing developing countries, the role of the private sector, and the need to improve access to capital markets. It also considered a possible increase in the role of international financial institutions in fostering energy development. The United States fully recognized the importance of such financial and investment issues to the oil-importing developing countries.

International Trade Policy

The key emphasis of our trade policy remained our commitment to maintaining and improving an open international trading environment in the face of increasing protectionist pressures. The May 1977 summit conference in London and the renewal of the OECD trade pledge provided vital opportunities for the United States and its major trading partners to reconfirm their commitment to avoid protective trade measures. During the year, the United States also participated actively in efforts to achieve a broadened and strengthened international consensus on export credits to avoid destructive competition in this area.

At the same time, the administration responded to serious problems of import competition in domestic television and shoe sectors through mutual agreements which facilitate domestic adjustment, by slowing the pace of imports from the one or two countries responsible for the rapid surge in U.S. imports. The President asked Treasury Under Secretary for Monetary Affairs Solomon to chair an interagency task force to look into the problems of the steel industry and propose a comprehensive policy program for that industry early in fiscal 1978.

The United States and the European Community succeeded in achieving a major breakthrough in the stalemate which had deadlocked the multilateral trade negotiations and established a timetable for the submission of requests, offers, and draft codes. Treasury remained actively involved in the preparation of subsidy/countervailing duty and safeguard codes in particular.

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. Secretary Blumenthal was cohost of the Sixth Session of the Joint U.S.-U.S.S.R. Commercial Commission on June 9-10, 1977, in Washington, D.C. [He also served as cochairman of the U.S.-U.S.S.R. Trade and Economic Council meeting in Los Angeles on November 14, 1977.]

International Investment

The administration established a policy on direct international investment that is based on four basic premises:

- First, international investment will generally result in the most efficient allocation of economic resources if it is allowed to flow according to market forces.
- Second, there is no basis for concluding that a general policy of actively promoting or discouraging international investment would further the U.S. national interest.
- Third, unilateral U.S. Government intervention in the international investment process could prompt counteractions by other governments with adverse effects on the U.S. economy and U.S. foreign policy.
- Fourth, the United States has an important interest in seeking to assure that established investors receive equitable and nondiscriminatory treatment from host governments.

In accordance with these premises, it was determined that U.S. policy should be neither to promote nor discourage inward or outward investment flows or activities. From this it followed that the U.S. Government should not give any special incentives or disincentives to international investment or intervene in the activities of individual companies regarding international investment.

On the basis of this policy, a task force identified several objectives that the U.S. Government should seek. They include strengthening international restraint over government interventions in the investment process which adversely affect other countries, obtaining equitable treatment for investors based on national treatment and the principles of international law, and fostering international cooperation in this area.

REVIEW OF TREASURY OPERATIONS

FINANCIAL OPERATIONS

Summary

On the unified budget basis the deficit for fiscal 1977 was $45 billion. Net receipts for fiscal 1977 amounted to $356.9 billion ($48.3 billion over the period October 1, 1975, through September 30, 1976), and outlays totaled $401.9 billion ($32.7 billion over the period October 1, 1975, through September 30, 1976).

Fiscal 1977 borrowing from the public amounted to $53.5 billion as a result of (1) the $45 billion deficit, (2) a $2.2 billion increase in cash and monetary assets, and (3) a $6.2 billion decrease in other means of financing.

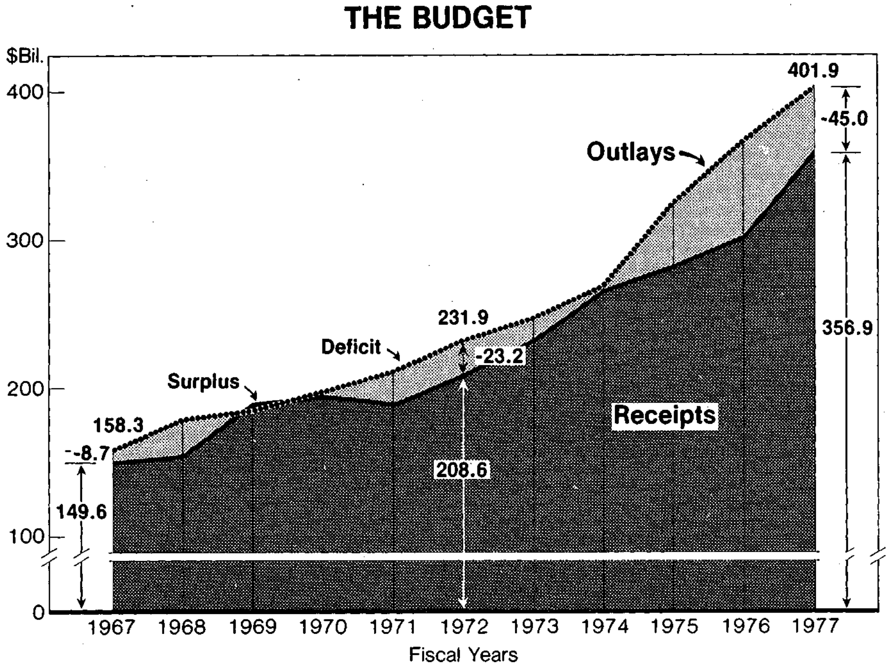
As of September 30, 1977, Federal securities outstanding totaled $709.1 billion, comprised of $698.8 billion in public debt securities and $10.3 billion in agency securities. Of the $709.1 billion, $551.8 billion represented borrowing from the public.

The Government's fiscal operations for the period October 1, 1975, through September 30, 1976, and fiscal 1977 are summarized as follows:

[In billions of dollars]

	Comparable prior period [1]	Fiscal 1977
Budget receipts and outlays:		
Receipts	308.6	356.9
Outlays	369.2	401.9
Budget deficit	−60.6	−45.0
Means of financing:		
Borrowing from the public	77.5	53.5
Increase in cash and other monetary assets	−8.9	−2.2
Other means:		
Increment on gold and seigniorage	.6	.4
Outlays of off-budget Federal agencies	−8.5	−8.7
Other	−.1	2.0
Total budget financing	60.6	45.0

[1] Oct. 1, 1975, through Sept. 30, 1976.



Receipts

Total budget receipts amounted to $356.9 billion in fiscal 1977, an increase of $48.3 billion over the comparable period ended September 30, 1976. Net budget receipts by major source for fiscal 1977 and the comparable prior period are shown below.

[In billions of dollars]

Source	Comparable prior period [1]	Fiscal 1977
Individual income taxes	135.8	156.7
Corporation income taxes	42.0	54.9
Employment taxes and contributions	82.5	92.2
Unemployment insurance	9.0	11.3
Contributions for other insurance and retirement	4.9	5.2
Excise taxes	17.1	17.5
Estate and gift taxes	5.3	7.3
Customs duties	4.4	5.2
Miscellaneous receipts	7.7	6.5
Total budget receipts	308.6	356.9

[1] Oct. 1, 1975, through Sept. 30, 1976.

NOTE.—Detail will not agree with final Monthly Treasury Statement, fiscal 1977.

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 $156.7 billion in fiscal 1977, an increase of $20.9 billion over the comparable prior period, substantially all due to increased personal incomes.

Corporation income taxes.—Corporation income taxes increased by $12.9

billion over the prior period to reach $54.9 billion. This sharp (31 percent) increase reflected high final payments on 1976 liability and continued increases in corporate earnings.

Employment taxes and contributions.—Receipts from this source totaled $92.2 billion reflecting in part an increase in the social security taxable earnings base from $15,300 to $16,500 effective January 1, 1977.

Unemployment insurance.—Unemployment insurance receipts increased by 26 percent in fiscal 1977 to $11.3 billion. State tax deposits at the Treasury, the largest component in this category, increased by $2.0 billion (or 28 percent), reflecting increased State financing of past unemployment benefits. In addition, the Federal unemployment insurance tax rate was raised from 0.5 percent to 0.7 percent effective January 1, 1977.

Contributions for other insurance and retirement.—Receipts in this category increased by $0.3 billion to a total of $5.2 billion in fiscal 1977.

Excise taxes.—Receipts of excise taxes in fiscal 1977 were $17.5 billion, an increase of $0.4 billion over the prior period.

Estate and gift taxes.—Receipts in this category increased by $2.0 billion to reach $7.3 billion in fiscal 1977. An estimated $1.4 billion of this increase was due to increased gifts in anticipation of the estate and gift tax provisions of the Tax Reform Act of 1976.

Customs duties.—Customs duties increased by $0.8 billion in fiscal 1977 to reach $5.2 billion.

Miscellaneous receipts.—These receipts totaled $6.5 billion in fiscal 1977, a decrease of $1.2 billion over the prior period. Deposits by the Federal Reserve System increased by $0.3 billion while oil import fees declined from $1.5 billion in the prior period to −$13 million in fiscal 1977.

Outlays

Total outlays in fiscal 1977 were $401.9 billion (compared with $369.2 billion for the comparable prior period). Outlays by major agency for fiscal 1977 and the comparable prior period are presented in the following table. For details see the Statistical Appendix.

[In billions of dollars]

	Comparable prior period [1]	Fiscal 1977
Funds appropriated to the President	3.7	2.5
Agriculture Department	13.5	16.7
Defense Department	90.7	98.0
Health, Education, and Welfare Department	132.4	147.5
Housing and Urban Development Department	5.7	5.8
Labor Department	25.0	22.4
Transportation Department	12.0	12.5
Treasury Department	44.7	49.6
Energy Research and Development Administration	4.1	5.0
National Aeronautics and Space Administration	3.6	3.9
Veterans Administration	18.2	18.0
Other	31.3	35.0
Undistributed offsetting receipts	−15.8	−15.1
Total outlays	369.2	401.9

[1] Oct. 1, 1975, through Sept. 30, 1976.

Cash and monetary assets

On September 30, 1977, cash and monetary assets amounted to $28.8 billion. The balance consisted of U.S. Treasury operating cash of $19.1 billion ($1.7 billion more than September 30, 1976); $1.3 billion held in special drawing rights ($0.3 billion less than September 30, 1976); a net $4.1 billion with the International Monetary Fund ($0.1 billion more than September 30, 1976); $0.7 billion in loans to International Monetary Fund ($0.7 billion more than September 30, 1976); and $3.7 billion of other cash and monetary assets (a slight increase over September 30, 1976).

For a discussion of the assets and liabilities in the Treasury's account, see page 158. Transactions affecting the account in fiscal 1977 are shown in the following table:

Transactions affecting the account of the U.S. Treasury, fiscal 1977
[In billions of dollars]

Operating balance Sept. 30, 1976			17.4
Excess of deposits or withdrawals (−), budget, trust, and other accounts:			
Deposits		411.4	
Withdrawals (−)		451.6	−40.2
Excess of deposits or withdrawals (−), public debt accounts:			
Increase in gross public debt		64.1	
Deduct:			
Net discounts on new issues	8.5		
Interest increment on savings and retirement plan securities	3.9		
Net public debt transactions included in budget, trust, and other Government accounts	9.9		
Net deductions		22.3	41.8
Operating balance Sept. 30, 1977			19.1

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. Many Federal agencies finance programs through this bank that would otherwise involve the sale or issuance of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and sales of assets.

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 1977 borrowings from the Treasury, exclusive of refinancing transactions, totaled $30 billion, repayments were $21 billion, and outstanding loans on September 30, 1977, totaled $66.4 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 1977, all funds loaned by the bank have been borrowed from the Treasury.

During fiscal 1977, Congress granted new authority to borrow from the Treasury in the total amount of $9.2 billion, adjustments increased borrowing authority by $2.5 billion, making a total increase of $11.6 billion. The status of borrowings and borrowing authority and the amount of corporation and agency securities outstanding as of September 30, 1977, 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 September 30, 1977, is shown in the Statistical Appendix.

During fiscal 1977, the Treasury received $3.8 billion 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 are 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, 1977, are shown in the Statistical Appendix.

Government-wide financial management

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, coordinated the collection of Federal Government finance statistics. Information sources outside the Treasury sphere furnished statistical data for fiscal years 1973 through 1975 to the Treasury for review and transmission to the Fund. Statistics were published in the Fund's "Government Finance Statistics Yearbook, 1977." A Treasury project team has also initiated a study of transactions between the United States and the

Fund in order to improve the accounting and reporting system used for these transactions.

Joint Financial Management Improvement Program.—JFMIP activities were concentrated in the following four areas: Audit improvement, financial management, productivity, and cash management. A study designated as the "Audit Improvement Project" was initiated to review the various aspects of auditing federally assisted programs administered by State and local governments. The sixth annual Financial Management Conference was held in February 1977, featuring "New Challenges for Financial Managers." In March 1977, JFMIP published a booklet entitled "Implementing a Productivity Program: Points to Consider," to capture some of the lessons learned concerning productivity programs. A series of cash management workshops were approved, featuring the specific areas of loan accounting systems, letters of credit, and regulations governing cash management practices within the Federal Government.

DOMESTIC FINANCE

Federal Debt Management

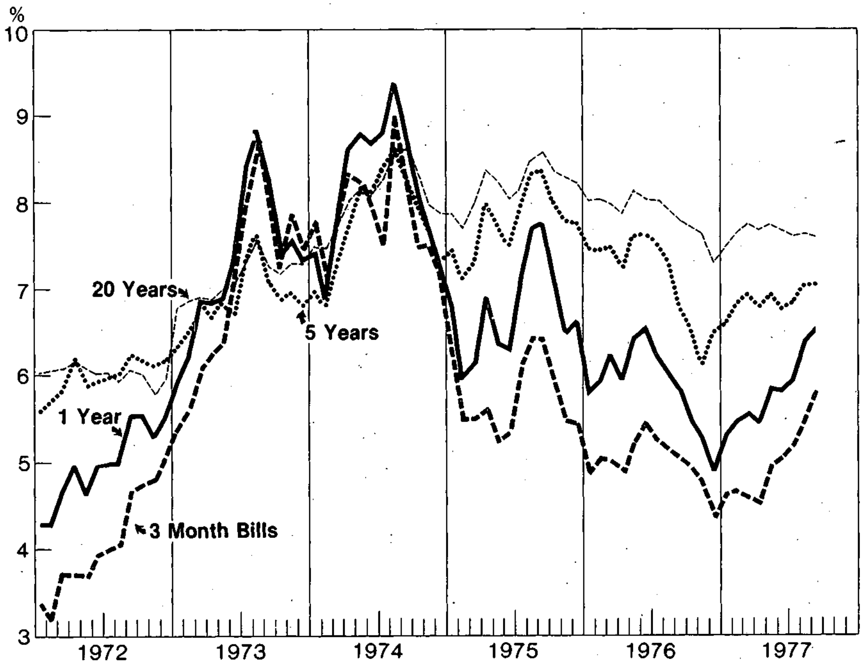
Federal debt management was conducted in an economic atmosphere of general recovery in fiscal 1977. Following the "pause" of 1976 the economy began to pick up and subsequently set a brisk pace of economic activity over the first half of calendar 1977. Beginning in July 1977 the rate of economic expansion slowed, but over the fiscal year as a whole significant progress was made. Industrial production increased, housing showed strong gains, personal income rose, and price increases moderated. The labor force expanded, and the unemployment rate declined from about 8 percent at the beginning of the fiscal year to about 7 percent at the end of the year.

The Ford administration January budget estimate for fiscal 1977 showed a deficit of $57.2 billion. This estimate was raised to $68 billion in February by the incoming Carter administration to accommodate the proposed economic stimulus package aimed at promoting growth in the economy and improving unemployment. The first phase was to consist mainly of a tax rebate to stimulate consumer spending while the second phase was designed to reduce business taxes, expand training and employment programs, and increase public works spending and countercyclical revenue sharing. However, after the economy began to make impressive gains the rebate proposal was withdrawn. The canceling of the rebate proposal combined with outlay shortfalls reduced the estimated budget deficit to $48 billion. As it turned out, outlays continued to be less than expected, and the actual budget deficit was $45 billion. Throughout the fiscal year Treasury financing of the deficit was accomplished with a minimum of market disturbance.

From the outset, the Treasury indicated that the amount of financing that had to be done, though large, was manageable. In fact, the Treasury found through its "regularization" of note offerings (the 2-, 4-, and 5-year cycle notes) and the quarterly refundings there were ample borrowing opportunities to raise needed cash. This was due in part to the large amount of new cash provided by foreign "add-ons" in the auctions of marketable securities and to the nonmarketable securities sold to State and local governments. Combined, these two sources of funds provided over $18.6 billion, or 35 percent of the total budget and off-budget new financing requirements for the fiscal year. Moreover, the Treasury took advantage of the good market atmosphere that prevailed throughout most of the fiscal year to improve the structure of the debt. This was done primarily by deliberately paying down bills and raising large amounts of new cash in the coupon market when the market was receptive.

For the fiscal year, total Treasury financing in coupons, including refundings, amounted to $86.7 billion, $77.6 billion of which was with private investors and $9.1 billion was with the Federal Reserve System and Government accounts. Nearly 59 percent or $44.1 billion of the coupon financing with private investors was for cash, while the remaining $33.5 billion, or 41 percent, was for refunding maturing notes privately held. The amount of new cash raised through coupons amounted to $43.7 billion, $27.6 billion, or 63

MARKET YIELDS AT CONSTANT MATURITIES 1972-1977[1]



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

percent, of which was raised with notes in the 2- to 7-year maturity area. Two-, 4-, and 5-year cycle notes provided $13.1, $11, and $7.9 billion, respectively. About $11.7 billion was raised in quarterly refundings and the issuance of a 15-year bond. In the bill market a $5.4 billion paydown in regular bills was achieved, the first such paydown since fiscal 1964. The bill paydown in fiscal 1977 was in marked contrast to the past 2 fiscal years when the Treasury tapped the bill market for $23.6 billion in fiscal 1975 and $32.6 billion in fiscal 1976 for part of its new cash needs. Total new cash raised through marketable debt amounted to $38.3 billion in fiscal 1977, compared with $79.6 billion in fiscal 1976 and $50.4 billion in fiscal 1975. Overall financing operations resulted in the average length of the privately held marketable debt increasing from 2 years 9 months at the beginning of fiscal 1977 to a peak of 3 years in August 1977 and settling at 2 years 11 months at the end of the fiscal year.

Federal debt and Government-sponsored agency debt

[In billions of dollars]

Class of debt	June 30, 1976	Sept. 30, 1976	Sept. 30, 1977	Increase, or decrease (−)
Public debt securities:				
Marketable public issues by maturity class:				
Within 1 year	204.2	206.1	217.9	11.8
1 to 5 years	127.0	131.1	148.4	17.3
5 to 20 years	49.5	57.3	58.9	1.6
Over 20 years	11.9	13.2	18.3	5.1
Total marketable issues	392.6	407.7	443.5	35.8
Nonmarketable public issues:				
Series E and H savings bonds	69.7	70.8	75.4	4.6
U.S. savings notes [1]	.4	.4	.4	0
Investment series bonds	2.3	2.3	2.2	−.1
Foreign government series:				
Dollar denominated	19.9	19.2	20.5	1.3
Foreign currency denominated	1.6	1.6	1.3	−.3
Other nonmarketable debt	2.2	3.0	14.2	11.2
Total nonmarketable public issues	96.1	97.3	114.0	16.7
Government account series (nonmarketable)	130.6	128.6	140.1	11.5
Non-interest-bearing debt	1.2	1.1	1.2	.1
Total gross public debt	620.4	634.7	698.8	64.1
Federal agency securities:				
Government National Mortgage Association	4.2	4.1	3.8	−.3
Export-Import Bank of the United States	r2.7	r3.6	2.9	−.7
Tennessee Valley Authority	2.1	2.0	1.8	−.2
Defense family housing	1.2	1.1	1.0	−.1
Other	.8	.8	.8	0
Total Federal agency debt	r11.0	r11.7	10.3	−1.4
Total Federal debt	r631.4	r646.4	709.1	62.7
Government-sponsored agency securities:				
Federal home loan banks	19.4	19.1	19.2	.1
Federal National Mortgage Association	29.9	30.7	31.5	.8
Federal land banks	16.1	16.6	18.7	2.1
Federal intermediate credit banks	10.3	10.8	11.7	.9
Banks for cooperatives	3.7	3.9	4.1	.2
Farm Credit discount notes	r1.0	r.7	1.0	.3
Farm Credit consolidated bonds	....	....	1.0	1.0
Government-sponsored agency debt	r80.3	r81.8	87.2	5.4

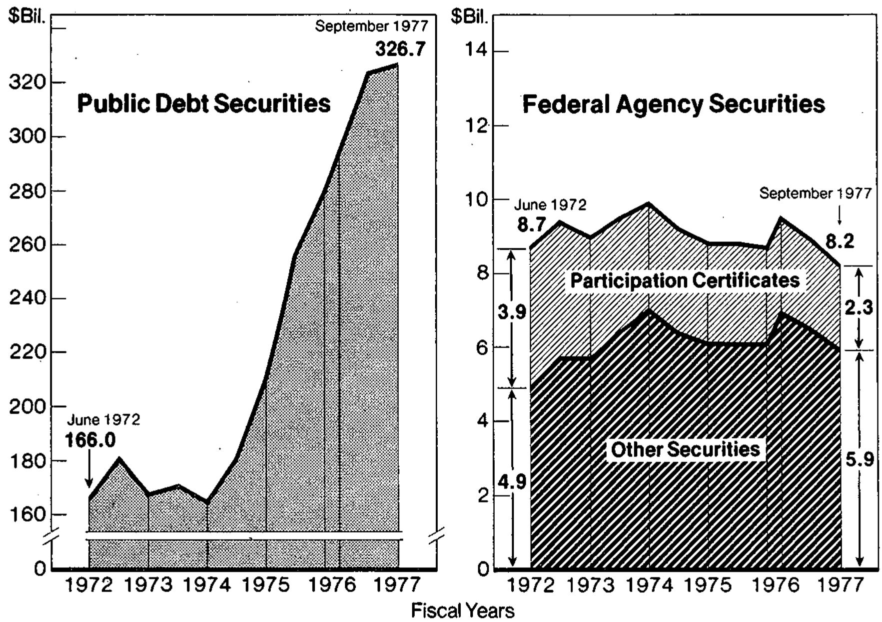
r Revised.
[1] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.

Changes in Federal securities

Federal securities consist of the debt issues of the Treasury, both marketable and nonmarketable, as well as those obligations issued by Federal agencies which are included in 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.

At the end of fiscal 1977 there was $709.1 billion Federal securities outstanding, compared with $646.4 billion a year earlier. Outstanding public debt issues of the Treasury amounted to $698.8 billion, an increase of $64.1 billion for the fiscal year. Federal agency issues outstanding totaling $10.3 billion were down $1.4 billion from a year ago. Marketable Treasury securities outstanding at the end of fiscal 1977 amounted to $443.5 billion, an increase of $35.8 billion but $41.1 billion less than the fiscal 1976 increase of $77 billion. Nonmarketable Treasury securities increased $28.2 billion to a level of $254.1 billion at the end of fiscal 1977. The increase in fiscal 1977 was $18 billion more than in fiscal 1976. Special nonmarketable securities issued only to Government accounts and trust funds such as the Federal old-age and survivors insurance trust fund increased $11.5 billion, or 41 percent. Special

PRIVATE HOLDINGS OF MARKETABLE FEDERAL SECURITIES



nonmarketable securities issued to State and local governments increased $8.6 billion, or 30 percent. Savings bonds and notes outstanding rose $4.6 billion while special nonmarketable issues to foreign investors increased $1 billion. A special certificate issued to the Federal Reserve System on September 30, because Congress delayed the extension of the debt limit, accounted for $2.5 billion of the increase in nonmarketables. All other nonmarketables increased by less than $0.1 billion net.

The securities issued by Government-sponsored agencies are not part of Federal securities since these agencies are not owned in whole or in part by the Government. However, these privately owned and managed agencies are subject to some degree of Federal supervision. In fiscal 1977 Government-sponsored agency debt increased by $5.4 billion to a level of $87.2 billion. Private investors held $80.2 billion and accounted for the total $5.4 billion increase. Holdings of Federal Reserve banks and Government accounts totaled $7 billion, about the same as a year ago.

Ownership

At the end of fiscal 1977 private investors held $446.8 billion of the $709.1 billion of Federal securities outstanding. The remaining $262.3 billion was held by the Federal Reserve System and Government accounts. Borrowings from the public, which includes the Federal Reserve and foreign investors, amounted to a net $54.8 billion in fiscal 1977. This was $28.2 billion less than the $82.9 billion borrowed in fiscal 1976. Of the $54.8 billion borrowed from the public $46.5 billion, or 85 percent, was accounted for by private investors while the Federal Reserve System acquired $8.3 billion, or 15 percent.

Individuals.—Holdings of public debt securities by individuals increased $4.2 billion in fiscal 1977, compared with a fiscal 1976 increase of $9.3 billion. A $4.5 billion increase in savings bonds in fiscal 1977 was partially offset by the $0.3 billion decrease in individuals' holdings of other securities, mostly marketables. This decline in marketables reflects, in part, the redemption of the maturing 9 percent notes in May 1977 by those individuals who did not participate in the May refunding where two new issues were offered which bore coupon rates much lower than the maturing 9 percent notes. On September 30, 1977, individuals held $103.9 billion of public debt securities. Holdings of U.S. savings bonds and notes totaled $75.6 billion and holdings of other Treasury securities were $28.3 billion. Individuals reduced their holdings of Federal agency securities by $0.3 billion to a level of $0.4 billion in fiscal 1977.

Insurance companies.—Holdings of public debt securities by insurance companies rose $2.7 billion in fiscal 1977. This compares with a $3.5 billion increase in fiscal 1976. On September 30, 1977, insurance companies held $14.5 billion of public debt securities, while holdings of Federal agency securities remained virtually unchanged at $0.5 billion.

Savings institutions.—Savings and loan associations increased their holdings of public debt securities by $1.5 billion in fiscal 1977, compared with $3.7

Estimated ownership of public debt securities on selected dates 1967–77
[Dollar amounts in billions]

	June 30, 1967	June 30, 1976	Sept. 30, 1976	Sept. 30, 1977	Change during fiscal 1977
Estimated ownership by:					
Private nonbank investors:					
Individuals: [1]					
Series E and H savings bonds	$50.4	$69.2	$70.5	$75.2	$4.7
U.S. savings notes [2]	(*)	.4	.4	.4	(−*)
Other securities	r20.0	26.8	28.8	28.3	−.5
Total individuals	r70.4	96.4	99.7	103.9	4.2
Insurance companies	r9.0	r10.6	r11.7	14.5	2.7
Mutual savings banks	r4.2	r5.4	r5.7	6.1	.4
Savings and loan associations	7.9	r8.0	r8.3	9.8	1.5
State and local governments	r23.6	r39.2	r38.7	53.5	14.8
Foreign and international	[3]11.4	r69.8	74.6	95.1	20.5
Corporations	r11.0	r24.3	r25.3	23.9	−1.4
Miscellaneous investors [4]	r11.3	r30.0	r32.8	30.9	−1.9
Total private nonbank investors	[3]148.9	r283.8	r296.9	337.6	40.8
Commercial banks	55.5	r92.5	r95.3	101.0	5.7
Federal Reserve banks	46.7	94.4	96.4	104.7	8.3
Government accounts	71.8	149.6	146.1	155.5	9.4
Total gross debt outstanding	[3]322.9	620.4	634.7	698.8	64.1
			Percent		
Percent owned by:					
Individuals	22	16	16	15	....
Other private nonbank investors	r24	30	31	34	....
Commercial banks	17	15	15	14	....
Federal Reserve banks	r15	15	15	15	....
Government accounts	22	24	23	22	....
Total gross debt outstanding	100	100	100	100	....

r Revised.
* Less than $50 million.
[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 amount was $3,328 million at the end of fiscal 1967.
[4] Includes nonprofit institutions, corporate pension trust funds, nonbank Government security dealers, certain Government deposit accounts, and Government-sponsored agencies.

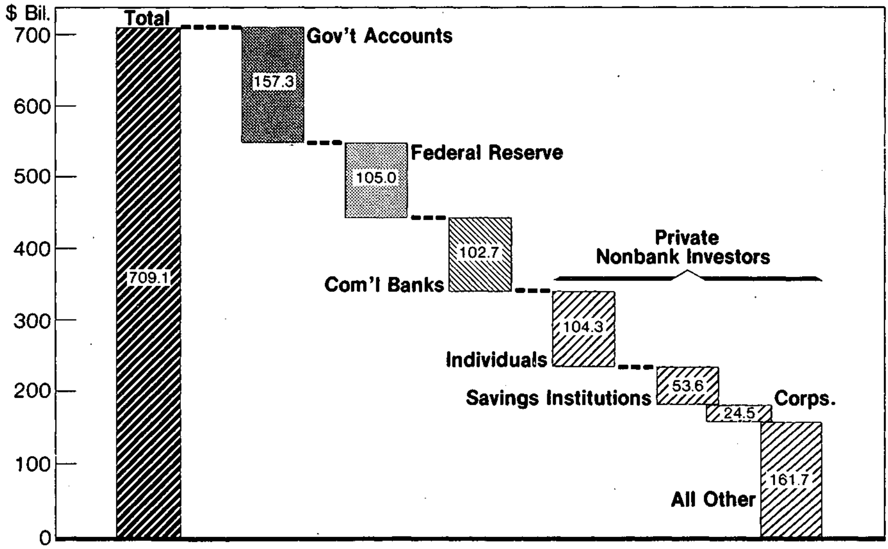
billion in fiscal 1976. Federal agency security holdings climbed $0.1 billion. At the end of fiscal 1977, savings and loan associations held $9.8 billion of public debt securities and $0.5 billion of Federal agency issues.

On September 30, 1977, mutual savings banks held $6.1 billion of public debt issues, representing a $0.4 billion increase during the fiscal year. In fiscal 1976, the increase was $1.9 billion. Holdings of Federal agency securities registered a small decline and stood at $0.4 billion at the close of fiscal 1977.

State and local governments.—State and local governments held $53.5 billion of public debt securities on September 30, 1977. This represented a record $14.8 billion increase during fiscal 1977, compared with a $7.6 billion rise in fiscal 1976. About $8.6 billion, or 58 percent of the increase, was from special nonmarketable issues sold exclusively to these governmental units as they invested the proceeds from the sale of lower coupon issues that are to be

OWNERSHIP OF FEDERAL SECURITIES

September 30, 1977



used to "advance refund" higher coupon securities. Holdings of Federal agency issues dropped by almost $0.5 billion to $3.4 billion during fiscal 1977.

Foreign and international.—Foreign investors increased their holdings of public debt securities by $20.5 billion to a record level of $95.1 billion at the close of fiscal 1977. The increase in holdings was more than five times the $3.8 billion gain in fiscal 1976. Holdings of foreign special nonmarketables rose $1 billion while holdings of marketables increased $19.5 billion. Over 51 percent, or $10 billion, of the increase in marketable securities was foreign add-ons. Foreign add-ons represent additional amounts of a publicly offered marketable security sold to foreign official accounts at the average price. Federal agency securities held by foreign and international investors were just under $0.7 billion on September 30, 1977, after a small decline over the year.

Nonfinancial corporations.—Corporate holdings of public debt securities declined $1.4 billion in fiscal 1977, in contrast to an $11.1 billion increase the previous fiscal year. The level on September 30, 1977, was $23.9 billion. Holdings of Federal agency securities, on the other hand, rose $0.2 billion to a level of $0.6 billion.

Other private nonbank investors.—Other private nonbank investors decreased their holdings of public debt securities $1.9 billion to $30.9 billion in fiscal 1977. During fiscal 1976 holdings increased $8.9 billion. Holdings of Federal agency issues decreased $0.2 billion to a level of $0.6 billion at the end of fiscal 1977.

Commercial banks.—Commercial bank holdings of public debt securities rose to a record $106.3 billion at the midpoint of fiscal 1977 and then declined to a level of $101 billion by the close of the fiscal year. This represented a net increase of $5.7 billion for the fiscal year as a whole, compared with a $23.5

billion increase in fiscal 1976. Although banks experienced much stronger loan demand in fiscal 1977 than during the prior fiscal year, loan demand was still low. As a consequence, banks had an incentive to take longer maturities than usual. In 31 offerings, the Treasury sold $77.6 billion of marketable coupon securities to private investors in fiscal 1977 and commercial banks received $31.1 billion, or 40 percent, of the original allotments in these offerings. Commercial bank holdings of Federal agency securities totaled $1.7 billion on September 30, 1977, down $0.4 billion over the year.

Federal Reserve System.—In fiscal 1977, the Federal Reserve System increased its holdings of public debt securities $8.3 billion, compared with a $9.7 billion rise in fiscal 1976. About $5.8 billion of the increase was in marketable securities while $2.5 billion was a nonmarketable special certificate. Holdings of public debt issues stood at $104.7 billion while holdings of Federal agency securities rose slightly to $0.3 billion by the end of fiscal 1977.

Government accounts.—Public debt securities held by Government accounts rose $9.4 billion in fiscal 1977, compared with a $4.3 billion increase in fiscal 1976. Special nonmarketable securities held by these accounts rose $11.4 billion while holdings of marketables declined $2 billion. Holdings of Federal agency issues declined $0.1 billion. On September 30, 1977, Government accounts held $155.5 billion of public debt securities and $1.8 billion of Federal agency issues.

Financing operations

The Treasury began the fiscal year with a record opening cash balance of $17.4 billion, due in part to a lower-than-expected budget deficit of $12.7 billion for the transition quarter. Because of this large cash balance, market participants believed Treasury financing requirements would be moderate in the near term.

The first coupon issue of the new fiscal year was a 7 percent 5-year 1-month note dated October 12, maturing November 15, 1981, from which over $2.5 billion was raised in new cash. This note, which had been auctioned on September 28, completed the 5-year cycle note issues for 1976. Only moderate interest at lower-than-expected yield levels was shown for the issue as $4.2 billion of tenders were received. Noncompetitive tenders totaled $0.4 billion. About $1.4 billion went to commercial banks and $0.8 billion went to dealers. Together they accounted for 86 percent of the issue. The 7.08 percent average yield was 55 basis points below the last 5-year cycle note auctioned on June 29, and was the lowest average yield of the four 5-year cycle notes sold to date.

On October 15 the Treasury announced an auction of 2-year notes to be held on October 21. About $2.5 billion was to be sold to refund $1.5 billion of notes held by the public and raise $1 billion in new cash. Issue date for the new notes was November 1. The Treasury accepted $2.5 billion of the $4.1 billion of public tenders in a rather unenthusiastic but cautious market atmosphere. Noncompetitive tenders accounted for $0.2 billion of the issue. Including the $0.3 billion of foreign add-ons, $1.3 billion of new cash was raised.

Commercial banks and dealers were awarded $1.3 billion and $0.8 billion, or 46 percent and 27 percent, respectively. The average yield was 5.96 percent, 34 basis points below the September 21 auction of 2-year notes. A 5 7/8 percent coupon was set on the issue. Accepted tenders included 94 percent of the amount of notes bid for at the highest yield of 5.99 percent. Market participants were discouraged by these results and the notes began trading at a discount.

Interest rates continued to decline in October. The effective Federal funds rate was down over 20 basis points from September and 90- to 119-day commercial paper rates dropped by a like amount. Most banks lowered their prime rate from 7 percent to 6 3/4 percent during the first week of October, and rates on 3-month CD's were down over the month. Treasury bill rates moved between 10 and 25 basis points below September levels. Treasury intermediate coupon yields were down about 25 basis points on average, and long rates declined slightly. Corporate and municipal bond yields also fell during this period.

The economy did not pick up much steam in October, although there was as much good news as bad. The index of leading economic indicators, originally reported as unchanged from September, was twice revised to show

Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1977

[In millions of dollars]

Date	Description	Allotted to private investors: For cash	Allotted to private investors: For refunding	Allotted to Federal Reserve and Government accounts	Total	Average auction yield (percent)
1976	NOTES AND BONDS					
Oct. 1	1 1/2 percent note, Oct. 1, 1981[1]	....	14	....	14	......
Oct. 12	7 percent note, Nov. 15, 1981	2,543	....	....	2,543	7.08
Nov. 1	5 7/8 percent note, Oct. 31, 1978	1,342	1,481	98	2,921	5.96
Nov. 15	6 1/4 percent note, Nov. 15, 1979	1,295	2,011	70	3,376	6.36
Nov. 15	7 percent note, Nov. 15, 1983	885	1,374	50	2,309	7.02
Nov. 15	7 7/8 percent bond, Feb. 15, 1995-2000	392	609	....	1,001	7.80
Nov. 30	5 3/4 percent note, Nov. 30, 1978	1,435	1,370	136	2,941	5.86
Dec. 7	5 7/8 percent note, Dec. 31, 1980	2,692	....	....	2,692	5.91
Dec. 31	5 1/4 percent note, Dec. 31, 1978	1,107	2,017	252	3,376	5.37
1977						
Jan. 6	6 1/8 percent note, Feb. 15, 1982	2,697	....	....	2,697	6.19
Feb. 3	5 7/8 percent note, Jan. 31, 1979	2,855	....	....	2,855	5.97
Feb. 15	6 1/2 percent note, Feb. 15, 1980	2,184	1,124	1,300	4,608	6.62
Feb. 15	7 1/4 percent note, Feb. 15, 1984	1,336	688	881	2,905	7.25
Feb. 15	7 5/8 percent bond, Feb. 15, 2002-07	496	256	391	1,143	7.63
Feb. 28	5 7/8 percent note, Feb. 28, 1979	1,180	1,515	150	2,845	5.98
Mar. 8	6 7/8 percent note, Mar. 31, 1981	2,809	....	....	2,809	6.88
Mar. 31	6 percent note, Mar. 31, 1979	943	2,053	523	3,519	6.02
Apr. 1	1 1/2 percent note, Apr. 1, 1982[1]	....	1	....	1	......
Apr. 4	7 percent note, May 15, 1982	2,613	....	....	2,613	7.02
May 2	5 7/8 percent note, Apr. 30, 1979	413	1,469	110	1,992	5.87
May 16	7 1/4 percent note, Feb. 15, 1984	....	2,910	2,623	5,533	7.28
May 16	7 5/8 percent bond, Feb. 15, 2002-07	....	1,004	900	1,904	7.77
May 31	6 1/8 percent note, May 31, 1979	....	1,897	190	2,087	6.23
June 3	6 3/4 percent note, June 30, 1981	2,514	....	....	2,514	6.80
June 30	6 1/8 percent note, June 30, 1979	138	1,906	264	2,308	6.14
July 8	7 1/4 percent bond, Aug. 15, 1992	1,504	....	....	1,504	7.29
Aug. 1	6 1/4 percent note, July 31, 1979	1,664	1,451	65	3,180	6.34
Aug. 15	6 3/4 percent note, Aug. 15, 1980	2,037	1,671	425	4,133	6.84

Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1977—Continued

Date	Description	Allotted to private investors: For cash	Allotted to private investors: For refunding	Allotted to Federal Reserve and Government accounts	Total	Average auction yield (percent)
Aug. 15	... 7 1/4 percent note, Aug. 15, 1984	1,408	1,155	300	2,863	7.26
Aug. 15	... 7 5/8 percent bond, Feb. 15, 2002-07..	551	452	199	1,202	7.72
Aug. 31	... 6 5/8 percent note, Aug. 31, 1979	1,460	1,898	123	3,481	6.68
Sept. 7	..... 6 3/4 percent note, Sept. 30, 1981	2,968	....	....	2,968	6.84
Sept. 30	... 6 5/8 percent note, Sept. 30, 1979	635	3,136	90	3,861	6.74
	Total notes and bonds	44,096	33,462	9,140	86,698	......
	BILLS (MATURITY VALUE)					
	Change in offerings of regular bills:					
1976						
	October-December	482	....	....	482	......
1977						
	January-March	272	....	....	272	......
	April-June	−7,195	....	....	−7,195	......
	July-September	1,027	....	....	1,027	......
	Total change in regular bills	−5,414	....	....	−5,414	......
	Other bill offerings:					
1976						
Dec. 10	.....4.448 percent, 132-day, maturing Apr. 21, 1977	2,005	....	....	2,005	......
1977						
Apr. 6	.......4.632 percent, 15-day, maturing Apr. 21, 1977	4,506	....	....	4,506	......
June 7	......5.240 percent, 9-day, maturing June 16, 1977	2,002	....	....	2,002	......
Sept. 6	......5.760 percent, 9-day, maturing Sept. 15, 1977	901	....	....	901	......
Sept. 6	......5.760 percent, 16-day, maturing Sept. 22, 1977	903	....	....	903	......
	Total other bill offerings	10,317	....	....	10,317	......
	Total offerings	48,999	33,462	9,140	91,601	......

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

a 0.2-percent and then a 0.6-percent increase. Personal income posted a good $12.5 billion increase. Inflation remained under control as the Consumer Price Index rose only 0.4 percent. Housing and hardgoods orders both looked strong while unemployment edged back up to its August level of 7.9 percent. The Federal Reserve Board index of industrial production held steady while the Board's index of manufacturing capacity dropped to a utilization rate of 79.7 percent. This low rate of utilization and continued high unemployment were two major signs of weakness in the economy.

Meanwhile, the market cautiously awaited the terms of the November refunding operation. On October 27, the Treasury announced it would refund $4 billion of privately held notes maturing November 15 and raise $2 billion of new cash. Three securities were offered. The auctions were held on consecutive days beginning with $3 billion of 3-year notes on November 3. The following day $2 billion of 7-year notes were sold, and $1 billion of reopened 7 7/8 percent bonds due February 15, 2000, were auctioned on November 5.

These amounts, which were at the low end of preliminary market estimates, resulted in a very favorable market reception of the financing. Unlike the previous three quarterly financings, the November financing did not include a fixed-price note offering. However, beginning with this financing, the maximum amount of tenders accepted on a noncompetitive basis for preferred allotment was raised from $500,000 to $1 million. The Treasury felt that raising the noncompetitive maximum would broaden the yield auction technique. This allowed greater direct participation by investors not in close contact with daily market developments who were unwilling to bid for larger amounts competitively. It gave these investors in this size range the assurance that they would get securities at the average rate.

The November 3 auction of 3-year notes elicited aggressive bidding. About $3 billion of the $5.4 billion tenders submitted was accepted, including $0.6 billion of noncompetitive tenders. An additional $0.3 billion of foreign add-ons brought the total issue to $3.3 billion. The average yield was 6.36 percent, and the highest yield accepted was 6.37 percent. A 6 1/4 percent coupon was set on the notes. Commercial banks were allotted $1.2 billion, or 37 percent, and dealers were allotted $1 billion, or 31 percent. The issue began to trade at a premium following the auction.

On November 4, the 7-year note was auctioned. Again, there was strong bidding interest present. The average yield of 7.02 percent on this issue was also the highest yield accepted and a 7 percent coupon was set. The Treasury accepted $2 billion from the more than $6.2 billion of tenders received, including almost $0.9 billion of noncompetitive tenders. An additional $0.2 billion of foreign add-ons brought the total issue to $2.3 billion. Commercial banks received $0.9 billion or 40 percent and dealers received $0.8 billion or 35 percent of the notes due November 15, 1983.

On November 5, the reopened 7 7/8 percent bonds were sold in a price auction. About $1 billion of the $1.5 billion of tenders received was accepted. The average price was $100.79 which yielded 7.80 percent. Almost $0.2 billion of accepted tenders were noncompetitive. Commercial banks and dealers were awarded $0.3 billion and $0.6 billion, respectively, which accounted for 90 percent of the bonds. This brought the total of this financing package to $6.6 billion of securities sold to private investors. The $2.6 billion of new cash was the smallest amount raised in calendar 1976 quarterly financings. One effect of this financing was to raise the average length of the privately held Treasury marketable debt by 1 month to 2 years 10 months at mid-November.

The next financing conducted by the Treasury was to refund $1.4 billion of 2-year notes maturing November 30, 1976. The auction was held on November 18, with the Treasury accepting $2.5 billion of the $3.8 billion of public tenders, including $0.3 billion of noncompetitive tenders. Including $0.3 billion of foreign add-ons new cash amounted to $1.4 billion. Commercial banks and dealers received $1.2 billion and $1 billion, or 42 percent and 34 percent, respectively. Although bidding interest was weaker than anticipated, as competitive tenders were accepted from over an unusually wide range of yields (5.76 percent up to 5.94 percent), the average yield of 5.86 percent was 10 basis points below the previous 2-year note auctioned in October. A 5 3/4 percent coupon was assigned to this November 30, 1978, maturity and it was bid to a premium in when-issued trading.

The Treasury announcement on November 23 of the sale of a 49-month note for new cash was generally expected. The November 30 auction of this 4-year cycle note took place in an atmosphere in which most Treasury coupon prices were at or near highs for the year thus far. Of the $5.6 billion of tenders from the public, $2.5 billion was accepted. Foreign add-ons of $0.2 billion brought the total issue to $2.7 billion. About $0.5 billion of this amount was from noncompetitive tenders. Commercial banks took $1.2 billion, or 46 percent, and dealers accounted for $0.9 billion, or 32 percent, of the issue. Very strong bidding interest resulted in a 5.91-percent average yield, down 102 basis points from the last auction of 4-year notes on August 31. A 7 7/8 percent coupon was set on these notes, which were to be dated December 7 and mature December 31, 1980. These notes also began trading at a premium.

November brought further declines on virtually all fixed-income security yields and lending rates. Some commercial banks reduced their prime lending rate to 6 1/4 percent late in the month after an earlier November reduction from 6 3/4 percent to 6 1/2 percent. On November 19 the Federal Reserve announced a discount rate reduction of one quarter point to 5 1/4 percent. The month's final auction of 13- and 26-week Treasury bills produced rates 46 and 53 basis points, respectively, below the 13- and 26-week bills sold the last week in October. These, and other short-term interest rates, reached their lowest levels since 1972. Intermediate and long rates in the Treasury, corporate, and municipal sectors also continued their downward slide.

Most measures of the economy's performance gave good readings in November. Employment rose, but due to the rapid growth of the labor force the unemployment rate jumped to 8 percent, the highest level of calendar 1976. Personal income rose 1.2 percent, the largest increase since August 1975. The Federal Reserve Board index of industrial production was up by 1.1 percent—its best increase in 9 months. Retail sales posted a good increase, and the Commerce Department's index of leading economic indicators was up 0.7 percent. Increases of 0.3 percent in the Consumer Price Index and 0.2 percent in the Wholesale Price Index indicated inflation was holding steady. At the end of the month, on November 29, a $2 billion issue of 132-day cash management bills was announced with very little market reaction. The bills were auctioned on December 7 and issued December 10 as an addition to outstanding bills dated October 21, 1976, due April 21, 1977. About $4.7 billion of tenders were received for the $2 billion issue. The average discount rate was 4.45 percent.

On December 13, the Treasury announced a December 20 auction of 2-year notes to mature December 31, 1978. About $3 billion of the $6.6 billion of public tenders was accepted, including noncompetitive tenders of $0.4 billion.

About $1.1 billion of new cash was raised, including $0.1 billion of foreign add-ons. Commercial banks were awarded $1.2 billion, or 37 percent, and dealers took $1 billion, or 33 percent. Bidding interest was good, and a 5.37-percent average yield resulted in the assignment of a 5 1/4 percent coupon. The average yield and coupon rate were the lowest since the Treasury began selling 2-year cycle notes regularly, over 4 years ago.

Most government securities continued to make strong price gains in December. Although investors were uncertain over what course inflation and economic growth would take in the near future, optimism prevailed. The concern of market participants at this time focused primarily on the extent to which the Federal Reserve and the economy in general would affect interest rates.

The December 17 announcement of a sale of 5-year 1-month notes for new cash was expected, as market participants were thoroughly familiar with the Treasury's regular 2-, 4-, and 5-year note cycles. The December 28 auction drew stronger-than-anticipated bidding interest as $2.5 billion of the $5.3 billion of public tenders was accepted, including $0.9 billion of noncompetitive tenders. Foreign add-ons of $0.2 billion brought the total issue of $2.7 billion. Average yield was 6.19 percent, 89 basis points below the last auction of 5-year notes on September 28. A 6 1/8 percent coupon was set. Commercial banks and dealers received $1.4 billion, or 50 percent, and $0.7 billion, or 25 percent, respectively, of the notes due on February 15, 1982. Secondary market demand was sufficient at first, but by the time the notes were issued on January 6, 1977, they were trading slightly below the average auction yield.

The average length of the marketable interest-bearing public debt held by private investors stood at 2 years 9 months at the end of December. This was down 1 month from its peak in November but was at the same level as at the beginning of fiscal 1977.

Throughout the first quarter of fiscal 1977, the Treasury bill market was seldom tapped for new cash. The 52-week bill auctions raised about $0.2 billion in November and $0.3 billion in December, while all 13- and 26-week bill maturities were simply rolled over during the period. Including the $2 billion raised through the sale of 132-day cash management bills, just under $2.5 billion of new cash was raised in the bill market in the first quarter of fiscal 1977. However, about $11 3/4 billion of new money was raised in the coupon market, of which nearly $1 1/2 billion was from foreign add-on amounts which averaged $0.2 billion per coupon issue over the quarter. Total new money raised from marketable securities for the October–December period amounted to $14 1/4 billion.

For the past 2 months many market-watchers were expecting each new drop in rates to be the bottom of the decline, but rates continued downward through December. Early in December, most banks followed the lead of the few banks that had reduced their prime rate to 6 1/4 percent in late November, while some banks lowered their prime to 6 percent. These rates had not been seen since early 1973. At midmonth, the Federal Reserve lowered its reserve requirements on demand deposits by one quarter to one half point. The effective Federal funds rate dropped by about 25 basis points in December. Rates on commercial paper and large CD's were also down. The Treasury's 52-week bill auction on December 8 produced a 4.71 average discount rate, the lowest since May 1972. The first three auctions of 13-week bills in December and all four 26-week bill auctions produced successive new low yields not seen since August 1972.

In the coupon market, prices continued to improve with yields on Treasury securities down from November by 35 to 50 basis points. Prices of municipal bonds rose to 2 1/2-year highs while corporate bond prices rose to 3-year highs. The economy gained some momentum in December. The Commerce Department's index of leading indicators posted an 0.8-percent increase. Retail sales showed a very strong 4.2-percent (seasonally adjusted) uptick while production, income, employment, housing, and consumer credit registered strong advances. Unemployment dropped 0.2 percent to 7.8 percent after a downward revision. A downward-revised 0.3-percent gain in the Consumer Price Index brought the total rise to 4.8 percent in calendar 1976, the smallest in 4 years. Business loans and short-term business credit in general were the strongest in 2 years by the end of December.

Immediately after the beginning of the new year, interest rates in the money and bond markets began to climb as fears of increased inflation were fueled by signs of faster economic growth and President Carter's proposed fiscal stimulus package. Market participants were also concerned with the heavy new supplies of corporate and municipal bonds coming to the market. Participants began to feel that any further easing of Federal funds rates was unlikely and the relatively large weekly increases in the money supply might induce the Federal Reserve Board to adopt a tighter policy. There was little investor buying interest, and, as dealers sought to reduce large inventories, upward pressure on rates increased.

January was the only month in fiscal 1977 in which there were no Treasury coupon maturities. A 2-year note issue for new cash was announced on January 12. About $2.5 billion would be auctioned January 19 and come due on January 31, 1979. The issue date was February 3, 1977. Bidding interest was stronger than anticipated, given the atmosphere of falling prices and slack demand in the coupon market. Almost $2.6 billion of the $5.5 billion of tenders was accepted, including $0.4 billion of noncompetitive tenders. An additional $0.3 billion was accepted from foreign add-ons, which brought new cash raised to $2.9 billion. Commercial banks and dealers took 72 percent of the issue, or $1.2 billion and $0.9 billion, respectively. The average yield of 5.97 percent was 60 basis points above the December 20 auction of 2-year notes. The issue, which was assigned a 5 7/8 percent coupon, lost about eighteen thirty-seconds from the average-yield price in when-issued trading.

The few banks that lowered their prime rate to 6 percent in December raised it back to 6 1/4 percent in mid-January. Prime 4- to 6-month commercial paper yields rose about 18 basis points while rates on 3-month CD's jumped 30 basis points in January. Three-month Treasury bill yields climbed almost 40 basis points. Yields on most Treasury issues in the 2- to 5-year maturity range rose 75 basis points or more, and longer maturities rose 40 to 60 points.

On the economic front, consumer prices jumped a seasonally adjusted 0.8 percent in January while wholesale prices rose at a 0.5-percent clip. The index of leading economic indicators fell by 1.2 percent. Also declining were industrial production, manufacturing capacity utilization, new construction, housing starts, and retail sales as the Nation attempted to cope with an unusually harsh winter. A surprisingly large 0.5-percent drop in unemployment brought that rate down to 7.3 percent.

One sector of the Treasury bond market experienced an even more dramatic plunge in prices as the new year began. These were the "flower" bonds. These marketable Treasury bonds were issued before March 3, 1971, with coupons of 4 1/4 percent or less. They are redeemable at par plus accrued interest in payment of Federal estate taxes on a deceased owner's estate. Tax law changes, brought about by the Tax Reform Act of 1976, led the market to reassess the value of these bonds. The rules regarding the basis of assets received from a decedent and the required holding period for realization of long-term capital gains were changed. Although the Tax Reform Act was passed in October 1976, the market did not really digest the implications for "flower" bonds until January 1977. Between early January and mid-February, market prices of the "flower" bonds fell more than $100 per $1,000 face value.

The market was still under heavy downward price pressure when the Treasury announced its plans on January 26 for the February quarterly financing. Market participants considered the financing to be routine because of the small amount maturing and the Treasury's large cash balance. The refunding consisted of three new issues to refund $2.1 billion of privately held notes maturing February 15 and raise $3.7 billion of new cash. The securities to be issued on February 15 were: $3 billion of 3-year notes due February 15, 1980; $2 billion of 7-year notes due February 15, 1984; and $0.8 billion of 30-year bonds due February 15, 2007, callable on February 15, 2002. Market prices continued to fall following this announcement but stabilized just prior to the auctions.

The 3-year note was auctioned on February 1. Interest in the auction materialized only at a yield much higher than those prevailing on comparable outstanding issues. About $3 billion of the $5.9 billion of public tenders was accepted, including $0.7 billion of noncompetitive tenders. Foreign add-ons raised an additional $0.3 billion. A 6 1/2 percent coupon was set after the average yield was calculated at 6.62 percent. Commercial banks and dealers accounted for $1.7 billion, or 52 percent, and $0.9 billion, or 26 percent, of the issue, respectively.

About $4.8 billion of tenders from the public were received at the February 3 auction of 7-year notes. Of the $2 billion accepted, $0.7 billion were noncompetitive tenders. Commercial banks and dealers accounted for 80 percent of the issue as they took $1 billion and $0.6 billion, respectively. The

7.25-percent average yield was the result of stronger than expected bidding interest and a 7 1/4 percent coupon was assigned.

The refinancing operation was completed on February 4 with the auction of the 30-year bonds. Of the $2.4 billion of public tenders received, $0.8 billion was accepted, including $0.3 billion of noncompetitive tenders. Dealers and brokers were allotted over $0.4 billion, or 59 percent of the bonds. Strong bidding interest led to a 7.36-percent average yield. A 7 5/8 percent coupon was placed on the issue. Over $4 billion in new cash was raised through the three new issues. The 3- and 7-year note issues encountered strong secondary demand while the bonds sold at slightly lower prices in when-issued trading. The success of the sale touched off a strong but brief price rally in the bond markets.

On February 11, the Treasury announced a February 17 auction of $2.5 billion of 2-year notes to refund $1.5 billion of notes coming due on February 28. The auction drew $6.5 billion of tenders, of which $2.5 billion was accepted, including $0.4 billion of noncompetitive tenders. Foreign add-ons of $0.2 billion brought the total to $2.7 billion. Commercial banks received $1 billion, or 37 percent, while dealers took $0.8 billion, or 30 percent. The average yield was 5.98 percent and a 5 7/8 percent coupon was assigned. Following the auction the price of the notes dropped in response to weak demand in the market.

February 15 brought the expected Treasury announcement of a February 23 auction of a cycle note. The security announced was a 4-year 1-month note to raise $2.3 billion in new cash. The notes were to be issued March 8 to mature on March 31, 1981. A 6 7/8 percent coupon was set after moderate bidding interest led to a 6.88-percent average yield. This was almost 100 basis points higher than the last 4-year cycle note auctioned on November 30, 1976. Of the $4.5 billion of tenders received from the public, $2.3 billion was accepted, including $0.4 billion of noncompetitive tenders. In addition, a significant amount of foreign add-ons, $550 million, raised the total of new cash to $2.8 billion. Commercial banks and dealers were awarded $1.3 billion, or 45 percent, and $0.6 billion, or 22 percent, respectively. In secondary market trading the 6 7/8 percent notes were bid slightly higher in price.

Fears of a return to higher levels of inflation were revived when the wholesale and consumer price indices were reported for February. The seasonally adjusted rates rose 0.9 percent and 1.0 percent, respectively. Despite the severe winter weather, the economy seemed to be gaining strength. Among the indicators posting increases were industrial production, retail sales, housing starts, and new construction. Even though employment increased, a larger increase in the labor force pushed the unemployment rate from 7.3 percent to 7.5 percent.

Interest rates recorded mixed changes in February in contrast to January's steady increases. Treasury 3- and 6-month bill rates moved slightly lower on balance. Federal funds traded in a slightly higher range while 3-month CD rates were down and commercial paper rates remained virtually unchanged over the month as a whole. Yields on Treasury coupons maturing within 3 years moved lower while longer maturities posted small yield increases. Corporate bond yields rose while good demand for municipals contributed to moderate rate declines in that sector.

Economic data reported for March indicated continued strengthening. Large increases were recorded in industrial production, personal income, and retail sales. Manufacturing capacity utilization rose to 82 percent, its best rate in over 2 years. Unemployment dropped back to 7.3 percent. Consumer prices rose 0.6 percent seasonally adjusted while wholesale prices increased 1.1 percent. Consumer installment credit extended in March was $18.3 billion, the third consecutive monthly record. Expenditures for new plant and equipment in the January–March period were almost $5 billion above the previous quarter. Finally, gross national product increased at a healthy 6.9-percent annual rate in the quarter.

The March 10 announcement of 2-year notes to be auctioned March 22 was well received, due, in part, to the favorable outlook for Treasury cash requirements. Only $0.4 billion in new cash was sought as the March 31 issue refunded $2.1 billion of privately held notes maturing. About $2.5 billion of the $4.8 billion of public tenders was accepted, including $0.3 billion of noncompetitive tenders. New cash raised amounted to $0.9 billion, including $0.5 billion of foreign add-ons. Dealers took $0.6 billion, or 19 percent, of the notes and commercial banks received $1.2 billion, or 42 percent. Routine bidding resulted in a 6.02-percent average yield and a 6 percent coupon. The issue did not meet with much retail demand and traded lower until just before the payment date when it was bid up to par.

In an announcement expected by the market, the Treasury, on March 21, said it planned to raise $2.3 billion of new cash by auctioning 5-year 1-month notes on March 29. Public tenders totaled $3.9 billion for the April 4 issue and $2.3 billion was accepted, including over $0.2 billion in noncompetitive tenders. An additional $350 million was issued to fulfill foreign add-ons. Commercial banks and dealers subscribed for $1.4 billion and $0.6 billion, respectively, or 76 percent together. Moderate bidding interest resulted in a 7.02-percent average yield and a 7 percent coupon. The issue was well accepted and traded at a premium in the secondary market.

Rates on 3- and 6-month Treasury bills moved lower in March. The 52-week bill auctioned on March 30 brought an average auction rate of 5.16 percent, seven basis points lower than the bill sold on the second of the month. The effective Federal funds rate dropped early in March but rose to end the month at 4.74 percent, almost unchanged from the end-of-February rate. Commercial paper rates averaged about 4 3/4 percent throughout the month. In the coupon markets, yields on corporate bonds rose in March for the most part while municipal yields declined on the whole. Most yields on Treasury coupons fell with the largest decreases of up to 25 basis points registered on shorter maturities.

Over the January–March quarter only $0.3 billion of new cash was raised in the Treasury bill market. The 52-week issues dated February 8 and March 8 raised $0.2 billion and $0.1 billion, respectively. About $14.5 billion of new cash was raised with coupon issues, of which $2 billion was from foreign add-ons. This $14.8 billion of new money raised in the January–March quarter brought the total for the first half of fiscal 1977 to $29 billion.

Increases in production and manufacturing capacity utilization and the decline in unemployment from 7.3 percent to 7.0 percent were among the favorable economic signs in April. Worries centered around the growth in the money supply during April and the resulting Federal Reserve policy considerations to tighten money. Concern over inflation was heightened by large increases in the April consumer and wholesale price indices. The market was in excellent technical position and participants were relieved because Treasury's borrowing needs would be smaller as a result of President Carter's decision to cancel the personal tax rebates and business tax incentives proposed in his 1977–78 fiscal stimulus package.

After a brief rally in early April short- and long-term interest rates began to move in opposite directions. Rates on short-term instruments began to rise when the Federal Reserve began to supply reserves less generously in response to the sharply higher growth in the monetary aggregates. In the meantime, yields in the long-term debt markets were generally declining.

On April 1, the Treasury auctioned the $4.5 billion of 15-day cash management bills that had been announced on March 28. Payment date for these bills, which represented an additional amount of bills maturing April 21, 1977, was April 6. The issue drew heavy bidding interest as $14.9 billion of tenders were received. The average discount rate of 4.63 percent on this issue was close to the rate prevailing on the outstanding bills due April 21.

Later, on April 12, the Treasury announced its intention to auction $1.5 billion of 2-year notes on April 19 to refund a like amount of maturing notes held by private investors. Market reaction was favorable, but little interest surfaced at auction time as only $2.8 billion of tenders were received. About $1.5 billion was accepted, including $0.2 billion in noncompetitive tenders. An additional $0.4 billion of new cash was accounted for by foreign add-ons. Commercial banks took $0.7 billion, or 38 percent, of the notes while dealers received $0.5 billion, or 26 percent. The average auction yield was 5.87 percent, and a 5 7/8 percent coupon was assigned to the May 2 issue. The price of the notes dropped in secondary trading in an atmosphere dominated by the prospect of a less accommodative Federal Reserve System policy.

Data on the strength of the economy and money supply growth continued to contribute to investor uncertainty. The April 27 announcement concerning the Treasury's May quarterly financing improved the market outlook somewhat since the terms of the announcement were not greatly different from what the market had expected, except for the small $500 million paydown.

Two notes falling due on May 15, totaling $4.3 billion, were to be refunded through the sale of $3.8 billion of additional amounts of two issues originally offered in February. The balance of the $4.3 billion of privately held maturities were to be paid off from the Treasury's cash balance.

A 6-year 9-month note representing a reopening of the 7 1/4 percent note issued in the February 1977 refunding was sold in a price auction on May 3. Interest in the auction was high as $6 billion of tenders were received from the public. Of the $2.8 billion accepted, $0.9 billion was in noncompetitive tenders. About $0.1 billion of foreign add-ons raised the total to $2.9 billion. Commercial banks received $1.2 billion, or 40 percent, of the notes while dealers received $1 billion, or 35 percent. The average price of accepted tenders corresponded to a yield of 7.28 percent, and the issue moved to a premium in when-issued trading.

A second price auction on May 4 attracted $2.7 billion of tenders from the public for an additional $1 billion of 7 5/8 percent bonds also issued in the February 15, 1977, refunding. The bonds were due February 15, 2007, and callable February 15, 2002. Only $0.1 billion of noncompetitive tenders were awarded. Dealers took $0.5 billion, or 53 percent of the issue. The average auction yield was 7.77 percent, but the bonds traded at slightly higher yields in the secondary market. The net effect of the mid-May refunding operation was to increase the average length of the privately held Treasury marketable debt by 2 months to 2 years 11 months and realize a $0.4 billion reduction in marketable coupon securities held by private investors. This was the first paydown in a quarterly refunding since May 1974. Moreover, the Treasury indicated that further debt reduction would be accomplished during the quarter. In fact, beginning with the last weekly auction in April, the Treasury had started paying down regular bills. This continued through the third weekly auction in July.

On May 11, the Treasury announced the sale of a 2-year cycle note to refund $1.5 billion of the $1.9 billion notes maturing on May 31. This amounted to a paydown of $0.4 billion; however, this was mostly offset by a like amount of foreign add-ons. The new notes were due May 31, 1979. Unenthusiastic bidding at the May 18 auction resulted in an average yield of 6.23 percent and a 6 1/8 percent coupon. This yield was the highest on a 2-year cycle note since the September 21, 1976, auction. About $1.5 billion of the $3.8 billion of public tenders was accepted, including $0.3 billion of noncompetitive tenders. Including the foreign add-ons private investors took nearly $1.9 billion of the issue. Commercial banks were awarded $0.6 billion, or 29 percent, of the notes while dealers took $0.7 billion, or 35 percent. The net paydown in this refunding was less than $0.1 billion.

In a May 17 announcement, the Treasury said it would sell $2 billion of 4-year 1-month notes for new cash. Although the announcement of this cycle note was expected, some participants thought $2 billion was on the high side. The notes were to be issued June 3 and mature June 30, 1981. Bidding interest was good at the May 24 auction and of the $4.3 billion of public tenders submitted, about $2 billion was accepted, including $0.3 billion of noncompetitive tenders. An additional $0.5 billion of the notes were issued as foreign add-ons. The average yield was 6.80 percent, and the coupon was set at 6 3/4 percent. Commercial banks and dealers each received $0.8 billion of the issue, or a combined total of 63 percent. The notes subsequently sold at a small premium in when-issued trading.

With the Federal Reserve adopting a tighter stance in response to the growth in monetary aggregates, between late April and mid-May the Federal funds rate rose about 60 basis points to a level of 5 3/8 percent. Following the rise in most other short-term rates banks increased their prime rate first to 6 1/2 percent and then to 6 3/4 percent in May.

On the economic front, unemployment dropped to 6.9 percent in May, the lowest level in 30 months. Price increases slowed from their April pace and most economic gauges, including industrial production and new construction, showed signs of further strengthening. On May 31, the Treasury announced a $2 billion sale of 9-day cash management bills representing an addition to outstanding 13- and 26-week bills maturing June 16. The June 3 auction drew $9.5 billion of tenders. The good bidding interest for the bills led to an average issuing rate of 5.24 percent on the June 7 issue, slightly higher than the rate on outstanding bills maturing June 16.

At mid-June the Treasury announced, on June 14, plans to refund $1.5 billion of the $1.9 billion notes maturing on June 30 with a 2-year cycle note due June 30, 1979. The June 21 auction met with routine bidding interest as the average yield of 6.14 percent resulted in the assignment of a 6 1/8 percent coupon to the issue. Of the $4.4 billion of tenders received from the public, $1.5 billion was accepted, including $0.3 billion of noncompetitive tenders. The foreign add-on for this issue was more than $0.5 billion which resulted in raising about $0.1 billion of new cash. Commercial banks received $0.6 billion, or 27 percent, and dealers received $0.5 billion, or 23 percent. This issue, which was the last coupon security offered in the third quarter, moved to a slight premium in when-issued trading.

During the third quarter of fiscal 1977, the Treasury managed a $9.2 billion paydown in bills excluding those cash management bills redeemed in the same month in which they were issued. This significant paydown in debt included a $2 billion cash management bill issued in December 1976 and paid off in April; the cumulative paydown in 52-week bills of $1.1 billion during the quarter; and the $6.1 billion paydown in 13- and 26-week bill maturities. From coupon issues, a total of $5.3 billion of new cash, which included $2.3 billion of foreign add-ons, was raised, mostly through the 4- and 5-year cycle note issues. For the quarter, Treasury market financing resulted in a net $3.9 billion paydown. The reductions in interest-bearing marketable public debt in April, May, and June 1977 were the only reductions since June 1974.

During the quarter ending June 30, short-term interest rates posted significant increases. For example, the Treasury bill auction at the end of June, compared with the last auction in March, produced average rates 36 basis points higher for 13-week bills and 30 basis points higher for 26-week bills.

Most rates surged higher between late April and mid-May. From April to June, M-1, the narrowest measure of the money supply, grew at an 8.5-percent annual rate, its fastest increase since 1972. Other factors influencing rates included the continued economic expansion and the corresponding increase in funds raised in domestic credit markets. In particular, short-term business credit grew at a 15.8-percent annual rate and consumer installment credit grew at a record pace.

Prices in the Treasury coupon market continued to improve for the most part throughout June. Taking the quarter as a whole, most intermediate- and long-term rates moved slightly lower as business and the Treasury reduced their needs for long-term funds. Although short-term corporate borrowing increased, gross bond and equity financing declined. This enabled bond yields, as measured by the Federal Reserve index of new triple-A-rated utility bond yields, to drop 15 basis points to 8.07 in the 3-month period. Good demand for tax exempts permitted yields on those instruments to decline even as long-term bond offerings by State and local governments reached a record level for the second consecutive quarter. As in the previous quarter about 20 percent of the new issues were sold to advance refund higher coupon issues outstanding. One long-term rate which did rise was the conventional new home mortgage rate. As the volume of net mortgage borrowing rose to a record level, this rate climbed about 15 basis points to 9 percent by the end of June.

At the end of June the market outlook was good as dealers' inventories were modest and new Treasury issues were expected to be within manageable proportions. In addition, it was felt that money market conditions would be relatively stable. However, as the fourth quarter of the fiscal year was underway this optimistic attitude started to deteriorate. Concern over near-term Federal Reserve System policy and expectations of faster growth in the monetary aggregates led some market participants to believe that the recent price improvements and the market's good technical position would not hold up. It was at this time that the Treasury was issuing its first 15-year bond in 2 1/4 years.

The 15-year 1-month bond issued on July 8 had been announced on June 20 and auctioned on June 28 to raise $1.5 billion in new cash. The possibility of substituting a 15-year issue for the 5-year cycle note usually issued in the month following the end of a quarter had been discussed at the time the terms of the May quarterly refunding were announced, so the August 15, 1992, maturity was generally expected by market participants. This was the first 15-year bond sale since April 1975. The aggressive bidding for the bond at the June 28 auction led to a 7.29-percent average yield, which was below preauction estimates. A 7 1/4 percent coupon was placed on the issue. Public tenders totaled $3.7 billion and, of the $1.5 billion accepted, a lower-than-expected $0.4 billion of noncompetitive tenders was awarded. Dealers and commercial banks each received $0.6 billion, which equaled 81 percent of the issue. In contrast to the success of the auction, weak investor demand caused the bonds to drop in price in the secondary market to 98 10/32 to yield 7.44

percent, 15 basis points above the auction average at the close of business on July 7.

Around midmonth, on July 13, the Treasury said it would sell $2.5 billion of 2-year cycle notes to refund $1.5 billion of maturing notes held by the public and raise $1 billion of new cash. The new notes were to be dated August 1 and were due July 31, 1979. About $4.7 billion of tenders were submitted by the public at the July 19 auction and $2.5 billion was accepted, including $0.3 billion of noncompetitive tenders. Including $0.6 billion of foreign add-ons, new cash raised totaled $1.6 billion and the total issue exceeded $3.1 billion. Commercial banks received $1.4 billion, or 46 percent, while dealers took $0.5 billion, or 17 percent of the issue. A coupon rate of 6 1/4 percent was placed on the notes when routine bidding resulted in an average auction yield of 6.34 percent. On a when-issued trading basis, the yield was bid up to 6.50 percent by August 1 in a cautious market atmosphere.

Included in the official offering circular for the 6 1/4 percent 2-year notes was a provision similar to one which had been dropped from Treasury offering circulars and announcements that prohibited participation in this and all subsequent coupon auctions by anyone who contracted to purchase or sell the security prior to the deadline for receipt of tenders. The Treasury felt that preauction trading would be distracting or confusing to auction participants and, in fact, would facilitate undesirable speculative activity in Treasury securities, while not contributing to the efficient marketing of new Treasury issues.

As the Treasury approached its August refunding the data being released on the performance of the economy was mixed. In early July the Labor Department had reported a 0.4-percent decline in the Wholesale Price Index for June, the first drop in almost a year. Industrial production was reported to have been up in June while the Federal Reserve's rate of manufacturing capacity utilization had risen for the sixth consecutive month. In addition, real GNP had advanced at a strong 6.4-percent rate in the April–June quarter. By contrast, the Consumer Price Index rose 0.7 percent in June. Housing starts fell, while the Commerce Department's index of leading economic indicators registered a 0.6-percent decline, the largest drop since January, and unemployment climbed 0.2 percent to 7.1 percent.

Meanwhile, short-term rates had continued to climb in July and had a depressing effect on the market. Also, market participants were concerned about the large increases in the money supply and the possible course of Federal Reserve action since it later was revealed that the seasonally adjusted annual growth rate of the M–1 monetary aggregate had been 18.3 percent in July, almost a repeat of April's performance. The lack of secondary investor demand for the Treasury's new 15-year 1-month bonds also had a depressing effect on the market as did the anticipation of higher Treasury financing needs in the immediate future.

In the coupon securities market, most intermediate and long market rates were also rising. Corporate and municipal bond rates edged up, while rates in the Treasury sector rose somewhat on intermediate issues but held steady on longer term maturities.

The terms of the Treasury's August quarterly refunding were announced on July 27. Three new securities would be issued for the $3.3 billion of notes held by private investors maturing on August 15 to refund the maturities and raise $3 billion of new cash. The new issues were: $3 billion of 3-year notes, $2.3 billion of 7-year notes, and $1 billion of reopened 29 1/2-year bonds. Market prices dropped slightly in reaction to the size of the offerings.

The 3-year notes were well received at an auction on August 2. About $7.9 billion of tenders was submitted by the public and, of the $3 billion accepted, $0.7 billion was in noncompetitive tenders. The acceptance of $0.7 billion of foreign add-ons increased the size of the issue to $3.7 billion. A 6 3/4 percent coupon was assigned to the notes due August 15, 1980, as the average auction yield was 6.84 percent. Commercial banks received $1.4 billion, or 36 percent, and dealers took $1.1 billion, or 30 percent. Initially, the notes moved to a premium but, by mid-August, the price had dropped below the auction average.

Strong interest developed at the August 3 auction of 7-year notes due August 15, 1984. About $5 billion of tenders were submitted by the public and $2.3 billion was accepted, including noncompetitive tenders totaling more than $0.8 billion. Close to $0.3 billion of foreign add-ons brought the total issue to $2.6 billion. Commercial banks received $0.9 billion, or 35 percent, and dealers took $0.8 billion, or 30 percent. The average yield was 7.26 percent, and a 7 1/4 percent coupon was set on the issue.

The August 4 price auction of 7 5/8 percent bonds due February 15, 2002–7, also drew good bidding interest. These bonds were first issued in the February 1977 financing operation and reopened in the May financing. About $1 billion of the $2.1 billion of public tenders was accepted, including $0.1 billion of noncompetitive tenders. Dealers were awarded $0.5 billion, or 49 percent, of the bonds. Commercial banks received $0.2 billion, or 20 percent, while an unusually high $0.1 billion, or 14 percent, of the bonds was taken by insurance companies. The average yield to maturity of 7.72 percent was about the prevailing rate on those outstanding bonds of this reopened issue. In summary, $7.3 billion of securities were sold to the public in the August financing, $3.3 billion to refund the maturing issue and $4 billion for new cash.

Later, on August 12, the Treasury announced that it would refund $1.9 billion of notes held by the public maturing on August 31 by selling $2.9 billion of 2-year cycle notes due August 31, 1979. About $7 billion of public tenders were submitted at the August 23 auction, and good bidding interest resulted in a 6.68-percent average yield, which was also the highest yield accepted. Although slightly below market participants' expectations, this was the highest yield in a 2-year note auction in 13 months. A 6 5/8 percent coupon was placed on the note. Over $2.9 billion of tenders were accepted from the public, including $0.4 billion of noncompetitive tenders. The issue size was enlarged to almost $3.4 billion when over $0.4 billion of foreign add-ons were also accepted. Commercial banks took $1.2 billion, or 35 percent, while dealers took $1 billion, or 29 percent of the notes. The issue traded above the auction price in the secondary market in when-issued trading.

On August 19, the sale of a 4-year 1-month note issue was announced. In line with market expectations, $2.5 billion of new cash was sought with this cycle note to be dated September 7 and to mature September 30, 1981. The August 30 auction attracted good interest as $5.1 billion of tenders were received from the public. About $2.5 billion was accepted, including $0.2 billion of noncompetitive tenders. The total issue size reached almost $3 billion with the addition of over $0.4 billion of foreign add-ons. Dealers were awarded $0.6 billion, or 20 percent, of the notes and commercial banks took $1.3 billion, or 44 percent. A 6.84-percent average yield resulted in the auction, and the Treasury set the coupon rate at 6 3/4 percent. The 4-year cycle notes began trading at higher yield levels on a when-issued basis but by September 7 they were below the auction yield.

Most short rates continued to rise throughout August. Bill rates continued to move higher, and the weekly auction held on August 15 produced the highest average 13-week rate since October 1975 while the 26-week rate was the highest since December 1975. By the end of August the 3-month bill rate was 30 basis points above its July level. After a brief dip in the second week the Federal funds rate rose sharply to 6 percent where it remained for the remainder of the month. Late in the month most banks raised their prime rate to 7 percent. Also at the end of August the Federal Reserve raised its discount rate one half percent to 5 3/4 percent to bring it closer to prevailing rates and discourage excessive use of bank borrowing privileges. In the Treasury coupon market, due to the dramatic rise in rates on maturities of less than 3 years, the Treasury yield curve became very flat in August. In fact, it was flatter at the time of the August refunding than for any quarterly refunding in the previous 2 years. After initial increases Treasury intermediate and long rates leveled off around midmonth and ended August slightly below their month earlier levels. Corporate and municipal bond yields also drifted lower.

This improvement in the Government securities and capital markets at the end of August reflected the encouragement of market participants by the economic data reports (leading business indicators, wholesale prices, and the unemployment rate) indicating a slower pace to both the recovery and inflation pressures. This along with the unchanged M-1, monetary aggregate was favorable to the debt markets. However, the Treasury's announcement on August 31 that it intended to raise new cash by issuing $1.8 billion in cash management bills caught the market by surprise.

The announcement indicated that two cash management bill issues were to be auctioned on September 1 and would be issued on September 6. The issues were $0.9 billion of 9-day bills due September 15 and $0.9 billion of 16-day bills due September 22. Both were additions to outstanding 13- and 26-week issues. The 9-day bills drew $4.3 billion of tenders from the public while the

Disposition of marketable Treasury securities excluding regular bills, fiscal 1977

[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
1976	NOTES AND BONDS				
Oct. 1	1 1/2 percent note, Oct. 1, 1976	Oct. 1, 1971	11	....	11
Oct. 31	6 1/2 percent note, Oct. 31, 1976	June 6, 1975	1,481	98	1,579
Nov. 15	6 1/4 percent note, Nov. 15, 1976	Sept. 8, 1971	4,205	120	4,325
Nov. 30	7 1/8 percent note, Nov. 30, 1976	Apr. 8, 1975	1,371	136	1,507
Dec. 31	7 1/4 percent note, Dec. 31, 1976	Dec. 31, 1974	2,030	252	2,282
1977					
Feb. 15	8 percent note, Feb. 15, 1977	Feb. 15, 1970	2,591	2,572	5,163
Feb. 28	6 percent note, Feb. 28, 1977	Mar. 3, 1975	1,515	150	1,665
Mar. 31	6 1/2 percent note, Mar. 31, 1977	Mar. 31, 1975	2,053	523	2,576
Apr. 1	1 1/2 percent note, Apr. 1, 1977	Apr. 1, 1972	5	....	5
Apr. 30	7 3/8 percent note, Apr. 30, 1977	Apr. 30, 1975	1,469	110	1,579
May 15	6 7/8 percent note, May 15, 1977	Feb. 15, 1974	2,038	527	2,565
May 15	9 percent note, May 15, 1977	Aug. 15, 1974	2,333	2,996	5,329
May 31	6 3/4 percent note, May 31, 1977	May 27, 1975	1,947	190	2,137
June 30	6 1/2 percent note, June 30, 1977	June 30, 1975	1,906	264	2,170
July 31	7 1/2 percent note, July 31, 1977	July 31, 1975	1,451	65	1,516
Aug. 15	7 3/4 percent note, Aug. 15, 1977	Aug. 15, 1970	3,994	924	4,918
Aug. 31	8 1/4 percent note, Aug. 31, 1977	Aug. 29, 1975	1,898	123	2,021
Sept. 30	8 3/8 percent note, Sept. 30, 1977	Sept. 30, 1975	3,136	90	3,226
	Total coupon securities		35,434	9,140	44,574
	BILLS				
1977	Other:				
Apr. 21	4.448 percent (132-day)	Dec. 10, 1976	2,005	....	2,005
Apr. 21	4.632 percent (15-day)	Apr. 6, 1977	4,506	....	4,506
June 16	5.240 percent (9-day)	June 7, 1977	2,002	....	2,002
Sept. 15	5.760 percent (9-day)	Sept. 6, 1977	901	....	901
Sept. 22	5.760 percent (16-day)	Sept. 6, 1977	903	....	903
	Total other bills		10,317	....	10,317
	Total securities		45,751	9,140	54,891

16-day bills attracted $5.3 billion. An identical 5.76-percent average discount rate resulted in both auctions.

The last coupon issue of fiscal 1977 was announced on September 13. The Treasury indicated that about $3.1 billion of 2-year cycle notes would be issued September 30 to refund a like amount of privately held notes maturing on that date. A good interest in the notes was shown at the September 21 auction as $5.5 billion of tenders were received from the public. Included in the $3.2 billion accepted was $0.5 billion of noncompetitive tenders. About $0.6 billion of foreign add-ons raised the issue size to $3.8 billion. Commercial banks and dealers took $1.3 billion, or 34 percent, and $1 billion, or 25 percent, respectively. A 6.74-percent average yield resulted at the auction, and a 6 5/8 percent coupon was assigned to the notes. On the date of issue, the notes finished trading on a when-issued basis at a bid price equivalent to a yield of 6.81 percent.

Short rates were still on the rise in September. In the Federal funds market, rates fluctuated around 6 percent until late in September when funds traded at 6 1/4 percent. By the end of the month, the "effective" rate was approaching 6 1/2 percent. Three-month Treasury bill rates jumped about 40 basis points during the month, and commercial paper rates climbed a similar amount. Commercial banks raised their prime rate to 7 1/4 percent in mid-September and by the 30th pressure was mounting for another rise. Intermediate and long rates also rose in September. Treasury maturities in the 7-year range rose an average of about 15 basis points while maturities of 20 years rose about 10 basis points. Corporate rates also climbed about 10 to 15 points while municipal bond yields remained relatively stable. By the end of September, the volume of long-term municipal bond sales for the first three quarters of 1977 had surpassed the previous record for a full calendar year sales set in 1976. Of the approximately $34 billion sold during this 9-month period, an unprecedented $6 billion was issued for advance refunding purposes. Short-term corporate financing in September also produced a record when outstanding commercial paper reached a level of nearly $61 1/2 billion.

In the final quarter of fiscal 1977 the Treasury raised $1 billion of new cash in the bill market. About $0.2 billion new cash was raised through 52-week issues, and $1.8 billion was raised with the two September 6 issues of cash management bills. A net paydown of $1 billion was realized in the regular 13- and 26-week bill auctions. In the coupon sector $12.2 billion of new cash was raised, including $3.8 billion in the three 2-year note auctions. About $3 billion was raised in auctions of 3-year and 7-year notes in the August refunding. Foreign add-ons included in the new cash raised in this quarter amounted to $3 billion, the highest of any quarter in fiscal 1977.

Although the growth in economic activity moderated somewhat during the final quarter of fiscal 1977, inflation also slowed down. Along with GNP, industrial production and personal income advanced at a slower pace during the quarter ending September 30 than in the previous two quarters. The GNP implicit price deflator indicated inflation was around a 5-percent annual rate in the July–September quarter, compared with a rate of 6.2 percent over the two prior quarters. So, while the economy did not look as strong as it did earlier in the year, the pace of the expansion was more sustainable and less inflationary as the Treasury approached the beginning of fiscal 1978.

Federal Financing Bank

The Federal Financing Bank (FFB) is a Government corporation under the general supervision of the Secretary of the Treasury established by the Federal Financing Bank Act of 1973 to coordinate and reduce the costs of public borrowings by Federal agencies and borrowers whose obligations are guaranteed by Federal agencies. To carry out this purpose, the act authorizes the bank to purchase obligations issued, sold, or guaranteed by Federal agencies with funds obtained by the issuance of bank obligations to the public or the Secretary of the Treasury.

The FFB's officers are Treasury officials, and its operations are conducted by Treasury employees who furnish services to the bank on a reimbursable basis. Except for an initial public offering of bills in 1974, the FFB has financed its lending by borrowing from the Secretary of the Treasury.

Since it began operations in 1974, the FFB has become the vehicle for financing most Federal agency direct borrowings, guaranteed loans, and asset sales. The major programs eligible for bank financing still not financed by the bank are Department of Commerce guaranteed ship mortgages, Department of Housing and Urban Development guaranteed tax-exempt housing and urban renewal notes and bonds, and Government National Mortgage Association guaranteed passthrough securities.

On September 30, 1977, FFB holdings of Federal and federally backed obligations totaled $35.4 billion, an increase of $9.5 billion from the end of September 1976. Significant changes during the year for existing programs include an increase of $5 billion in FFB holdings of loan assets purchased from the Farmers Home Administration, and a $1 billion decrease in the amount of FFB-held U.S. Postal Service debt. The latter change results from $1 billion in congressional appropriations to the Postal Service to retire part of its operating debt.

The FFB began financing several new guarantee programs during fiscal 1977. On January 31, 1977, the bank purchased a $22 million bond issued by the Virgin Islands and guaranteed by the Secretary of the Interior pursuant to Public Law 94–392. As authorized by Public Law 94–395, the FFB during the year advanced a total of $36 million to the Guam Power Authority, the repayment of which is guaranteed by the Secretary of the Interior. The FFB lent the Missouri, Kansas, Texas Railroad $4.4 million of a $12 million commitment; the loan is guaranteed by the Secretary of Transportation pursuant to section 511 of the Railroad Revitalization and Regulatory Reform Act of 1976. On December 30, 1976, the FFB entered into a $687 million commitment with Western Union Space Communications, Inc., to finance the construction of a satellite tracking system for the National Aeronautics and Space Administration. Repayment of advances under this commitment is secured by NASA's unconditional obligation to make payments under its procurement contract with Western Union.

During its 4 years of operations, the FFB has twice lowered its lending rates, resulting in further savings to programs financing through the bank rather than directly in the securities markets. However, even these reduced rates have generated a return to the bank in excess of its operating needs. Consequently, the FFB's Board of Directors at its June 27, 1977, meeting authorized the transfer to the Treasury of $142.7 million of the bank's accumulated cash surplus, and directed the bank's officers to study the advisability of further modifying the bank's lending rate from the current one-eighth percent above the new issue rate on marketable U.S. securities with similar maturities.

Summary of Federal Financing Bank holdings, fiscal years 1975–1977

[In millions of dollars]

Obligation	Holdings end of period				Net change in holdings			
	Fiscal 1975	Fiscal 1976	T.Q.	Fiscal 1977	Fiscal 1975	Fiscal 1976	T.Q.	Fiscal 1977
On-budget agency debt:								
Export-Import Bank of the United States [1]	4,049.4	4,984.6	4,768.1	5,923.5	4,049.4	935.2	−216.5	1,155.3
Tennessee Valley Authority	1,435.0	2,180.0	2,735.0	3,880.0	1,435.0	745.0	555.0	1,145.0
Off-budget agency debt:								
U.S. Postal Service	1,500.0	2,748.0	3,248.0	2,181.0	1,000.0	1,248.0	500.0	−1,067.0
U.S. Railway Association	33.9	85.3	96.8	310.4	33.9	51.4	11.5	213.6
Agency assets:								
Farmers Home Administration	5,000.0	8,800.0	9,650.0	14,615.0	5,000.0	3,800.0	850.0	4,965.0
Health, Education, and Welfare health maintenance organization	...	...	...	29.8	...	...	...	29.8
Health, Education, and Welfare medical facilities loan program	62.1	118.5	125.5	152.2	60.1	56.4	7.0	26.7
Overseas Private Investment Corporation	5.5	5.5	5.5	44.5	5.5	...	...	39.0
Rural Electrification Administration	...	166.4	353.6	353.6	...	166.4	187.3	...
Secretary of the Treasury (N.Y.)	...	...	1,082.1	1,157.2	...	...	1,082.1	75.1
Small Business Administration	...	166.4	159.6	133.1	...	166.4	−6.8	−26.5
Government-guaranteed loans:								
Chicago, Rock Island & Pacific Railroad	...	...	5.6	15.0	...	...	5.6	9.4
Defense foreign military sales	111.7	898.9	1,106.5	2,515.7	111.7	787.2	207.7	1,409.2
General Services Administration	45.1	68.8	75.0	142.1	45.1	23.7	6.2	67.1
Guam	...	...	...	36.0	...	...	...	36.0
Housing and Urban Development New Communities Administration	21.0	27.5	37.5	42.5	21.0	6.5	10.0	5.0
Missouri, Kansas, Texas Railroad	...	...	...	4.4	...	...	...	4.4
National Railroad Passenger Corporation (Amtrak)	317.5	567.5	602.4	558.5	317.5	250.0	34.9	−43.9
Rural Electrification Administration	254.8	948.0	1,159.9	2,382.4	254.8	693.3	211.9	1,222.5
Small business investment companies	47.5	70.7	90.9	176.0	47.5	23.2	20.2	85.1
Student Loan Marketing Association	240.0	400.0	405.0	510.0	140.0	160.0	5.0	105.0
Virgin Islands	...	...	...	22.0	...	...	...	22.0
Washington Metropolitan Area Transit Authority	177.0	177.0	177.0	177.0	177.0	...	...	...
Western Union space communications	...	...	...	56.5	...	...	...	56.5
Total	13,300.4	22,413.2	25,884.3	35,418.4	12,698.5	9,112.8	3,471.1	9,534.3

[1] Restored to on-budget status on Oct. 1, 1976.

Capital Markets Policy

Fiscal 1977 was a period of change for the Department's capital markets operation. The Secretary created the new Office of the Deputy Assistant Secretary for Capital Markets Policy. That group includes both the Office of Securities Markets Policy (which is primarily concerned with markets and equity securities), and the Office of Capital Markets Legislation (which is primarily concerned with administration policy toward banks and other financial institutions).

A review of financial institutions reform proposals was conducted for the Economic Policy Board, and the administration's NOW account bill was introduced in the Senate. That bill would permit all depositary institutions to accept transaction deposits and pay interest on those deposits. In addition, the President established an interagency task force on regulation Q and other aspects of deposit interest rate controls. This group will consider not only the economic effect of the controls but the effect of any changes in the control on the supply of mortgage credit. This office has also monitored the work of the National Commission on Electronic Fund Transfers and is carefully reviewing its recommendations.

In the securities markets area, the Office participated in the Securities and Exchange Commission's proceedings to eliminate off-exchange trading restrictions. Moreover, its examination of the Glass-Steagall Act restrictions on bank securities activities continues.

Finally, during fiscal 1977, this Office represented the Treasury on the Boards of several Government corporations, including the U.S. Railway Association and the Pension Benefit Guaranty Corporation.

State and Local Finance

The Office of the Deputy Assistant Secretary for State and Local Finance was created in the spring of 1977 to serve as the point of coordination for the existing offices of Municipal Finance and New York Finance. In addition, the Office is expected to improve Treasury's capacity to evaluate the financial condition of State and local governments as well as the fiscal impact of Federal programs on these governments.

Office of New York Finance

During fiscal 1977, the Department oversaw the loan program to New York City pursuant to the provisions of the New York City Seasonal Financing Act, which authorizes the Secretary to extend up to $2.3 billion in annual seasonal financing in fiscal 1977 to the city. The Secretary is authorized to make loans to New York City until June 30, 1978.

Shortly after the Carter administration took office, the Department was faced with a financial crisis in New York City as a result of a New York State Court of Appeals decision in November 1976. Under the decision, New York City was required to repay up to $1.6 billion in so-called moratorium notes within 6 months. The Secretary and other Department officials worked closely with representatives of the city, New York State, and the private sector to develop a feasible solution to the fiscal situation.

For New York City's current fiscal year, which began on July 1, 1977, the Department has extended $1.15 billion to the city and anticipates additional seasonal cash needs by the city during its fiscal year of approximately $725 million.

The duties of the Office include, among other things, loan closings, monitoring New York City cash flows, and related financial arrangements.

Office of State and Local Fiscal Research

The Office of State and Local Fiscal Research was established within the Department of the Treasury for evaluating the overall fiscal condition of State and local governments and also to perform periodic analyses of the fiscal impact of Federal programs on State and local governments.

The Office will first attempt to establish a quality data base, which will incorporate a series of key financial indicators from a representative cross section of governments. While considerable work in this field has already been done within the Government and by academicians and research organizations, it is frequently not sufficient to be beneficial in shaping Federal Government policy in a number of critical areas.

In addition, the Office will review developments and proposals in the field of fiscal management and financial administration of State and local governments, with particular attention to analyzing budgetary and accounting practices.

In 1977, the Office completed major evaluations of the President's economic stimulus package and the antirecession fiscal assistance program and the fiscal impact of these programs on State and local governments.

Office of Municipal Finance

The purpose of the Office of Municipal Finance is to keep the Department aware of various trends in the municipal credit market. The Office provides policy recommendations relating to the condition and regulation of, and access by State and local governments to, the municipal credit markets.

The Office is giving significant attention to current issues which may affect this market, in particular the development of uniform financial disclosure in the sale of State and local securities, the impact of new Federal bankruptcy laws for municipalities on credit markets, and related issues.

ECONOMIC POLICY

In the domestic economic area, the Office of the Assistant Secretary for Economic Policy is responsible for informing the Secretary and other senior policy officials of the Department of current and prospective economic developments, in the determination of appropriate economic policies. This office participates in the interagency group which develops the official economic projections that serve as the basis for choices among alternative courses of economic policy. Other agencies participating in the group are the Council of Economic Advisers, the Office of Management and Budget, the Department of Commerce, and the Department of Labor. Within OASEP staff support for these projection exercises is provided by the Office of Financial Analysis.

The economic projection for calendar 1977 developed within the Troika and presented along with the revised budget in February 1977 called for an increase of about 6 percent in real GNP during 1977, a rise of 5.9 percent in the GNP deflator, and an average unemployment rate for the year of 7.1 percent. By the end of the fiscal year, it was apparent that the actual results were likely to be close to target, with real growth and inflation near 6 percent and the unemployment rate averaging close to 7 percent. These results were achieved without the $50 tax rebate initially proposed when the expansion seemed to lack sufficient forward momentum.

During the year, a series of regular biweekly briefings for the Secretary and other policy officials was initiated. These briefings analyze important economic and financial developments, both domestic and international, on a timely basis and supplement the flow of information provided through other channels.

In addition, during the past year this office undertook analyses and evaluations of the President's economic stimulus package, and the impact of the package on economic growth, employment and unemployment, prices and incomes. An evaluation was made of the shortrun and longrun effects of the President's energy plan on the economy, jobs, and prices.

Other analyses and evaluations undertaken during the year centered on Government agricultural policies and programs, social security and welfare proposals; and the President's program for controlling and reducing inflation.

U.S. balance of payments

The main balance of payments development during the fiscal year was a rapid and continuing increase in the merchandise trade deficit—from a $1 1/2 billion seasonally adjusted annual rate in the second (January–June) half of fiscal 1976 to a $31 billion rate in the second (April–September) half of fiscal 1977.

The primary causes for this worsening of the trade balance were: An extremely sharp volume increase in oil imports, at increased prices; and a near-stagnation of nonagricultural export volume, reflecting a combination of unexpectedly sluggish economic recovery in the major foreign countries and stabilization programs undertaken by a number of less developed and smaller industrial countries faced with balance of payments difficulties.

U.S. current account transactions, July 1975–September 1977
[Seasonally adjusted; $ billion]

	Fiscal 1976 (quarterly averages)	Transition quarter	Fiscal 1977* Oct.-Dec. 1976	Jan.-Mar. 1977	Apr.-June 1977	July-Sept. 1977
Exports	27.4	29.6	29.7	29.5	30.6	30.9
Agriculture	5.6	6.2	5.9	6.1	6.7	6.0
Other	21.8	23.4	23.8	23.3	23.9	24.9
Imports	−27.1	−32.4	−33.3	−36.6	−38.3	−38.4
Petroleum and products	−7.5	−9.4	−9.3	−11.0	−11.9	−11.5
Other (including other fuels)	−19.6	−23.0	−24.0	−25.5	−26.4	−26.9
Trade balance	.3	−2.8	−3.6	−7.1	−7.8	−7.5
Net services and remittances	2.0	3.2	2.8	3.6	3.9	4.0
Government economic grants	−.6	−1.5	−.6	−.6	−.7	−.8
Net invisibles	1.4	1.7	2.2	2.9	3.2	3.2
Balance on current account	1.7	−1.1	−1.4	−4.2	−4.6	−4.3

* Due to seasonal adjustment on calendar-year basis, quarterly data will not add precisely to fiscal-year totals.

Source: Survey of Current Business, June and December 1977, published by U.S. Department of Commerce, Bureau of Economic Analysis.

*Financing of U.S. current account balances, July 1975–September 1977**
[Inflows (+) and outflows (−); $ billion]

	Fiscal 1976 (quarterly averages)	Transition quarter	Fiscal 1977 Oct.-Dec. 1976	Jan.-Mar. 1977	Apr.-June 1977	July-Sept. 1977
Current account balance*	1.7	−3.8	.3	−3.4	−4.8	−6.9
U.S. reserve assets (increase (−))	−.7	−.4	.2	−.4	.0	.2
Other U.S. Government assets*	−.8	−1.3	−1.0	−1.1	−.8	−1.0
Foreign official assets	2.3	3.1	7.0	5.7	7.9	8.2
Industrial countries	−.8	−.3	4.9	2.2	5.5	7.2
OPEC members	2.8	1.8	.8	3.2	1.1	1.4
Other countries	.3	1.6	1.3	.3	1.4	−.4
U.S. banks, net	−1.9	−1.6	−4.1	−1.9	1.8	2.7
Claims	−3.6	−3.4	−9.1	3.4	−4.6	.2
Liabilities [a]	1.6	1.8	5.0	−5.3	6.3	2.5
Securities, net	−.5	.4	−2.2	1.2	−2.4	−.4
Foreign securities	−1.8	−2.7	−2.2	−.7	−1.8	−2.2
U.S. securities [a]	1.3	3.1	−.1	1.9	−.6	1.8
Direct investment, net	−.6	−.6	−.4	.1	−1.4	−.6
U.S. investment abroad	−1.1	−1.2	−.8	−.4	−2.0	−1.1
Foreign investment in United States	.5	.6	.4	.5	.6	.5
Other U.S. corporate capital, net	−1.0	.4	−1.2	−1.1	−1.5	.6
Claims	−.9	.7	−1.0	−.7	−1.1	.7
Liabilities	−.1	−.3	−.2	−.4	−.4	−.1
Statistical discrepancy*	1.5	3.9	1.5	.8	1.3	−2.7

* All data are seasonally unadjusted, because capital flows except U.S. Government lending are not available on seasonally adjusted basis.
[a] Excluding foreign official assets.

Source: Survey of Current Business, June and December 1977, published by U.S. Department of Commerce, Bureau of Economic Analysis.

Growth of nonpetroleum imports, though strong, was generally in line with past normal relationships to domestic business activity; and agricultural exports showed a respectable gain in value as well as volume.

Partially offsetting the trade deficit increase was a $6.5 billion annual-rate gain—between second-half fiscal 1976 and the second half of fiscal 1977—in the surplus on current invisibles transactions.

Thus, the current account balance (seasonally adjusted) swung from a $2 billion annual-rate surplus in the second half of fiscal 1976 to an annual-rate deficit of $6.5 billion in the second half of fiscal 1977.

The sharply increased current account deficit, plus continued Government lending and moderately larger net outflows on nonbank private capital transactions, was financed by increased holdings (particularly by other industrial countries) of foreign official assets in the United States.

OFFICE OF THE GENERAL COUNSEL

The General Counsel, appointed by the President by and with the advice and consent of the Senate, 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. This includes the legal staffs of all subordinate offices, bureaus, and agencies.

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, he 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 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.

During this fiscal year, the General Counsel was given full responsibility over the Office of Tariff Affairs.[1] That office administers the U.S. antidumping and countervailing duty laws.

[1] See exhibit 63.

The General Counsel manages the Legal Division through the Deputy General Counsel, the Assistant General Counsel for the Department, and the Chief Counsel and Legal Counsel of the various bureaus. In addition, the Office of Director of Practice is under the supervision of the General Counsel.

Legislation

During fiscal 1977, the General Counsel provided the Department's views to the Congress and the Office of Management and Budget 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. Among the more significant were:

1. The renewal legislation for general revenue sharing which was enacted into law on October 13, 1976, as the State and Local Fiscal Assistance Amendments of 1976 (Public Law 94–488).
2. The legislation for the Intergovernmental Antirecession Assistance Act of 1977, enacted on May 23, 1977 (Public Law 95–30).
3. Legislation to revise section 5(b) of the Trading with the Enemy Act to remedy problems with the grant of authority given to the Office of Foreign Assets Control. The legislation has passed both Houses and is expected to be signed by the President.

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 thousand individual cases pending in the Customs Court, the Tax Court, and other Federal courts pertaining to Treasury functions.

In *Zenith Radio Corporation* v. *United States*, the U.S. Court of Customs and Patent Appeals reversed the Customs Court and sustained the long-held Treasury position that the nonexcessive remission by an exporting country of an excise tax alone was not a bounty or grant as a matter of law and did not require that countervailing duties be levied. Zenith has petitioned the U.S. Supreme Court for a writ of certiorari to review the decision.

In *United States* v. *Ramsey*, the Supreme Court decided that where a customs inspector had "reasonable cause to suspect" the presence of contraband in an envelope entering the country as international mail, there was no fourth amendment prohibition against opening the envelope without obtaining a search warrant.

In *Richardson and Chaimowitz, as Executors of the Estate of Concepion Brodermann Stuetzel* v. *Simon and the Bank of Nova Scotia*, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of the complaint by the U.S. District Court for the Eastern District of New York, ruling against plaintiff's argument that certain Foreign Assets Control regulations were not authorized by the Trading with the Enemy Act or, if authorized, violated the due process clause of the fifth amendment.

Regulations

During the fiscal year, the Office of the Chief Counsel for Revenue Sharing prepared interim and final regulations covering all aspects of the renewal legislation for general revenue sharing and the antirecession fiscal assistance program.

The Office of the Chief Counsel of the Office of Foreign Assets Control prepared amendments to the Rhodesian Sanctions Regulations reimposing the prohibition on importation of strategic and critical materials from Rhodesia and certain products produced in other countries from Rhodesian ores and concentrates. The action was necessitated by the repeal of the Byrd amendment (Public Law 95–12) by the Congress. In addition, the office prepared amendments to the Cuban Assets Control regulation statement of policy for the issuance of specific licenses for trade with Cuba by foreign affiliates of U.S. firms, and added a general license to both Cuban and Foreign Assets Control Regulations authorizing persons who visit Cuba, North Korea, Vietnam, and Cambodia to pay for their transportation and maintenance expenditures while in those countries.

ENFORCEMENT AND OPERATIONS

At the beginning of fiscal 1977, six operating bureaus of the Department of the Treasury were nominally organized under an Assistant Secretary (Enforcement, Operations, and Tariff Affairs), who was assisted by three deputies and three staff offices (Offices of Law Enforcement, Operations, and Tariff Affairs). The bureaus were 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 were also under the purview of the Assistant Secretary.

However, after Assistant Secretary David R. Macdonald was appointed Under Secretary of the Navy in September 1976, the Assistant Secretary position remained vacant and during fiscal 1977 official functions of the Assistant Secretary were performed over the signature of the Under Secretary.

In the latter half of the fiscal year, the new administration made several organizational changes.[1] The Office of Tariff Affairs was assigned to the supervision of the General Counsel; the Bureau of the Mint and the Bureau of Engraving and Printing were formally placed directly under the supervision

[1] See exhibit 63.

of the Under Secretary; the Assistant Secretary position was assigned to Public Affairs; and the position of Chief Deputy to the Under Secretary (Enforcement and Operations) was established and assigned responsibility for the remaining four bureaus and the Office of Foreign Assets Control, assisted by the two Offices of Enforcement and Operations.

The Office of Law Enforcement continued its oversight and coordination of Treasury's law enforcement policies and programs, with particular attention to legislation affecting the enforcement bureaus, such as those relating to gun control and the general revision of Title 18 of the U.S. Code. The Office of Operations placed special emphasis on review and support of bureau activities in the areas of budgeting, cost-effective execution of programs, productivity improvements, equal employment, management information reports, and improved controls over utilization of official vehicles and qualification for special premium pay.

Reorganization studies were initiated in the U.S. Customs Service and the Bureau of Alcohol, Tobacco and Firearms. An intensive study of the justification for, and administration of, the Federal Alcohol Administration Act was begun.

The activities of each of the bureaus are recorded in the "Administrative Reports" section of this volume. Policy statements on law enforcement are contained in exhibits 21, 22, and 23.

Interpol

Under an agreement negotiated with the Attorney General, the operating supervision and the physical establishment of the U.S. National Central Bureau (USNCB) of the International Criminal Police Organization (Interpol) were transferred from Treasury to the Justice Department in March 1977. The agreement provided for a reciprocal rotation between Treasury and Justice of the two major Interpol offices of Chief, USNCB, and U.S. Representative to Interpol.

Financial recordkeeping and reporting

Under Treasury regulations (31 CFR 103) issued to implement the Bank Secrecy Act, financial institutions, including banks and brokerage firms, are required to keep certain basic records that have a high degree of usefulness in the investigation of tax, regulatory, or criminal matters. The regulations also require reports of the international transportation of monetary instruments, reports of foreign bank accounts, and reports of large and unusual domestic currency transactions.

The Under Secretary has been delegated responsibility for general supervision of the enforcement and administration of the regulations. Specific compliance responsibilities have been delegated to the Federal bank supervisory agencies, the Securities and Exchange Commission, the Internal Revenue

Service, the U.S. Customs Service, the Federal Home Loan Bank Board, and the National Credit Union Administration.

In fiscal 1977, the Commerce, Consumer, and Monetary Affairs Subcommittee of the House Committee on Government Operations continued its review of Treasury's implementation of the act. Under Secretary Anderson and other Treasury officials testified at the subcommittee hearings held on March 29 and 30, 1977.[2]

The subcommittee indicated in those hearings, as well as in the recommendations in House Report 95–246, dated May 5, 1977, that it favored action to encourage wider use of the information filed with Treasury in compliance with the act. In response, Treasury took steps to improve the utilization of that data. Treasury's Office of Enforcement now reviews all currency transaction reports filed with the IRS and makes them available to other agencies where appropriate. During fiscal 1977, 474 reports pertaining to more than $87 million were transmitted to the Drug Enforcement Administration. These reports have already led to investigation of at least one large drug conspiracy. A number of reports of currency transactions and the international transportation of monetary instruments have also been furnished to other components of the Justice Department and various congressional committees for use in their investigations.

Arrangements to computerize the currency transaction reports are also underway. Computerization will greatly increase Treasury's ability to perceive and correct patterns of noncompliance with the reporting requirements. It will also facilitate reference to individual reports and their association with other reports.

In another action intended to improve the implementation of the act, the Office of the Secretary and the IRS have agreed to convert IRS form 4683 to Treasury Department Form 90.22–1, Report of Foreign Bank, Securities, and Other Financial Accounts. It is anticipated that information on the new form, which will be filed with the Treasury, will be available to other Federal agencies on a selective, need-to-know basis. The form will no longer be tied to tax returns and, consequently, will not be subject to the disclosure provisions of the tax law.

During the fiscal year, Customs made 463 seizures totaling more than $7 million in connection with violations of the requirement to report the international transportation of currency and monetary instruments. A significant percentage of the cases appear to involve persons who have been engaged in illegal activities. The total number of convictions obtained during the year was 35.

As the result of an investigation in which IRS agents, the Federal Reserve bank examiners, and Federal prosecutors in New York cooperated, a large New York bank pleaded guilty to 450 counts of failure to file currency transaction reports as required by the regulations. The bank was fined

[2] See exhibit 22.

$222,500. A significant element in the case was the fact that some of the unreported transactions involved narcotics traffickers.

The bank supervisory agencies have started to provide the Under Secretary with the names of those institutions they determine have violated provisions of the regulations pertaining to the recording and reporting of large currency transactions. This procedure should provide additional assurance that instances of noncompliance by banks will be given appropriate attention and corrected.

Antinarcotics program

A U.S. (Treasury) sponsored resolution was adopted unanimously by the United Nations Commission on Narcotics Drugs and by the Economic and Social Council (ECOSOC) urging governments to include narcotics economic alternative/crop substitution projects in their national development programs when applying for technical and financial assistance from the international financial institutions. Adoption of the resolution served to bring about noteworthy contributions from certain Scandinavian countries to the United Nations Fund for Drug Abuse Control, which for some time has been trying to tap development assistance budgets of developed countries for narcotics-related projects. These contributions reduce the percentage of total contributions to the Fund attributed to the United States from 79 percent to 53 percent.

TAX POLICY

Legislation

During fiscal 1977, the Carter administration proposed substantial tax reduction to stimulate economic activity and to reduce tax burdens on individuals and businesses. The administration also recommended tax changes to simplify tax return preparation by individuals. In addition, a long-range tax program was proposed to conserve energy use, to reallocate energy-producing resources, and to stimulate a greater energy supply. The administration also proposed social security tax changes directed at solving the problems of short- and long-term financing of benefits.

Economic stimulus and tax simplification.—In January 1977, President Carter announced an economic stimulus program.[1] Part of the program consisted of tax provisions designed to provide a stimulus to consumer and business spending and to take a significant first step in a program of tax simplification and reform.

The tax stimulus plan had a budget cost of approximately $14 billion in fiscal 1977 and $8 billion in fiscal 1978.

[1] See exhibit 24.

The program included a one-time tax rebate to be distributed to more than 70 million tax filers in the form of a $50 payment per person reported on 1976 tax returns. In addition, 36 million beneficiaries under social security, supplemental security income, and railroad retirement who do not file income tax returns would have received $50 payments.

The program also included a change in the standard deduction to provide tax relief and to simplify tax computations. A simple standard deduction amount of $2,200 for single people, and $3,000[2] for married couples would be substituted for the complex provisions then in effect. Under then existing law, the standard deduction was 16 percent of adjusted gross income with a minimum of $1,700 and a maximum of $2,400 for single people and a $2,100 minimum and $2,800 maximum for married couples.

In addition, the President proposed the extension for 1 year of certain temporary tax cut provisions of the Tax Reform Act of 1976. These extensions included: The $35 tax credit per exemption or a credit equal to 2 percent of the taxpayer's taxable income up to $9,000, whichever is larger; the earned income credit for families with dependent children, equal to 10 percent of earned income subject to a maximum credit of $400; and corporate rate reductions from 22 percent to 20 percent on the first $25,000 of income and from 48 percent to 22 percent on the second $25,000.

The program included business tax relief. Each business would be given the option to choose (1) a refundable credit generally equal to 4 percent of the employer's share of social security payroll taxes, or (2) an additional 2-percent investment credit. The optional credits would have been in effect from January 1, 1977, through December 31, 1980.

On April 14, 1977, the President announced that the primary thrust of his tax program would be the simplification of the income tax structure with an increased standard deduction. He withdrew the $50 rebate because consumer confidence had returned and consumer spending was up.

Public Law 95–30, the Tax Reduction and Simplification Act, was approved on May 23, 1977. The act contained the essence of the President's simplification proposal. It provided a flat amount standard deduction of $2,200 for single persons and $3,200 for married couples. The act also made compensating changes in filing requirements, tax withholding, and tax rate schedules, to reflect the individual income tax credits originally enacted in the Tax Reduction Act of 1975 and then extended in the Tax Reform Act of 1976. These temporary credits included a general tax credit equal to the greater of $35-per-capita tax credit for each taxpayer and dependent, or 2 percent of the first $9,000 of taxable income ($180). The credit is nonrefundable. The 1977 act with some modifications extended the credit to the end of 1978.

The temporary credits included also an earned income credit equal to 10 percent of the first $4,000 of earned income. The credit is phased out as adjusted gross income or earned income increases from $4,000 to $8,000. The

[2] As originally proposed by the President, the standard deduction would have been $2,400 for single taxpayers and $2,800 for couples.

credit is available to those maintaining a household for a child under 19, a student, or disabled dependent. The earned income credit is refundable. The 1977 act extended the earned income credit to the end of 1978.

The act extended to the end of 1978 the $50,000 corporate surtax exemption which has a 20-percent tax rate on the first $25,000 of taxable income, 22-percent tax rate on the next $25,000, and 48-percent in excess of $50,000.

The act also introduced a new jobs tax credit. The credit is equal to 50 percent of the increase in an employer's wage base (up to $4,200 per employee) under the Federal Unemployment Tax Act (FUTA) over 102 percent of that wage base in the previous year. Wages on which the credit is based are limited to total wages paid during the year in excess of 105 percent of total wages paid during the previous year. However, an employer's deduction for wages must be offset by the amount of the credit. The law provides a limitation on the amount of the credit available to new or rapidly expanding businesses. The law also provides an overall limitation on the credit of $100,000 per year exclusive of carrybacks or carryovers to that year. The new jobs tax credit applies to tax years beginning in 1977 and 1978.

The 1977 act made additional changes as follows:

Delays until taxable years beginning after 1976 the effective date of the sick pay exclusion changes made in the Tax Reform Act of 1976.

Allows taxpayers to elect for the first taxable year beginning in 1976 to compute either the credit for the elderly enacted in the Tax Reform Act of 1976 or the retirement income credit under prior law.

Delays until taxable years beginning after 1976 the effective date for 1976 Tax Reform Act changes to (1) the exclusion of income earned abroad by U.S. citizens and (2) the allowance of the foreign tax credit for foreign taxes paid by U.S. citizens who elect the standard deduction.

Extends to taxable years beginning in 1976 the election of a State legislator to treat his place of residence within his legislative district as his tax home for the purpose of computing the deduction for living expenses.

Provides an exception from the general disallowance rule and the exclusive use test for expenses incurred in connection with the business use of any portion of a residence to provide day care services.

Extends through June 13, 1981, the period during which deductions are allowed for (1) charitable contributions of remainder interests in real property and (2) charitable contributions, exclusively for conservation purposes, of perpetual leases, options, and easements with respect to real property.

Modifies the requirement for withholding on gambling winnings effective after April 30, 1977.

Delays until taxable years beginning after 1977 the effective date of accrual accounting requirement for certain farm corporations.

Changes the minimum tax provision so that excess intangible drilling costs are considered a tax preference item only to the extent these costs exceed the taxpayer's net income from all oil and gas properties. The provision was effective only for a taxable year beginning in calendar 1977.

Extends the period of election by a taxpayer of a 5-year rapid amortization period for child-care facilities. The election period begins after 1976 and ends before 1982.

Other changes included the withholding of certain taxes from Federal employees, special relief from additions to tax, interest, and penalties attributable to changes in the 1976 Tax Reform Act.

Energy.—On April 20, 1977, President Carter proposed to the Congress a comprehensive long-term national energy program[3] which would conserve energy use and reduce the annual energy growth to less than 2 percent a year by 1985. The program was also directed at reallocation of energy-producing resources and at stimulation of growth in energy supply.

Tax recommendations were an important element of the President's program:

A graduated excise tax on new "gas guzzling" automobiles and light trucks which do not meet Federal mileage standards. The auto efficiency tax would be phased in from 1978 through 1985. The effect would be to shift the demand for new automobiles from fuel-inefficient, relatively expensive cars to fuel-efficient, relatively inexpensive cars. Collected taxes would be returned to consumers through graduated rebates on motor vehicles that are more efficient than the mileage standard. Electric vehicles would also qualify for a consumer rebate.

A standby tax on gasoline consumption of an additional 5 cents per gallon would automatically take effect each year beginning in 1979 if gasoline consumption fails to meet an annual reduction target in the previous year. The cumulative taxes in any one year would not exceed 50 cents per gallon and would be reversible if consumption fell below the target level. The effect of the tax, if imposed, would be to accelerate the movement from fuel inefficient to fuel-efficient vehicles and to reduce travel mileage. Collected taxes would be rebated on a per capita basis through the Federal income tax system and by direct payments to people who do not pay taxes.

Businesses would generally be entitled to a 10-percent tax credit in addition to the existing investment tax credit for investments made in "business energy property" if acquired after April 20, 1977, and put in place before 1983 as part of a building or other structure which has been substantially completed on or before April 20, 1977. Cogenerative equipment and special types of alternative energy equipment, principally coal handling equipment, would be eligible for the additional credit. Building insulation and heating and cooling equipment (including solar energy

[3] See exhibit 25.

equipment) not eligible for the existing investment credit would receive a 10-percent tax credit.

All domestic oil would be subject to a crude oil equalization tax applied in three stages beginning in 1978. When fully phased in, in 1980, the tax per barrel would equal the difference between the controlled domestic price and the world price of oil. A tax rebate would be provided in the case of home heating oil payable to retailers who demonstrate that the amount of rebate had been fully passed through to consumers in the form of lower prices. All other collected taxes, after adjustment for the revenue loss from deductions of the tax as a business cost, would be returned to the public, on a per capita basis, in the form of tax credits or direct payments for those who have no income tax liability.

Use of natural gas or petroleum in a trade or business would be taxed beginning in 1979 (1983 for electric utilities) whenever annual usage of the two products is equivalent to 86,000 barrels of oil. The tax on petroleum (except for electric utilities) would rise gradually to 1985. Petroleum used by electric utilities would be taxed at a flat rate per barrel. The tax rates would be adjusted for changes in the implicit price deflator for the gross national product. The tax on natural gas usage would be based on the difference between the user's average cost of natural gas during the year and a price target keyed to the current price of No. 2 grade distillate oil. Exemptions from the taxes would be available for usage in specified categories such as transportation, farming, or production of refined petroleum products. Taxable users of fuel (other than electric utilities) could offset expenditures for boilers and fuel-handling equipment for fuel other than petroleum or natural gas against their oil or gas tax liability instead of taking the 10-percent additional energy investment tax credit for these expenditures. In the case of electric utilities, the offset would apply only for expenditures for electrical generating property to use coal or other fuels to replace generating property using petroleum or natural gas.

A tax credit would be provided of 40 percent of the first $1,000 and 25 percent of the next $6,400 (a maximum of $2,000) spent for installation of qualifying residential solar equipment. The credit percentages would be reduced in subsequent years so that the maximum credit would be $1,210 in 1982–84.

Homeowners would be entitled to a tax credit of 25 percent of the first $800 of expenditures and 15 percent of the next $1,400 of expenditures (for a maximum credit of $410) for energy conservation purposes (insulation, etc.) if made to their principal residence after April 20, 1977, and before January 1, 1985, if the dwelling were in existence on April 20, 1977.

To encourage geothermal drilling, a tax deduction for intangible geothermal drilling costs would be provided comparable to the deduction for intangible drilling costs now available for oil and gas drilling.

The current 10-percent excise tax on buses would be removed to encourage expansion in the use of that form of transportation.

The excise taxes on fuel for general aviation and motorboats would be increased. As a result, the tax on aviation fuel would increase from 7 to 11 cents a gallon. The current 2-cent rebate for motorboat fuel would be deleted and the additional revenue transferred to the land and water conservation fund.

Social security.—On May 9, 1977, President Carter proposed to the Congress revision of the social security laws to solve both short- and long-term financing problems. His recommendations were as follows:

General revenues would be used in countercyclical fashion to replace the payroll tax receipts lost during recessions.

The ceiling of the first $16,500 of wages which is the base for both the employer and employee payroll taxes would be removed by 1981 for the employer tax. The purpose is to help long-term financing.

The wage base ceiling for employees would be increased by $600 in 1979, 1981, 1983, and 1985, in addition to automatic increases provided in current law. This would provide a progressive source of financing.

The tax rate on self-employed would be increased from 7 percent to 7.5 percent for OASDI.

The timing of the future tax rate increase in current law would be adjusted. The 1-percent tax rate increase presently scheduled for the year 2011 would be moved forward so that 0.25 percent would occur in 1985 and the remainder in 1990.

At the end of fiscal 1977, Congress had not completed action on social security legislation.

Tax reform.[4]—President Carter stated early in his administration that he planned to present a tax reform program to the Congress in the fall of 1977. However, congressional deliberations on energy and social security tax legislation had continued into the late fall of 1977. The delay in these enactments, which would have substantial tax connotations, made it inappropriate to make also major tax reform proposals in that congressional session. Therefore, President Carter in a press conference on October 27, 1977, stated that he preferred to make a final decision on tax reform after the Congress had completed action on the energy and social security programs.

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. But Public Law 94–566, approved October 20, 1976, increased the effective rate temporarily to 0.7 percent, effective January 1, 1977. The rate

[4] See exhibit 27.

will be reduced back to 0.5 percent after all advances to the Federal extended unemployment compensation account are repaid. The Federal tax is imposed on taxable wages defined as wages up to $4,200 per year in calendar 1977 and $6,000 beginning January 1, 1978.

Public Law 95–19, approved April 12, 1977, the Emergency Unemployment Compensation Extension Act of 1977, extended emergency unemployment benefits (Federal supplemental benefits) and changed financing provisions. Until this enactment, the Federal Government made repayable advances from the general revenues (without interest) to the extended unemployment compensation account. The act makes such advances nonrepayable if the advances are made after March 31, 1977. After March 31, 1977, the costs of the Federal supplemental benefits program are met from general revenues and not from employer payroll taxes on the grounds that long-term joblessness (beyond 39 weeks) results from general economic and social problems. The act also extends the payback time of Treasury advances to State programs by an additional 2 years, through January 1, 1980. The Federal employer tax for a State will automatically increase by 0.3 percent a year, for each year the loan remains unpaid after the extended payback period.

Other legislation.—Additional tax legislation was enacted during fiscal 1977.

Public Law 94–452, approved October 2, 1976, amended the tax treatment of certain divestitures of assets by bank holding companies.

Public Law 94–455, approved October 4, 1976, generally reformed the tax laws of the United States (see the 1976 Secretary's Annual Report, pp. 54–6).

Public Law 94–514, approved October 15, 1976, amended the rules relating to the deduction of interest on certain corporate indebtedness to acquire stock or assets of another corporation.

Public Law 94–528, approved October 17, 1976, provided for a distribution deduction for certain cemetery perpetual care funds and modified the effective dates of certain provisions of the Tax Reform Act of 1976.

Public Law 94–529, approved October 17, 1976, reduced the tax on beer from $9 to $7 a barrel for certain small breweries.

Public Law 94–530, approved October 17, 1976, exempted certain aircraft museums from Federal fuel taxes and the Federal tax on the use of civil aircraft.

Public Law 94–547, approved October 18, 1976, amended the definition of the term "compensation" for purposes of the railroad retirement tax.

Public Law 94–553, approved October 19, 1976, amended the treatment of copyright royalties as personal holding company income.

Public Law 94–563, approved October 19, 1976, amended the rules relating to the payment of social security taxes by a nonprofit organization.

Public Law 94–568, approved October 20, 1976, provided that a social club need be operated only "substantially" rather than "exclusively" for social purposes to be exempt from the income tax.

Public Law 94–569, approved October 20, 1976, provided an extension of certain tax provisions relating to members of the Armed Forces missing in action.

Administration, interpretation, and clarification of tax laws

During fiscal 1977, 35 final Treasury decisions, 37 temporary Treasury decisions, and 32 Treasury notices of proposed rulemaking were published in the Federal Register. A substantial number of these publications implemented provisions of the Tax Reform Act of 1976, including regulations relating to limitations on percentage depletion in the case of oil and gas wells; duties of income tax return preparers; public inspection of written determinations of the IRS; exclusion of certain disability income payments; deduction for expenditures to remove architectural and transportation barriers to the handicapped and elderly; and qualified possession source investment income.

In addition, regulations implementing the Employee Retirement Income Security Act of 1974 were published relating to minimum vesting and funding standards of qualified retirement plans.

Guidelines were issued under the antiboycott provisions of the Tax Reform Act of 1976 in November 1976, with additional guidelines in December 1976. Public hearings were held on the guidelines in April 1977, and revised guidelines were issued in August 1977.

Tax reports

High-income taxpayers.—Pursuant to the Tax Reform Act of 1976, the Department published the first in a series of annual reports on high-income taxpayers entitled "HIGH-INCOME RETURNS: 1974 and 1975; A Report on High-Income Taxpayers Emphasizing Tax Returns with Little or No Tax Liability." The 1976 act requires the annual publication of a report containing data on high-income taxpayers (for income defined in four different ways), including the number of taxpayers who do not pay any taxes, and the importance of various tax provisions which permit individuals to be nontaxable.

Domestic international sales corporation (DISC).—Pursuant to the Revenue Act of 1971, the Treasury submitted to the Congress its fourth annual report on the operation and effect of the DISC legislation. The report covered DISC year 1975 (essentially calendar 1974).

Tax policy conference.—On July 17 and 18, 1975, a conference on tax policy was held at the Treasury at which distinguished consultants and researchers presented theoretical and empirical analysis related to a number of key issues in tax policy. The report of the conference entitled "Conference on Tax Research 1975" was published during fiscal 1977.

Basic tax reform.—On January 17, 1977, the Treasury under the Ford administration published a report, "Blueprints For Basic Tax Reform," which presented two model tax systems prepared by the Treasury staff. One was a plan for comprehensive broadening of the base of the income tax. The second was based on consumption taxation rather than income taxation and substituted a cash flow tax for the income tax.

International taxation.—On December 31, 1976, the Treasury published the third volume in a continuing series of Treasury tax policy research studies analyzing the interactions between tax policy and economic policy. The report, "Essays in International Taxation: 1976," is a collection of essays which addressed international tax issues and represented the work of economists and lawyers.

Tax treaties

Income tax treaties with Morocco and the Philippines were signed during the year and have been submitted to the Senate for approval. Treasury officials testified before the Senate Foreign Relations Committee in July 1977 on pending income tax treaties with the United Kingdom, Korea, and the Philippines. Negotiations and technical discussions on income tax treaties were conducted with Australia, Brazil, Canada, France, West Germany, Italy, Jamaica, New Zealand, Spain, and Sri Lanka. Estate tax treaty discussions were held with Germany, and negotiations were concluded on an estate tax treaty with the United Kingdom. On May 17, 1977, 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. On March 16, 1977, the text of a "model" estate tax treaty was released.

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 meetings of the Inter-American Center of Tax Administrators (CIAT), and the UNESCO conference on the taxation of copyright royalties.

INTERNATIONAL AFFAIRS

Trade and Investment Policy

Trade issues

In the aftermath of the global oil crisis, fundamental structural changes have been taking place in the world economy with a profound impact on trade. Economies have not yet adjusted to the new regime of energy prices; as a result, production worldwide has stagnated and unemployment soared. Countries have increasingly looked to export markets to maintain production, while experiencing strong pressures to protect their domestic markets from foreign goods. Competition has been keen for the limited export opportunities, and increased import competition has been especially sensitive in such sectors as steel, ships, shoes, and televisions.[1]

The sensitivity of trade issues has underscored the need for strong improvements in international trading rules, and stimulated countries to focus attention on securing meaningful progress in multilateral trade negotiations (MTN) underway in Geneva. At the London summit in May and through bilateral understandings with the European Community in July, the talks were given renewed impetus to reduce barriers to trade in an effort to counter the trend towards increased trade protectionism.

Working in close cooperation with other executive departments, Treasury was very active during fiscal 1977 in the formulation of a U.S. policy which emphasized our long-term interest in an open economy while meeting the shortrun demands of adjustment to the new regime of energy prices.

One of the major challenges for U.S. trade policy in the past year has been to maintain an open economy in spite of continuing high levels of unemployment and increased imports. The U.S. economy made strong gains in fiscal 1977, but recovery abroad proceeded at a slower pace. As a result, demand for U.S. exports was sluggish while the growing U.S. market absorbed increasing volumes of imports. The U.S. trade deficit soared to historic highs as our annual energy bill increased to almost $45 billion.[2]

Domestic trade problems

In light of the growing imbalance in trade, industry increasingly called on the Government to provide protection against imports of sensitive industrial products. The U.S. International Trade Commission (ITC) received numerous requests for import relief, and recommended the imposition of quantitative restrictions and/or tariff increases on imports of shoes, televisions, and sugar.

After review by executive agencies, the President decided to reject the ITC proposals for across-the-board import restraints. He decided, instead, to negotiate arrangements which would provide temporary relief to allow domestic industry time to adjust to changing competitive conditions. Orderly marketing agreements were negotiated with our major suppliers of shoes and color televisions, and talks initiated to develop and defend a floor for the international price of sugar. In the case of shoes, the President also announced a major new program under the trade adjustment assistance program specifically tailored to the adjustment needs of that industry. Our trading partners thus participated in the development of import policies aimed at smoothing the adjustment process for trade in these products.

The consumer electronic and steel industries also availed themselves of new provisions in the Trade Act of 1974 to challenge Treasury rulings in the courts in an effort to force Treasury to impose countervailing duties. In one case, the

[1] See exhibit 32.
[2] See exhibit 33.

Zenith Radio Corp. argued that the rebate of the Japanese commodity tax was a subsidy under the provisions of U.S. law. The Government argued that, consistent with international rules, the rebate of an indirect tax was not a bounty or grant. On April 12, 1977, the Customs Court ruled in favor of Zenith, and Treasury immediately suspended liquidation on the import entries of consumer electronic products from Japan. Importers were required to post a 15-percent bond to cover potential duty liabilities. The Treasury appealed the decision to the Court of Customs and Patent Appeals, which overturned the lower court ruling by a 3-to-2 vote on July 28. Zenith then asked the Supreme Court to review the case. Treasury will continue to suspend liquidation, however, until conclusion of the judicial review.

In a separate case, United States Steel Corp. charged that the Treasury should impose countervailing duties against the rebate of the value-added tax on steel exports from the European Community. The case has not yet been heard before the Customs Court.

In sectors where structural adjustment problems arose, the United States sought multilateral solutions to specific trade problems. Steel was faced with a fundamental problem as lower growth worldwide resulted in excess capacity in the major steel producers. To prevent a further increase in protectionist pressures in the world steel industry, the United States and other Organization for Economic Cooperation and Development (OECD) member nations proposed the establishment of an ad hoc steel group. This body met twice in July and September to review and monitor developments in world steel trade. To coordinate domestic policy in this area, the President also asked Treasury Under Secretary for Monetary Affairs Solomon in September to chair an interagency task force to develop a comprehensive policy program for this sector in early fiscal 1978 that will include both domestic and international elements.

Maintaining open world trade

At the same time, the United States was in the forefront of nations committed to maintaining an open and nondiscriminatory world trading system. This goal was reaffirmed by the participants at the Downing Street summit in May, who stressed the need to reject protectionism and to make substantive progress in key areas in the MTN in 1977. The leaders pledged to "provide strong political leadership to expand opportunities for trade to strengthen the open international trade system."

To reinforce this commitment, the United States joined with other members of the OECD in June to reaffirm the OECD trade pledge for the third year in a row. 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 results of these international commitments began to bear fruit in July when Ambassador Strauss reached agreement with our major trading partners on an accelerated timetable for the negotiation and conclusion of the MTN. The agreement covered conditions for the tabling of requests, offers, and new codes for the regulation of nontariff barriers to trade such as subsidies, government procurement practices, and standards, as well as new rules on safeguards. The Treasury is actively involved in the preparation of U.S. positions, in particular the development of codes of conduct on subsidy/countervail and safeguards. Tentative agreement on a tariff plan was reached in late September which presaged an overall cut of around 40 percent. All offers are to be tabled by January 15, 1978.

East-West trade

Progress in the development of U.S. commercial relations continued in fiscal 1977, despite legislative restrictions on the normalization of 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 1976 was $4.70 billion, up substantially from the 1975 total of $3.98 billion.

On June 3, 1977, President Carter recommended to the Congress 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.[3] By not voting in either House against extension, Congress allowed the agreement to remain in force.

In his role as U.S. Chairman of the Joint U.S.-U.S.S.R. Commercial Commission, Secretary Blumenthal chaired the Commission's sixth session in Washington June 9–10, 1977.[4]

Secretary Blumenthal, as honorary Director, attended an executive session of the U.S.-U.S.S.R. Trade and Economic Council in Washington on June 13, 1977.

Export credits

Treasury representatives led the U.S. delegation to the semiannual meetings of the OECD Export Credits Group and the meeting of the Participants in the Consensus on Officially Supported Export Credits, which took place in the framework of the OECD. The discussions in the Export Credits Group resulted in the expanded participation in the Consensus from the original 7 countries—United States, Canada, France, Germany, Italy, the United Kingdom, and Japan—to 19 countries and the EEC Commission. Thus, all the members of the OECD Export Credits Group except Austria and New Zealand are Participants in the Consensus. The trial period of 1 year for the operation of the Consensus, i.e., July 1, 1976, to June 30, 1977, was extended for 6 months

[3] See exhibit 35.
[4] See exhibit 34.

so that the Participants could negotiate a new international arrangement which substantially improved the Consensus.

Treasury attends the weekly meetings of the Board of Directors of the Export-Import Bank. On March 25, Under Secretary for Monetary Affairs Solomon testified to extend the life of the Eximbank from June 30, 1978, to September 30, 1978.[5]

United States-Saudi Arabian Joint Commission on Economic Cooperation

Serving in his capacity as cochairman of the United States-Saudi Arabian Joint Commission on Economic Cooperation, Secretary Blumenthal hosted the third annual meeting of the Joint Commission in Washington in May 1977. At the meeting, three new project agreements were signed in the areas of desalination, financial information services, and consumer protection.[6] This brought the total number of major project agreements under the Joint Economic Commission to 12 with a total ultimate value of over $500 million.

[In October 1977, Secretary Blumenthal visited Saudi Arabia and held a series of wide-ranging discussions with leaders of the Saudi Arabian Government. During this visit, a multimillion-dollar project agreement was signed under which the two nations will cooperate in solar energy research.]

There are at present over 120 Americans working in Saudi Arabia under Joint Commission auspices, and this number is expected to increase substantially during the coming year.

Investment policy statement

As indicated in the Introduction to this Report, the administration established during the period under review a new policy on direct international investment. The policy is contained in a statement drafted by a task force that was cochaired by Assistant Secretary Bergsten; the statement was approved by the Cabinet-level Economic Policy Group in July 1977. It was intended both to serve as a general expression of this administration's policy in this area and to provide a basis for decisions on specific issues that arise from time to time. (The major provisions of the statement are outlined in the Introduction.)

International Investment Survey Act of 1976

The International Investment Survey Act of 1976 provides authority for the President to collect information on international investment and to provide analyses of such information to Congress, executive agencies, and the general public. Permanent and unambiguous authority is provided by the act for ongoing data collection programs on international capital flows administered by the Treasury and other departments, while new authority is provided for other benchmark and special studies.

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[5] See exhibit 30.
[6] See exhibit 31.

The act requires that benchmark surveys of foreign direct investment and foreign portfolio investment in the United States be conducted every 5 years. In addition, U.S. direct investment abroad is to be surveyed in a benchmark every 5 years, while a benchmark census of U.S. portfolio investment abroad must be undertaken at least once within a 5-year period after enactment of the act. In the last benchmark surveys the Departments of Commerce and Treasury collected data on foreign direct and portfolio investment in the United States as of the end of 1974. The last census of U.S. direct investment abroad covered 1966 data, and outward U.S. portfolio investment has not been surveyed since 1941. Commerce is preparing to undertake a benchmark survey on U.S. direct investment abroad to gather data as of the end of 1977.

Overseas Private Investment Corporation (OPIC)

Since 1948 the U.S. Government has had various types of investment insurance programs to protect private American overseas investments against the political risks of currency inconvertibility, expropriation, and war. The current principal purpose of these programs is to mobilize and facilitate the participation of U.S. private capital and skills in the economic and social progress of less developed friendly countries as a complement to our development assistance to those countries.

To accomplish its purpose, OPIC administers three types of programs: Investment insurance, financing, and investment information and promotion activities.

In its core program, insurance, OPIC has issued protection against three forms of risk associated with foreign investment. Maximum insured amounts as of September 30, 1977, were: (1) $3.4 billion for expropriation; (2) $2.9 billion for inconvertibility; and (3) $2.8 billion for war, revolution, and insurrection.

OPIC's finance program consists of: (1) Investment guarantees on medium- and long-term loans from institutional lenders to private enterprises in less developed countries (LDC's); and (2) direct loans to private projects in LDC's.

As of September 30, 1977, outstanding commitments under the investment guarantee program were $164.7 million and outstanding commitments under the direct loan program were $32.9 million.

Finally, in order to identify and assess investment opportunities, and stimulate U.S. private investment in developing countries, OPIC has a third program in which it identifies foreign investment opportunities and "brokers" these projects to U.S. investors. OPIC also provides financial, technical, and other assistance to potential investors as part of its "brokering" activities. OPIC may not finance surveys for minerals, but is now seeking authorization to do so for minerals other than oil and gas.

OPIC wrote much less insurance in fiscal 1977 than in fiscal 1976, sustaining a decline in both dollar volume (maximum insured amount) to $700 million from $1.2 billion and numbers of individual insurance coverages from 389 to 245.

OPIC's statutory authority to issue new insurance and investment guarantees was due to expire December 31, 1977. In view of this, the administration completed a review of OPIC's insurance programs in May 1977. This review concluded that OPIC can advance several U.S. foreign economic policy objectives and should be continued. It also was concluded that, with new program directions, OPIC could play a more important role in the future than it has in the past.

The administration concluded that three changes were needed in the emphasis of OPIC programs to enable it to play such a role.[7] First, OPIC should focus its efforts more heavily on the poorer developing countries which have the greatest difficulty in attracting adequate flows of public and private development resources. Second, OPIC should develop innovative, risk-reducing coverage for selected new investments in energy and other raw materials. Third, existing legislation should be modified to eliminate OPIC's statutory objective of increasing private participation in its insurance functions with the aim of withdrawing completely from direct underwriting by the end of 1980.

Expropriation

U.S. policy regarding expropriation was spelled out in a statement issued by the President in January 1972. That message, which is still germane, acknowledges a government's sovereign right to nationalize foreign property, provided that such action does not violate commitments to the contrary and is carried out in accordance with international law. This requires that the action be nondiscriminatory; for a public purpose; and accompanied by prompt, adequate, and effective compensation. Since the end of the Second World War, the Congress has also enacted various laws providing for the imposition of sanctions against countries which expropriate properties in which U.S. citizens hold 50 percent or more interest but which do not take reasonable steps to compensate the former owners. The basic statutory sanctions are included in the Hickenlooper amendment, the Gonzalez amendment, and the "General System of Preferences (GSP) provision" in the Trade Act of 1974. The Hickenlooper amendment requires suspension of assistance provided under the Foreign Assistance and other acts, including development loans and technical and military assistance. The Gonzalez amendment extends the foreign assistance prohibitions of the Hickenlooper amendment to U.S. multilateral lending policy. The amendment requires the President to instruct the U.S. Executive Directors of the various international development institutions (the International Bank for Reconstruction and Development, Inter-American Development Bank, etc.) to vote against the loan of bank funds to expropriating countries which have not provided prompt,

[7] See exhibit 36.

adequate, or effective compensation; engaged in good faith negotiations to make such payments; or established a suitable mechanism to arrive at a solution, such as submitting the dispute to arbitration under the International Centre for the Settlement of Investment Disputes (ICSID). Finally, the 1974 Trade Act requires the President to deny the GSP benefits to expropriating developing countries which have failed to pay or otherwise take steps toward paying prompt, adequate, and effective compensation.

On January 12, 1974, the People's Republic of the Congo issued a decree nationalizing eight oil companies, including Mobil and Texaco. The companies promptly submitted claims and on a number of occasions sought to enter into discussions or negotiations looking towards a settlement, but there was no progress in that direction.

On December 14, 1976, the Gonzalez amendment was invoked and the U.S. Executive Director voted against an $8 million International Development Association (IDA) loan to the People's Republic of the Congo. On January 19, 1977, President Ford notified Congress of his intention to withdraw that country's eligibility for GSP and the People's Republic of the Congo was so informed on February 18, 1977. In the note to the African nation it was made clear that in considering whether to implement withdrawal upon expiration of the required minimum period of prior notice (60 days), the U.S. Government would take into account any information received in the interim regarding steps taken to provide compensation to the concerned firms. In July 1977, the People's Republic of the Congo and representatives of Texaco met and entered into substantive negotiations regarding compensation for the expropriated property.

International codes of conduct

In accordance with its general policy of encouraging multilateral action to maintain an international environment in which investment is relatively free to move, the United States has agreed to participate in several negotiations on codes of conduct dealing with the activities of multinational enterprises (MNE's). The United States believes that codes of conduct consisting of general guidelines can serve a useful purpose by providing a basis for firmer expectations of accepted behavior for both investors and host governments. At the same time, in view of the varied legal and social traditions among nations, as well as the differing perceptions of the role of foreign investment and the MNE, general codes of conduct dealing with a wide range of issues are by necessity broad in nature and not amenable to legally binding arrangements.

OECD investment package.—As noted in last year's Report, the United States and 22 other members of the OECD adopted a Declaration on International Investment and Multinational Enterprises on June 21, 1976. During the past year, these countries have been implementing the various elements of the Declaration—the guidelines for MNE's and the agreements concerning national treatment of foreign investors and official incentives/disincentives for foreign investment—and the accompanying decisions to hold consultations on each. They have held preliminary exchanges of views on experience gained under the guidelines and will initiate discussions on national treatment and exceptions thereto, i.e., the laws and regulations under which established foreign investors are treated less favorably than their domestic counterparts. No consultations have yet been held on the Incentives/Disincentives Agreement. A formal review of the three elements of the Declaration will take place in 1979.

U.N. code of conduct negotiations.—In the United Nations the Commission on Transnational Corporations began work on a comprehensive code of conduct during the past fiscal year, but is unlikely to meet its goal of preparing an annotated outline of a code for submission to the Commission in 1978. Significant differences remain between the developed and developing countries that are participating in the negotiations.

UNCTAD code on technology transfer.—A code of conduct on the international transfer of technology is being negotiated in the United Nations Conference on Trade and Development (UNCTAD). Major areas of disagreement have arisen between the developed and developing countries concerning the legal nature of the code, the extent of governmental involvement in private transactions, "guarantees" by suppliers of technology, restrictive business practices, and elaborate new international machinery to oversee transfer arrangements. A U.N. negotiating conference is now tentatively scheduled for fall 1978, but slow progress may warrant a further postponement of it.

UNCTAD discussions on restrictive business practices.—In May 1972, the UNCTAD established a group of experts to investigate various aspects of restrictive business practices and to take into account the need for appropriate remedial measures at the national, regional, interregional, and international levels. Work has progressed slowly, in large part because the developing countries want a set of legally binding principles. The position of the United States and some other developed countries is that the time has not yet come for a binding international antitrust code and that any set of principles should be voluntary for both corporations and governments. A report will be presented to the UNCTAD in 1978.

ILO principles concerning MNE's.—A tripartite group within the International Labor Organization (ILO), composed of business, labor, and government representatives from four developed and developing countries, adopted a "Draft Declaration of Principles Concerning Multinational Enterprises and Social Policy" in April 1977. The Governing Body of the ILO, a specialized agency associated with the United Nations, is to take action on the Draft in November 1977. The 58 principles cover such issues as general policies, employment, training, conditions of work and life, and industrial relations. They are voluntary and are addressed to both MNE's and to home and host governments.

Illicit payments

In March 1977, Secretary Blumenthal—while offering suggestions for improvements—testified on behalf of the executive branch in support of proposed legislation to criminalize corrupt payments to foreign officials by U.S. nationals.[8] By the end of this period, the Senate version had passed unanimously, and its House counterpart was still in committee.

The U.S. Government has also continued to pursue its initiative in the United Nations for an international agreement on illicit payments. In response to a proposal made by the United States in March 1976, the U.N. Economic and Social Council (ECOSOC) had established an 18-member working group to elaborate the scope and contents of an agreement and to report back to the ECOSOC in 1977. In July, the ECOSOC received the report of the working group and adopted a resolution containing the following elements: (1) A continuation and expansion of the working group; (2) a mandate for the working group to draft an international agreement on illicit payments in 1978; and (3) a recommendation to the U.N. General Assembly to decide when appropriate to convene a diplomatic conference to conclude such an agreement.

Commodities and Natural Resources Policy

U.S. commodity policy

The Carter administration modified U.S. international commodity policy during 1977 in the interest of promoting price stability and smoother economic growth, both at home and abroad.[9] Under this program, the United States supported the negotiation of international agreements, based on buffer stocks, to stabilize commodity prices. It also agreed to participate in the negotiation of a common fund to facilitate financing of these agreements.

The United States sought to encourage increased investment in the production of key raw materials in developing countries through an expansion in such activities by the World Bank, the regional development banks, and the Overseas Private Investment Corporation in cooperation with the investment insurance agencies of other industrialized countries. In addition, the United States supported the recommendation of the Development Committee of the International Monetary Fund and the World Bank for a review of existing mechanisms to stabilize export earnings.

Officials of Treasury, State, and other agencies participated actively in the formulation of this comprehensive commodity policy and pursued its implementation in several international fora in the belief that it could enhance the general welfare of all nations and, thereby, contribute to the lessening of economic and political tensions worldwide.

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[8] See exhibit 29.
[9] See exhibit 39.

In June 1977, the Conference on International Economic Cooperation (CIEC) concluded its 1 1/2 years of periodic meetings in Paris. Discussion of commodity issues took place in the Commission on Raw Materials (CORM). These discussions were impeded by conflicting views between developed and developing countries on the issues of indexation of commodity prices and the stabilization of export earnings of developing countries. However, participating nations did agree that a common fund should be established to facilitate the financing of international commodity agreements. Negotiations of the purposes, objectives, and other constituent elements of the fund were to be conducted in the United Nations Conference on Trade and Development (UNCTAD).

The idea of a common fund dates back to late 1975, when the UNCTAD Secretariat first proposed it as a central element of an integrated commodity policy. As originally conceived, the fund would finance: (1) buffer stock arrangements for 10 commodities, (2) non-buffer-stock measures to aid in development of commodity industries in developing countries, and (3) intervention in commodity markets to support declining prices. While the developing countries quickly adopted the proposal, the United States and other developed countries were generally opposed to this concept of a common fund because it could lead to disruptions in commodity markets, encourage uneconomic commodity agreements, and duplicate some of the financing activities of existing international financial institutions.

Negotiating sessions on the common fund were continuing under the auspices of UNCTAD. At the session in November 1977 the United States was prepared to endorse a common fund based on a financial pooling arrangement. Under this proposal, the financial resources of individual commodity buffer stocks would be consolidated in a central facility comprising several commodity agreements. Such a fund would be financially more efficient than buffer stock organizations acting independently because of cost-saving benefits through the pooling of cash resources and the consolidation of borrowing operations. Utilization of the fund's resources would be strictly confined to the buffer stock needs of commodity agreements.

The United States continued its membership in both the coffee and tin agreements and announced its intentions to join the new sugar agreement. Though not a member of the cocoa agreement, the United States indicated its willingness to participate in renegotiation sessions. Preliminary discussions of wheat and natural rubber appeared to hold some promise for agreements. Discussions among producing and consuming countries for copper, jute, tea, hard fibers, and tungsten also showed some progress in identifying trade, production, and marketing problems.

The United States, in 1977, adopted a positive approach toward the negotiation of commodity agreements aimed at price stabilization around long-term market trends so as to achieve greater stability in economic growth. This objective was felt to be in the interest of developing and developed countries alike whether they were producers, consumers, importers, or exporters. In the U.S. view, buffer stocks provided the most effective price stabilization mechanism. Under such a scheme, authorized stocking of a particular commodity must be sufficient to defend the price floor as well as the price ceiling. Ideally, the price range of the agreement would be sufficiently broad to permit the free functioning of market forces under normal circumstances. By insulating prices from excessive fluctuations, commodity production could be more efficiently maintained to the benefit of producers and consumers alike. Under these conditions, investment prospects in commodity production would be more favorable and adequate commodity supplies could be assured.

For international agreements to operate effectively, sufficient financial resources must be made available to assure adequately sized buffer stocks, with such financial resources to be provided by both producing and consuming countries. For commodities where an international buffer stock is not appropriate, an export quota arrangement might be suitable if it also provided for the accumulation of nationally held stocks and the export quotas were reallocated frequently so as to encourage new investment and allow entry of new production facilities. Production controls, on the other hand, were considered unacceptable because they could lead to destabilization of prices through inefficient production patterns.

Agricultural commodity developments

Sugar.—The United States actively participated in the negotiation of the new International Sugar Agreement (ISA) because it believed that a new agreement would serve the interests of the United States as a major sugar-producing nation as well as the world's leading sugar importer. Negotiations of the ISA were successfully concluded, and it is scheduled provisionally to enter into force on January 1, 1978. The agreement is designed to stabilize prices within a 10-cent-per-pound price band (11–21 cents), through the combined use of stock and quota mechanisms. Market forces would be allowed to operate freely over a substantial segment of this band.

Wheat.—At the June meeting of the International Wheat Council the United States introduced its revised grain reserve proposal. The U.S. scheme called for international coordination of nationally held grain reserves that would be accumulated and released according to changes in grain prices. It provided for a sharing of costs between exporters and importers with special financing provisions for the poorer nations. The principal objective is to avoid interruptions in trade due to conditions of surplus or scarcity. Scheduled preparatory conferences appeared to be leading to a draft agreement which would be the basis for negotiations in early 1978.

Coffee.—The export quota provision of the International Coffee Agreement did not come into effect in 1977 because of the extremely high coffee prices caused by a small Brazilian crop. Nevertheless, the International Coffee Council (ICO) meetings provided an appropriate forum for an exchange of views between producers and consumers over high prices and uncertain supplies. In this regard, the United States made a significant contribution to an ICO working group's study of the short-term world supply and demand situation.

Grain sales.—In the first year of the 5-year U.S.-Soviet Union grain trade agreement which became effective October 1, 1976, Soviet purchases barely exceeded the minimum levels of 6 million metric tons of wheat and corn. Shipments during the year included 3.1 million tons of corn and 3 million tons of wheat. A recovery in Soviet production to a record level was the major factor in keeping U.S.S.R. purchases to near-minimum levels. For 1977–78, expanded Soviet grain purchases are likely because of lower Soviet grain production, lower U.S. grain prices, and possibly some additional stock building in the U.S.S.R.

Industrial commodity developments

Tin.—Tin prices rose from $3.81 to $5.50 per pound between October 1976 and October 1977 despite the existence of the International Tin Agreement (ITA). Partly because of its relatively small buffer stock, the ITA has had little success in moderating tin price fluctuations during the 1970's. The administration, recognizing the deficiency in the buffer stock, requested authorization from Congress to permit a U.S. contribution of up to 5,000 tons of tin to the agreement. In addition, the United States indicated its objection to high production and export taxes levied by producing countries, which discourage production and lead to escalation of tin prices.

Rubber.—In January, and again in June, the major natural rubber producing and consuming countries met under UNCTAD auspices to discuss problems in the international rubber market. Both groups agreed that excessive price fluctuations had adverse effects on both consumers and producers and that appropriate measures to smooth price movements should be examined. Preliminary analysis indicated that a stock arrangement was feasible and could provide economic benefits to the United States. Since producers had already agreed to a limited buffer stock arrangement, an agreement of some kind appears likely. Therefore, it was determined to be in the economic interest of the United States to take an active role in attempts to design a workable rubber agreement.

Copper.—International meetings under the UNCTAD program considered possible measures to stabilize copper prices. While the characteristics of copper (standardized grading, open trading, and storability) appear suitable for a buffer stock arrangement, a feasibility study of stabilization measures is currently underway. A producer-consumer conference, scheduled for February 1978, will help decide whether a negotiating conference for a commodity agreement should be convened. The feasibility of establishing an international producer-consumer organization for copper is also being considered.

Tungsten.—Although tungsten was not one of the commodities listed in the Integrated Program for Commodities, tungsten producers and consumers met in July in Geneva under UNCTAD auspices to consider measures to stabilize trade in tungsten. Producers and consumers will meet again in November to discuss background studies on the tungsten industry and to assess proposed measures to improve tungsten trade. A major obstacle to any agreement is the lack of a central market.

Energy policy

The administration has made the development, adoption, and implementation of a national energy program one of its prime objectives. Treasury's interests center on the tax, financial, and economic implications of such a program. Treasury staff have participated in the evaluation of various options affecting domestic and international policy. Treasury has focused on the effects of Organization of Petroleum Exporting Countries (OPEC) pricing decisions on the U.S. and world economy, and on policy options which would encourage the development of indigenous resources in non-oil-producing developing countries. In addition, Treasury officials have responded to numerous inquiries and invitations by the Congress and the public to speak on a wide range of energy issues, energy-related legislation, and energy regulatory policy.

Alaskan natural gas transportation.—Treasury issued a comprehensive report on the financing of the Alaskan natural gas transportation system, assisted in the preparation of the President's Decision Report to Congress, and appeared before Congress to support that report.

Strategic petroleum reserves.—Through review of environmental impact statements, estimations of trade effects, and review of the plans for strategic storage reserves, Treasury assisted in the development of this important emergency measure.

Financial considerations for electric utilities.—Early in the fiscal year Treasury staff prepared a comprehensive financial analysis of the domestic electric utility industry, resulting in policy recommendations to the Energy Resources Council.

Interagency cooperation

Treasury staff participated in various interagency task forces and committees:

Interagency Geothermal Coordinating Council.—This Council encourages and facilitates expanded development of geothermal energy. Treasury participated in the development of taxation and loan guarantee policies which will provide additional financial incentives for expeditious development of this source of energy.

Energy information.—Treasury participated in the Federal Interagency Council on Energy Information, an intergovernment forum to coordinate the collection and use of energy data.

Presidential Task Force for the Reform of FEA Regulations.—This task force was established to simplify and make improvements in the FEA price and allocation regulations. Treasury staff participated in the task force and helped prepare the final report.

Liquefied natural gas (LNG).—Treasury representatives participated in the interagency Task Force on Liquefied Natural Gas, which considers LNG import policy.

Cogeneration Interagency Task Force.—This considers tax incentives and other financial incentives which may be required to foster the development of cogeneration projects.

Nuclear energy policy coordination.—Treasury staff assisted the Nuclear Subcommittee in formulating an interagency decisions schedule for the nuclear fuel cycle, including waste management. The Nuclear Subcommittee had been formed by the Energy Resources Council to integrate Federal regulatory procedures affecting nuclear energy development.

Nuclear energy policy.—Treasury staff provided trade, financial, and economic analyses for various interagency committees concerned with nuclear power development and proliferation.

Conference on International Economic Cooperation (CIEC)

The Conference on International Economic Cooperation was established at a Ministerial meeting in Paris in December 1975. The Conference consisted of representatives from developed countries, nonoil developing countries, and OPEC countries. Its objective was "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."[10]

There were 27 participants in the CIEC. These included seven industrial countries (Australia, Canada, Japan, Spain, Sweden, Switzerland, and the United States) plus the European Economic Community, and 19 countries representing the developing world (Algeria, Indonesia, Iran, Iraq, Nigeria, Saudi Arabia, Venezuela, Argentina, Brazil, Cameroon, Egypt, India, Jamaica, Mexico, Pakistan, Peru, Yugoslavia, Zaire, and Zambia).

Discussions took place in four different commissions: The Energy Commission, the Raw Materials Commission, the Commission on Development, and the Commission on Financial Affairs. Each Commission consisted of 15 CIEC members, 5 from among the industrial country participants and 10 from the developing country participants. The Conference concluded on June 3, 1977, with a Ministerial meeting, which adopted a final communique by consensus.[11]

Energy.—The CIEC participants agreed to a general set of guidelines that (1) recognize the essentiality of adequate and stable energy supplies to global

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[10] See exhibit 37.
[11] See exhibit 59.

growth and the responsibilities of all nations to ensure that such supplies are available; (2) call for intensified national and international cooperation efforts to expand energy conservation and accelerate the development of conventional and nonconventional energy supplies during the energy transition period and beyond; (3) affirm that special efforts should be made to assist oil-importing LDC's alleviate their energy burdens; (4) recommend that the IBRD, in the context of a general capital increase, give priority to lending for LDC energy development; (5) call for new international efforts to facilitate the transfer of energy technology to LDC's wishing to acquire such technologies; (6) endorse enhanced international cooperation in energy research and development; and (7) recognize the desirability and inevitability of the integration of the downstream processing industries of the oil-exporting countries into the expanding world industrial structure as rapidly as practicable.

Raw Materials.—The objectives of the industrialized countries consisted of ensuring a pragmatic, objective treatment of the various problems in commodity trade as well as the possible solutions to these problems. There were general areas of agreement but greater areas of disagreement, particularly on such traditional developing country objectives as indexation and measures to harmonize the production of synthetics with that of natural products. The CIEC participants reached agreement in principle on the establishment of a common fund with its purposes, objectives, and other constituent elements to be further negotiated in UNCTAD.

Development.—Agreement was reached on a number of useful concepts and programs in the areas of development finance, transfer of technology, trade, assistance to agriculture, infrastructure, and industrialization. These include (1) a commitment by donor countries to seek increases in official development assistance and to enhance the quality and distribution of aid flows; (2) agreement to begin negotiations on a general capital increase of the IBRD; (3) agreement to establish a special action program of $1 billion of additional aid for the poorer developing countries; (4) agreement on a set of general concepts concerning infrastructure development, with particular reference to a conference to establish objectives for an African transport and communications decade; and (5) agreement on a 500,000-ton emergency grain reserve, support for early negotiation of a grains agreement with stocks, and recommendations for enhanced aid for food production and research. In the area of trade, the participants agreed to (1) recognize the importance of making general progress in the MTN, (2) call for efforts to improve the GSP, and (3) reach an early conclusion to the multilateral textile negotiations.

Finance.—Discussion within the Financial Commission focused on four main areas: Private foreign direct investment, developing countries' access to capital markets, other financial flows including monetary issues, and measures to enhance economic cooperation among developing countries. The Commission made considerable progress toward agreement on the essential elements that constitute a favorable investment climate. In addition, support was expressed for the recommendations of the IMF/IBRD Development Committee on increasing access of developing nations to international capital markets. The initiative to establish a supplementary credit facility within the IMF was also endorsed. Finally, participants agreed to take appropriate measures to enhance economic cooperation among developing nations.

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 (SEQ).—The Standing Group has now essentially completed preparation of the IEA emergency program which establishes procedures necessary to implement the sharing of fuel assets in emergencies. Current activities involve refinement and testing of the system. During the year, the "Emergency Management Manual" was completed. This document reflects all the basic decisions, goals, and procedures for emergency operations in the event of embargo-related petroleum shortages. In addition, a successful test of the emergency oil allocation system was conducted during a 6-week simulated shortage period in the fall of 1976.

Standing Group on Long-Term Cooperation (SLT).—Largely as the result of the Standing Group action, IEA participants recently agreed in Ministerial session to a 1985 objective for group dependence on imported oil of 26 mmb/d (millions of barrels per day), and pledged individual country action on energy policies designed to achieve this goal. Treasury participated in several working groups of the SLT on conservation and on accelerated development of energy resources. The SLT has also concentrated on an annual assessment of the energy programs of IEA member countries with a view toward reaching the IEA reduced oil import objective.

Standing Group on Oil Market (SOM).—Treasury has participated in general meetings of the SOM, and in particular in its Ad Hoc Working Group on Capital Investment and Financial Structure. It 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.

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 negotiating sessions in

Geneva and New York, in 1977, has endeavored to draft a single comprehensive treaty package which will include provisions for 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. With the exception of the deep ocean mining text, the text produced at the recent New York session represented compromises which were generally acceptable to most nations.

The U.S. concerns over the lack of progress and the inequitable negotiating process in the deep ocean mining negotiations have increased to the point that the question of continued U.S. participation in the Conference has come under review within the administration. At stake is access to extensive deposits of manganese nodules which contain significant quantities of manganese, cobalt, nickel, and copper. The basic position of the United States has been to ensure that the treaty provides assured access for private companies and state-operated enterprises, after they have satisfied certain objective criteria concerning safety, pollution, and work requirements. The major industrial countries, some of which are currently cooperating with American firms in consortia, have supported this concept. On the other hand, the G–77 has wanted a discretionary access system controlled by the proposed International Seabed Authority.

At the open negotiating sessions in Geneva and New York, progress was made toward drafting an acceptable compromise text; however, further negotiations would have been necessary. In spite of this progress, at the last minute, the Chairman of the Ocean Mining Committee drafted a text in private which largely ignored the earlier progress. This text was never discussed with a representative group of concerned nations and treated weeks of serious debate and responsible negotiation as essentially irrelevant.

The United States objects to this lack of due process and to provisions of the text which (1) give the Authority and the proposed one-country-one-vote Council discretionary power to require a transfer of technology to the Authority in return for a mining contract; (2) set an artificial limit on seabed production to protect land-based producers; and (3) fail to specify the financial burden on the firms of any revenue sharing scheme.

The resource policy and revenue sharing issues in the deep ocean mining negotiations have important implications for U.S. economic policies. Underlying the position of the United States in favor of assured access is the desire to encourage an efficient increase in the output of important minerals and to minimize controls over investment, production, and prices. The United States has taken the position that revenue sharing should be limited to a portion of the value added from mining. Such payments would be a deductible expense and not a credit against tax liability.

On October 4, 1977, Ambassador Richardson, the special representative of the President, announced that the administration now supports the enactment of deep ocean mining legislation to cover the transition until a treaty enters into force. Treasury is developing a program of domestic tax treatment for the

U.S. portion of an ocean mining operation.[12] However, such beneficial tax treatment for the industry must be viewed as part of an overall ocean mining finance program which provides benefits for the international community (revenue sharing) and which contains no provisions for investment guarantees for ocean mining firms. If the Government were to provide such guarantees, the ocean miners would have more favorable Federal financial treatment than other U.S. industries whose interests are also affected by international negotiations.[13]

International Monetary Affairs

World economic and financial developments

The world economy.[14]—At the beginning of fiscal 1977 the world economy was entering the second year of recovery from the 1974–75 recession. Most observers expected a steady solid expansion that would reduce both inflation rates and unemployment levels.[15] The first half of the fiscal year produced solid industrial production growth in most countries, but inflation rates—partly reflecting the strong production increases—rose rather than declined. Commodity prices posted sharp increases in the September 1976–March 1977 period.

Toward the end of fiscal 1977 the pattern of faster growth and lower inflation was reversed. As of August, aggregate industrial production in the six largest OECD countries (excluding the United States) had registered declines for 5 consecutive months, and the aggregate level was less than 2 percent above that of a year earlier.

Not surprisingly, the weak domestic demand picture was associated with decelerating inflationary pressures. Worldwide commodity prices (excluding oil) retreated from the fall and early spring increases, and were only slightly above December 1976 levels at the end of the fiscal year. Wholesale price increases reflected this softness, and cost-of-living increases began to decelerate by the end of the summer in most countries. In the OECD area, cost-of-living increases averaged less than 6 percent (annual rate) in the 4 months ending in September 1977 after rising at a roughly 11-percent rate earlier in the year.

The soft growth picture was also reflected in unemployment levels, which continued to rise in most countries during the fiscal year. By the end of the fiscal year more than 16 million persons in the OECD area were unemployed—roughly 5.4 percent of the civilian labor force. Near-record levels prevailed in most countries and even in the expanding economies—especially Japan and the United States—unemployment continued to be sticky in the downward

[12] See exhibit 40.
[13] See exhibits 38 and 40.
[14] See exhibit 47.
[15] See exhibit 51.

direction and hovered around 2 and 7 percent levels, respectively—both quite high by historic standards. Within most economies unemployment was particularly troublesome in demographic terms. Given widespread job security arrangements, disproportionate shares of the unemployment had fallen on young workers seeking their first jobs and in some countries on minority groups.

Perhaps most disturbing was the continued slow growth in real investment demand. In many countries, business confidence continued to be weak and essentially only replacement or labor-saving investment was undertaken. In prior recoveries, real investment followed rather closely behind increases in consumption levels, providing a "third-stage" boost to the recovery/expansion path. To date no country outside the United States has yet experienced anything like the expected pattern of investment demand. Clearly continued business pessimism clouded investment decisions and, hence, the third stage of the cycle has not materialized.

The expansion of the nonoil LDC's has been substantially more encouraging. Most of the LDC's facing external financing constraints in fiscal 1976 registered sharp improvements in both external and internal imbalances during fiscal 1977. For LDC's as a whole inflation rates slowed somewhat and dramatic declines were recorded for Latin America, as annual rates of cost-of-living increases declined from 80 to 50 percent.

Payments patterns and financing developments.—The world pattern of current balances in aggregate terms experienced the largest changes witnessed since the oil price increase of 1973. Basically, however, these shifts were within the broad groupings of countries—the OECD, nonoil LDC's, OPEC—rather than between groups. Since 1973, major groups in the world economy witnessed sharp year-to-year changes in their respective external balances. During 1977 this tendency was substantially dampened. In broad, aggregate terms OPEC's current account surplus stood essentially unchanged in 1977. The OECD's aggregate deficit rose by roughly $6 billion, partly reflected in a reduction of the nonoil LDC deficit (about $4 billion) and partly due to a contraction of the rest-of-the-world's deficit—largely in Eastern Europe—of about $2 billion.

It is the changes in individual country positions within the major groupings which have been important. This past year brought impressive proof that appropriate stabilization policies can produce meaningful adjustments in both external and internal imbalances. Improvements were recorded by the United Kingdom and Italy and both will likely run small surpluses on their current accounts—a significant and welcome change from the deficits of recent years. A number of non-oil-producing LDC's have also benefited from the enactment of stabilization policies last year. India, Brazil, and Mexico have substantially reduced external and internal imbalances—inflation rates have declined current account deficits have receded, and private sector evaluations of creditworthiness have improved.

The change in the U.S. current account deficit was the most dramatic as the deficit on current account, influenced by the country's rapid growth and slower growth in other major countries, rose about $18 billion. At the other extreme, the Japanese current surplus increased by $7 billion as the economy failed to reach its target growth rate.

The pace of gross external borrowing by oil-importing countries reflected the changes in current account position within major country groupings. By the end of fiscal 1977, the rate of increase in gross medium- and long-term borrowing from private capital markets had slowed appreciably. The improved aggregate deficit position of the non-oil-producing LDC's enabled gross borrowings to remain essentially at the 1976 pace but with a decline in net borrowings. In addition, these LDC's were able to increase gross foreign exchange reserves substantially for the second straight year. The nonmarket economies of Eastern Europe, the U.S.S.R., and the People's Republic of China continued to face resistance in private capital markets to new credit arrangements but were able to arrange borrowings at a pace equal to that of 1976 levels. More important was the successful reentry to private markets of several borrowers who had been excluded due to a lack of creditworthiness. Markets were apparently impressed by the results of stabilization programs.

Role of private banks.—International lending by commercial banks[16] has grown rapidly in recent years, largely as a consequence of the massive OPEC surpluses and the associated needs of many countries for financing of their current account deficits. Bank lending has been of vital importance in cushioning the twin shocks of worldwide recession and massive oil price increases, while permitting deficit countries time to institute appropriate adjustment policies aimed at restoring external equilibrium. In calendar 1976, the private markets provided about three-quarters of the gross financing of all the deficit countries.

Concerns have been expressed that the banks might not be able to continue their intermediation because of the decline in the creditworthiness of borrowers, that some countries may have borrowed beyond their capacity to service debt, and that banks themselves may be overexposed.

Despite the large volume of bank lending, however, the banks on the whole have not incurred undue risks.[17] While the phasing in of adjustment programs has not been uniform in all countries, considerable progress has been made in reducing substantially the large payments deficit which many countries have been running in recent years.

Moreover, the capacity of most countries to service their external debt has increased over time as a result of an expansion in real income and in the volume of the exports of goods and services. Also, inflation has substantially reduced their debt burden in real terms.

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[16] See exhibit 46.
[17] See exhibit 50.

Bank loans continue to be heavily concentrated in the developed countries. At the end of 1976, the foreign claims of banks in the major industrial countries totaled $530 billion. Of this, $400 billion represented claims on residents in developed countries and the offshore banking centers. The pattern was similar for U.S. banks. At the end of 1976, their foreign claims totaled $225 billion, excluding claims on their affiliates abroad, and over 60 percent of these, or $140 billion, were claims on residents in the developed countries and on banks in the offshore centers.

Foreign exchange developments and operations.—During the fiscal year, countries followed a variety of exchange rate practices. There continued to be a greater willingness among countries to permit changes in exchange rates than there was 5 or 10 years ago and a much clearer recognition of the importance of exchange rate movements in facilitating the adjustment of international imbalances. During the fiscal year, there were a number of movements in the exchange rates of important, internationally traded currencies as market forces continued to respond to the wide divergencies in domestic economic and financial conditions.

During 1976, the major market developments had involved the depreciation in terms of the dollar of currencies of a few industrial countries experiencing payments deficits and the efforts of those countries, notably the United Kingdom, France, and Italy, to deal with imbalances in their domestic economies. In 1977, attention was attracted to the currencies of the major countries experiencing payments surpluses as well as to the progress being made by countries pursuing stabilization programs. The German mark, Japanese yen, and Swiss franc, which had been appreciating in terms of the dollar in 1976, continued to appreciate. The United Kingdom and Italy took advantage of improved positions to rebuild depleted reserves and to begin the process of debt repayment. The U.S. dollar, on a trade-weighted basis, continued to fluctuate rather narrowly, though the dollar depreciated briefly by about 1 1/2 percent between late June and late July. Following the release of an OECD Ministerial communique, stating that countries with current account surpluses would allow their currencies to appreciate in response to underlying market forces, the dollar experienced a period of speculative selling fostered by an impression in the market that the United States sought a lower dollar. This impression was dispelled by U.S. officials when the speculative atmosphere persisted. At the end of September, the dollar, on a trade-weighted basis in terms of OECD currencies, was about 2.4 percent above its level of a year earlier.

Early in the fiscal year, speculative pressures on the German mark, in large part in expectation of a DM revaluation within the European common margins ("snake") arrangement, resulted in an appreciation of that currency; the mark moved to DM 2.40 per dollar following the October snake realignment, which included a 2 percent DM revaluation. Late in 1976 the DM began to appreciate again, but the rate returned to the DM 2.40 level early in 1977 as the German economy showed signs of weakening and reflows of funds were attracted by countries which had undertaken stabilization measures. The DM traded rather narrowly below that level before appreciating from about DM 2.36 in late June to less than DM 2.25 briefly in late July during the speculative period following release of the OECD communique. The rate then fluctuated around DM 2.32, moving to about DM 2.31 at the end of September, reflecting an appreciation of about 6 percent in terms of the dollar over the fiscal year.

The Japanese yen appreciated during the first half of 1976, and was trading at less than Y290 per dollar by August. The rate then began to depreciate in advance of the Japanese elections in December and midst apprehension of a major boost by OPEC in oil prices; the trade and current account surplus had narrowed, and the yen reached nearly Y300 before the elections. The yen then resumed appreciating, reaching less than Y275 in April, during a period in which there were only minor fluctuations in the rates of other internationally important currencies. After a brief period of uncertainty, stemming from the prospects of the imposition of trade restrictions by other major countries on imports from Japan and an easing in Japanese monetary policy, the yen again began to appreciate early in June and reached Y263 briefly in early July. Subsequently, the rate receded to about Y265 per dollar, reflecting an appreciation of about 8 percent from September 1976.

Throughout much of the period under review, the Swiss franc attracted funds from countries whose currencies were experiencing selling pressure, primarily because of a low Swiss inflation rate and a large current account surplus. During October 1976–early January 1977, however, the rate fluctuated around SF 2.45 per dollar. The franc then depreciated and traded above SF 2.56 in March; with Swiss interest rates low and capital outflow encouraged, there were reflows from the franc—as well as from the DM—to currencies of countries which had undertaken stabilization programs. In April, the franc was temporarily affected by the reports of the losses at the Chiasso branch of a major Swiss bank, but by the end of May the franc was appreciating rather strongly again and traded below SF 2.40 by the end of July. The rate was fairly steady in August, as funds were drawn, in particular, into sterling, but in September the franc appreciated to a record high in terms of the dollar of less than SF 2.35, reflecting an appreciation of about 5 percent from September 1976.

The major change in the Canadian dollar was in November 1976, when it depreciated from about $1.03 to less than $0.97. The Canadian dollar had been appreciating earlier in the year, reflecting Canada's progress in reducing inflation and the effects of large Canadian borrowings abroad. With the pace of recovery slow and unemployment gaining, however, the Separatist Party's election victory in Quebec brought the currency under selling pressure. Subsequent concern about Canada's, and especially Quebec's, continuing ability to place long-term bonds in U.S. and other foreign capital markets, as well as about Canadian economic performance, led to further depreciation. Although Canada continued to borrow in foreign capital markets, the Canadian dollar reached a low of less than $0.93 in August. The rate was also at this level at the end of September, reflecting a depreciation of about 10 percent over the period under review.

The Italian lira, which had reached a record low of Lit 917 per dollar in May 1976, appreciated following the imposition of severe exchange restrictions. A new Italian Government was installed in September, and planning began on an economic stabilization program, announced in October. The lira fluctuated widely throughout the latter part of 1976, ending the year at about Lit 875. Some exchange controls were removed, and the lira reached about Lit 887 in April 1977, when agreement was reached with the IMF for a standby arrangement of SDR 450 million. In connection with the standby, the Italian stabilization was able to rebuild reserves, and at the end of September, the rate was about Lit 883, representing a depreciation of about 2 percent over the period.

Sterling began to depreciate in early March 1976, after having traded above $2.02 1/2. By early June the rate was little more than $1.70, and sterling reached a low of $1.55 1/2 briefly late in October. A series of discussions among the Group of Ten countries, Switzerland, and the Bank for International Settlements (BIS) was initiated in early June to deal with the immediate concerns of the British foreign exchange situation. These discussions resulted in an agreement on June 7 to provide a $5.3 billion package of short-term standby facilities. The Treasury, through the Exchange Stabilization Fund (ESF), and the Federal Reserve, against its reciprocal currency ("swap") arrangement with the Bank of England, agreed to provide up to $1 billion each as part of the package, to terminate on December 9. The British Government pledged that it would arrange to draw additional amounts on its IMF credit tranches if necessary to obtain funds for repayment. The United Kingdom drew a total of about $1.5 billion against these facilities, in June and in September; drawings on the U.S. portion totaled $600 million, with the ESF and the Federal Reserve each providing $300 million. All drawings under the arrangement were repaid at maturity on December 9.

Following the imposition of emergency measures in October, including a severe tightening in monetary policy, sterling began to appreciate, the rate reaching $1.65 in November and $1.70 in December.

The British had begun negotiating a standby arrangement with the IMF; a stabilization program, announced in December, led to the conclusion in January 1977 of an SDR 3,360 million, 2-year IMF standby arrangement. As a supplement to this IMF standby, only part of which could be drawn immediately, the ESF and the Federal Reserve each agreed to provide short-term swap facilities to the Bank of England of up to $250 million, to be repaid following subsequent drawings on the IMF standby; these facilities were not used. Negotiations were also undertaken on a multilateral credit arrangement to alleviate pressures on sterling which might arise from further shifts out of officially held sterling balances and under which such balances would be reduced. Such a facility would be designed to accompany and reinforce the economic program undertaken by the British Government in connection with the IMF standby. The arrangement, concluded in January, established a medium-term standby facility, provided to the Bank of England by the BIS, backed up by the participating countries. Under the arrangement, the Bank of England may draw up to $3 billion to finance net reductions in official sterling holdings below December 1976 levels. For the United States, the Federal Reserve and the ESF agreed to provide a combined amount of up to $1 billion in short-term swaps to the BIS. For their part, the British authorities agreed to offer medium-term, foreign-currency-denominated securities to official holders to fund part of the sterling balances outstanding. There were no transactions under this arrangement during the period under review.

The position of sterling in the market reversed toward the end of 1976, the United Kingdom external and domestic financial position improved, and the Bank of England gained reserves. Sterling fluctuated narrowly around $1.72 during January–July, moving then to $1.74 1/2, an appreciation of about 4 percent over the fiscal year. The Bank of England intervened strongly in the market to prevent an appreciation of sterling which it considered incompatible with trends in domestic prices.

The French franc traded at less than FF 4.50 per dollar in early 1976 and was supported heavily to maintain its EC snake margins until the French withdrew from the arrangement in mid-March. By August, the franc was trading at over 5.00, and the French instituted an economic stabilization program. The rate then fluctuated fairly widely as the market gradually regained balance by early 1977. With progressive improvement in the French price and external payments performance, and bolstered by borrowings abroad, the franc appreciated slightly in 1977, and the Bank of France regained reserves. At the end of September the rate was about FF 4.90, reflecting an appreciation of 1 percent from its September 1976 level.

There were a number of changes in the EC snake arrangement. The resistance to market pressures inherent in the arrangement has often been unsettling to the exchange market. The snake was instituted in March 1972, when the six members of the European Community announced their intention to maintain their exchange rates within 2 1/4 percent of each other; the Benelux members maintained narrower margins of 1 1/2 percent among their own rates. Since that time, Britain has joined and withdrawn; France has withdrawn, reentered, and withdrawn again; Italy has withdrawn; Denmark joined, withdrew, and rejoined; Norway and Sweden joined, and in 1977 Sweden withdrew. The Benelux arrangement was abandoned in March 1976. During the period under review, exchange rate realignments among participants were undertaken in October 1976 and in April and August 1977, and at the end of the period the participants were Belgium, Denmark, Germany, the Netherlands, and Norway.

U.S. policy on intervention in the foreign exchange market is based on the view that exchange rates should be permitted to reflect market forces. The Federal Reserve and the Treasury intervene in the market not to influence the trend of exchange rate movements, but only when necessary to counter disorderly market conditions. An expression of U.S. policy on intervention is found in the December 1976 revisions of the FOMC Authorization for Foreign Currency Operations and Foreign Currency Directive which were developed in consultation with the Treasury. The United States considers a strong dollar to be in its national interest as well as in the interest of the system generally, and seeks to pursue that objective through the achievement of a strong, expanding, noninflationary domestic economy.

All U.S. foreign exchange market intervention during October 1976–September 1977 was undertaken by the Federal Reserve, through the Federal Reserve Bank of New York, in consultation with the Treasury. Operations were conducted almost entirely in German marks, the most important foreign currency affecting the market for dollars. Sales of DM were at times financed by drawings against the Federal Reserve's $2 billion swap arrangement with the Bundesbank, necessitating subsequent purchases of DM to repay the swap drawings. DM were also purchased from time to time when especially strong demand for dollars tended to unsettle the New York market, and the Federal Reserve often maintained some balances in DM in order to be able to conduct relatively small operations without drawing on the swap line. At no time during the period did outstanding Federal Reserve drawings under the swap line exceed $108 million, or DM balances held by the Federal Reserve exceed $93 million.

In addition to market intervention, the U.S. authorities began in November 1976 to undertake foreign exchange transactions for the repayment of Swiss franc indebtedness remaining from August 1971. Pursuant to an agreement with the Swiss authorities, regular repayment will be made over a 3-year period on $1,147 million equivalent of Swiss franc drawings under the Federal Reserve swap line and $1,599 million equivalent of Swiss franc-denominated U.S. Treasury securities. By September 30, 1977, the Federal Reserve indebtedness had been reduced to $615 million equivalent, and the Treasury's outstanding securities had been reduced to $1,289 million equivalent. Most of the Swiss francs used for the repayments were purchased directly from the Swiss National Bank against dollars; in addition, some francs were purchased against third currencies acquired in the market by the Federal Reserve, and some francs were purchased by the Federal Reserve from correspondents.

During the period, the Treasury, through the ESF, and the Federal Reserve System also provided short-term credit facilities to Mexico and the ESF to Portugal,[18] described below. All drawings were repaid. ESF commitments which remained outstanding at the end of the period, and against which drawings could be made, consisted of a $300 million Exchange Stabilization Agreement with Mexico and the commitment of up to $1 billion, shared with the Federal Reserve, under the sterling balance facility. The Federal Reserve maintained reciprocal currency arrangements with 14 foreign central banks

[18] See exhibit 45.

and the BIS totaling $20,160 million, under which drawings by either party may be made subject to agreement.

In conjunction with its new policies following its decision to allow the peso to float on August 31, 1976, the Mexican Government entered into negotiations for medium-term financing from the IMF. Within that context, in September the Treasury and the Federal Reserve agreed to a special arrangement with the Bank of Mexico, making available up to $600 million of interim financing. Under this arrangement, the Bank of Mexico drew $365 million in a currency swap with the ESF and repaid that amount in November following a Mexican drawing on the IMF. The remaining $235 million under the arrangement was not utilized. In October, Mexico repaid the full $360 million which had been drawn under its swap line with the Federal Reserve in April. In November, Mexico drew $150 million in two equal installments from the ESF under the longstanding stabilization agreement with the Treasury. At the same time, Mexico drew equivalent amounts on its swap line with the Federal Reserve. The remaining $150 million available under the stabilization agreement was drawn in November and repaid in December. Mexico repaid its outstanding drawings to the Federal Reserve in February and to the ESF in April 1977.

In February 1977, the Exchange Stabilization Fund was used to extend up to $300 million in short-term credit facilities to the Bank of Portugal. The ESF arrangement was envisaged as part of a three-phase program of assistance—involving this short-term credit, drawings on the IMF by Portugal, and a proposed medium-term multilateral credit facility—designed to assist Portugal in stabilizing its economy. The ESF facilities were provided during a period of critical need, pending the arrangement of more substantial multilateral medium-term financing, in the context of the implementation by Portugal of a sound economic program to correct underlying factors that had led to instability. Thus, the facility was designed to encourage Portugal to adopt measures which would enable that country to draw from the IMF and ultimately to obtain adequate financing through private channels. Under the arrangement, dollar/escudo swaps were extended, which were repaid following Portuguese drawings on the IMF: A $50 million swap was provided in February and repaid in May, and a $35 million swap was provided in May. The remaining $215 million under the arrangement was in the form of reciprocal gold deposits made during February–July. These deposits enabled Portugal to mobilize part of its gold reserves during an especially critical period. All of the drawings were repaid by September 1, the gold deposits were withdrawn, and the facility expired.

International monetary cooperation

I. Meeting official financing requirements

During fiscal 1977, international monetary developments continued to reflect cooperative efforts to promote sound economic growth and to deal with the unprecedented imbalances in international payments arising since the 1973–74 oil price rise. In the initial period following the oil price rise emphasis had been placed on financing the oil deficits, thus enabling countries to "accept" them and avoid self-defeating efforts by some to shift their deficits to others through excessive deflation, protectionist measures, or competitive exchange rate depreciation. As some countries began to approach the limits of prudence in their borrowing and it became apparent that OPEC surpluses would continue longer than originally anticipated, a general consensus developed that greater emphasis must be placed on adjustment of payments positions to achieve a more sustainable pattern. The outlines of a broad new strategy were initially developed at the IMF/IBRD annual meetings in Manila in October 1976,[19] and subsequently elaborated at the London economic summit.[20] This approach seeks to redistribute and reduce the deficits so that necessary borrowing is undertaken by those nations whose creditworthiness and economic strength are adequate to sustain the additional debt.

The private markets have provided about 75 percent of the $225 billion in financing required during 1974–76 and can and should continue to provide the bulk of the funds in the years ahead. In a relatively few cases, however, where the need for adjustment is pressing, the private markets have become less willing to provide all the financing required. Without adequate financing, some countries might be forced to take adjustment measures—for example, excessively restrictive domestic policies and recourse to protectionist controls—that would be destructive of national and international prosperity.

In order to ensure that needed adjustment is pursued—in a cooperative and internationally appropriate manner—by countries facing balance of payments difficulties, it is therefore important that adequate official financing be available on appropriate terms and conditions. The IMF is the primary source of "conditional" financing—that is, financing keyed to the adoption by the borrower of sound adjustment policies designed to eliminate the need for such financing and to provide a basis for repayment. Between 1974 and 1976, the IMF provided about 7 percent, or roughly $15 billion, of total financing. This record use of Fund resources has reduced its holdings of currencies that are available for lending to about $4.5 to $5.5 billion. While additional funds will be available when the quota increase agreed in 1976 takes effect pursuant to the sixth quota review, and some uncommitted resources remain under the General Arrangements to Borrow (see below), IMF resources nonetheless are quite low in relation to potential demands over the next few years.

Supplementary Financing Facility.—At its April 1977 meeting,[21] the IMF Interim Committee concluded "that there was an urgent need for a supplementary arrangement of a temporary nature that would enable the Fund to expand its financial assistance to those of its members that in the next several years

[19] See exhibits 41 and 42.
[20] See exhibit 49.
[21] See exhibit 48.

will face payments imbalances that are large in relation to their economies." After a period of intensive negotiations, agreement was reached in August with a number of major industrial and oil-exporting countries in strong financial positions to provide, on a roughly equal basis between the two groups, about SDR 8.6 billion (about $10 billion). In September, the IMF Executive Board decided on the final terms and conditions for the financing arrangements and for use of the facility.

The financing commitments of participants in the facility would remain effective for 5 years, with actual drawdowns repaid over 3 1/2 to 7 years, equivalent to an average maturity of 5 1/4 years. Participants in the financing arrangement will receive a liquid reserve claim on the IMF that can be encashed at any time upon representation of a balance of payments need, can be sold to IMF members and to other approved purchasers, and will earn interest equal to the yield on U.S. Treasury securities of comparable maturity (rounded up to the nearest one-eighth of 1 percent).

The terms and conditions on use of supplementary financing by IMF member countries include the following provisions:

a. *Eligibility.*—There are basically three criteria: (a) The member's balance of payments financing need must be greater than its remaining access to regular IMF resources; (b) the member's problems must justify an adjustment and repayment period longer than normally applies to use of regular IMF resources; and (c) the member must provide a detailed economic program that the IMF is satisfied is adequate to solve the country's problems and is compatible with the IMF's policies on use of its resources in the upper (more conditional) credit tranches.

b. *Access.*—Access will parallel access to the IMF's regular credit tranches and Extended Fund Facility. In conjunction with use of regular credit tranches, an eligible member's access to supplementary financing will initially be in an amount approximately equal to its quota in the IMF. Supplementary financing will be made available in amounts up to 140 percent of quota in conjunction with use of the Fund's Extended Fund Facility. The IMF may decide to provide larger amounts of financing in special circumstances.

c. *Period of availability.*—Members will be able to apply to the IMF for use of the facility at any time within 2 years of the date the facility enters into force. This period will be reviewed and may be extended for a third year. Drawings will normally be made over 2 to 3 years, provided that all drawings must be completed within 5 years of the facility's entry into force.

d. *Repayment.*—Repayment of drawings under the supplementary facility will be made in equal semiannual installments beginning not later than 3 1/2 years and completed not later than 7 years from the date of drawing.

e. *Charges.*—Charges on drawings under the supplementary facility will be equal to the rate of interest paid on financing provided to the facility, plus a margin that will average slightly less than one-quarter of 1 percent. The margin will be used to meet IMF administrative expenses in connection with operations of the facility.

The facility will enter into force when the IMF has completed formal financing agreements for a total of at least SDR 7.75 billion (about $9 billion), including agreements with at least six countries each providing at least SDR 500 million of financing to the facility. The United States requires prior congressional approval to participate in the facility. A bill[22] authorizing the Secretary of the Treasury to make resources available for U.S. participation in an amount not to exceed the dollar equivalent of 1,450 million special drawing rights (about $1.7 billion) was submitted to Congress on September 16, 1977, and hearings were underway as the fiscal year ended.

IMF quotas.—The Supplementary Financing Facility is intended as a temporary measure and quota subscriptions will continue to be the means of providing the IMF with permanent resources. As part of the monetary reform arrangements agreed in 1976, the sixth general review of quotas was completed in 1976 and it was decided to increase IMF quotas by SDR 10 billion (one-third) to SDR 39 billion (about $45 billion).

The increase in IMF quotas will not enter into force until the effective date of the second amendment of the IMF Articles, and members having not less than three-fourths of total quotas have consented to the increase in their quotas. Legislation authorizing the United States to consent to the increase in its quota was approved by Congress and signed into law on October 19, 1976. The United States formally notified the Fund of its consent to the increase in its quota on November 15, 1976. As of September 30, 1977, 45 IMF members accounting for 52.43 percent of quotas had consented to their increases.

As part of the 1976 quota decision, it was also agreed to initiate the next (seventh) general review of quotas after a 3-year period instead of waiting the customary 5 years. At its April 1977 meeting, the Interim Committee agreed in principle to a further "adequate" increase in quotas and requested the Executive Board to prepare a report, including recommendations, for the September meeting of the Committee. Discussions in the Board have revealed a wide variety of views on the size and distribution of a quota increase and on the timing of a subsequent (eighth) quota review. A consensus had not emerged by the end of the fiscal year and the Interim Committee therefore requested that the Executive Board continue its deliberations with a view towards submitting a report in 1978.[23]

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[22] See exhibit 53.
[23] See exhibits 54 and 55.

II. Implementing monetary reform

The 1976 Annual Report described in detail the agreements on reform of the international monetary system reached last year. The focus of attention during fiscal 1977 was in implementing these reforms, particularly ratification of the amendment of the IMF Articles of Agreement and the increase in Fund quotas, phasing out the monetary role of gold, and providing for the increased IMF responsibility for surveillance of exchange rate arrangements.

Ratification of IMF amendments.—A central feature of the reform agreement was a general revision of the IMF Articles, particularly as they relate to exchange rate arrangements and gold. The amendments do not enter into force until formally accepted by at least three-fifths of members (79) with at least four-fifths of the total voting power. As of September 30, 1977, 56 members with 58.14 percent of the total voting power had completed the ratification process.

The United States required congressional authorization to accept the amendments, and legislation for this purpose was submitted on May 31, 1976. The bill also provided for amendment of the Bretton Woods Agreements Act and the Special Drawing Rights Act to conform their provisions with the new Articles and to modify the Gold Reserve Act of 1934 to retain the value of the dollar in terms of gold solely for the purpose of serving as the legal standard for the issuance of gold certificates. The House passed the bill, with amendments, on July 27, 1976, and the Senate accepted the House bill on October 1, 1976. The bill was enacted into law on October 19, 1976 (Public Law 94–564), and the United States formally notified the IMF of its acceptance of the amendments on November 15, 1976.

Exchange rate arrangements.[24]—The amended Articles provide for a fundamental change in exchange rate arrangements. Instead of requiring adherence to a particular exchange rate regime, members are given wide latitude in the choice of exchange rate practices best suited to their domestic requirements but subject to important undertakings regarding exchange rate policies. The IMF has been provided with increased authority and responsibility to oversee the compliance of each member with these undertakings, and the Fund is directed to adopt specific principles to guide members with respect to exchange rate policies.

In preparation for this role, the IMF Executive Board adopted in April 1977 a decision on surveillance over exchange rate policies that will take effect when the amended Articles enter into force. This decision sets forth the principles for guidance of members' exchange rate policies, principles for Fund surveillance over those policies, and procedures for IMF surveillance.

The principles for guidance of members are broad and build on the concepts contained in the amended Articles. They provide—

[24] See exhibit 43.

That a member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or gain an unfair competitive advantage;

That a member should intervene in the exchange market if necessary to counter disorderly conditions; and

That in intervention policies members should take account of the interests of others, including countries whose currencies they use for exchange market intervention.

The principles for surveillance by the IMF are more detailed and include developments in a country that might indicate the need for discussions between the Fund and the member—for example, protracted intervention in one direction; unsustainable levels of borrowing or lending; the adoption or intensification of restrictions. Procedures are also set forth which the Fund would use in appraising the situation and reaching a judgment.

This approach reflects recognition that a comprehensive assessment of countries' policies is required rather than rigid quantitative measurements. It is based on the fundamental premise of the new exchange rate article that stability of exchange rates can only be achieved by promoting stable underlying economic and financial conditions.

Gold.[25]—Concrete measures were incorporated in the amended Articles to eliminate effectively any important monetary role for gold in the IMF and to provide for the future disposition of IMF gold holdings. In addition to these steps, it was agreed to begin disposal, under existing authority, of 50 million ounces of gold held by the Fund, of which half would be sold for the benefit of developing countries (see below) and the remainder would be sold to IMF members in proportion to their quotas.

In January–February 1977 the IMF sold about 6 million ounces of gold to members in proportion to quotas at the official price of SDR 35 per fine troy ounce. The United States received about 1.4 million ounces, paying SDR 50.2 million equivalent in dollars.

III. IMF operations

The recent record use of IMF resources slowed during the current fiscal year from the extraordinary levels of the preceding year due to a convergence of several factors. Successful stabilization efforts in some countries—both developed and developing—helped to redress domestic and external imbalances, thereby improving access to private credit, reducing official financing requirements and permitting early repayment of previous IMF drawings by several countries. An improvement in commodity prices contributed to a reduction of export shortfalls and thus use of the liberalized compensatory financing facility from the very high levels in 1976. The temporary oil facility, which had been a major source of relatively unconditional IMF financing in prior years, ceased operations. Finally, some countries may have been

[25] See exhibit 44.

reluctant to use the IMF's more conditional facilities in view of the limited amount of financing that would be available to them under present IMF rules and resources.

General account transactions.—Total gross drawings by IMF members in fiscal 1977 (including use of IMF reserve position) amounted to SDR 4.0 billion by 36 countries, compared with SDR 7.1 billion by 59 countries in the preceding year. During the period, the United Kingdom was the largest single borrower, accounting for SDR 2.3 billion. The principal currencies drawn from the IMF were the U.S. dollar, SDR 1.7 billion; German mark, SDR 755 million; and Japanese yen, SDR 471 million. A total of SDR 268 million in special drawing rights were also used for drawings.

Repayment of outstanding drawings totaled SDR 2.9 billion in fiscal 1977, largely reflecting repurchases by Italy, SDR 950 million; the United Kingdom, SDR 610 million; and India, SDR 281 million. Currencies used in repurchases included U.S. dollars, SDR 1.2 billion, and German marks, SDR 459 million. Repayments with special drawing rights amounted to SDR 844 million.

General Arrangements to Borrow.—The General Arrangements to Borrow (GAB) was established in 1962 by 10 industrial member countries of the IMF*, including the United States, as a means of supplementing the Fund's resources when needed to cope with developments that threaten to impair the operation of the international monetary system. Each participant undertakes to provide specified amounts of its currency when called to help finance drawings from the IMF by another GAB participant. Total commitments currently amount to the equivalent of SDR 6.7 billion, of which the U.S. share is SDR 1.7 billion.

During fiscal 1977, the IMF Managing Director activated the GAB to help finance an SDR 3.36 billion standby arrangement with the United Kingdom and an SDR 450 million standby with Italy. In January, May, and August calls totaling SDR 945 million were made to finance United Kingdom purchases under its standby, of which the United States provided SDR 552 million. In May, the United States also provided SDR 24 million as part of an SDR 98 million call for Italy.

Compensatory and buffer stock financing facilities.—The compensatory financing facility was established in 1963 and liberalized in 1966 and 1975 (see 1976 Annual Report for details) to provide IMF members, particularly primary producing countries, with additional access to Fund resources to meet balance of payments difficulties arising from temporary shortfalls in export earnings due primarily to circumstances beyond their control. After extremely heavy use in fiscal 1976, the pace of drawings slackened this year as commodity prices improved. During the year, gross drawings amounted to SDR 691 million by 20 countries, bringing the level of outstanding drawings to SDR 2,789 million. Developed countries accounted for 42 percent of drawings in fiscal 1977, with South Africa the largest DC borrower. Among LDC's, Mexico drew SDR 185 million as the largest user of the facility.

* Switzerland also participates in the GAB but is not a member of the IMF.

The buffer stock facility was created in 1969 to help members experiencing balance of payments difficulties finance their contributions to international buffer stocks that satisfy IMF criteria. The tin and cocoa buffer stocks are eligible for financing but no use of the IMF facility was made in fiscal 1977.

Extended Fund Facility.—The Extended Fund Facility was established in September 1974 to provide assistance to IMF members in meeting their balance of payments deficits for longer periods than is the practice under normal credit tranche policies. A member may draw up to 140 percent of its quota under the extended facility, but not in excess of 165 percent of its quota from this source plus regular IMF sources combined. (The combined limit was temporarily raised to 176.25 percent of quota by the temporary expansion of access to the IMF's regular resources agreed in 1976 and effective until the sixth quota increase comes into effect.)

Assistance from the Extended Fund Facility was approved for one country in fiscal 1977—Mexico—for an amount of SDR 518 million. In February 1977 Mexico drew SDR 100 million under its extended arrangements. The only other purchase under this facility in fiscal 1977 was made by the Philippines in August in the amount of SDR 78.8 million, as part of a 3-year arrangement for SDR 217 million agreed in September 1976. Since the facility was established, only one other country—Kenya—has entered into an extended arrangement. After an initial purchase of SDR 7.7 million in August 1976, Kenya has made no further purchases. Total purchases in fiscal 1977 amounted to SDR 178.8 million, for a cumulative total since the facility was established of SDR 276.5 million.

Special drawing rights.—The Managing Director of the IMF is required by the Articles of Agreement to submit to the Board of Governors, not later than 6 months before the end of each basic period (a basic period lasts 5 years), a proposal with respect to the allocation of special drawing rights in the next basic period. Calendar 1977 is the last year of the second basic period that began on January 1, 1973, and in 1977 Managing Director Witteveen submitted a report to the Board of Governors and to the Executive Directors indicating that he had concluded that there was no proposal for allocation consistent with the Articles that had broad support among participants. Accordingly, at its April meeting the Interim Committee deferred a decision on an SDR allocation until its first meeting in 1978. The Interim Committee also requested the Executive Directors to "review the characteristics and uses of the SDR so as to promote the purposes of the Fund, including the objective of making the SDR the principal reserve asset in the international monetary system." This review was in progress as the fiscal year ended.

Trust fund gold auctions.—As part of the process of phasing out the monetary role of gold agreed in the reform negotiations, the IMF initiated in June 1976 a program of sales of 25 million ounces of Fund gold for the benefit of developing countries. In fiscal 1977, the IMF held 10 public auctions at which about 6 million ounces of gold were sold, bringing total sales as of September

30, 1977, to 8.4 million ounces. The profits received from sales in 1977 amounted to SDR 512 million, raising total resources to be used for the benefit of LDC's to SDR 839 million. Following a review of the gold sales program in November-December 1976, the IMF Executive Directors decided to retain the basic features of the sales program but placed it on a more regular basis by initiating monthly auctions and acted to widen the range of potential participants.

A portion of the proceeds from the gold sales corresponding to LDC shares in IMF quotas are to be distributed directly to each eligible country in proportion to its quota. The remainder is to be used to finance a trust fund to provide balance of payments financing on concessional terms to the poorest IMF members. The trust fund was established in May 1976, and initial loan disbursements of about SDR 131 million to 19 of the 61 eligible countries were made during fiscal 1977. As the fiscal year ended, the Executive Board was completing arrangements for the first direct distribution.

Oil facility subsidy account.—The IMF oil facility was a temporary program designed to respond to emergency needs arising from sharply increased oil prices. New lending from the facility terminated on March 31, 1976. On August 1, 1975, the IMF established an interest subsidy account under a trust arrangement separate from the oil facility, and financed by voluntary contributions, to reduce the cost of borrowing from the facility to those IMF country members most seriously affected by the oil price increases. Subsidy payments are to be made during the period 1976–83, and the first payments were made to 18 eligible members in July 1976. For 1977, the IMF Executive Board decided to make subsidy payments of SDR 27.5 million, bringing total disbursements to SDR 41.3 million.

U.S. initiative in the OECD Committee on Financial Markets

At its November 1976 meeting, the OECD Committee on Financial Markets discussed a U.S. initiative aimed at further liberalizing international flows of portfolio capital.

In March 1977, the Committee reviewed a U.S. submission identifying possible obstacles to international securities transactions in selected OECD countries. Other countries were asked to verify the information in the U.S. submission and to provide any additional information on possible obstacles to international flows of portfolio capital. At the June 1977 meeting, the Committee received additional information from member countries and instructed the OECD Secretariat to integrate the material into a single matrix based in large part upon the U.S. submission. The Committee was expected to review this information at its November 1977 meeting and subsequently to discuss the importance of various obstacles to international securities transactions, and possible liberalization measures.

Proposed International Banking Act of 1977[26]

Virtually identical to last year's bill, this bill (H.R. 7325) would provide for Federal regulation of foreign banks operating in the United States. The bill was reintroduced by members of the House Committee on Banking, Finance and Urban Affairs, and hearings were held by the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance in July 1977. As of the end of September 1977, the Senate had taken no action on the proposal.

The bill would affect the U.S. operations of foreign banks, by applying Federal regulations and supervision similar to existing regulations on large, domestically owned banks. The bill provides for permanent grandfathering of foreign banks' multi-State branches in existence prior to May 1, 1976, and subsequent multi-State branches would be prohibited as long as national banks cannot branch across State lines. Also, foreign banks would be prohibited, as are domestic banks, from engaging simultaneously in both commercial and investment banking in the United States, and existing simultaneous operations would have to be terminated by December 1985. The bill would permit foreign banks to establish Edge Act corporations, as well as Federal branches and agencies, and to have foreign citizens as minority directors of national banks.

Treasury testified for the administration in support of H.R. 7325 with certain modifications to achieve more equal treatment of foreign and domestic banks as well as to avoid undue burdens on the existing operations of foreign banks in the United States.

International investment and capital flows (OPEC investors)

The financial surpluses accruing to oil-exporting countries on current accounts continue to be a source of sizable inflows of funds to U.S. capital markets. The estimated distribution of investable OPEC surpluses between 1973 and end-June 1977 is given in the table which follows this text.

An increasing share of OPEC's investable surplus was placed in the United States from 1974 to 1976, rising from about 20 percent in 1974 to nearly 30 percent in 1976. Since 1975, the Mideast oil exporters have been the only OPEC countries making new investments in the United States. Mideast placement of funds in the United States continued in the first half of 1977 but at a slower rate, with the U.S. share declining to about 18 percent of total OPEC placements. Following 1974, when 86 percent of OPEC's money market and portfolio investments in the United States were placed in short-term assets, OPEC investments in the United States have progressively shifted toward long-term instruments. This pattern is continuing in 1977, with 86 percent of OPEC investments placed in long-term U.S. instruments (primarily debt securities), compared with 84 percent in first half 1976.

[26] See exhibit 52.

Estimated distribution of OPEC investable surpluses, end 1973–June 1977

	Amount	Relative share
	$ billion	*Percent*
United States	39 1/2	23
Eurobanking market	48 1/2	28
Other developed countries	33 1/2	20
United Kingdom	7 1/4	
Other	26 1/4	
Developing countries and international financial institutions	30 1/4	18
Communist countries	4 1/2	3
Unallocated	13 3/4	8
Total	170	100

Developing Nations

International development banks[27]

In fiscal 1977, the Congress approved legislation authorizing $5,124.7 million in increased U.S. participation in the World Bank group (the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC)), the Asian Development Bank (ADB), and the African Development Fund (AFDF), and appropriated $1,925.5 million for the banks as part of the fiscal 1978 Foreign Assistance Appropriations Act. The amount appropriated represented an increase of 69 percent over the fiscal 1977 appropriation of $1,141.5 million. A breakdown of authorizing and appropriations legislation approved by Congress is shown in the table below:

U.S. participation in the international development banks during fiscal 1977
[$ millions]

Institution	Authorization	Fiscal 1978 appropriation	Comment
International Bank for Reconstruction and Development:			
Paid-in	156.9	38.0	Authorization is U.S. share in selective capital increase; appropriation is first U.S. installment of increase.
Callable	1,412.1	342.0	
International Development Association	2,400.0	800.0	Authorization is U.S. share of fifth replenishment; appropriation is first U.S. installment of replenishment.
International Finance Corporation	111.5	38.0	Authorization is U.S. share in first capital increase; appropriation is first U.S. installment of increase.
Inter-American Development Bank:			
Paid-in		36.7	$67.3 million paid-in and $561.4 million callable remains to be appropriated from amount authorized in fiscal 1976.
Callable		328.5	
Fund for Special Operations		114.7	$325.3 million remains to be appropriated from amount authorized in fiscal 1976.

[27] See exhibits 57 and 58.

U.S. participation in the international development banks during fiscal 1977—Continued

Institution	Authorization	Fiscal 1978 appropriation	Comment
Asian Development Bank:			
Paid-in	81.4	16.8	Authorization is U.S. share of second capital increase; appropriation is first U.S. installment of increase.
Callable	732.8	151.2	
Asian Development Fund	180.0	49.5	Authorization is U.S. share of first replenishment; appropriation is first installment of replenishment.
African Development Fund	50.0	10.0	Authorization is for U.S. contribution to first replenishment. Appropriation is final installment of initial U.S. $25 million contribution authorized in fiscal 1976.
Total	5,124.7	1,925.5	

The international development banks committed $9,407 million to 84 developing countries in fiscal 1977. The distribution of commitments by institution was as follows: World Bank group, $7,197 million; Inter-American Development Bank (IDB), $1,385 million; Asian Development Bank, $722 million; and the African Development Fund, $130 million.

The international development banks are an important source of finance and economic advice for developing countries. Measured on a disbursement basis, total lending flows from the banks to developing nations in calendar year 1976 were equal to over 45 percent of total bilateral development assistance from DAC donors.

The development banks help fulfill a variety of U.S. foreign policy objectives. By attacking the economic and social causes of poverty, they address U.S. humanitarian interests and help increase world stability and security. The banks serve to promote U.S. economic relations with developing countries; they help expand the market for U.S. exports, improve U.S. access to sources of raw materials, and increase the security of present and future U.S. investments in developing countries. U.S. contributions to the development banks also foster cooperative political relations with developing countries by demonstrating our commitment to their growth while permitting the United States to share the burden of this commitment with other donor countries.

World Bank group

The World Bank group committed a total of $6,943 million for economic assistance to its borrowing member countries in fiscal 1977, an increase of $65 million over the previous fiscal year. IBRD lending totaled $5,521 million in fiscal 1977, compared with $4,977 million in fiscal 1976, an increase of about 10 percent. New IDA credits declined 11 percent from $1,655 million in fiscal 1976 to $1,422 million in fiscal 1977, due largely to foreign exchange losses resulting from currency shifts and the failure of Switzerland to make its expected contribution. IFC commitments increased to $273 million in fiscal 1977 from $230 million in fiscal 1976, an increase of 1.6 percent. As of September 30, 1977, IBRD commitments outstanding totaled $31,550 million and IDA credits totaled $11,800 million. IFC commitments outstanding totaled $1,715 million.

During fiscal 1977, both the IBRD and IDA increasingly concentrated their lending in agriculture. The IBRD increased its commitments to the agricultural sector in fiscal 1977 to $1,733 million (31 percent of total lending), compared with $1,258 million (25 percent of lending) in fiscal 1976. More dramatically, the amounts committed by IDA to agriculture increased from $327 million in fiscal 1976 to $864 million in fiscal 1977, an increase of almost 165 percent. Other important sectors of IBRD and IDA lending in 1977 included development finance companies and industry (17 percent), transportation (16 percent), and electric power (13 percent). IFC investments were concentrated in development finance companies (30 percent), food and food processing (12 percent), general manufacturing (18 percent), and mining and iron and steel (18 percent).

The IBRD and IDA committed resources for 220 projects totaling $6,943 million in 74 countries distributed by region as follows: Africa, 62 ($809 million); Asia, 69 ($2,722 million); Latin America, 42 ($1,613 million); Europe, Middle East, and North Africa, 47 ($1,799 million). India was the largest borrower from the IBRD and IDA ($811 million), while Indonesia was second ($425 million) and Korea was third ($418 million).

IFC commitments during fiscal 1977 went to 28 enterprises in 17 developing countries. These commitments included 5 projects in Europe, the Middle East, and North Africa (29 percent of the total committed), 19 projects in Asia (22 percent), 16 projects in Latin America (40 percent), and 3 in Africa (19 percent). Brazil received the largest individual total ($56 million) with Greece second ($40 million) and Yugoslavia third ($21 million).

At the October 1976 annual meeting of the World Bank in Manila, the Philippines, the Secretary of the Treasury outlined U.S. concerns and efforts for assisting the developing world. He emphasized that a shared prosperity between developed and developing countries was the best means of promoting development and affirmed the priority being given to the ongoing replenishment efforts by the administration in Congress.

At the September 1977 meeting of the World Bank in Washington, D.C., the Secretary of the Treasury stressed the commitment of the new administration to meeting the basic human needs of the world's poor. He noted that development requires action on the part of both industrialized and developing nations and emphasized the need for effective domestic policies in the developing countries. The Secretary expressed support for the new directions charted by the World Bank in financing social and economic development and the increased lending by the World Bank for expansion of energy resources in developing countries.

The lending operations of the IBRD are financed from five sources: Paid-in capital subscriptions; borrowings in private capital markets, and from governments and central banks; sales of participations; principal repayments on loans; and earnings on its loans and investments.

The Bank's outstanding funded debt increased to $19,939 million as of September 30, 1977. As of June 30, 1977, estimates indicate that 28 percent of Bank bonds were held by investors in the United States, 24 percent in Germany, 9 percent in Japan, 7 percent in Saudi Arabia, and 8 percent in Switzerland. The remaining 24 percent of outstanding borrowings was held by central banks and government agencies in more than 80 countries.

To an increasingly large extent, borrowings provide the major portion of the Bank's funds. In fiscal 1977, IBRD gross borrowings reached a new record, with 39 issues totaling $4,728 million. This was $917 million (24 percent) more than was raised in the preceding fiscal year. During the five fiscal years 1973 through 1977, the Bank's gross borrowings aggregated $16,625 million, more than 2 1/2 times the amount raised in the preceding 5-year period.

As in fiscal 1976, the principal sources of borrowed funds to the Bank were borrowings on private capital markets. The Bank sold 28 issues totaling the equivalent of $3,696 million in private markets, or slightly more than 78 percent of total funds raised through borrowings. This continues the trend of obtaining more from private financial sources rather than governments and central banks, which together in fiscal 1973–75 accounted for more than 70 percent of the IBRD's borrowed funds. In fiscal 1977, governments and central banks purchased $1,633 million of Bank issues, or 22 percent of the year's total. This was $318 million less than in fiscal 1976.

In fiscal 1977, the Bank also borrowed $37.5 million from the interest subsidy fund, or third window. This facility was established in fiscal 1976 to permit lending on terms intermediate between those of the IBRD and IDA. Aggregate borrowings by the Bank from the subsidy fund totaled $167.5 million as of September 30, 1977.

During the year under review, the Bank's public and private borrowings came principally from the following countries: $1,885 million in the United States; $1,463 million in Germany; $1,033 million from the issuance of 2-year dollar bonds to central banks and other government agencies in some 70 countries; $367 million in Switzerland; and $186 million in Japan.

During the fiscal year, the Bank's borrowers repaid $917 million of principal, raising cumulative repayments on the Bank's loans to $8,053 million; of this amount, $5,699 million was repaid to the Bank and $2,359 million to purchasers of loans. Income on Bank investments amounted to $541 million, up $116 million, or nearly 26 percent, over the previous fiscal year. Income on loans passed the $1 billion mark, rising $224 million, or 23 percent, to a total of $1,121 million. For the same period, sales of participations in the Bank's loan portfolio amounted to $253 million, compared with loan sales of $65 million in fiscal 1976. This fourfold increase over the previous fiscal year was the highest level in a decade. Net income of the Bank in fiscal 1977 was $194 million, down $26 million, or nearly 12 percent, from the previous fiscal year. However, after taking adjustments arising from currency devaluations into account, income was $192 million, compared with $69 million in the previous fiscal year.

In May 1976, the Executive Directors of the IBRD recommended that the Bank be authorized to increase its capitalization by $8.4 billion and accept subscriptions from its 127 member countries. During fiscal 1977, Congress approved authorizing legislation for a U.S. share in the capital increase of $1,568.9 million. As the first installment in the capital increase, Congress also appropriated $380 million for fiscal 1978.

In order for the IBRD to continue to be able to increase lending in real terms into the next decade, Bank management, in February 1977, proposed that a further general capital increase (GCI) would be necessary. IBRD President McNamara hopes to reach agreement on the GCI by June 1978. The actual payment period for the increase would not become effective until 1981 or 1982.

The administration believes that U.S. participation in the GCI of the IBRD is an important element in our foreign assistance policy. With an increase in its capital, the Bank can continue to be a key source of financing for sound projects and programs in developing countries, and provide indispensable assistance to developing countries in formulating effective domestic policies.

During fiscal 1977, IDA granted new credits totaling $1,422 million, a decrease of $233 million from fiscal 1976. IDA credits are funded primarily by member country contributions, grants from the net income of the IBRD, repayments of credits, and earnings. Usable resources of IDA, cumulative to September 30, 1977, amounted to $13,141 million, consisting of $11,725 million in member contributions, $1,189 million in transfers from IBRD net income, and the remainder from earnings, participations in credits, and repayments on outstanding credits.

In March 1977, the Part I members of IDA concluded negotiations for a fifth replenishment of the resources of IDA. The $7.6 billion replenishment will provide IDA with loanable funds from July 1, 1977, through June 30, 1980. During 1977, the Congress approved legislation authorizing a U.S. contribution of $2,400 million to the replenishment, or 31.4 percent of the total—down from the 33.3 percent, the U.S. share in IDA's fourth replenishment. Congress also appropriated $800 million for the first of three U.S. installments to IDA V.

In May 1976, the Board of Directors of the International Finance Corporation recommended a $540 million increase in the authorized capital of the Corporation. The increase was the first since the establishment of the IFC in 1956. During 1977, Congress approved authorizing legislation for a $111.5 million U.S. subscription to the capital increase and appropriated $38 million for the IFC as the first U.S. installment. When the IFC's capital increase is fully completed, the U.S. share of the funding of the IFC will drop from 33 percent to 25 percent.

Inter-American Development Bank

During fiscal 1977, the IDB committed a total of $1,350 million, an 8-percent increase in lending over fiscal 1976. Of this amount, $704.8 million was lent on conventional terms from the capital account and $583 million was lent on concessional terms from the Fund for Special Operations (FSO). In addition, the IDB committed $86.5 million in funds administered for various donors (primarily the Venezuelan trust fund). Cumulative lending by the IDB, as of September 30, 1977, totaled $10.7 billion, of which $5 billion had been lent from the capital account, $4.9 billion from the FSO, and $0.8 billion from other resources (primarily the United States Social Progress Trust Fund).

Agriculture, industry, and transport received the greatest attention in fiscal 1977. About 25 percent ($337.7 million) of the funds committed were for agriculture, 21 percent ($282 million) for industry and mining, and 14 percent ($190 million) for transportation and communications. On a cumulative basis, through the end of fiscal 1977, agriculture had received the largest amount, 24 percent, or $2.5 billion, and power projects had received the next largest amount, 20 percent, or $2.1 billion.

IDB lending operations are financed principally from paid-in capital subscriptions, borrowings in international capital markets, and member country contributions to the FSO. As of September 30, 1977, the total subscribed capital of the Bank was $8,901 million, of which $1,257 million was paid-in and $7,644 million was callable. The resources of the FSO amounted to $5,897 million. The U.S. subscriptions to IDB capital shares amounted to $3,105 million, or approximately 35 percent of the total. Including contributions authorized, but still pending appropriation, the United States accounted for $3,400 million, or 63 percent of total resources contributed to the FSO.

In fiscal 1977, the IDB borrowed $331.4 million equivalent in international capital markets, including $100 million in the United States. In addition, the Bank sold $74 million in 2-year bonds to central banks in Latin America. The Bank's outstanding funded debt amounted to $2,246 million as of September 30, 1977.

At the 1977 annual meeting of the IDB in Guatemala City, Guatemala, the major issues which Secretary Blumenthal, as U.S. Governor, raised in his address were the Carter administration's support for the international development banks and the concern of the United States in working with other countries to meet the basic human needs and promote the dignity of the people of the developing world.

The U.S. Governor commended the Bank on its impressive achievements in Latin America and made a series of suggestions for improvements and new directions in the Bank's programs. He referred to President Carter's reaffirmation of U.S. support for regional and subregional integration efforts in Latin America, and encouraged the IDB to expand its efforts to develop indigenous resources to meet Latin America's needs for energy and raw materials, to continue support for the private sector, and to encourage mobilization of domestic savings through lending to credit unions, cooperatives, and savings and loan associations.

As discussed in last year's Annual Report, a major replenishment of the Bank's resources totaling $5 billion for the 1976–78 period was approved on June 1, 1976. Under the terms of the replenishment agreement, the regional member countries would increase their capital subscriptions in the Bank by $4 billion, and would contribute more than $1 billion to the Fund for Special Operations. Agreement was also reached in principle on an additional $1.3 billion increase in the Bank's callable capital, to take effect after the final payment of the callable portion of the $4 billion increase has been made. In conjunction with the replenishment exercise, the membership of the IDB was expanded to include donor countries from outside the Western Hemisphere, including Western European countries and Japan.

During fiscal 1977, six additional nonregional countries (Austria, the Netherlands, France, Finland, Sweden, and Italy) joined the Bank, pledging to subscribe $153.6 million to capital and an equivalent amount to the FSO. During 1977, Congress also appropriated $365.2 million for the capital resources of the Bank and $114.7 million for the FSO.

Asian Development Bank

ADB lending in fiscal 1977 totaled $722 million, compared with $878 million in fiscal 1976. Of fiscal 1977 loans, $515 million came from Ordinary Capital resources and $207 million from concessional funds. Lending in U.S. fiscal 1977 brings cumulative ADB lending through September 30, 1977, to $3,742 million—$2,783 million from Ordinary Capital and $959 million on concessional terms.

In fiscal 1977, agriculture and agro-industry continued to be the largest beneficiaries of Bank lending, accounting for $206 million, or almost 28 percent of total lending. Since the Bank's inception in 1966, public utilities have received the largest amount of ADB loan funds ($1,242 million, or 33 percent) followed by agriculture and agro-industry ($909 million, or 24 percent), industry ($819 million, or 22 percent), and transportation and communications ($728 million, or 19 percent).

The three largest borrowers from the ADB's Ordinary Capital resources in fiscal 1977 were the Philippines ($150 million, or 30 percent), Korea ($92 million, or 18 percent), and Indonesia ($114 million, or 22 percent). Bangladesh and Nepal were the two largest recipients from the ADB's concessional lending, having borrowed $69 million (33 percent) and $45 million (22 percent), respectively, in fiscal 1977.

ADB Ordinary Capital lending operations are financed by paid-in capital subscriptions, funds borrowed in private capital markets and from governments and central banks, repayments of principal and interest on loans, and net earnings on investments. Asian Development Fund resources—used for concessional loans—derive from member country contributions, amounts set aside from Ordinary Capital earnings, and repayments on loans.

As of September 30, 1977, the Bank's subscribed Ordinary Capital stock totaled $6.95 billion. In fiscal 1977, the Bank borrowed $112 million in international capital markets. The ADB raised $70 million in the United States and $42 million in Germany.

On October 15, 1976, the Bank's Board of Governors ratified a 135-percent increase in the Bank's capital subscriptions. The replenishment took effect on September 30, 1977. The capital increase amounts to $5,003 million and consists of 10 percent paid-in capital and 90 percent callable capital. During fiscal 1977, Congress authorized $814 million as the U.S. share in the Bank's capital increase and appropriated $168 million as the first U.S. installment.

Also in 1976, the membership of the ADB reached agreement on an $809 million replenishment of the Asian Development Fund. Under the terms of the agreement, the U.S. share was set at $180 million, or 22.2 percent of the total—down from the 28.5-percent U.S. share of the original resource mobilization in the ADF. During fiscal 1977, Congress appropriated $49.5 million as the first U.S. installment in the replenishment. This replenishment of the Asian Development Fund will finance soft-loan lending from 1976 through 1978.

In April 1977, at the 10th annual meeting of the Board of Governors, the new administration expressed the continuing support of the United States for the goals and operations of the Asian Development Bank, particularly the Bank's increasing efforts to assist rural development through the introduction of integrated rural development projects, and the special attention paid by the Bank to the use of appropriate technology. The U.S. representatives urged the Bank to pay special attention to its financial policies in order to preserve the Bank's well-deserved reputation for fiscal prudence and administrative austerity. The U.S. Alternate Governor also detailed the efforts being made by the new administration to fully meet the resource commitments made by the United States to the Bank.

African Development Fund

The African Development Fund was created on July 3, 1973, as the concessional lending affiliate of the African Development Bank. The fund is designed to channel resources to the poorest African nations. Except under the most unusual circumstances, AFDF loans are not granted to countries with a per capita GNP above $400.

The United States joined the AFDF in November 1976, with a contribution of $15 million. In addition to the United States, the fund's membership includes 12 European countries, Canada, Brazil, Japan, Saudi Arabia, and the AFDB representing its 47 member states.

In fiscal 1977, AFDF lending amounted to $129.7 million, distributed among 19 African nations. This represents an increase of $36.9 million, or 39.8 percent, above the fiscal 1976 lending level of $92.8 million. Malawi was the largest borrower ($16.5 million), receiving 12.7 percent of the year's loans, Rwanda ($13.6 million) received 10.5 percent, Madagascar ($10.7 million) received 8.2 percent, and Mali ($10.6 million) received 8.2 percent.

AFDF lending for the fiscal year financed projects in health, water supply and sewerage, agriculture and rural development, education, and transportation. Agricultural projects accounted for the largest share of AFDF lending activities, $48.9 million, or 37.7 percent of total lending. The two other leading sectors of AFDF lending were water supply projects ($34.9 million, or 2.7 percent of total lending), and transportation, particularly road construction, which received $26.3 million, or 30.3 percent of lending.

The U.S. initial contribution of $15 million raised total resources pledged to the fund to $410 million—up from the initial figure of $100 million in 1973. For fiscal 1978, Congress has appropriated an additional $10 million for the fund. As of September 30, 1977, total contributions received by the AFDF amounted to $292 million. At the current rate of commitment, the fund's financial resources will be exhausted in 1978. In order to finance the 1979–81 lending program, member states will meet in December 1977 to begin discussions of a major replenishment of fund resources.

The fourth annual meeting of the African Development Fund held in Mauritius during May 1977 was the first which the United States attended as a full-fledged member of the AFDF. The U.S. representative expressed support for the African Development Fund as a way of addressing African aspirations for a better material life and a fair share in the international economic system. The United States indicated its desire to assume an appropriate role in funding the AFDF and supported the creation of an independent review committee to examine fund operations and policies.

Situation of the non-OPEC developing countries

The economic situation of the non-OPEC developing countries improved considerably in 1976, and the trend of improvement continued into 1977. The improvement was clearly reflected in the aggregate current account deficit of these countries, which declined from $37 billion in 1975 to $26 billion in calendar 1976 (excluding the receipt of official transfers). In 1977, a further decline of about $3 billion is projected.

The recent improvement in the balance of payments situation of the nonoil developing countries resulted from buoyant exports to the industrial countries, improved terms of trade, and continued import constraints. Export earnings increased about 20 percent to a level of around $110 billion in 1976. The increase in export volume was more than 12 percent. At the same time, imports (f.o.b.) increased only 4 percent to a level of about $125 billion, which meant that the increase in volume was barely 1 percent. The rapid growth in exports was associated with the economic recovery in the industrialized countries, while the lack of growth in imports was associated with stabilization programs implemented by a number of key countries combined with the efforts of many others to restrain imports.

Available data for 1977 indicate a continuation of the favorable trend established in 1976. On the basis of these data, it is projected that exports will again increase rapidly. Commodity prices were particularly buoyant during the first half of the year. Imports are expected to increase somewhat more rapidly than last year but not so much as to offset the increase in exports.

In 1976, the pattern of financial flows changed very little from the previous year. About $20 billion in official flows (including transfers) were provided to the non-OPEC developing countries, on a net basis. The bulk of these flows came from DAC countries and the multilateral financial institutions. About $5 billion were provided by the OPEC countries.

Net private direct investment continued at the level of about $4 billion. Other private capital flows remained at a high level. In particular, gross private borrowing by these countries continued at the rapid pace set in the previous 2 years. Publicized Eurocredits and bond issues in 1976 amounted to $11 billion, compared with $7.5 billion in 1975 (gross basis). Net borrowing from the IMF was about $2 billion. Altogether, the flows of capital to the non-OPEC developing countries exceeded their requirements by a substantial margin. Consequently, their international reserves increased by $11 billion (37 percent) to a level of $41 billion at the end of 1976.

Even though gross borrowing from private capital markets continued at a high level in the first half of the year, the pattern of external financing in 1977 appears to be shifting toward a more historically "normal" pattern in which official flows (on a net basis) constitute a larger share of the total net flows. While gross borrowing has remained at a high level, more of the borrowing this year represents rolling over of maturing debt. If borrowing does not slacken in the second half of the year, then reserve accumulation is again likely to be in the $10 billion range.

There are corresponding changes in the debt situation of these countries during the period covered by this report. Specifically, their external debt increased substantially for the third year in a row in calendar 1976. However, in 1977, the rate of increase in debt is expected to be lower. The creditworthiness of the non-OPEC developing countries is generally considered to be improving. If present trends continue, the size of their external debt relative to their capacity to repay (as indicated by GDP and exports) will be close to historical levels.

From the point of view of economic growth, the situation of the non-OPEC developing countries is also returning to "normal." Average growth for all developing countries in the 1960's was 5.5 percent per annum. In 1975, average growth in GDP for the non-OPEC developing countries bottomed out at around 3 percent. Average growth in 1976 bounced back to a level of around 5 percent and is expected to stay at this level in 1977.

While the situation of the non-OPEC developing countries is reassuring in the aggregate, a few countries dominate the aggregate figures. Just three countries (Brazil, Mexico, and India) account for about half of the GNP and the population of the non-OPEC developing countries. The deficits of those three countries set the pace for the rest in 1974 and 1975. In 1976, stabilization programs in Brazil and Mexico began to take hold and their deficits began to decline significantly. India experienced a rather dramatic improvement in its balance of payments situation of over $2 billion between 1975 and 1976 as a result of favorable harvests and unexpectedly large private remittances.

Another useful distinction is between countries that finance their deficits primarily by borrowing from private sources, and others that rely predominantly on official flows or a combination of the two. There are about a dozen countries in the first group, including Brazil, Mexico, Korea, and the Philippines. In general, the deficits of the first group increased more sharply in 1974 and 1975 than did those of the second group. Now the pattern is shifting so that the privately financed countries are accounting for an increasingly smaller share of the aggregate non-OPEC developing countries deficit. This pattern is necessarily consistent with the projected trends in flows from official and private sources.

Among the non-OPEC developing countries, of course, are a few that appear to be in a particularly strong balance of payments situation at the present time. There are also a few individual countries facing particularly difficult situations.

Development Committee

The Development Committee was established in October 1974 by the Governors of the World Bank and the International Monetary Fund to maintain an overview of the development process and to consider all aspects of the broad question of the transfer of real resources to the developing countries. The Development Committee was formed with the understanding that its performance would be reviewed at the end of its second year.

The sixth meeting of the Development Committee was held in Manila on October 3, 1976, in conjunction with the joint annual meetings of the Boards of Governors of the Bank and the Fund.[28] An important item on the agenda was a report by the Executive Directors of the Bank and the Fund on the performance of the Committee. While noting a number of problems during its first 2 years, there was general agreement that the Committee was a useful forum for the discussion of issues relating to the transfer of real resources. At the joint meeting, the Governors of the Bank and the Fund passed parallel resolutions extending the Committee for another 2 years without any changes in its mandate.

The most significant action taken by the Development Committee at its sixth meeting was a decision to establish a new working group—the Working Group on Development Finance and Policy—in addition to the existing Working Group on Access to Capital Markets. At the initiative of the United States, the Committee agreed that this new working group should consider a study of the International Resources Bank to be prepared by the World Bank. Other subjects to which the Committee assigned high priority were the volume, terms, and distribution of official flows, and the resources situation of the multilateral financial institutions.

The Development Committee also received a report from the Working Group on Access to Capital Markets. The Committee endorsed recommenda-

[28] See exhibit 56.

tions of this working group relating to the removal of legal and administrative barriers to LDC access, technical assistance activities in this field, and cofinancing between multilateral financial institutions and private lenders.

The seventh meeting of the Development Committee was held in Manila on October 6, 1976, for the purpose of electing a new Chairman and appointing a new Executive Secretary. Cesar E. A. Virata, Secretary of Finance of the Philippines, was elected Chairman of the Development Committee, and Sir Richard King of the United Kingdom was appointed Executive Secretary.

The eighth meeting of the Development Committee was held in Washington, D.C., on April 27, 1977. Because the meeting was held only a month before the conclusion of the CIEC and shortly after the formation of new governments in several of the member countries, the eighth meeting was more an opportunity for reflection and discussion of general positions than for taking action. The main substantive items on the agenda were reports from the Development Committee's two working groups.

In connection with the report of the Working Group on Access to Capital Markets, the Development Committee discussed multilateral guarantees and the International Investment Trust. The Committee also accepted a recommendation from this working group to call on all governments to cooperate in the process of improving the collection, processing, and dissemination of information on international financial stocks and flows.

In connection with the report of the Working Group on Development Finance and Policy, the Development Committee agreed that the working group should examine the International Resources Bank; procedures for replenishment of the multilateral financial institutions; the distribution, terms, and quality of official development assistance; and the effectiveness of aid in promoting development.

The policy of the new administration toward the Development Committee was set forth in remarks by Secretary Blumenthal, who noted the commitment of the new administration to promoting economic development throughout the world. Secretary Blumenthal also expressed the view that the Committee has the potential of playing an important role in the years ahead in discussing the most pressing economic issues between developed and developing countries.

The ninth meeting of the Development Committee was held in Washington, D.C., on September 25, 1977, in conjunction with the 1977 annual meetings of the Bank and Fund. The major accomplishment at this meeting was agreement on a work program consisting of: (a) Issues related to official development assistance; (b) issues related to LDC access to capital markets; (c) the role of borrowing in development; (d) a report on world development issues to be prepared during the coming year by the World Bank; (e) coordination of the lending programs and the replenishment of the multilateral development institutions; (f) stabilization of export earnings of developing countries; and (g) the role of private direct foreign investment in the development process. At its ninth meeting, the Development Committee also endorsed recommendations contained in reports from its two working groups.

In connection with the report of the Working Group on Access to Capital Markets, the following four recommendations were endorsed:

To have the IFC test the feasibility of a program to promote the bond issues of selected developing countries;

To have the IBRD and other development banks consider requests from member countries for guarantees of bond issues in full or partial substitution for direct project loans;

To have the IFC undertake a simulation of operations and results of international portfolio investment such as might be done by an International Investment Trust; and

To discuss progress reports on the elimination or reduction of barriers and restrictions to borrowing by developing countries in capital markets of the capital-exporting countries.

In connection with the report of the Working Group on Development Finance and Policy, the Development Committee agreed that the establishment of an International Resources Bank was not feasible or generally desirable. The Committee also agreed that the creation of a consultative group for energy resources development was not necessary. At the same time, however, considerable interest was expressed in the general area of mineral and energy resources. The subjects of volume, terms, and distribution of official development assistance were discussed. The Committee welcomed suggestions for steps to be taken to provide better information on aid flows from OPEC countries.

A procedural innovation was adopted by the Committee in September 1977, namely, the creation of a Deputies group. The first meeting of Development Committee Deputies was held in Paris on September 15, 1977. The future work program of the Development Committee and other matters on the agenda for the upcoming September 25 meeting were discussed. The Deputies resolved a number of difficult issues that enabled the Committee to reach agreement on the work program and other matters without extensive debate.

Delinquent debt and rescheduling

The total long-term principal outstanding on post-World War II debts owed the United States was $41.6 billion on September 30, 1977. Most of this debt is a result of U.S. Government foreign aid and export credit programs undertaken during the last 30 years, and consequently a high proportion of it (about 70 percent by value) is owed by non-OPEC developing countries.

Since World War II, the vast majority of these debts have been paid on time. During fiscal 1977, the United States collected over 3 billion in U.S. dollars on principal and interest due on long-term credits, and the equivalent of almost $300 million in principal and interest on loans repayable in foreign currencies. As of September 30, 1977, principal and interest due and unpaid 90 days or more on post-World War II debt amounted to $591 million. More than two-thirds of delinquent debt is subject to special political or other factors, as in the cases of China and Cuba, which make prompt payment unlikely at this time.

On January 13, 1977, Treasury submitted to Congress the administration's third 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.

During fiscal 1977, the United States participated in multilateral debt rescheduling for only one country, Zaire. On January 17, 1977, a bilateral agreement was signed with Zaire, rescheduling approximately $46 million of debt service falling due in calendar years 1975 and 1976. This agreement, effective as of August 30, 1977, implemented an ad referendum debt rescheduling agreement reached on June 16, 1976, with Zaire by the Paris Club of creditor countries. Under the 1976 Paris Club agreement, other creditors will provide the equivalent of about $150 million in debt relief for the period 1975 and 1976. All creditors agreed that the rescheduled amounts would be repaid in 10 years. The interest rates charged by the creditors were generally in the range of 7–8 percent, and the weighted average interest rate of the United States was 7.8 percent. Continued adverse economic conditions caused Zaire to seek further debt reschedulings in 1977, and the Paris Club creditors concluded another ad referendum rescheduling agreement on July 7, 1977. Under the terms of this agreement, 85 percent of principal and interest falling due in the first half of calendar 1977, plus 85 percent of principal only in the second half of 1977, are to be rescheduled. During the course of the negotiations, the creditors countries indicated their concern that rescheduling agreements with private creditors be based on comparable terms. It was further decided that the Paris Club would meet again in November 1977 to consider reschedulings for calendar 1978. 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 U.S. Government requirements. The purpose of this determination is to assure maximum use of local currencies in lieu of dollars for U.S. programs in the countries concerned.

As U.S. foreign currency receipts decrease and in-country expenses increase, currencies lose their excess status. Two countries, Tunisia and Poland, are being removed from the excess currency list after fiscal 1977, leaving only five excess currency countries—Burma, Egypt, Guinea, India, and

Pakistan. When countries are removed from the excess list special foreign currency programs in those countries conditioned on the availability of excess funds are phased out. These programs involve scientific and research projects which usually have some political benefit to the United States but, because of their lower priority, might not be funded were it not for the availability of excess currencies.

Development assistance policy

The Department of the Treasury, in addition to its responsibilities with regard to the international financial institutions, participates in the formulation of U.S. development assistance policy through its membership in the National Advisory Council on International Monetary and Financial Policies, in the Development Coordination Committee (DCC), and in various other interagency committees designed to coordinate economic assistance programs. Treasury's principal concerns are to promote the efficient utilization of development assistance resources and to assure that bilateral aid objectives and programs remain consistent with overall U.S. economic interests and with U.S. multilateral aid efforts, in particular.

As a member of the DCC Treasury has participated in coordination of U.S. development interests in the less developed countries. Of particular significance has been the DCC's review of U.S. aid effectiveness. In the PRM 8 North/South planning group, created in March 1977, Treasury representatives have worked closely with other agencies in assessing the progress realized in U.S. relations with developing countries as well as in the formulation of strategic U.S. North/South options on a wide range of development issues. Treasury also participates with other agencies in the NSC ad hoc group on population policy to coordinate and implement U.S. worldwide population policy. Toward this end, the group has developed a set of performance criteria for Agency for International Development (AID) population assistance programs.

The principal U.S. bilateral economic assistance programs in which Treasury is interested are the programs administered by AID (development loans and grants and supporting assistance) and Public Law 480 food for peace program, administered by the Department of Agriculture and AID.

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 1977, AID committed $4.2 billion in loans and grants for specific projects and supporting assistance. Of this amount, $1.8 billion was in grants and $1.3 billion 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, as well as on the development efforts and financial prospects of the recipient countries. During fiscal 1977, Title I sales agreements were signed with participating governments and private trade entities for a total value of $740 million. Title II donations totaled $459 million.

Relations with developing nations

In April 1977, the Office of Development Policy and the Office of Developing Nations merged to form the Office of Developing Nations Finance. This reorganization brought desk officers and economists working on functional issues involving the developing world together in the same office in order to improve coordination.

OPEC current account trends in 1976 and 1977.—The combined current account surplus (excluding official transfers) of the 13 members of the Organization of Petroleum Exporting Countries (OPEC) in calendar 1977 is expected to decline only slightly from the near-$42 billion level attained in 1976. Since yearend 1973, the cumulative OPEC surplus has totaled nearly $150 billion. About $125 billion of this combined surplus was earned by four Arab Gulf countries (Saudi Arabia, Kuwait, Iran, and the United Arab Emirates) and $65 billion of this by Saudi Arabia alone. Estimates of the OPEC current account position for 1976–77 are contained in the accompanying table.

OPEC current account position

[$ billion]

	1976	Forecast 1977
Trade:		
Oil exports (government-take basis)	115	129
Nonoil exports (f.o.b.)	9	10
Imports (f.o.b.)	−68	−83
Trade balance	56	56
Services and private transfers	−14	−16
Current account balance (excluding government transfers)	42	40
Surplus countries	44	43
Deficit countries	−2	−3
Total OPEC	42	40

OPEC oil earnings (government take basis) totaled $115 billion in 1976 and should reach $129 billion in 1977. Oil demand in 1976 was bolstered by strong economic recovery, especially in the United States, and heavy stockpiling in the final quarter in anticipation of a yearend price rise. While demand for OPEC oil continued to rise sharply through the first half of this year as a result of abnormally cold weather and a natural gas shortage in the United States, a downturn is underway as new production from Alaska and the North Sea begins to outpace consumption growth and oil companies draw down large inventories. For the year as a whole, OPEC oil exports should average about 4 percent higher than in 1976.

The two-tier pricing arrangement arrived at by the OPEC ministers at Doha in December 1976 was resolved at midyear. At that time, Saudi Arabia and the United Arab Emirates agreed to raise their prices an additional 5 percent, bringing them in line with the majority of OPEC members that had raised prices 10 percent in December. In return, the other 11 members agreed to drop a 5-percent additional increase planned for July. The OPEC ministers will meet again in December of this year to discuss the question of prices.

Merchandise imports by the OPEC group will probably grow by about 21 percent in aggregate value, reaching approximately $83 billion this year, due about equally to increases in prices and volume. Individually, import growth rates differ significantly. The Arabian Gulf countries of Saudi Arabia, United Arab Emirates, and Kuwait as well as Iraq and Libya are increasing their import levels about 12–16 percent in volume, which is substantially faster than the other OPEC members. These countries have ambitious development plans and in general do not face serious financial constraints. Even in these countries, however, import growth has declined significantly from the very rapid rates of growth experienced over the period 1974–75 due to absorptive constraints arising from limited manpower and infrastructure. For similar reasons, the growth of imports into Iran will be limited to about 3 percent in volume. Deficit countries such as Algeria, Nigeria, Indonesia, and Venezuela have continued borrowing externally to finance import volume increases in the 5- to 10-percent range. Ecuador and Qatar have increased imports little in real terms due to financial constraints in the first case and limited development potential in the latter.

On the services account, the increase in the deficit in 1977 will be much more moderate than the jump that took place in 1976. In that year, large increases in expatriate remittances, especially in Saudi Arabia, boosted the services deficit by nearly $5 billion. A contributing factor was the slower growth of investment earnings that year due to recession-induced lower oil revenues in 1975. This year, the services account deficit should grow by only about $2 billion as increased payments for freight and insurance on imports, expenditures for management and consulting services, travel, remittances, and, in the case of the major debtor countries, foreign interest payments are largely offset by increased earnings on overseas investments.

The surplus is highly concentrated among the low absorbing countries of the Arabian Gulf. Saudi Arabia accounted for about 43 percent of the total in calendar 1976 and its share will rise to about 55 percent this year because of increased exports during the first half. Together the four Arabian Gulf States now account for about 85 percent of the total net surplus.

Middle East.—The United States-Israel Joint Committee for Investment and Trade, cochaired by the Finance Minister of Israel and the Secretary of the Treasury, did not convene during fiscal 1977. The Committee subgroups, however, were active. The Sub-Committee on Science and Technology presided over the establishment of the Israel-United States Binational Industrial Research and Development Foundation, when Assistant Secretary of the Treasury for International Affairs C. Fred Bergsten exchanged letters with Ambassador of Israel Simcha Dinitz on May 18, 1977. The Joint Steering Group, cochaired by Assistant Secretary Bergsten and Israel Embassy Economic Minister Ze'ev Sher, met in July and September to develop issues for consideration by the Joint Committee early in fiscal 1978.

In 1977 Treasury had several discussions with Egyptian Government officials on matters of mutual concern. The Secretary met on three occasions with Egyptian Government officials in Washington and held extensive discussion on economic questions with government officials in Cairo during his Mideast trip. In addition, Treasury participated in the first meeting of the Egypt Consultative Group as part of the U.S. delegation. Discussion in this meeting focused on Egypt's economic problems and donor assistance. Treasury was also active in interagency policy towards Egypt.

Latin America.—The Department of the Treasury continued to work closely with the Government of Mexico in its efforts to strengthen the economy. Treasury and the Federal Reserve System made available a $600 million swap line to counter disorderly exchange market conditions during the transition period when Mexico was making arrangements for IMF financing. Mexico drew and repaid $335 million under the agreement through the Exchange Stabilization Fund. The Secretary met twice with Finance Minister Moctezuma Cid and other Mexican officials, who outlined the progress realized under their IMF program and the substantial improvement in the balance of payments situation. Under Secretary Solomon also met with President Lopez Portillo to discuss the economic situation and actively participated in the Consultative Group Mechanism, which the U.S. and Mexican Presidents established in February 1977, by chairing the subgroup on financial affairs. Treasury also strongly supported a $590 million credit from the Export-Import Bank for the development of petroleum and gas reserves in Mexico.

Important steps were taken this year toward the resolution of several bilateral economic issues between the United States and Brazil. On two occasions, Secretary Blumenthal met with Finance Minister Simonsen to discuss issues of mutual concern. Earlier this year, negotiations continued on a proposed income tax treaty between the United States and Brazil; some progress was made. Early this fall, the United States-Brazil Subgroup on Trade met in Washington to discuss current bilateral trade issues and the prospective multilateral trade negotiations. On several occasions, IRS staff met with U.S. businessmen working in Brazil to discuss the recent IRS ruling which limits deductions on income earned in a foreign country. Treasury is now reviewing the ruling based on input obtained from those businessmen and from other businessmen working abroad. Agreement was also reached between the United States and Brazil on countervailing duty cases involving cotton yarn and scissors and shears.

Subsequent to meetings Jamaican Foreign Minister Patterson had with Secretary Blumenthal and Secretary Vance, and in response to Jamaica's severe economic problems, a Joint United States-Jamaica Technical Team was formed. The U.S. members of the team (including a Treasury economist) visited Jamaica May 1–7 to study recent economic measures undertaken by the Government of Jamaica and to identify resource requirements for development programs. It was decided that U.S. assistance to Jamaica should be coordinated with the efforts of other donors. In July, Jamaica reached agreement with the IMF for a standby arrangement.

Although Treasury is not a member of the team which negotiated the Panama Canal Treaty, Treasury staff and officials were involved in analyzing for U.S. negotiators options on the financial aspects of the treaty and on the economic cooperation package. In addition, Under Secretary for Monetary Affairs Solomon testified before the Senate Foreign Relations Committee on September 30, 1977, on the economic aspects of the Panama Canal Treaty and the economic arrangements.[29] Under Secretary Solomon agreed to serve on the Interim Board of Directors of the Panama Canal Company.

Asia.—Korea's economy resumed its strong pace of development following the setback caused by the oil crisis and international recession of 1974–75. Treasury supported an IMF standby loan to Korea designed to help Korea solidify its stabilization efforts and to lay the foundation for resuming a high growth level. A number of trade issues arose in the past year. Treasury was involved in the negotiation of trade agreements with Korea to resolve some of these issues, including an orderly marketing agreement on nonrubber footwear and a new 5-year textile agreement. In the past year, Treasury assessed countervailing duties on one item exported by Korea—textiles. In addition, the Department has been active in discussions regarding appropriate levels of U.S. assistance to Korea in order to help assure that country's long-term political and economic viability despite the withdrawal of U.S. ground forces.

In April Secretary Blumenthal met with the leading Indonesian economic official to explain new U.S. policy initiatives on a common fund to stabilize commodity prices. Indonesia is an LDC that relies heavily on earnings from primary commodity exports (including petroleum) to finance economic development and is a leading advocate of, and LDC spokesman for, the implementation of such a funding facility. Several other discussions between U.S. Treasury and Indonesian officials to discuss broad international economic policies have also taken place in the last year. During this period, Treasury has also agreed to Indonesia's reinstatement for IDA eligibility, as the number of eligible countries for these concessional funds was increased. Treasury has also been active in helping to formulate U.S. Government bilateral aid policy toward Indonesia through participation in interagency policymaking groups.

[29] See exhibit 60.

ADMINISTRATIVE REPORTS

ADMINISTRATIVE MANAGEMENT

Special studies, projects, and programs

The management staff of the Office of the Assistant Secretary (Administration) completed numerous studies and projects and initiated new procedures to strengthen analytic capability and administrative control, to improve the operation of Treasury activities, and to respond to new responsibilities.

Office of the Assistant Secretary (Administration).—The Assistant Secretary (Administration) commissioned a study of the responsibilities within the Office of the Secretary for personnel management, equal employment opportunity, and program evaluation. Following the study, the supervision of the operational personnel functions in the Office of the Secretary was consolidated under the Director of Personnel by the transfer of the Office of the Secretary Personnel Division from the Office of Management and Organization to the Office of Personnel. In addition, the personnel staff of the Office of the Assistant Secretary (International Affairs) was transferred to the Office of Personnel.

Offices under the Assistant Secretary (Administration) established management objectives and developed action plans for achieving them. Quarterly meetings were held with each of the Office Directors and their key staff members to discuss the objectives and related problems. Future meetings with Office Directors will be conducted in accordance with recently implemented zero-base budgeting procedures.

Office of the Secretary.—With the change in administration, Treasury officials and analysts reviewed the organization and current operations of the Office of the Secretary. The basic departmental organization was restructured to redistribute responsibilities among senior Office of the Secretary officials and to facilitate direction and coordination of both operational and policymaking functions. Major organizational changes included:

(1) Designation of an Assistant Secretary (Public Affairs);

(2) Reassignment of the Office of Tariff Affairs from the Assistant Secretary (Enforcement, Operations, and Tariff Affairs) to the General Counsel;

(3) Designation of a Chief Deputy to the Under Secretary (Enforcement and Operations) with the concomitant disestablishment of the Office of the Assistant Secretary (Enforcement, Operations, and Tariff Affairs);

(4) Transfer of international economic research and analysis functions from the Assistant Secretary (International Affairs) to the Assistant Secretary (Economic Policy);

(5) Changing the title of the Assistant Secretary (Capital Markets and Debt Management) to Assistant Secretary (Domestic Finance), thereby emphasizing the role of this Office as a focal point for Treasury policy regarding State and local public financing;

(6) Reassignment of responsibility for supervising the Office of Revenue Sharing from the Under Secretary to the Assistant Secretary (Domestic Finance); and

(7) Disestablishment of the Office of National Security, and transfer of the Office's secretariat-type functions to a newly created Office of Intelligence Support under the supervision of the Executive Secretary.

Departmental.—The Department provided several personnel on detail to two of the task forces of the President's reorganization project: those dealing with law enforcement and personnel management. Treasury also furnished comments on numerous issue papers produced by these task forces.

The field structure of the criminal enforcement side of the Bureau of Alcohol, Tobacco and Firearms was reorganized in December 1976, eliminating the regional headquarters and establishing straightline authority from the Assistant Director (Criminal Enforcement) to the Special Agents in Charge at the district level. At that time, the regulatory enforcement side of the Bureau was left untouched, except that the Assistant Regional Directors (Regulatory Enforcement) were retitled Regional Regulatory Administrators, reporting directly to the Assistant Director (Regulatory Enforcement). In the early summer of 1977, the Secretary directed a study of the field structure of the regulatory enforcement side of ATF. This study is continuing.

At the Secretary's direction, joint Office of the Secretary and bureau task forces undertook reviews of the field organization of the Internal Revenue Service, the U.S. Customs Service, and the U.S. Savings Bonds Division. The results of these studies will be submitted to the Office of Management and Budget early in fiscal 1978.

A management review of the Old Mint, San Francisco, was conducted to examine its organizational structure with the objective of improving operations. The review included an assessment of the Old Mint's capability of meeting the challenge of an expanded mission resulting from the implementation and operation of Treasury's payroll/personnel information system.

Management by objectives.—The departmental management by objectives program was integrated with the President's zero-base budgeting program to strengthen overall planning efforts by highlighting the financial impact of the objectives.

Productivity.—The Department initiated a formal productivity management program designed to continue its long history of productivity improvement. Treasury bureaus have quantified productivity measures covering activities that comprise 78 percent of the Department's staff-years.

For the period 1967 through 1976 Treasury had a 1.5-percent average annual rate of productivity improvement compared with the 1.2-percent annual rate Government-wide. Many activities have been started throughout the Department to continue this improvement trend. A study was completed which related productivity measurement to criminal enforcement activities. A major Department-wide study is nearing completion which will identify directives that adversely affect Treasury's productivity. Additionally, each bureau prepares an annual plan of projects and activities which are undertaken during the year to improve productivity.

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. A comprehensive review of all Treasury advisory committees, requested by the President, resulted in a reduction in the number of Treasury committees from 27 to 10.

Assistance to foreign governments and officials.—The Foreign Visitor Program office has provided orientation and specialized consultation and training on a continuing basis to foreign visitors referred by the Agency for International Development (AID) and other agencies, both governmental and nongovernmental. Visitors have come from less developed countries and also from Western Europe and other industrial areas of the world.

Emergency preparedness

The Emergency Planning Staff has directed primary emphasis to several ongoing activities and to new individual projects with potential to significantly enhance the Department's emergency preparedness posture and to facilitate overall administration of the program.

The program emphasis on state of readiness in the 10 standard Federal regions, stressed in the previous Annual Report, has been continued. Since the final reports of the joint Federal Preparedness Agency (FPA)-Treasury regional readiness reviews found that the Department's readiness posture in the 10 regions varied from satisfactory to excellent for the individual regions, the knowledge has been used in evaluating, modifying, and reemphasizing the regional program. An in-house management review of the Treasury civil emergency preparedness program was initiated in calendar 1976 and culminated in the fourth quarter of fiscal 1977. The study recommendations within the Department's authority to implement are being formalized for adoption. The implementation of other recommendations, which would impact on the overall Federal program, is being coordinated with the FPA.

The Department's report to the Joint Congressional Committee on Defense Production in September 1976, which provided a comprehensive compilation of all significant aspects of the Treasury emergency preparedness program, was published later as an integral part of the Annual Report of the Joint Committee. One of the committee's major oversight agenda activities, a comprehensive assessment of the Federal civil emergency preparedness effort, paid particular attention to preparedness resources, institutional arrangements, plans, and programs.

In May and September 1977, the departmental emergency planners participated in interagency civil readiness Exercise REX–77 which, in sharp departure from previous nationwide exercises, was conducted as two separate regional seminar/exercises in Atlanta and Dallas. Significant achievement of the objective, to increase the overall experience and knowledge of regional planning personnel, was realized through meaningful bureau and national level participation.

Based upon the lessons learned in civil readiness Exercises REX–76 and REX–77, the Assistant Secretary (Administration) initiated a comprehensive review of Treasury's emergency plans and policy documents. The senior departmental officials participating in this review have also been asked to provide their conceptual thoughts on emergency preparedness as it pertains to their areas of functional responsibility.

The Department's overall emergency readiness capability was improved with (a) the installation of a sophisticated new headquarters operations and communications center and additional communications equipment at its emergency operating facilities, and (b) the replacement of obsolete rations at the Treasury alternate relocation site with new freeze-dried foods of improved shelf life, nutrition, and ease of preparation.

Because of the significant turnover in senior Treasury officials with the new administration, special emphasis was given to familiarizing the members of the three Emergency Executive Teams with the national level preparedness program, alert notification procedures, readiness levels, emergency operating capabilities, and prepositioned emergency plans and vital records. Briefings and tours were conducted at the two emergency operating facilities.

Other important interagency participatory activities for the period included:

1. Major review of "Civil Emergency Preparedness Policy Planning Guidance."

2. Federal-State planning for crisis relocation within the overall coordination of the FPA and the Defense Civil Preparedness Agency. Treasury's existing emergency planning authorities for declared national emergencies and natural disasters appear adequate for crisis relocation; however, further study of these authorities is being conducted.

3. Coordinated planning with the Federal Reserve Board and the Bureau of Engraving and Printing to revise the emergency currency inventory, based upon modified production capabilities and procedures.

4. Preliminary planning for "Guidance for Federal Responses to the Consequences of Disruptive Terrorism."

5. Preparation for an interagency reorganization study of "Federal Preparedness and Response to Disasters," to be conducted at Presidential request by the Office of Management and Budget.

Treasury payroll/personnel information system

The thrust of the resources of the Treasury Employee Data and Payroll Division has been the implementation of the Treasury payroll/personnel information system (TPPIS). The Division is charged with direction of the effort to convert Treasury bureau payroll and personnel systems to TPPIS and with management responsibility for the efficient operation of the system. TPPIS, a singular Treasury project inasmuch as it encompasses all bureaus, is an automated personnel and payroll processing and information system which provides labor distribution for cost center accounting.

The Office of the Secretary and six bureaus have been converted to TPPIS during fiscal 1977. The remaining six Treasury bureaus and five other Federal agencies are expected to be converted to TPPIS during fiscal 1978.

TPPIS is currently being implemented at the Bureau of the Mint, San Francisco, for all Treasury bureaus, except IRS, and other Federal agencies. TPPIS as serviced by the Mint will be a multiagency system and will total some 45,000 employee accounts. TPPIS will be implemented at the IRS Detroit Data Center for some 99,000 IRS employee accounts. TPPIS joins the resources of the Department of the Interior and Treasury in the maintenance and development of the system. However, TPPIS as a Treasury system is unique in that it centralizes the computer systems' maintenance and development and certain fiscal responsibilities while decentralizing the accountability for data entry and the correctness of data. Data entry is provided through a remote intelligent terminal subsystem.

The new system has provided savings to the Department with lower costs for payroll support, the liquidation of antiquated computer equipment, the consolidation of personnel resources, and the elimination of numerous manually prepared reports which are now automatically produced.

Internal auditing

The Office of Audit provides leadership and professional assistance to Treasury bureaus on their systems of auditing and administrative accounting. The staff also furnishes audit service directly to the Office of the Secretary and to other organizations upon request.

Formal appraisals were made of third-party audit activities of the U.S. Customs Service and internal audit activities of the Bureau of Engraving and Printing. These were done in fulfillment of a plan to review periodically the audit system of each Treasury bureau.

The review of Customs regulatory audit program included field work in three of the nine Customs regions. The resulting report urged the carrying out of initiatives designed to establish a national program, strengthening the planning process, more consistently adhering to Federal reporting and examination standards, and more systematically following up on audit reports.

The appraisal at Engraving and Printing recommended consolidation and better scheduling of segmented financial audits. The report also promoted a more complete development of audit findings in audit reports.

Fulfilling departmental accounting responsibilities, a substantial amount of advisory assistance was provided in support of the new Treasury payroll/personnel information system. This effort was directed toward ensuring proper conversion from the IRS system and establishing bureau procedures for auditing the system.

A review was made of the U.S. Secret Service administrative accounting system. Improvements were suggested in property control, the classification of accounts and undelivered orders, the preparation of management reports, and computer security. The report also recommended submission of the design of the new automated system to the Comptroller General for approval.

Direct audit services were provided to the Federal Law Enforcement Training Center at Brunswick, Ga. An audit of appropriated funds resulted in discontinuing the financing of certain construction from the salaries and expenses appropriation and correcting weaknesses in financial reporting and accounting control over funds, property, and payroll activities. An audit of contracts for food and janitorial services and the operation of the student center identified opportunities to improve contract award and administration practices.

Several audits were conducted in the Office of the Secretary. While improvements were promoted in property accounting, procurement practices, and payroll activities, no significant deficiencies were found in such activities as travel and relocation expenses and appropriation reimbursements.

The Director of the Office of Audit coordinates Treasury employee allegations of merit system violations inappropriate for normal grievance or appeals procedures. Able technical counsel is provided by departmental personnel specialists. Almost all of the 70 cases established in the last 3 years have been resolved to the satisfaction of the parties involved.

The Director is also the liaison within the Department on matters involving GAO reports. About 200 draft and final reports were reviewed; Treasury officials were apprised of the special significance of the reports to them; and where appropriate, Treasury responses were coordinated and reviewed.

Budget and program analysis

The Office of Budget and Program Analysis continues to provide departmental leadership for developing, administering, and analyzing bureau budget estimates and short-term and long-range financial plans.

For fiscal 1977, budget estimates totaling $54 billion were submitted to the Congress. The amount included $2.8 billion for the operating accounts, $6.9 billion for general revenue sharing and the antirecession programs, and $44.3 billion for public debt interest and miscellaneous accounts.

During the period of this report, the staff—

1. Maintained controls on expenditures, number of personnel on roll, and motor vehicle fleet to comply with limitations and directives prescribed by OMB.

2. Obtained supplemental appropriations for the cost of pay increases authorized by Executive Order 11941, wage board actions, and administrative actions amounting to $92.7 million.

3. Assisted in the preparation and presentation of budget requests totaling nearly $750 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.

4. Revised the Department's budgetary execution procedures and reprogramming guidelines in order to obtain better controls on yearend spending, as well as a more detailed review of spending throughout the year.

5. Issued Department-wide zero-base budgeting directive implementing the zero-base budgeting concept within Treasury.

6. Studied the costs of alternative sites and financing plans for an expansion of the production facilities of the Bureau of Engraving and Printing.

7. Performed a cost-benefit study of the use of the electronic funds transfer program for distributing revenue sharing payments.

8. Assisted in analyzing the impact on tax revenue of a proposed change in the tobacco regulations.

9. Coordinated a zero-base review of overseas staffing requirements.

10. Developed a request for proposal for a contract to study the impact of the antirecession financial assistance program on the budget-related actions of States and local governments.

11. Reviewed Treasury compliance with OMB instructions on financial controls to assure that funds are spent in accordance with congressional intent.

12. Evaluated the costs, benefits, and funding arrangements for a new program proposed by the Customs Service to improve the quality of export statistics.

13. Analyzed the motor vehicle fleets of Treasury law enforcement bureaus to determine their adequacy in numbers and condition, and developed a more equitable method for determining the number of replacement vehicles to be included in the Treasury budget request.

14. Assisted the Customs Service in developing the Customs compliance measurement system to obtain a statistical estimate of the "universe of violations" of the laws and regulations being committed by persons arriving in the United States.

15. Issued a report on the first phase of the budget automation project recommending a compatible budget activity and program structure for all Treasury bureaus and offices.

16. Assisted the Bureau of Alcohol, Tobacco and Firearms in evaluating the impact of Operation Concentrated Urban Enforcement on gun-related crime.

17. Coordinated a survey of Treasury program evaluation activities and a survey of Treasury information sources and systems for the General Accounting Office.

18. Conducted a survey of Federal agency compliance with Treasury Circular No. 1082, Notification to States of Grant-in-Aid Information.

Personnel management

A major effort is being made to improve the quality and accuracy of Treasury-wide personnel management issuances. Bureaus will have in writing clearly stated personnel management policies and approved practices against which to measure bureau efforts. Twenty-five chapters have been issued or are in process. Also published were a manager/supervisor handbook designed to better acquaint these managers with proper procedures for improving employee productivity, performance, and discipline; and a "How-To Handbook" on personnel management onsite surveys. Also, a course on onsite surveys was developed and presented to bureau personnelists and EEO staffs.

Onsite surveys have helped stimulate major personnel management improvements at Mint, Secret Service, Customs, Public Debt, and ATF. Additionally, position management system surveys were conducted in all bureaus to assure that they are giving adequate emphasis to the economical and efficient uses of positions and people to accomplish their missions.

Treasury's labor relations program continues to play an expanding and more complex role in the overall management of human resources. Once again it leads all Cabinet agencies in the extent to which its employees have organized. More than 98,000 employees are represented by 18 different unions in 9 Treasury bureaus and the Office of the Secretary. A trend toward more complex negotiations continues as the unions seek to consolidate bargaining units within Treasury bureaus to expand the scope of bargaining. Union-management controversies requiring third-party resolution continue to increase in both volume and complexity. To enable management Department-wide to more effectively meet the increased challenges, the Labor Relations Staff established the Department's Labor Relations Information Center to meet research and case-handling informational resource requirements. This Center permits access to a computerized retrieval system of Federal labor relations cases.

With the issuance of a new departmental executive and management development policy, bureaus have embarked on efforts to revise and upgrade their programs. The Department initiated a three-phase, intradepartmental program for executives, described by the Civil Service Commission as an ideal way to initiate team building and organization improvement efforts.

Summer training programs for college and graduate-level Federal interns and disadvantaged youth proved highly successful both from the standpoint of student participation and the high level of interest shown by the Secretary and other top executives. Secretary Blumenthal, Deputy Secretary Carswell, Under Secretaries Solomon and Anderson, and other key members of the Secretary's staff served as principal speakers and discussion leaders for seminars and panel discussions. Interns working in Treasury and other Federal agencies had a number of opportunities to discuss with the Secretary and other senior officials the major issues surrounding economic, monetary, social, and administrative policymaking. All the sessions were given high ratings by the participants.

Combined Federal Campaign

Secretary Blumenthal served as Chairman for the Federal-wide 1978 Combined Federal Campaign. The Secretary established a significant increase in the 1978 local Federal goal over last year's contributions, specifically a goal of $11.3 million, a $1.3 million, or 12.5-percent, increase for all Federal agencies.

Procurement and personal property management

Total commercial procurements for the Department in fiscal 1977 amounted to $248 million, of which $51.8 million in contracts was awarded to small business firms. This amount excludes contracts funded by the Saudi Arabian Government. Of the total amount, $171 million was expended through Treasury-negotiated and advertised contracts, with the balance being ordered under established General Services Administration and other agency contracts. The expenditures made to minority owned and operated businesses, both through the Small Business Administration's "8(a)" program and other contracts, totaled $2 million.

During fiscal 1977, the negotiation of 39 blanket purchase agreements for use by all Treasury bureaus provided a savings in excess of $225,000 over standard unit prices under existing Government contracts. The Department-wide consolidation of Treasury requirements for 855 law enforcement vehicles (procured through GSA) and an estimated 33 million rounds of small-arms ammunition resulted in a significant dollar savings over separate procurement methods. Vehicles purchased included compacts, intermediate-size and full-size automobiles; types of ammunition covered 29 varieties.

The Department issued an "ADP Procurement Handbook" as a working tool to assist bureau contract specialists and computer personnel involved in acquiring ADP equipment and services. The program staff also continued its staff assistance visit program designed to help identify potential for improvement in the overall contracting activities of the Department and individual bureaus.

In support of the U.S. technical cooperation agreement with the Saudi Arabian Government, Treasury contract specialists awarded, using Saudi funds, and administered contracts in excess of $90 million in fiscal 1977. Contracted services and equipment were to provide improvements to several aspects of the Saudi socioeconomic conditions.

Treasury personal property transactions included the reassignment within Treasury of property valued in excess of $480,000 and transfer of personal property valued in excess of $5.3 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 national laboratories of the Bureau of Alcohol, Tobacco and Firearms will be relocated in February 1978 from the Internal Revenue Service headquarters building at 12th and Constitution Avenue, Washington, D.C., to a recently acquired suburban facility located in Rockville, Md. Relocation of the labs from a densely populated office building to a location separate from other buildings will reduce the potential safety hazards to other Treasury employees posed by the examination of explosive materials and devices by ATF.

A request has been filed with GSA on behalf of the Federal Law Enforcement Training Center for the transfer of 31 townhouse buildings at the former Glynco Naval Air Station, Brunswick, Ga., which had been declared excess to the needs of the Department of the Navy. The townhouses will be used to provide dormitory-style housing for 410 FLETC students and will eliminate the need to construct new dormitories. A cost avoidance of approximately $3.7 million will result. Until the formal transfer of the property early in fiscal 1978, the townhouses will continue to be used by the FLETC on a right-of-entry permit granted to Treasury by the Navy.

A U.S. Customs Service facility in Laredo, Tex., was declared excess to Treasury's needs. Since no interest in the property was expressed by Federal, State, or local agencies, Treasury was able to transfer the property to the Ruthe B. Cowl Rehabilitation Center at no cost. The Center is a nonprofit organization engaged in health and educational programs for the underprivileged and the handicapped.

The U.S. Secret Service pistol range was relocated in September 1977 from the existing antiquated facility in the Main Treasury Building to a new range in the 12th and Pennsylvania Avenue Federal Building. This relocation will resolve the lead contamination problems experienced in the old facility. Originally scheduled for November 1976, the move was delayed for almost a year while air circulation deficiencies identified by the National Institute for Occupational Safety and Health were corrected. The new facility was retested and accepted by the Institute in mid-September.

Several space planning initiatives have been undertaken to consolidate bureau headquarters activities and reduce Treasury's physical fragmentation from the present 54 locations in the metropolitan Washington, D.C., area. A study to define the existing and long-range space needs of the U.S. Secret Service was completed, while a similar study for the Fiscal Service is scheduled to be completed by January 1978. Plans have been developed to consolidate portions of the Office of the Secretary, now scattered in 11 leased locations, contingent upon the achievement of a Fiscal Service consolidation and the resultant evacuation of the Treasury Annex Building by the Bureau of Government Financial Operations.

Efforts to achieve better space utilization in the Main Treasury complex resulted in the reclamation of 10,000 square feet of previously unoccupied storage and mechanical space for office and specialized operational use. This will result in recurring annual space rental savings of about $77,500.

Construction was completed on April 22, 1977, for a telecommunications complex in the Main Treasury Building. Over 5,200 square feet of the complex was converted from underutilized security vaults. The consolidation of telecommunications activities and the replacement of obsolete equipment with electronic devices made available approximately 2,500 square feet of office space to the Office of the Secretary.

Engineering design efforts for major renovation projects in the Main Treasury complex are continuing. Awards of construction contracts which will provide for the installation of 6 additional zones of a 10-zone air conditioning project and extensive electrical renovations are anticipated in the spring of 1978. Upon completion of these projects, only two zones of the air conditioning project will remain.

The historically significant Cash Room in the Main Treasury Building was opened for conference and ceremonial use in the fall of 1976, following the discontinuance of banking activities previously conducted there by the Bureau of Government Financial Operations. An interim "adaptive use" of the Cash Room was made possible by a combined space planning, interior design, and construction implementation effort by Treasury personnel. A study has been completed which defines the scope of work and estimates the costs for a complete restoration of the Cash Room at approximately $350,000. No action is planned for the implementation of the restoration until after fiscal 1979.

Printing management

The wage print employees in Treasury's departmental printing plant have expressed a desire to be represented by a union in their dealings with management. Therefore, in an election held on April 29, 1976, the craft employees voted to grant exclusive recognition to the National Alliance of Postal and Federal Employees. Soon after the union was recognized, representatives of Printing Management, the union, and the Union Relations Branch began bargaining sessions to establish a contract. A contract was agreed upon, but it remained unsigned through the 7 succeeding months due to the objection of the union to some items it initially agreed to. With new negotiations starting in late summer, a successful contract and signing are expected to be consummated this fall.

The departmental printing plant, in providing printing, binding, mailing, photographic, and related services to the Office of the Secretary and all bureaus, operates under a working capital fund by which the plant is reimbursed for all work produced for all customers. Except for a small yearly inflation factor, the charges used for the work performed have remained unchanged since 1971. During fiscal 1977, a consultant was retained to perform a study to determine the validity of charges billed to customers. The study took 4 months to complete and resulted in a cost increase of approximately 37 percent for work produced. The new working capital fund charge sheet currently reflects the actual costs for operating the printing plant, including the latest raises received by the wage print employees and the newer, more sophisticated equipment now employed to produce work for all customers.

Treasury operates nine printing plants authorized by the congressional Joint Committee on Printing. As a result of a factfinding trip to New York City by that Committee and representatives of the Government Printing Office, the Secretary of the Treasury received direction from the chairman of the Joint Committee in August 1976 to reduce the IRS plant in New York from the status of an authorized printing plant to a duplicating facility. The purpose of this downgrading was to comply with OMB's directive to procure all feasible work from commercial sources through GPO contracts as opposed to producing this work in-house. Since a duplicating facility is not allowed to operate the sophisticated equipment, nor to produce the volume of work allowed that of an authorized printing plant, a written departmental appeal was sent to the JCP to reconsider its decision. In May of 1977, another onsite survey was conducted in New York by staff members of the JCP, GPO, and Treasury representatives that supported the earlier findings, and the chairman of the JCP upheld his original decision to downgrade the IRS plant.

The economic policy staffs within the Office of the Secretary submitted a requirement to the Printing Management Division to produce a biweekly colored slide presentation to keep top staff up to date on the status of current domestic and international economic trends. An average of approximately 110 work hours is required to complete each slide show, involving the Graphics Branch, the departmental printing plant, and the Photographic Services Staff.

The Bureau of Alcohol, Tobacco and Firearms requested and received from Printing Management the authority to establish a duplicating facility on Bureau premises within the headquarters building. Authorization was granted to operate it on a test basis for a 1-year period because of its special internal requirement. At the end of the test period, staff of the Printing Management Division and the Bureau will evaluate the effectiveness of this plant and will decide, from both a service and economic standpoint, whether to continue its operation.

Physical security

An active training, orientation, briefing and debriefing program was established for employees concerned with classified information and material. This Department-wide briefing program is designed to impress upon all employees their responsibility for exercising vigilance and care in complying with the provisions of departmental security policies.

A classification management program review of the Department by the Interagency Classification Review Committee, National Security Council, recommended that Treasury review the number of documents it had originally classified to reduce the number of departmental officials authorized to classify national security information and material as "top secret," "secret," and "confidential." A review by the Office of Physical Security of over 3,000 documents classified from 1973 through 1976 revealed that Treasury could not justify the number of authorized classifiers compared with the relatively few classification actions attributable to some of the authorized officials. Therefore, reductions were made of certain classification authorities on an individual basis, by position, to a lower classification category.

Extensive physical security program evaluation reviews were conducted throughout the Department regarding the management of classified documents and facilities. Recommendations were provided to upgrade the programs to meet specific requirements. One of these surveys resulted in reducing the number of security alarm systems in the Main Treasury and Annex Buildings and leased buildings, realizing a savings of $9,000.

A defensive international travel briefing program has been developed for use throughout the Department. This briefing is given to all personnel traveling or assigned overseas and provides for an individual awareness of the risks inherent in foreign travel and basic procedures to be used for protecting themselves and their families.

Telecommunications

Telecommunications complex.—A major redesign and construction project has created over 10,000 square feet of highly sophisticated communications space on two levels in the Main Treasury Building. This complex now contains the Telecommunications Management operational facilities, including the new Treasury Centrex telephone system and a secure control room for use in conducting classified activities. The complex will also contain the Treasury automated communications system (TACS) and support activities for all operational facilities. When TACS becomes operational, the Treasury telecommunications capability will have attained a status comparable to that of other major governmental agencies and one that can be viewed with pride.

Treasury automated communications system.—A contract was awarded to D. Brown Associates on August 1, 1977, for the automation of the Treasury telecommunications operations center. The implementation of TACS in 18 months will round out the Treasury communications capability by providing a modern message processing and dissemination facility which will increase productivity and efficiency.

Treasury Centrex telephone system.—The final major steps in the conversion of the Treasury telephone system to Centrex II service were accomplished in the first quarter of fiscal 1977 followed by conversion of 16,000 Touch-Tone instruments in the second quarter. Currently, all the Treasury telephones in the District of Columbia, plus some in other areas, have been converted to the new service. Application of the "single-line" telephone in lieu of the more expensive "multilined" telephones or "call directors" is the next major milestone to be reached in fiscal 1978. Because of the community of interest, arrangements were made to provide telephone service to the Export-Import Bank effective September 16, 1977.

Radio frequency management.—An extensive effort was put forth to obtain a complement of radio frequency channels for the Customs Service to permit expansion and modernization of its nationwide communications system. The additional channels will provide the capability to extend radio coverage and improve operational flexibility to meet the increasing demands of Customs law enforcement activities throughout the United States.

Federal telecommunications system (FTS) cost reduction program.—A major effort was initiated in fiscal 1977 to reduce long-distance telephone costs. The first step of this program involved collecting and disseminating detailed calling data, along with distributing educational memoranda to Treasury employees on the proper use of FTS. In the second step, a unique restriction capability will be made available on Centrex which will permit placing long-distance FTS calls to other Government telephones but will inhibit calls to non-Government numbers. These and other planned actions are aimed at a cost reduction of $2 million in long-distance calling.

Improvement of commercial carrier service to Treasury.—In fiscal 1977 Treasury was one of four Government agencies to be designated by the American Telephone & Telegraph Co. to be served by a national account manager. This action had the immediate effect of doubling the staff available at the Washington A.T.&T. office to handle Treasury requirements. There has also been a noticeable beneficial impact on the service provided by local operating telephone companies, and a general improvement in service response on a nationwide basis is anticipated.

Overseas communications support.—Telecommunications Management is assisting the Office of Saudi Arabian Affairs in developing a Treasury communications capability between Saudi Arabia and the United States. A system has been proposed which will support both data processing and voice transmission facilities for the United States-Saudi Arabian Joint Commission on Economic Cooperation and the numerous projects sponsored by the Commission.

Departmental audiovisual management program.—Responsibility for the management of the departmental audiovisual program has been formally delegated to the Assistant Director (Telecommunications Management). Additional White House interest in audiovisual activities within the Federal Government suggests that the need for central programmatic control of audiovisual expenditures will be increased. Substantial savings are possible through reducing duplication of equipment and sharing of resources within Treasury.

Paperwork management

Directives system implementation.—Approximately 80 percent of all administrative policy and procedures directives have been converted to the new system. Completion of the unified directives system conversion is expected by the end of fiscal 1978.

Reports management.—As a result of creating an internal reports management program, the Department now has a comprehensive reports management program covering internal, interagency, and public-use reporting systems.

Public-use reports burden reduction.—In response to the President's directive to reduce the number of reports required of the public, the Department mounted an intensive program in fiscal 1976. Through this project, which continued into fiscal 1977, the Department intends to reduce the number of work hours required to fill out its reports by 10 percent.

Forms management program implementation.—After extensive coordination, analysis, and design work, a comprehensive forms management program has been approved and implemented. A concerted effort will be made over the next few years to inventory all forms in use in the Department and reduce the number substantially. Significant dollar savings will result.

Records management.—A number of projects to improve Office of the Secretary records management practices were initiated and completed. They include the development of a unified subject file manual for the Office of the Assistant Secretary (International Affairs). The system provides for filing material based on functional areas of each of the offices. Also, the files room of the Office of Tax Policy has been reorganized and reequipped. By removal of 232 cubic feet of files, very valuable and much-needed additional prime office space in the Main Treasury Building was made available for other uses.

Reduction of Privacy Act systems of records.—Under the provisions of the Privacy Act of 1974 (5 U.S.C. 552a (e) (4)), the Department is required to publish annually in the Federal Register a notice of all the systems of records containing personal information. With over 300 systems, the Department's notices in the Federal Register required 368 pages last year. As the result of reducing those 300 systems, which duplicated each other many times, to 4 basic models of systems of records, the number of pages this year has been reduced by approximately 100 pages. At a cost of $285 per printed page in the Federal Register, this represents a $28,500 savings to the Department.

General services

International support.—The IMF/IBRD annual meetings bring together the Finance Ministers, central bankers, and other top officials from around the world in discussions concerning international monetary and financial policies. The Office of General Services planned and coordinated all administrative requirements for Treasury's participation in the 1977 IMF/IBRD conference. Complete logistical support, including telecommunications, furniture and supplies, and other office services, was provided in a major temporary office installation for top Treasury officials in a wing of the Sheraton Park Hotel, Washington, D.C. Numerous events were arranged for the Secretary and other officials, including a reception by the Secretary for approximately 1,000 guests.

In addition, the Office of General Services continued to provide planning and coordination services for overseas travel by the Secretary and other top Treasury officials.

Facilities management.—The Office of General Services planned and coordinated a large number of relocations for top staff offices in the Main Treasury Building and leased space assigned to the Office of the Secretary. During this period, detailed planning and close coordination involving each office's requirements were undertaken. Almost every top official and elements of every staff in Main Treasury were affected.

Environmental programs

Environmental quality.—The Assistant Secretary (Administration) approved completed environmental assessments concerning applications to the Comptroller of the Currency to establish two new national banks in Oklahoma and a branch bank in Pennsylvania. In addition, the initial phase of an environmental impact statement on a proposed new Bureau of Engraving and Printing facility was completed, and an addendum to a Customs Service assessment concerning small border stations was approved. Assistance was also provided to the Council on Environmental Quality in the revision and improvement of National Environmental Policy Act implementation and the environmental impact statement process as directed by the President.

Historic preservation.—Treasury continued its participation as a statutory member of the Advisory Council on Historic Preservation (ACHP). This included the review of adverse impact studies on Federal projects involving historic properties, and representation on task forces which developed plans for historic preservation legislation and for establishing the ACHP as an independent agency. Historic preservation reviews were conducted in connection with Treasury activities, one of which involved coordination with State and Federal officials concerning the establishment of a Customs border station in Clinton County, N.Y., and a departmental directive on historic preservation is being completed. Treasury provided assistance to the ACHP and the Department of the Interior in the implementation of Section 2124, Tax Incentives to Encourage the Preservation of Historic Structures, of the Tax Reform Act of 1976. Treasury also served on the Presidential task force preparing a National Heritage Trust Proposal to reorganize and improve the treatment of national natural and cultural resources.

Energy conservation.—Continuing departmental energy conservation program efforts resulted in additional reductions in energy consumption each quarter. An emergency program was instituted throughout the Department during January–February 1977 to accomplish additional reductions in energy consumption and for reporting and responding to emergency conditions such as fuel shortages and interruptions to program operations. In compliance with the Energy Policy and Conservation Act and Executive Order 12003, "Relating to Energy Policy and Conservation," bureau personnel were briefed on the new requirements in order to organize the Department for identifying further energy conservation opportunities in buildings and departmental operations. Treasury also assisted the Federal Energy Administration in the development of new energy conservation guidelines.

Pollution abatement.—A study of Treasury facilities was completed and an implementation plan was developed for Customs facilities to comply with new Environmental Protection Agency (EPA) regulations issued under the Safe Drinking Water Act and designed to upgrade water quality. A feasibility study was conducted and implementation options are being considered concerning the applicability of source separation of high-grade paper wastes, and resource recovery and recycling programs in selected Treasury buildings. Action, including consultation with EPA, was initiated in response to a proposed claim by the city of Philadelphia for Treasury funds to partially subsidize the construction of a municipal wastewater treatment plant. Additional funds were being sought by the city in addition to the 75-percent share of total costs already provided by the Federal Government.

Library

An automated system for Treasury's library operations was introduced in March 1977. Participation in this on-line system from the Ohio College Library Center is coordinated through the Federal Library and Information Network (FEDLINK). In effect the system permits resource sharing with over 700 libraries.

Safety

The safety action plan project is well underway with the plans of five bureaus completed and the remainder scheduled for completion during fiscal 1978. The bureau plans comprise a detailed analysis of the extent of compliance with Federal regulations and a schedule of corrective actions with budget estimates. The prototype plan, produced by the Secret Service, was highly commended by the President in a letter from him to the Secretary of the Treasury.

A revised directive on accident reporting was finalized and issued to the bureaus. After considerable study by a committee of the Treasury Occupational Safety and Health Council, the directive now incorporates all the requirements of 29 CFR, part 1960.

Treasury Historical Association

The Treasury Historical Association held its third annual meeting on June 29, 1977. Highlighting the meeting were an election of new members to the Board of Directors, the unveiling of a plaque for life donor members, and the presentation of a check in the amount of $1,200 from the Catherine V. Coleman Memorial Fund to the George Washington University Continuing Education for Women Center.

At a meeting of the new Board held on September 13, 1977, an election of officers to fill vacancies resulted in the appointment of David Mosso as President and Rex D. Davis as Vice President. Continuing in their current offices are Dr. Charls E. Walker, Chairman; Arthur D. Kallen, Treasurer; Abby L. Gilbert, Secretary; and Sidney Sanders, Executive Secretary.

At the end of fiscal 1977, the Association had 324 members.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

The missions of the Bureau of Alcohol, Tobacco and Firearms (ATF) are: To reduce the criminal misuse of firearms and the misuse or unsafe storage of explosives; to assist other Federal, State, and local law enforcement agencies 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 efficiently collect all revenue due under the Federal alcohol and tobacco tax statutes, and to achieve, to the maximum extent possible, voluntary compliance with those laws; to eliminate the illicit manufacture and sale of nontaxpaid alcoholic beverages; and to quash 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.

As a key Federal law enforcement agency, ATF's primary goals are to keep firearms out of the hands of criminals, and to suppress and investigate criminal explosive incidents. These efforts are being focused upon metropolitan areas because successful ATF enforcement activities have reduced significantly the manufacture and sale of illicit alcohol.

Criminal violence in the 1920's and 1930's prompted Congress to enact the National Firearms Act of 1934. ATF enforces and administers the law, which imposed a tax on, and required registration of, automatic and other gangster-type weapons. In 1942, Congress passed the Federal Firearms Act, regulating interstate commerce in firearms, responsibility for which was also assigned to ATF.

Similarly, an upsurge in violence in the 1960's led to broader law enforcement responsibilities for ATF. Increased firearms crimes, spurred by assassinations of political and other leaders, brought passage of the Gun Control Act of 1968. It encompassed existing Federal firearms laws and added new provisions, to be enforced by ATF. In 1970, enactment of title XI of the Organized Crime Control Act assigned explosives regulation and enforcement jurisdiction to ATF.

A reorganization of field criminal enforcement functions into a new straight-line management authority from the Assistant Director (Criminal Enforcement) to Special Agents in Charge was implemented during fiscal 1977. The Bureau completed its first year of a program which reduced the use of firearms and explosives in crime in three metropolitan cities. A nationwide public awareness program was initiated to improve explosives storage security and prevent thefts. An explosives tagging program for identification was field tested and a national pilot test begun. National implementation is scheduled for 1978.

Intensified enforcement efforts to suppress interstate and international movement of firearms and explosives intended for criminal use revealed new weapons sources. Complex criminal investigations were developed successfully and forwarded for prosecution.

During fiscal 1977, ATF collected more than $8 billion in alcohol and tobacco excise taxes—the third largest source of U.S. revenue, following personal and corporate income taxes. ATF intensified its regulatory enforcement efforts to investigate trade practice violations and to conduct compliance inspections of firearms and explosives industry members.

Several steps were taken by ATF to modernize laws, regulations, and rulings including steps to deregulate while maintaining assurance of collecting tax revenues due. Consumer protection was promoted by proposed regulations to strengthen wine labeling requirements, and by requirements implemented for use of metric standards by the wine and distilled spirits industries. The system will be totally operational by January 1, 1980.

Criminal enforcement

Success was achieved in several areas during fiscal 1977. Operation Concentrated Urban Enforcement (CUE) curbed violent crime in three pilot areas; illegal sources of firearms used by criminals were identified; significant criminals were arrested; persons involved in illegal trafficking of firearms internationally were indicted; those involved in thefts from interstate firearms shipments were apprehended; and significant illicit liquor and explosives conspiracy investigations were undertaken.

During fiscal 1977, ATF special agents conducted 15,072 investigations in which 5,444 cases were recommended for prosecution. These resulted in 3,578 arrests and the seizure of 8,424 contraband firearms, explosive devices, and illicit liquor stills valued at $1.6 million. More than 30,000 pounds of explosives obtained or possessed illegally were seized. Nearly all of these investigations were initiated by ATF agents. Federal convictions on firearms and explosives violations totaled 3,472 during the year.

Operation CUE had been implemented fully in metropolitan Washington, D.C., Boston, and Chicago by the start of fiscal 1977. CUE's objective is to reduce the criminal use of firearms and explosives and to develop criminal cases against persons illegally using these tools of violence by the concentration of personnel and other investigative resources. Aggressive efforts have resulted in the initiation of 4,830 criminal investigations, the recommendation of 956 defendants for criminal prosecution, and the seizure of 3,083 illicit firearms.

The use of firearms during the commission of premeditated violent crimes (robbery and aggravated assault) within each target city has fallen during the operation period to an average rate significantly lower than previous years.

ATF has traced approximately 29,000 firearms obtained by police in the CUE cities, utilizing some analysis. "New" firearms, which prior to CUE efforts were predominantly utilized in violent acts, became less prevalent in the trace samples as enforcement pressures were applied to legal and illegal sources of firearms. During fiscal 1977, the percentage of "new" firearms decreased significantly in Washington, D.C., Chicago, and Boston.

As part of the analysis, firearms sources were identified for each CUE city and subsequent investigative efforts were formulated into an "interdiction" program designed to eliminate or reduce illegal firearm flow into the CUE city. These interdiction efforts during fiscal 1977 resulted in the identification of several major illegal sources and distributors of firearms; 40 firearms dealers are the subject of criminal cases; and administrative action is being taken against 19 other dealers.

Significant Criminal Enforcement Project.—The objectives of the project are to identify, investigate, and apprehend habitual criminals engaged in the commission of violent crimes and who, by their misuse of firearms and explosives, are a serious threat to the public safety and welfare. The project also provides assistance to State and local law enforcement officials in their fight against crime.

During fiscal 1977, special agents identified 1,350 criminals who met the project criteria; a total of 670 significant criminals were recommended for prosecution and 376 were convicted. At yearend, 1,004 were under active investigation.

In one major case, a convicted felon and known organized crime member was found to be acquiring firearms in Florida through associates using false identification. One firearm purchased by the group was recovered at the murder scene of an organized crime figure in New Jersey. Another firearm was later seized from the significant criminal at the time of his arrest. Prosecutions of individuals for Federal firearms violations are underway in Florida and New Jersey.

Another significant criminal investigation involved a subject engaged in narcotics and prostitution activities who was also a suspect in several murders. An ATF agent, acting in an undercover role, purchased a machinegun from the individual. He was arrested and prosecuted for violation of Federal firearms laws and was sentenced to 10 years in prison.

International traffic in arms.—This effort was created to cope with mounting illegal international gunrunning activities that originate within the United States. Firearms, ammunition, and explosives, illegally exported, frequently are acquired within the United States in direct violation of Federal laws enforced by ATF. Most enforcement efforts have focused upon gunrunning to Northern Ireland and Mexico.

For example, one investigation involved the illegal acquisition and exportation of handguns to Japan, where the banned weapons are sought by organized crime families. A Japanese national and four U.S. residents shipped the firearms hidden in used automobile transmissions which had been stripped of all internal parts. Another 67 firearms were seized by ATF agents before they could be exported to Japan. The five defendants were convicted in Federal court.

In another case, a convicted felon and six other Texas residents transferred high-powered rifles to Mexico, where four of the seven were arrested by Mexican authorities. The weapons and two late-model vehicles were seized. Through cooperation with Mexican officials, ATF special agents traced the firearms and perfected a criminal case against the seven for violations of the Gun Control Act and conspiracy.

Interstate Firearms Theft Project.—Initiated during fiscal 1974, this project is designed to eliminate interstate shipments of firearms as a source of weapons for criminals. During fiscal 1977, 582 reports of lost or stolen firearms were received representing approximately 2,500 weapons. Of this total, approximately 230 weapons were recovered and 9 criminal cases were perfected against 16 individuals.

Typical of ATF cases resulting from this project was one which occurred in New York City. Three defendants were arrested by ATF special agents and police officers because in an undercover investigation an ATF agent was offered 100 semiautomatic pistols for $8,500. The weapons were seized and found to be part of a shipment of 374 firearms stolen during June 1977 at Miami, Fla. An investigation is continuing in an effort to recover the remaining weapons.

Explosives investigations.—Because of the extreme threat to public safety, ATF has assigned a high priority to criminal incidents involving the misuse of explosives and destructive devices. During fiscal 1977, agents investigated 2,208 explosives incidents, including 960 bombings, 240 attempted bombings, 65 accidental bombings, and 301 incendiary incidents. These incidents account for approximately 70 percent of all reported explosives incidents investigated in the United States. In the process of investigating these incidents, agents purchased 2,818 pounds in the illicit market during undercover operations. Agents also recovered more than 60,000 pounds of explosives.

An example of the incidents investigated by ATF special agents in cooperation with local authorities is a case in which three explosions caused extensive damage to a compressor plant, and a fourth that damaged a nearby highway bridge. An Army explosives technician was killed while removing still another device located in the plant. Two days later, ATF and local officers arrested a man and two 17-year-old accomplices. The older suspect was sentenced to a prison term between 14 and 35 years. The bombings were the result of a domestic squabble between the man and his ex-wife, who was a plant employee.

Stolen explosives and recovery.—The nature and increasing incidence of crimes involving the illegal use of explosives is of grave concern to ATF. Efforts to develop better detection and investigation techniques in stemming the illegal flow and use of explosives are outlined under Technical and Scientific Services. Recognizing this as a serious national problem, ATF has expanded its Stolen and Recovered Explosives (SEAR) Project to encourage licensees, users, carriers, and any person who has knowledge of a loss or theft of explosives materials to notify ATF.

An incident in June 1977 demonstrates the threat to public safety from stolen explosives. In this case, 350 pounds of stolen dynamite detonated accidentally while being transported in a remote area, destroying the vehicle and killing the driver who was later identified as a quarry employee missing since the dynamite theft. Had these explosives detonated in an inhabited area, a greater number of deaths and property loss would have resulted. With directed criminal intent—unknown in this case—this amount of explosives could have created havoc.

ATF has under development an Explosives Academy at the Federal Law Enforcement Training Center in Brunswick, Ga. Its purpose will be to continue development of explosives investigative techniques for Federal as well as State and local law enforcement officers whose primary responsibility is investigating explosives incidents. The academy is scheduled to become operational in January 1978.

Organized crime.—ATF has implemented a uniform, nationwide enforcement effort against organized criminal activities, using available intelligence to expand investigations into the hierarchy of organized crime. An agent serves on each Federal strike force set up for this purpose. District offices outside strike force areas have an agent assigned to serve as coordinator for organized crime investigations.

The Bureau has met with some success in its effort to penetrate organized crime. ATF played a major role in the multibombing and murder conspiracy investigation of 13 violators, including a notorious Florida organized crime figure. ATF supplied impetus in tying together apparently unrelated violence to perfect a complicated conspiracy case that resulted in a multiviolation prosecution. Convictions were handed down for firearms, explosives, narcotics, and counterfeiting violations, in addition to armed robbery and murder.

Illicit liquor.—There is a decline in illicit liquor activity. A total of 360 distilleries were seized in fiscal 1977 in the southern United States. While some sizable illicit liquor operations still exist, ATF information indicates that the retail market for moonshine liquor remains sluggish.

Assistance to other law enforcement agencies.—ATF assisted State and local law enforcement agencies in the operation of projects known as "stings," usually involving law enforcement officers posing as fences for stolen goods. During fiscal 1977, ATF participated in 25 of these projects which resulted in numerous firearms and explosives cases.

Special agents conducted 16 schools on organized crime for 512 police officers representing 80 police departments. ATF agents also lectured to approximately 39,000 State and local officers throughout the country on ATF functions and resources.

During fiscal 1977, 4,382 referrals of information pertaining to criminal acts were made to other Federal, State, and local agencies by ATF. An example of the quality of these referrals: In Boston, after several weeks of intense investigation of an alleged automatic weapons violation, ATF learned that a suspect was planning an armed bank robbery. ATF discovered also that the suspect was wanted for first-degree murder. ATF furnished this information to the city police department and assisted in the arrest of the murder suspect. An example of ATF's investigative and technical assistance capability was shown when it assisted the Fairfax County, Va., police in investigating a robbery-homicide. A gunman robbed a restaurant of some $1,000, then forced five persons into the cold storage locker, methodically shooting each one. Four of the victims died from the gunshot wounds. The ATF Forensic Laboratory examined the limited ballistic evidence. With special agents developing and following investigative leads, a suspect was identified, tried, and convicted on four counts of murder and other charges. He is currently serving five consecutive life sentences. ATF special agents and technicians testified at the State trial proceedings.

Regulatory enforcement

Regulatory compliance.—In order to ensure the accurate determination and full collection of more than $5 1/2 billion in alcohol excise taxes, 7,876 revenue protection inspections were conducted at distilleries, breweries, and wineries. ATF field inspectors also conducted 3,796 application and 2,061 consumer protection inspections. During fiscal 1977, ATF issued 3,194 original alcohol permits, amended 3,291, and terminated 1,985. Over 31,000 tax refund claims for permittees were processed. ATF also audited semimonthly tax returns for approximately 250 distilleries, 110 breweries, and 650 wineries. ATF continued reduction of joint custody operations at distilled spirits plants. Draft legislation to permit elimination of joint custody has been submitted.

ATF controls 400 tobacco permittees. Many semimonthly tax returns were audited. In addition, 112 claims for tax refunds were handled. Inspectors conducted 918 revenue protection audits to ensure the collection of more than $2 1/2 billion in Federal revenue due from tobacco product taxes. An additional, 132 application inspections were conducted.

During fiscal 1977, ATF issued approximately 167,000 firearms licenses and inspected nearly 30,000 new firearms license applicants' premises to explain laws and regulations. Some 2,000 applications were either denied, withdrawn, abandoned, or revoked. And inspectors conducted 25,000 audits at the premises of firearms licensees to ensure accurate recordkeeping and regulation compliance.

ATF received and processed 6,880 explosives permit and license applications. This resulted in the issuance of 6,303 permits and licenses. ATF conducted 4,900 compliance inspections to determine that explosives licensees were complying with applicable laws and regulations. With the assistance of the Mining Enforcement and Safety Administration, ATF inspected every explosives applicant, licensee, and permittee during the year. Special emphasis was placed upon the safe and secure storage of explosives and the prompt reporting of losses and thefts.

Consumer protection.—Regulatory Enforcement continued to eliminate unlawful trade practices defined in the Federal Alcohol Administration Act. In fiscal 1977, ATF accepted 61 offers in compromise which totaled $377,000. In addition, there were 31 suspensions and 6 revocations of basic permits. Many of these actions were the result of a task force approach in which a team goes to a market area to resolve complaints of unfair trade practices. Regulatory Enforcement's actions were responsible for industry's withdrawal of 602 cases of alcoholic beverages from the market after samples were found to be deficient in proof, or products were mislabeled. To ensure compliance with Federal law and to prevent deceptive labeling and advertising, 74,499 applications for label approval were reviewed and 10,612 were disapproved. A total of 2,237 applications for special natural wines and rectified products were reviewed; 582 were disapproved, returned, or withdrawn.

Voluntary disclosure program.—Since becoming a bureau in 1972, ATF has placed increased emphasis on the enforcement of the unfair competition and unlawful practices provisions of the Federal Alcohol Administration Act. Industry members are encouraged to come forward under ATF's voluntary disclosure program, announced on September 14, 1976. Industry members entering the program are advised any information received may be used as evidence; that remedial action, commensurate with the seriousness of the violation, would be initiated against them; and that information received would be made available to other Federal and State agencies.

During fiscal 1977, 14 industry members notified ATF of their intent to enter the voluntary disclosure program. A national task force of special inspectors was established to verify such disclosures and investigate all possible trade practices violations.

Metrication.—ATF has implemented requirements for the wine and distilled spirits industries to convert to metric standards. In effect, all wine bottles, including imported wine bottles, will be converted to standard metric sizes by January 1, 1979. Metric standards of fill will be mandatory for distilled spirits beginning January 1, 1980. Before that date, bottlers of distilled spirits may voluntarily convert to using the new metric sizes or continue to use current U.S. standard sizes.

Advantages of metrication include aiding consumers by reducing the number of bottle sizes for comparative shopping, and by promoting international trade through adoption of common standards. Metrication permits packaging and handling efficiencies, which result in a cost savings to industry.

Ingredient labeling.—Public hearings on proposed ATF regulations to require ingredient labeling of alcoholic beverages were held in fiscal 1975 in Washington, D.C. Testimony presented and comments received were overwhelmingly negative. The Bureau concluded that ingredient labeling was not desirable and withdrew its proposal in fiscal 1976. The Food and Drug Administration then imposed ingredient labeling under the Federal Food, Drug and Cosmetic Act. A lawsuit, brought by members of the wine and distilled spirits industries, was won by the plaintiffs on the basis that FDA has given up any jurisdiction it may have had by deferring labeling matters to ATF over the years. ATF and FDA are conducting a joint study to review ingredient labeling approaches.

Wine-labeling terms.—In fiscal 1976, ATF proposed regulations to define the wine-labeling terms "appellation of origin," "estate bottled," "grape type designation," "ATF seal wine," and "viticultural area." At public hearings in Washington, D.C., and in San Francisco, in April 1976, it became evident that the proposal was controversial. Many of the comments and testimony of those hearings have been incorporated into amendments of the proposed regulations. Hearings for the new amendments were scheduled for September 1977 in Washington, D.C., and November 1977 in San Francisco.

Tobacco program.—The tax basis for large cigars (those weighing over 3 pounds a thousand) was changed by the Tax Reform Act of 1976. A tax of 8 1/2 percent of the wholesale price, with a maximum amount of $20 per thousand cigars, was substituted for the longstanding "bracket" tax based on the retail price, which had been in effect for 60 years. Proposed amendments to tax regulations for exported cigarettes would deter smuggling. This step was taken late in fiscal 1977 to reduce revenue losses from cigarette smuggling along the Mexican border.

Firearms and explosives.—Regulatory Enforcement's primary responsibilities in Operation CUE involve an expanded Federal effort to educate firearms and explosives licensees and to audit their operations to ensure conformity with laws and regulations. This is accomplished by a concentrated effort toward audit inspections. To date, one out of every three firearms or explosives dealers contacted has been found to be in violation of Federal firearms laws and/or regulations, and 71 percent of these violations involve recordkeeping procedures. This approach continues to complement enforcement efforts by decreasing the potential for recordkeeping errors that tend to break the audit-and-trace trail of firearms used in crime. In addition, one out of every eight inspections has disclosed information regarding potential criminal violations.

Public Law 93–639, which amended Federal regulations on the use of black powder and accessory items for antique firearms, raised the amount of commercially manufactured black powder which may be purchased for this purpose from 5 to 50 pounds. Regulations to implement the amended law became effective on May 12, 1977.

New explosives storage and recordkeeping requirements proposed in August 1977, when adopted, will enable ATF to use the standards of safety and security now recognized by the explosives industry. Implementation of these regulations is anticipated in fiscal 1978. ATF also took steps to improve explosives theft reporting. In May 1977, ATF reiterated the requirements of the explosives laws regarding the reporting of thefts, which stipulate that a person who has knowledge of the theft or loss report it within 24 hours. In July 1977, ATF sought the cooperation of common carriers who transport explosives, to ensure reporting of lost or stolen explosives from carrier vehicles.

Interagency cooperation.—ATF continuously cooperates with other Federal and State agencies in matters of mutual interest. Ongoing areas of cooperation include: Securities and Exchange Commission—efforts resulting in voluntary disclosure of Federal Alcohol Administration Act violations by industry members; Mining Enforcement and Safety Administration—explosives compliance investigations at mines; coordination with 10 other Federal agencies on explosives matters; Internal Revenue Service and Justice Department—referral of violations or potential violations of law and free access to investigative files; State and local agencies—new cooperation initiatives by ATF resulting in increased law compliance across the entire range of regulated industries.

Technical and scientific services

Laboratories.—ATF laboratories provide technical and scientific support to both regulatory and criminal enforcement operations through facilities in Washington, D.C., and in the field in Atlanta, Philadelphia, Cincinnati, and San Francisco. These laboratories process, without charge, analyses for State and local law enforcement agencies, which account for about 15 percent of their work. By the end of fiscal 1977, construction of the new ATF National Laboratory Center, in Rockville, Md., was near completion. Its move from downtown Washington is expected in early 1978.

Both the ATF special agent and local officer have available Bureau laboratory support for the analysis of physical evidence, utilizing forensic sciences and identification technology. Because of ATF's advances in specialized fields such as explosives and ink tagging, voiceprints, and tape filtering techniques, several international scientists visited ATF facilities this fiscal year to train in these fields.

About 300 cases have been examined to identify unknown voices since the voiceprint identification program was implemented in 1972. An ATF examiner is the only court-qualified expert in a Federal agency to hold international certification, one of 19 in the United States.

Ink tagging was developed by ATF in 1968 and implemented nationally in 1972. This program involves the voluntary addition of chemical taggants by manufacturers. By the end of fiscal 1977, half of the 16 manufacturers were participating in the program. The Bureau's ink identification and dating program is acknowledged as one of the world's finest.

ATF has acquired a new microscope with the X-ray analyzer unit which permits rapid, nondestructive testing of small samples such as paint flecks or bullet lead fragments. Scientists in fiscal 1977 examined 1,637 exhibits involving 156 cases using such comparative forensic analysis.

ATF is constantly developing new chemical and instrumental procedures to more efficiently solve forensic problems. In the San Francisco laboratory, a recently purchased spectrometer has increased significantly the ability to handle the more than 1,000 exhibits annually in gunshot residue and trace, and comparative evidence. ATF scientists examined nearly 10,000 exhibits in 1,086 cases in these areas in fiscal 1977. Technicians analyzed 8,769 exhibits in 1,205 arson and explosives cases. The Philadelphia laboratory developed a method for explosive detection and identification.

Among the 11,350 cases in which 219,568 exhibits were analyzed by forensic or identification personnel, one significant case involved the bombing of the Rockville, Md., home of a lobbyist supporter of Israeli activities. Field investigators were provided valuable clues to the investigation of this case by laboratory personnel. They also provided vital evidence in the Hanafi terrorist case in Washington, D.C.

In fiscal 1977, the headquarters laboratory acquired some 8,000 books and technical reports, and established computer access to 14 data banks enhancing ATF's research capabilities.

The chemical laboratory provides advisory and analytical services to regulatory enforcement operations for alcohol and tobacco products such as formula and label compliance, consumer protection, and analyses in connection with tax classification. It is concerned also with the accuracy of gauging instruments and the development of security devices to protect revenue. The field laboratories also provide many of these services.

During fiscal 1977, label and formula changes for special natural wines using flavors, and the ban of Red Dye No. 2 and No. 4 the preceding year, caused an 89-percent increase to 6,471 submissions for examination of nonbeverage formulas containing alcohol, products such as foods, flavors, and medicines.

Chemical laboratory technicians examined specially denatured alcohol articles: 7,090 labels and 6,063 formulas. Restriction on the use of benzene as a denaturant caused numerous formula changes in industries using denatured alcohol. Twenty-one new tobacco products were tested to classify them as cigars or cigarettes for tax purposes.

Consumer protection became increasingly important during fiscal 1977. Reports of asbestos in some foreign wines caused closer monitoring of imported alcoholic beverages. Throughout the year, the laboratories worked with ATF inspectors to give increased attention to formula compliance among manufacturers of alcoholic foods, flavors, and medicinal preparations.

In 1977, as the United States moved closer to metrication, ATF began steps to convert the system of determining alcoholic content and volume—the basics of tax determination—to metric measurement. Tests were completed and approval given for two high-security padlocks for ATF use at distilled spirits plants to tighten security and ensure revenue protection.

National Firearms Act weapons.—NFA weapons, which include short-barreled shotguns and rifles, machineguns, silencers, and destructive devices, are controlled by ATF. In fiscal 1977, ATF processed 15,863 documents involving the manufacture, importation and exportation, transfer, and registration of NFA weapons. A total of 2,604 certifications were prepared as evidence. Federal regulation changes are being developed which will provide better documentation of NFA weapons movement. If approved, the proposed changes will be implemented during fiscal 1978.

Firearms tracing.—ATF's National Firearms Tracing Center traced domestic and imported firearms to the point of first retail sale as an investigative aid for Federal, State, and local law enforcement agencies. Since the center's inception in October 1972, more than 172,000 firearms have been traced successfully either to an individual or to the last retail dealer. Fifty-four percent of the traces were for local law enforcement officers. Approximately 6,000 trace requests are received each month, with 63,965 traces requested during fiscal 1977. Technical support and expert testimony on firearms was provided to various law enforcement agencies. ATF tests and approves foreign firearms for importation, and maintains the firearms reference collection of more than 4,000 weapons. A new vault-storage area will be operational early in fiscal 1978.

Imports.—Under the International Security Assistance and Arms Export Control Act of 1976 (formerly the Mutual Security Act of 1954), import permits are issued for all firearms, ammunition, and implements of war. During fiscal 1977, 12,699 import permits were issued. Of these, 10,680 pertained to firearms, 901 covered firearms and ammunition, 486 were for ammunition only, and 632 covered other implements of war. Applications disapproved totaled 276, covering a total of 1,303 firearms.

Explosives technology.—In support of the investigation of the criminal use of explosives, ATF operates the National Explosives Tracing Center for other Federal, State, and local agencies, provides expert testimony for explosives cases at all levels of the criminal justice system, and provides onsite investigative assistance regarding criminal bombings and accidental explosions. ATF trains the State and local law enforcement community in all aspects of explosives.

During fiscal 1977, ATF technically evaluated more than 240 criminal bombing cases, providing immediate investigative assistance to the criminal investigator in compiling evidence and determining a suspect for prosecution. The work of the National Explosives Tracing Center, which began operation in January 1973, has increased 40 percent in the last year to more than 1,400 traces for fiscal 1977, with a 90-percent success rate.

Explosives tagging.—ATF began development of an explosives tagging program in 1972. This program is directed toward technology which will detect explosives used in bombs and identify the type and source of explosives after they have detonated. The program is coordinated through a 14-member Federal advisory committee, members of which represent all interested Federal, State, and local agencies, and explosives manufacturers.

ATF has developed and tested concepts for both predetonation detection and postdetonation identification of explosives. Efforts to date have been most successful in postdetonation identification. Coded chemical taggants can be safely added to explosives during the manufacturing process which survive detonation. Field tests have demonstrated that an investigator can easily recover these "tags" and a laboratory can readily read the code. Using this code, an explosives trace can identify the point of sale or theft.

During fiscal 1977, a pilot test began during which 7 million pounds of cap-sensitive dynamite was tagged because this explosive accounts for most deaths, injuries, and property damage. By April 1978, the system will be ready for the addition of coded taggants to all commercial explosives sold in the United States.

Predetonation detection has not proceeded as rapidly. A pilot test, to tag electric blasting caps with a detectable vapor by mid-1978, is planned. Research to expand both detection and identification tagging to additional explosives continues.

Administration

Treasury payroll/personnel information system (TPPIS).—The new payroll and personnel information system was implemented in December 1976, and will be fully operational as soon as remote terminals are installed in April 1978. The system will ultimately eliminate much manual recordkeeping.

Labor and employee relations.—In the area of labor-management relations, a contract was agreed upon by the National Treasury Employees Union and ATF, covering some 900 field personnel. Training of all managers was conducted to aid in the understanding and implementation of the provisions of the contract. The NTEU was certified to represent the headquarters personnel and negotiations for a contract covering them were conducted also.

Equal employment opportunity.—ATF's efforts to recruit minorities and women have resulted in meaningful increases. Colleges and universities, and community groups were contacted to make them aware of the Treasury enforcement agent examination. ATF negotiated bilingual certification from the Civil Service Commission and open hiring where insufficient Spanish-speaking applicants were available. ATF officials attended Spanish-speaking conventions to provide recruitment and employment information. The upward mobility program continues to be expanded. Skills surveys and training for supervisors in upward mobility have been conducted. Compliance reviews in the regions and training of regional EEO officers have been conducted. EEO training continues as part of the supervisory training provided each new firstline supervisor.

Forms reduction program.—The President requested that ATF reduce by 5 percent the amount of time the public spends in completing its reports. The Secretary doubled the original request to 10 percent. ATF achieved a reduction of 10.5 percent, exceeding both goals. Approximately 180 ATF forms were revised during fiscal 1977, without additional man-hours or overtime expenditures.

Property management.—The capital assets property system (CAPS), designed in fiscal 1976, is being implemented. This system will provide better information and property control than the previous system. CAPS will identify each item of equipment owned by ATF by description, monetary value, maintenance or repairs performed, precise location, and responsible official.

Communications.—During fiscal 1977, ATF's Communications Center assumed responsibility for the Explosives Report Center, to which all thefts or losses of explosive material must be reported. Reports are made via a nationwide toll-free number. Upon receipt, the theft or loss is entered into the Treasury enforcement communications system, and the responsible district office is notified for investigative action.

Transportation.—Savings of $25,000 were realized in fiscal 1977 due to use of excursion rates, reduced rates offered by carriers for shipment of employees' household effects, and shipment of packages via the most economical mode. A savings of $12,000 was realized through auditing of freight and rental automobile billings.

Firearms records.—The three-region pilot program for out-of-business firearms dealer records, started in fiscal 1976, has been extended and will encompass records previously stored at all regional offices. There were 655 record searches initiated in fiscal 1976. The number increased to 4,026 in fiscal 1977.

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 personnel and document security program. In addition, the Office of Inspection is responsible for conducting all Bureau equal employment opportunity complaint investigations, tort claim investigations, and formal accident investigations.

Integrity investigations.—During fiscal 1977, the Operations Review Division initiated 225 investigations of allegations involving employee conduct. A total of 100 separate actions resulted from these investigations: 4 resignations, 19 adverse actions, 74 clearances, and 3 referrals to other law enforcement agencies for their action.

Operations review.—Operations of three criminal enforcement district offices and regulatory enforcement area offices were reviewed. The reviews were used by management to improve field operations where necessary. Inspectors supervised 86 accident investigations involving Bureau personnel or property.

Internal auditing.—The objective of the program is to assist management in attaining its goals by furnishing information, analyses, appraisals, and practical recommendations pertinent to management objectives. Fifty-one audits were conducted during fiscal 1977, to appraise financial and program management activities affecting Administration, Regulatory and Criminal Enforcement, and Technical and Scientific Services.

Security.—Employee background and security update investigations are conducted for all ATF employees. The Security Division coordinated 247 such investigations in fiscal 1977.

Equal employment opportunity.—The Office of Inspection conducted investigations of 19 EEO complaints.

Public affairs

Information services.—More than 90 news releases, factsheets, and other information materials were prepared. Releases detailed the full range of ATF activities: firearms and explosives projects, industry regulation, and major cases. Seven major news conferences, covered by national and local media, were arranged for the ATF Director. A public service announcement on explosives theft was accepted and is being used by the three national television networks, and individual TV and radio stations in all 50 States. Information officers responded to more than 1,200 telephone inquiries.

Liaison.—Liaison was maintained between key congressional committees and the Bureau. Liaison officers responded to more than 700 written requests from the Congress, in addition to an average of 100 telephone queries each month. Liaison officers attended 15 national and international conferences as Bureau representatives. Conferences included the annual conventions of the International Association of Chiefs of Police, and an international meeting of firearms manufacturers in Germany.

Disclosure.—The Office of Disclosure directs the Bureau's implementation of the Freedom of Information Act (FOIA), amended in 1974, and the Privacy Act (PA) of 1974. The following statistics document the principal activities of the Disclosure Office for fiscal 1977: Freedom of Information Act requests, 414; requests granted in full, 337; requests granted in part, 52; requests denied, 25; administrative appeals, 16; appeals granted in full, 1; appeals granted in part, 11; appeals denied, 4; FOIA fees collected, $12,887; Privacy Act requests, 352; requests granted in full, 240; requests granted in part, 98; requests denied, 14; administrative appeals, 13; appeals granted in full, 3; appeals granted in part, 5; appeals denied, 5; Privacy Act routine disclosures, 66,754; suits against ATF (FOIA & PA), 0. Requests increased during fiscal 1977, 42 percent in the FOIA area, and 22 percent in the PA area.

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.

Operations of the national banking system reflected the recovery experienced by the U.S. economy. Total assets of the country's 4,703 national banks increased by 5.4 percent between yearend 1975 and yearend 1976. This increase is significant since it represents a change from the previous trend of moderate asset growth evidenced by the previous year's increase of only 3.6 percent.

Bank examinations and related activities

The Office of the Comptroller of the Currency is required by statute to examine all national banks twice in each calendar year. However, the Comptroller may, at his discretion, waive one such examination in each 2-year period, or may cause such examinations to be made more frequently, if considered necessary. In addition, the Comptroller examines all banks located in the District of Columbia.

More than 85 percent of the Office's employees are bank examiners, including specialists in the areas of trust department, electronic data processing, and international examinations. In fiscal 1977 the new procedures for national bank examinations, developed in 1975–76, were largely implemented. The procedures are designed to place greater emphasis on analysis and interpretation and less emphasis on detailed verification. Increased reliance is placed on systems for internal control and on work performed by internal and external auditors. In addition, systems for regular review and update of the examination procedures and for regional review of the revised report of examination were effected in 1977.

EDP

An evaluation and followup program for the Office's EDP examinations was implemented this year in all regions. Another major achievement in EDP was the promulgation of "Minimum Standards of Information for Automated Systems," a document which will contribute to the improvement of EDP evaluations performed by the Office and by bank management.

Special surveillance

In 1977 a new Department of Special Surveillance was organized, embracing the functions formerly exercised by three distinct units: National Bank Surveillance System, Special Projects, and Bank Review. The function of the new department is to identify banks having operating characteristics at variance with those of their peers, to oversee analysis of these banks to identify conditions of concern, and to prompt remedial attention through continuous monitoring. The department also provides unique management information to each national bank in the form of bank performance reports. Consolidation of the three units into one unified division has resulted in the accomplishment of departmental objectives while simultaneously reducing paperwork and examiner hours and increasing the effectiveness of management decisionmaking.

Consumer affairs

The Consumer Affairs Division, responsible for the enforcement of all consumer protection laws applicable to national banks, conducts specialized examinations of each national bank on a continuing basis to ensure compliance with consumer laws and regulations. During fiscal 1977 the Division conducted six 2-week examiner training sessions in various areas of the country. Following completion of this training, examiners are assigned to perform consumer examinations for a 6-month period.

In August 1977, the "Comptroller's Handbook for Consumer Examinations" was published for use by examiners and for distribution to all national banks to assist them in complying with the laws and regulations in the consumer area.

Also during the year, the Consumer Affairs Division, in conjunction with the Fair Housing Section, Civil Rights Division, Department of Justice, conducted an examination project involving six national banks, with the objective of determining the adequacy of the Office's examination procedures in the area of fair housing. Corrective action guidelines have been developed to direct the Office in its treatment of banks which have violated consumer protection laws. Discussions are in progress with other financial regulatory agencies regarding the final form of these guidelines.

Administration

The Administration Department was reorganized in 1976 with the transfer of the Research and Analysis and the Systems and Data Processing Divisions to the Deputy Comptroller for Economics. The Department is now comprised of three operating divisions: Bank Organization and Structure, Finance and Administration, and Human Resources.

Bank organization and structure

The Bank Organization and Structure Division continued its efforts to expand the decisionmaking role of the 14 regional offices by transferring to them the responsibility for processing applications for charters, branches, conversions, operating subsidiaries, title changes, and relocations. This transfer of process functions has resulted in a reduction of the time required for processing corporate applications.

In addition, policy guidelines have been adopted for all major corporate activities and integrated into the first draft of the corporate activities manual which will contain new forms, instructions, and processing checklists. The Division has also begun providing written explanations of disapproved corporate applications.

Although much processing responsibility has been delegated to the regional offices, the Bank Organization and Structure Division in Washington will continue to have primary responsibility for processing merger proposals and preparing substantive recommendations on mergers, new bank charters, and debt proposals.

Finance and administration

In January 1977, the Finance and Administration Division successfully implemented a computer-based budget system to project, monitor, and control Office costs. The system furnishes top management with monthly evaluation reports on expenditures, comparisons with budgeted amounts, and analyses of various accounts. Budget performance reports are provided to each organizational unit to enable managers to assess actual performance against budgeted costs, and should increase their awareness of the need to control expenses.

Capital budgeting is also part of the budget process and will permit later integration of property accounting into a total financial management information system.

Human resources

In March 1977, subsequent to Department approval of a new comprehensive human resources program, the Personnel Management Division was abolished and replaced by the present Human Resources Division. New programs are being implemented in each personnel sector including manpower planning, recruiting, employee relations, staffing and operations, salary administration, and personnel development. The overall purpose is to develop and maintain a staff with the technical and managerial ability to fully exploit the newly adopted supervisory tools and examination techniques. Major programs and goals are:

Manpower planning—to coordinate efforts of the operations planning function with human resources activities. The program involves maintenance of a comprehensive computer-based human resources information system to ensure that the Office will have the appropriate number of personnel with needed skills available at all times.

National recruitment—to recruit examining personnel, permitting the Office to compete effectively with other employers on a national basis.

Employee relations—to bring traditional Government personnel programs to the attention of all employees, conduct exit interviews, review job-related expenses, improve communications, establish a positive labor relations program, and develop a monitoring system to identify emerging problem areas.

Staffing and operations—to represent the core of the traditional staffing function including efficient processing of personnel actions and staffing of nonexamining positions.

Compensation and benefits—to design, implement, and maintain the Office's own salary administration program and ensure that compensation be internally fair, competitive with external pay levels, and results oriented.

Personnel development—to develop and maintain a seven-level continuing education program providing balanced technical and managerial training throughout an employee's career, and a three-level development program to identify and prepare Office staff for managerial and executive positions.

During the last quarter of the fiscal year, the Human Resources Division staff provided extensive support for the September conversion of the Office to the Treasury payroll/personnel information system. Employee performance was highlighted by the recognition of 30 Office employees at the September 1977 Treasury awards ceremony.

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 1977, the Department had 148 computer systems, used 32,000 man-years, and spent over half a billion dollars 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 included working with the Internal Revenue Service to upgrade the nationwide tax processing system; assisting the Bureau of the Public Debt, U.S. Customs Service, the Federal Law Enforcement Training Center, and other bureaus in developing and evaluating ADP plans and in acquiring new computer systems or equipment; and assisting the Bureau of the Mint and Customs Service in measuring the utilization of their computer equipment.

In fiscal 1977, important progress was made in the program to strengthen ADP management and performance in the Department. Key to this program was the development of an ADP directive which broadly outlines the requirement for an established overall Treasury ADP plan. This details the Office of Computer Science's new program for promoting the efficient use of ADP resources to support the Department's mission and program goals. Also, progress was made in developing policies and guidelines in Computer Center and application systems evaluation, justifying new systems, implementing the Privacy Act, and in protecting ADP resources. These policies and detailed guidelines will be issued formally in fiscal 1978 to augment the new departmental directive.

The Office of Computer Science staff manages the Office of the Secretary Computer Center, which provides a wide range of computing and data processing support to offices and to some bureaus that do not have in-house capabilities. The Center offers user organizations the potential for making important productivity gains. Major functions served include the debt analysis, tax analysis, and other analytical communities in the Office of the Secretary.

Workload processed by the Center increased 26 percent in fiscal 1977. More importantly, a wide range of end-user software was installed to help users make more efficient use of computer technology.

The Center has 23 registered organization users. Major applications processed include tax, econometric, and debt analysis programs, revenue sharing and antirecession systems, law enforcement, and a wide variety of management and administrative applications.

Specific achievements include assisting the Office of Revenue Sharing to meet tight deadlines on distribution of antirecession and general revenue sharing funds; helping the Office of Tax Analysis produce the data for a proposed far-reaching set of tax reforms; introducing new software to assist the Office of Government Financing in performing mission-related analysis; and working with the Bureau of the Public Debt to meet all deadlines associated with Treasury's debt management activities.

The Office actively pursued further development of general-purpose application programs for various offices in the Office of the Secretary. As an example, the time series analysis system was implemented to aid economists in developing and analyzing econometric models in support of tax, debt, monetary, trade, and energy policy analysis and formulation. Systems such as this eliminate the need for trained programmers as middlemen and permit functional specialists such as economists to interact directly with the computer to meet their needs.

Considerable strides were made in the development of certain application systems. These include financial management, legislative tracking, correspondence control, and property management systems in the management and administrative area. In policy and economic analysis, important progress was made on the quote sheet for Capital Markets, the economic analysis program, and the ongoing support for Tax Analysis.

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 immediate 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.

During fiscal 1977, amendments were promulgated to Circular 230. The revision was primarily predicated on recommendations made by the Chief Counsel, IRS, resulting from the report of his Advisory Committee on Rules and Professional Conduct. The revision increases the restrictions on former Government employees who represent clients before the IRS. The final rule appeared in 42 Fed. Reg. 145, dated July 28, 1977, and was effective August 29, 1977.

On October 1, 1976, there were 164 derogatory information cases pending in the Office under active review and evaluation, 7 of which were awaiting presentation to or decision by an administrative law judge. During the fiscal year, 139 cases were added to the case inventory of the Office. Disciplinary actions were taken in 74 cases by the Office or by order of an administrative law judge. Those actions were comprised of 6 orders of disbarment, 30 suspensions (either by order of an administrative law judge or by consent of the practitioner), 2 resignations, and 36 reprimands. The actions affected 10 attorneys, 32 certified public accountants, and 32 enrolled agents. Sixty-three cases were removed from the Office case inventory during fiscal 1977 after review and evaluation showed that the allegations of misconduct did not state sufficient grounds to maintain disciplinary proceedings under 31 CFR, part 10. As of September 30, 1977, there were 166 derogatory information cases under consideration in the Office.

During the fiscal year, 11 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 nine of those petitions and reinstatement was granted. One petition was denied, and one remained pending at the yearend. In addition, the Director of Practice granted the three petitions pending from the previous period. There were three appeals from denials by the Commissioner of Internal Revenue of applications for enrollment to practice before the IRS. These appeals remained pending as of September 30, 1977. There was one decision on an appeal pending from the previous period; the decision affirmed the denial.

Fourteen administrative proceedings for disbarment or suspension were initiated against practitioners before the IRS during fiscal 1977. Together with the 7 cases remaining on the administrative law judge docket on October 1, 1976, 21 cases were before the administrative law judge during the year. Seven 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 eight of the cases. In six cases, the initial decision of the administrative law judge was that the respondent be disbarred. Two suspensions from practice before the IRS were invoked. On September 30, 1977, six cases were pending on the docket awaiting presentation to or decision by an administrative law judge.

During fiscal 1977, two cases were appealed to the Secretary from initial decisions by an administrative law judge. One case resulted in an affirmation of the administrative law judge's order of disbarment; the other appeal remained pending at the year's close. In addition, one decision was issued by the Secretary on an appeal from the initial decision of an administrative law judge pending October 1, 1976. In that appeal, the administrative law judge's order of disbarment was affirmed.

During the fiscal year, the Office represented the Department in three employees' appeals to the Civil Service Commission from adverse actions taken by bureaus of the Department against them.

Regulations governing practice before the Bureau of Alcohol, Tobacco and Firearms were adopted on June 29, 1977. They provide the Director of Practice with parallel duties with respect to practice before ATF as he has relative to practice before the IRS.

On March 21, 1975, the Director of Practice was named Executive Director of 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, 359 applications pending under regulations governing enrollment before January 1, 1976, were before the Joint Board. Of these applications, 126 applicants were enrolled, 180 applicants were denied enrollment, and 39 applicants withdrew their applications. Fourteen applications were pending at the close of the fiscal year.

To assist the Joint Board in writing examinations, evaluating organization examinations, and reviewing university programs, the Joint Board established an Advisory Committee on Joint Board Examinations during the past fiscal year. The committee was formed under the Federal Advisory Committee Act and has held seven meetings in accordance with that statute. The Director of Practice serves as the Committee Management Officer.

Regulations governing enrollment for those making applications on or after January 1, 1976, were adopted November 12, 1976. The first examinations given under those regulations were held September 29 and 30, 1977.

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.

Since the inception of the revolving fund, Congress has supplied appropriations as increases to the fund on three occasions. The last such appropriation becomes available in fiscal 1978. The legislation approving this appropriation also authorized the Bureau to adjust prices to permit the acquisition of capital equipment and provide future working capital, thus replenishing its revolving fund on a regular basis and precluding the necessity of having to request additional appropriations in the future for such purposes.

During fiscal 1977 the Bureau included in the price of its products a surcharge totaling $7,838,000 earmarked for the acquisition of capital equipment. Beginning in fiscal 1978, the Bureau will also assess a surcharge to provide additional working capital.

The total cost of sales and services was $118,880,000 for fiscal 1977, as compared with $111,289,000 in fiscal 1976, exclusive of surcharge.

Currency program

Deliveries of currency in fiscal 1977 totaled 2.9 billion notes, as compared with 2.8 billion delivered in fiscal 1976. During fiscal 1977, the Bureau completed installation of two high-speed presses and six additional pieces of currency overprinting and processing equipment (COPE). Fail-safe apparatus being installed is designed to detect and prevent disoriented and other obviously defective sheets from traversing the equipment. Complete installation and operation will be accomplished during fiscal 1978.

Postage stamp program

Deliveries of U.S. postage stamps were 27.7 billion units in fiscal 1977, as compared with 31.5 billion in fiscal 1976.

During fiscal 1977, the Bureau acquired six booklet-forming machines. They are currently being installed and scheduled for full operation in the ensuing fiscal year, at which time the full cost benefits anticipated will be realized.

Food coupon program

The Bureau continued its responsibility for assuring the Department of Agriculture's requirements for food coupons by rendering technical, contractual, financial, security, quality control, and other services and advice.

Currency operations

The engineering program to design the next generation of security printing equipment is in the second year of a 7-year development program. Resources have been expended for developing more modern concepts which will be combined in a prototype security printing system.

A two-phase engineering development program resulted in a feasible plan to construct a prototype machine having capability for electronically examining, counting, and consolidating currency sheets into processing lots. This equipment is expected to reduce currency manufacturing costs and streamline the overall currency processing system. A prototype is projected for completion within 3 years.

The Bureau has acquired two Vacuumatic Super II sheet counting machines. Eight additional machines are scheduled for delivery early in 1978. Appropriate accountability, staffing, training, and work methodology are in the development stages. These high-speed electronic sheet counters provide for cost-effectiveness by replacing the manually intensive verification count of currency sheet stocks.

Complete recount of distinctive currency paper after delivery to the Bureau from the paper manufacturer has been discontinued and replaced by a Bureau-monitored quality and accountability and audit assurance program at the papermill. Annual recurring savings are estimated at $100,000.

The second phase of the automated currency packaging and processing system has been accomplished with the introduction of automatic compression and plastic strapping equipment for currency packages, to be installed in line with existing plastic film overwrapping equipment. Steel bands and associated manual operations will be eliminated. Savings equal to those realized from implementation of the first phase, estimated at $300,000 per year, are anticipated from the second phase.

A revision in currency sheet examining methods and procedures is being implemented. The change involves replacement of the two-step 32-subject examination and a subsequent 16-subject reexamination, with a single 16-subject sheet examination. A $1.5 million annual recurring savings is expected in addition to improved workflow and improved workplace alignment.

A pilot project is underway to validate projected savings by substituting secure mobile trash containers for plastic bags currently used in the trimming-splitting operation. This system obviates manual removal of trimmings requiring guard escorts. Savings in materials and manpower are estimated at $27,000 annually.

A successful, alternative method of destroying mutilated currency, cutting to 1/8-inch strips by guillotine cutter, was implemented, doubling the maximum destruction capability (65,000 sheets per shift, as compared with 30,000 sheets per shift by the hammermill method). The guillotine cutting method has the additional benefits of being safer and cleaner.

In the Bureau's continuing effort to improve accountability and security controls, a contract has been awarded for an electronic counting system for the final counting of currency during its compression and banding into the 4,000-note "brick" form.

Postage stamp operations

The operation of six newly acquired booklet-forming machines has provided the capability on each machine to form, from printed and examined rolls of stamps and rolls of unprinted cover stock, a finished stamp booklet ready for subpackaging. Savings from the use of the six machines are estimated at $1 million annually.

A fully automatic wrapping system was installed to wrap trays of postage stamp coils in transparent heat-sealable shrink film. The new packaging method enhances security, and the transparency provides for quick positive identification of the product. Coil packaging and shipping in open-face shrink-wrapped trays is expected to result in recurring annual savings of $175,000.

An extensive program to improve customer relations and provide higher quality postage stamps has been implemented. In addition to continuing quality control inspections made daily during all phases of manufacture, greater emphasis is being placed on the functional characteristics of the adhesive and phosphor used on postage stamps. The U.S. Postal Service estimates a $2 million cost per year for handling mail with insufficient phosphor. A program of onsite investigation of serious consumer concerns has been instituted to identify cause and ensure prompt remedial action.

Inks

The ongoing program of ink research has developed water wipeable inks for printing on web and sheet-fed intaglio presses. Advantages in using such 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. Postage stamps produced in whole or in part, using water wipeable inks, included the Telephone Centennial, Centennial of Sound Recording, Lafayette, Drafting of the Articles of Confederation, 50th Anniversary of Talking Pictures, and the Alta California commemorative issues.

Gravure cylinder production

The final phase of renovation and equipment acquisition for the manufacture of gravure cylinders was completed, with September 1 the established target date for the first gravure stamp to be produced completely in-house. That goal was exceeded by producing not only the 13-cent Herkimer at Oriskany commemorative stamp but also both issues of the 1977 Christmas stamps by that date. It is anticipated that this additional engraving capability will result in annual recurring savings of approximately $100,000 by eliminating private sector contract awards for such work.

Alien identification card

The Immigration and Naturalization Service implemented an automated system to regulate immigration, identified as alien documentation, identification, and telecommunications. At all ports of entry, photographic data of each alien is collected and sent to a central facility for fabrication of an identification card. On March 25, 1977, production of the resident alien identification cards was begun in the Bureau. The back of the card is printed using special formula inks which provide fluorescent characteristics and optical character recognition blindness. The face side is photographically manufactured by contractor personnel.

Management development

The Bureau provided staff support to the Department's efforts to develop a comprehensive executive/management development program which was issued on July 27, 1977. As a result of these concerted efforts, a fiscal 1978 management plan has been formulated which will enable the Bureau to identify, select, and train present and future high-potential managers.

Labor-management relations

The Bureau continues to foster constructive and harmonious relationships with its employees and the 17 bargaining units which represent them. In keeping with the spirit and intent of Executive Order 11491, as amended, management deals with 16 AFL–CIO affiliate unions representing 25 distinct craft groups, a noncraft unit, and a guard unit. One independent union represents the GS clerical/technical unit. Thirteen substantive negotiated labor-management agreements are presently in existence.

A series of training courses and seminars were initiated for each level of supervisory and management personnel. This program is designed to further improve the Bureau's record of effectiveness in negotiating with labor organizations and in dealing with labor relations matters.

Position management

The Bureau's Position Management Board, which recommends manpower policy, procedures, and allocations, has emphasized position management in its review of manpower needs. This has resulted in the downward revision of internal personnel ceilings and more effective utilization of manpower.

All Classification Act position descriptions are being prepared in accordance with the Civil Service factor evaluation system (FES) guidelines. Wage and classification specialists received Civil Service Commission training. FES training has been incorporated into the Bureau's supervisory training program to familiarize management and supervisory personnel with the FES guidelines of position classification.

Awards

During fiscal 1977, 1,280 employees received special achievement awards and 19 employees received high quality pay increases, with nonrecurring savings of $138,557 being realized. Under the employee suggestion phase of the program, 204 suggestions were received, of which 92 were adopted, with savings of $53,232.

Six summer employees were granted awards in recognition of their superior work performance.

Upward mobility program

Following comprehensive reviews by union and departmental officials, the Bureau's upward mobility program and promotion policies were revised and approved in fiscal 1977. Five positions identified to be filled through upward mobility were announced in April 1977, and 183 applications were received. Applicants were evaluated by the assessment center technique and by special supervisory evaluation. Selection was made of seven employees for whom individual development plans are being formulated. Nonselected candidates are afforded performance and career counseling.

Three of the five employees selected for upward mobility positions in the previous fiscal year have attained target positions and are no longer participants in the program.

Safety

The Bureau continued its efforts, consistent with stated policy, to be responsive to concerns as they related to employee safety and environmental well-being. Indicative of the successful accomplishments during the past fiscal year, the Bureau received the Secretary's Award for Safety (Honor) for having the most outstanding safety and health action plan. To promulgate and maintain a comprehensive and effective occupational safety and health program, several significant actions in terms of program development were accomplished, including a 1977 occupational safety and health action plan, personal protective equipment program, and a hearing conservation program. Recent interest in cardiopulmonary resuscitation as a lifesaving technique has resulted in programmed activity to provide training and familiarization to 300 key employees. Continuing priority attention is being given to the investigation and analysis of accidents to identify standard cause factors, comprehensive safety audits, and clarification and restatement of safety committee goals with particular emphasis on employee participation.

Internal audit program

An intensive program of internal audit provides for the evaluation and reexamination of operational efficiency and economy, and ensures compliance with prescribed regulatory directives. During fiscal 1977, 84 reports of audit were released and contained 552 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. Liaison is maintained with the departmental Office of Audit and the General Accounting Office.

Service to the public

The Bureau continues to be one of the major attractions for visitors to the Washington area. During fiscal 1977, a total of 553,522 visitors utilized the self-guided tour facilities of the Bureau.

Exhibits of securities were provided for 11 scheduled philatelic and numismatic events. In addition, four souvenir cards were produced and issued for first-day sale at the Milwaukee Philatelic Society Exhibition, Milwaukee, Wis., the Rocky Mountain Philatelic Exhibition, Denver, Colo., the American Numismatic Association Convention, Atlanta, Ga., and the Puerto Rico Philatelic Exhibition, San Juan, P.R. Sales of souvenir cards continue to respond to expressed public interest and serve to defray costs of participation by the Bureau at these events.

OFFICE OF EQUAL OPPORTUNITY PROGRAM

The Office of Equal Opportunity Program is under the immediate supervision of the Assistant Secretary (Administration), who is the Department's principal Compliance Officer and the Department's Equal Employment Opportunity Officer. The Office assists the Secretary and the Assistant Secretary (Administration) in the formulation, execution, and coordination of policies relating mainly to two programs: (1) The equal employment opportunity program for Treasury employees, and (2) compliance surveillance of the equal employment policies and programs of those financial institutions that are Federal depositaries or issuing and paying agents of U.S. savings bonds and U.S. savings notes.

Federal equal employment opportunity program

This component of the Office's program is concerned with administering Department-level equal opportunity program efforts for all of Treasury's employees. (See the following table for a breakout of this work force by grade groups.) The Office has the responsibility for developing and monitoring the Department's affirmative action program and for operating the Department's equal employment opportunity complaints processing system.

Department of the Treasury full-time employment by minority group status

	1968	1972	1974	1975	1976	Comparison 1975-76		Comparison 1968-1976	
						No.	Percent	No.	Percent
Total employees*	82,155	102,813	114,686	122,648	122,013	-635	-0.5	39,858	48.5
Black	11,777	15,619	18,216	19,533	19,466	-67	-.3	7,689	65.3
Spanish-American	1,052	2,247	3,437	3,912	4,090	178	4.5	3,038	288.3
American Indian	79	128	175	192	198	6	3.1	119	150.6
Oriental	482	813	1,230	1,485	1,466	-19	-1.2	984	295.4
Other	68,765	84,006	91,628	97,526	96,793	-733	-.7	28,028	40.8
GS 1-4:									
Total	19,120	24,126	25,526	28,174	27,534	-640	-2.3	8,414	44.0
Black	4,947	5,904	6,679	6,664	6,347	-317	-4.8	1,400	28.3
Spanish-American	255	791	1,065	1,168	1,234	66	5.6	979	383.9
American Indian	25	45	84	57	49	-8	-14.0	24	96.0
Oriental	80	159	181	228	213	-15	6.6	133	166.2
Other	13,813	17,227	17,517	20,057	19,691	-366	-1.8	5,878	42.5
GS 5-8:									
Total	19,480	27,601	33,295	33,064	31,645	-1,419	-4.3	12,165	62.4
Black	2,708	4,290	5,569	5,822	5,915	93	1.6	3,207	118.4
Spanish-American	264	551	1,008	960	1,030	70	7.3	766	290.1
American Indian	26	35	50	49	51	2	4.0	25	96.1
Oriental	141	249	445	437	420	-17	-3.9	279	197.8
Other	16,341	22,476	26,223	25,796	24,229	-1,567	-6.1	7,888	48.3
GS 9-12:									
Total	28,893	32,321	35,580	36,639	38,136	1,497	4.1	9,243	32.0
Black	1,144	1,587	2,050	2,406	2,696	290	12.0	1,552	135.7
Spanish-American	332	519	803	820	895	75	9.1	563	169.6
American Indian	21	34	44	47	58	11	23.4	37	176.2
Oriental	186	222	368	491	523	32	6.5	337	181.2
Other	27,210	29,959	32,315	32,875	33,964	1,089	3.3	6,754	24.8
GS 12-18:									
Total	9,491	12,037	13,257	13,328	13,598	270	2.0	4,107	43.3
Black	151	307	399	435	474	39	9.0	323	213.9
Spanish-American	35	88	136	130	134	4	3.0	99	282.9
American Indian	3	8	16	14	16	2	14.3	13	433.3
Oriental	55	90	105	131	139	8	6.1	84	152.7
Other	9,247	11,544	12,601	12,618	12,835	217	1.7	3,588	38.8

*The totals include wage board personnel. Grade comparisons are for GS series only.

NOTE.—For figures for 1969, 1970, 1971, and 1973, see 1974 Annual Report, p. 116.

More specifically, the Office guides and oversees the implementation of the Department's equal employment program and action plans of all the bureaus, provides consultative services on equal opportunity matters, and reviews and approves action plans promulgated by each bureau headquarters. It reviews and adjudicates the investigation of complaints alleging discrimination because of race, color, religion, sex, national origin, or age. Also, the Office provides guidance to Treasury officials and all its field activities through its onsite and offsite equal employment management review evaluations of the affirmative action plans and EEO complaints processing system; participates with the Office of Personnel in the conduct of personnel management evaluation program reviews; assesses personnel management effectiveness in the area of EEO, upward mobility, and special emphasis programs; and prepares and recommends corrective action plans.

Secretarial initiatives.—Personal accountability for EEO success has been introduced. Secretary Blumenthal, in a memorandum to heads of bureaus and offices, dated August 11, 1977, made clear his personal position and commitment on EEO. In that correspondence, he directed all bureau heads to cooperate fully with Assistant Secretary Beckham in assuring that equal opportunities were made a reality in the areas of merit promotions, training, and related program efforts for all Department minorities and women. Managers at all levels were also directed that zero-base budgeting should be applied to review of EEO planning and that they would be held personally accountable for expected positive program results.

Four personnel management evaluations of the bureaus' EEO operations have been completed and six are planned for the balance of calendar 1977. These survey efforts amplify the personal commitment of the Secretary and provide a regular context for learning about the accomplishments of each bureau and closely monitoring progress against stated goals.

The Department initiated a Civil Service Commission study that could reinstate "direct-hire" authority for outstanding college graduates. Under the provisions of the old Federal Service Entrance Examination (FSEE) program, agencies could appoint outstanding college graduates without exam qualification. The provisions of the Professional and Administrative Career Examination (PACE) program effectively eliminate many minorities and women who fail to qualify in the examination process. The heaviest burden is borne by minorities whose cultural history provides less adequate test preparation and who cannot advance through other loopholes such as those offered through the upward mobility program.

Contract compliance

The Department of Labor, the Federal agency assigned responsibility for implementing section 202 of Executive Order 11246, has designated the Department of the Treasury as the compliance agency responsible for assuring equal opportunity compliance by Federal contractors in the banking and savings and loan industries. Under the general policy direction of the Assistant Secretary (Administration), the Office of Equal Opportunity Program develops policy and directs a nationwide program of compliance surveillance to assure that these 16,000 or more institutions pursue policies of nondiscrimination and engage in positive programs of affirmative action in all of their employment operations and practices.

The Office has established six small regional offices located in Los Angeles, Atlanta, Chicago, Houston, New York, and Washington, D.C. These offices conduct compliance reviews, surveys, and inspections of the policies and programs of covered financial institutions in their various several-State regions. Their staffs also investigate complaints alleging discrimination against financial institutions by their employees or applicants for employment based on race, color, religion, sex, or national origin.

Program planning initiatives and achievements.—Eighty compliance reviews of financial institutions have been completed since January and 113 are in process of completion. Since commencement of the Carter administration, five formal enforcement actions have been initiated and an additional three show-cause notices are in process of issuance. A total of $1,332,000 has been budgeted for compliance enforcement during fiscal 1978, and an additional $568,000 is estimated for this program during fiscal 1979.

Strict enforcement policies have recently been emphasized in compliance reviews. In May of this year, for the first time in the history of the Executive Order 11246 program, sanction proceedings were initiated against a bank—proceedings which place in jeopardy the bank's authority to maintain deposits of Federal funds. Additional enforcement actions have been initiated and still others are pending issuance.

Minority employment has steadily increased as a result of Treasury's compliance activity. Between 1968 and 1976 a Treasury survey disclosed that minority employment in the financial industry increased from 40,000 to 165,000. Of these totals, blacks increased from approximately 22,000 to 90,000 and persons of Hispanic origin from 12,000 to 50,000. Current trends indicate that minority representation in the Nation's banks is increasing even more dramatically during 1977.

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, and is under the supervision of the Chief Deputy to the Under Secretary (Enforcement and Operations).

The Department of the Treasury is the lead agency for operating the Center and, as such, controls its 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, the Civil Service Commission, and the U.S. Capitol Police Board, 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. Only those Federal employees with arrest authority receive training at the Center. At present, 30 enforcement organizations and units, representing most major executive departments, independent Federal agencies, and the legislative branch, participate in Center programs. In fiscal 1977, the U.S. Supreme Court Police, Border Patrol agents and immigration officers of the

Immigration and Naturalization Service, and Federal Protective Service officers began participating in the Center's training programs. The Center also furnishes training on a space-available basis to personnel from other Federal, State, and local agencies.

The Center is dedicated to providing the finest law enforcement training available in a cost-effective and efficient manner. The recent growth of the Center and future plans for the continuing consolidation of Federal law enforcement training have thrust the Center into a position of national leadership in law enforcement training. Consolidation of the various Federal training sites at the FLETC is cost effective and in the overall best interest of the Government. During this reporting period, the Department of Justice closed its Border Patrol Academy at Port Isabel, Tex., and the General Services Administration closed training academies at Marietta, Ga., Alameda, Calif., and Washington, D.C., to take advantage of Center resources and facilities.

Training facilities

In May 1975, the Congress authorized the expenditure of $30 million for the adaptation of the former Glynco Naval Air Station as the facility for the FLETC. The Center is located on the southeast coast of Georgia near the city of Brunswick. It relocated from the Washington, D.C., area to the former naval air station in September 1975. Existing facilities at the 1,500-acre site were renovated or modified to accommodate the start of training. Several buildings, which were under construction at the time the Navy departed, have now been completed and are being used. The Center includes facilities for administration, classrooms and training, instructor offices, procurement and supply, facilities engineering and maintenance, instructional services (photolab, graphic arts, and TV production), motor pool service station and garage, driver training classroom, printshop, interim driver training range, gymnasium and physical training, outdoor firing ranges, student center, dining hall, dormitories, convenience store, auditorium, explosive range, and a practical exercise project which includes houses and a criminal court facility, a mock border patrol area and station, aquatic training pool, athletic fields, and tennis courts.

Master plan

A master plan for the conversion of the facility to meet current and unique requirements of law enforcement training has been completed and construction has begun. The plan was originally designed for a population of 750 students. However, by taking maximum advantage of existing facilities and including expansion capability in the design program, the Center will have the flexibility to double student capacity. The construction work is being time phased to ensure the least amount of interruption to ongoing training operations. Construction controlled by the master plan is expected to near completion in late 1979.

Public and community affairs

Several major projects were initiated or completed to provide the facilities and materials required to disseminate information to persons, groups, and organizations at the National, State, and local levels with an interest in law enforcement training. In addition, major strides were made in the integration and involvement of Center personnel and activities in community affairs through participation in civic organizations and events and assistance to schools, local government, and other interested groups.

General

Due to the increased activity at the outdoor firing ranges, explosive range, and driver training courses, the Center has been actively involved with Department officials in regard to the adequacy of the environmental assessment prepared in contemplation of the move to Glynco. An updated draft has been prepared for departmental review and comment. The Center does not anticipate any problems as a result of the updated assessment.

During this period the Center hired a safety officer to formulate and monitor an active safety program. Occupational Safety and Health Administration guidelines, mandated for Federal agencies, are being implemented.

The Center, through GSA, continues to upgrade facilities. Several old temporary buildings were demolished and considerable renovation and alteration work was completed at the physical training complex during the reporting period.

The Department approved the acquisition of a minicomputer which will be delivered to the Center in October 1977. The computer will be utilized initially in the student registration, dormitory assignment, and scheduling functions; however, financial, work orders, and property management applications will be mechanized as programs can be developed.

The Center has several major contracts in force that impact favorably on the labor statistics of the local community. Commercial contractors operate the dining facility, dormitories, student center, convenience store, and barbershop and perform janitorial services for the entire facility. Approximately 150 employees are on these payrolls. In addition, the Center in fiscal 1977 spent approximately three-quarters of a million dollars in the local community through purchase of supplies and equipment.

During the reporting period, the Center provided support services and facilities to Federal Disaster Assistance Administration team personnel who assisted the local shrimping community in obtaining financial aid.

The Center will provide, beginning fiscal 1978, indoor storage space for several Coast Guard boats utilized in surveillance activities when the Presidential party is on St. Simons Island.

Training programs

Criminal investigator training.—During the year, 19 basic 7-week criminal investigator classes were conducted and 863 students graduated—a 10-percent increase in graduates over fiscal 1976. Advanced Law Enforcement Photography, a common AIRS course conducted by the Criminal Investigator Training Division (CITD), graduated 228 students from 23 classes—a 443-percent increase in graduates over fiscal 1976. Considerable effort was expended to revise texts and practical exercise curriculum in order to keep pace with changes in the criminal investigator field. The CITD staff provided instructional support as required to the various agencies conducting AIRS training at the Center. The number of permanent instructors in the Legal Branch was increased as a result of a Board of Directors' policy decision. The Center is of the opinion this action will tend to stabilize the instructional staff, enhance professionalism, and increase productivity.

Police training.—During the year, the Police Training Division (PTD) conducted 41 classes and graduated 1,281 students—a 70-percent increase in the number of classes and a 62-percent increase in students graduated from the previous fiscal year.

The past 12 months have been very significant for the PTD in that 4 new major programs were established: 2-week National Park Service course; 4-week Capitol Police refresher course; 14-week immigration officers basic training course, and 16-week Border Patrol course. In addition to these new programs, the PTD effected a total review of terminal and interim performance objectives for all courses of instruction. New instructor lesson plans for all courses were formulated by members of the instructional staff in order to incorporate the most up-to-date techniques available in law enforcement instruction. A 2-hour slide program on the history of law enforcement was developed and has been well received by students and instructors. In addition, the PTD staff provides support to the various agencies conducting AIRS training at the Center.

Special training.—The special training facilities have been expanded and improved and now include outdoor firing ranges, an improved high-speed driving course, a rough terrain four-wheel-drive course, two vehicle skid control areas, an outdoor physical training obstacle course, and improved shower facilities and locker rooms for students.

The special training programs in driver training, firearms, and physical training support the basic schools and AIRS programs. Courses in arrest techniques, self-defense tactics, drownproofing, emergency medical techniques, first aid, basic marksmanship, safety, combat firing, riot gun training, advanced driving, rough terrain driving, defensive driving, and emergency vehicle control are provided trainees as part of the overall curriculum to turn out well-rounded criminal investigators and police officers. During this reporting period, the number of students participating in special training programs increased 45 percent over fiscal 1976.

Advanced, inservice, refresher, and specialized training.—A significant portion of the Center's mission involves providing support services and facilities to participating agencies for conducting AIRS training programs. During the year, 3,060 students graduated from the various AIRS training programs—a 32-percent increase over fiscal 1976. The greater percentage of these graduates are representatives of the Bureau of Alcohol, Tobacco and Firearms, U.S. Customs Service, National Park Service, Internal Revenue Service (Intelligence), U.S. Marshals Service, and Immigration and Naturalization Service.

Training support

Significant steps have been taken in the area of mechanization to improve the scoring, grading, and analysis of examinations. The Center designed and implemented an instructor training program and during this period trained over 120 instructors. It is planned to increase the scope of this program during the next fiscal year. The educational staff developed a field survey program for postgraduation evaluation and feedback in terms of student performance based on skills, knowledge, and attitudes acquired in the Center's training programs.

Management improvement

The Center continues the trend established in fiscal 1976 by training more students in improved facilities at lower overall cost per student. Many factors have contributed to this continuing, favorable trend; however, the Center's ability to obtain funding for student travel and en route per diem continues to be one of the most stabilizing factors in sustaining a constant student pipeline and cost-effective posture. A reorganization originated by the Center and approved by the Department during this period established the position of Associate Director for Training and brought all training functions under a single training head.

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 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 services involved in the management of the Government's cash resources; under specified provisions of law is responsible for investing various Government trust funds; oversees 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

During fiscal 1977, the Division of Disbursement operated 8 disbursing centers and 3 regional offices, servicing nearly 1,500 offices of agencies located throughout the United States and the Philippines, and rendered disbursing services for embassies located in certain foreign countries in Central and South America and in the Far East. In addition, the Division distributed Federal tax deposit forms to taxpayers and performed automated payroll accounting service on a reimbursable basis for certain small agencies.

Management improvements and significant achievements.—Presorting commenced in the Philadelphia Disbursing Center with supplemental security income (SSI) checks dated November 1, 1976, to take advantage of the 1-cent-per-item discount offered by the U.S. Postal Service on envelopes sorted into ZIP code sequence prior to release in the mails. Under this system, disbursing office employees band checks together in trays in either five-digit or three-digit ZIP code sequence for delivery to Postal Service sectional centers. Through September 30, 1977, the 1-cent discount has been obtained on 25.3 million SSI checks for a gross postage savings of $252,530. More than 11 million tax refund checks were also presorted for a gross postage savings of $110,208. Next fiscal year, the program will be expanded to include social security benefit, railroad retirement annuity, veterans compensation, and pension and educational payments, and civil service annuity payments. When presorting is fully implemented, it is estimated that more than 450 million checks will qualify for the 1-cent discount, resulting in an estimated net savings of $3 million.

Under the tape claims system, which eliminates most of the keypunching and manual preparation of claims and stop payment forms, stop payment requests were processed by magnetic tape in fiscal 1977 for social security payments. The claims processing schedule has been reduced from 4 working days to 7 hours for SSI payments.

As participation continues to increase, more than eight times the volume of electronic funds transfer (EFT) payments were made in fiscal 1977 as in 1976 and the transition quarter. In the second year of operation, more than 65 million payments were processed to recipients of social security, railroad retirement annuity, civil service annuity, veterans compensation and pension, and revenue sharing payments. EFT is a major element of the direct deposit system, and enables the rapid computer-assisted transfer of funds between the Treasury, Federal Reserve banks and member banks for the purpose of crediting payees' accounts with financial organizations. Another system which employs the concept of EFT is the Treasury financial communications system, which includes certain nonbenefit payments such as grants, investments, the replacement of lost composite checks, and unemployment compensation payments to States. In its first year of operation 13,981 transactions totaling $24.3 billion were made under this system.

Approximately 434.5 million checks were wrapped in fiscal 1977 under the check-wrapping system, which manufactures an envelope from a roll of paper while simultaneously enclosing a check and as many as three separate inserts. More than 1 billion checks have been wrapped since the inception of the system in 1973.

As a result of ongoing centralization and computerization of payments, and the related consolidation of claims operations, the New York Branch Disbursing Office, which had no EDP facilities, was closed effective July 12, 1977. Estimated annual recurring savings as a result of the closing are $195,300.

Six additional Federal agencies automated their accounting systems in 1977, enabling them to submit magnetic tapes to disbursing offices for the issuance of vendor and miscellaneous payments. Under the automated system, computer-generated cards accompanying the checks provide the recipient with a permanent record of the object of the payment. The system eliminates manual processing of paper enclosures with the checks, and reduces the volume of inquiries regarding the purpose of payments. Twenty agencies are actively working to convert to the automated system.

Disbursing operations.—During fiscal 1977, a total of 675 million checks, savings bonds, and EFT payments were issued under Treasury's centralized disbursing system at an average cost of $0.0445. Close to 98 percent of these payments were computer produced. In addition, 127.2 million Federal tax deposit forms were produced.

The following table is a comparison of the workload for fiscal years 1976 and 1977:

Classification	Volume	
	1976 [1]	1977 [2]
Operations financed by appropriated funds:		
Checks and electronic funds transfers:		
Social security benefits	360,589,208	379,493,103
Supplemental security income payments	53,826,563	51,957,379
Veterans benefits	86,049,429	77,772,027
Income tax refunds	68,407,107	68,005,540
Veterans national service life insurance dividends	2,965,693	2,956,546
Other	70,690,757	71,593,135
Savings bonds	8,032,199	7,896,031
Adjustments and transfers	334,380	243,986
	650,895,336	659,917,747
Operations financed by reimbursements:		
Railroad Retirement Board	13,876,014	13,705,160
Bureau of the Public Debt (General Electric Co. bond program)	1,558,599	1,684,412
Total workload—reimbursable items	15,434,613	15,389,572
Total workload	666,329,949	675,307,319

[1] July 1, 1975, through June 30, 1976.
[2] Oct. 1, 1976, through Sept. 30, 1977.

Settling check claims.—During fiscal 1977, the Division of Check Claims processed 1.4 million requests to stop payment of Government checks. This resulted in 572,283 paid-check claims acted upon, including 102,519 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 171,645 checks.

During the year, 69,370 paid-check claims resulted in settlement checks to payees totaling $19.5 million; 7,490 claims resulted in settlement checks to endorsers totaling $2.8 million, and 52,078 claims resulted in payments to other agencies of $14.4 million for death and nonentitlement cases. In addition 153,930 substitute checks valued at $173.2 million were authorized to replace checks that were lost, stolen, destroyed, or not received.

Claims modernization project

A high-priority project was initiated in December 1976 to substantially improve and modernize the processing of claims for Treasury checks which have been lost, stolen, or not received. It calls for changes designed to improve service to the public, increase efficiency, and reduce costs.

Under the direction of a steering committee, chaired by the Commissioner, the newly formed Claims Modernization Project Staff made considerable progress in this reporting period.

A reliable tracking system within the Bureau has identified areas of delay in processing time, and corrective action has been taken by streamlining procedures, redesigning workflow, and training employees. Negotiations are underway to extend this tracking system to operations of program agencies such as Internal Revenue Service and Social Security Administration.

Further automation efforts call for expanding the system where agencies submit claim data to disbursing offices on magnetic tape, upgrading Bureau data processing systems for better reporting, and designing new systems to support management planning and control of claims operations.

Treasury has proposed legislation to authorize issuance of a substitute check without an undertaking of indemnity except as the Secretary of the Treasury may require, and consideration is being given to proposing legislation which will shorten from 6 years to 3 years the statute of limitations applicable to claims for paid checks.

Government-wide accounting

Government accounting systems.—Prototype consolidated financial statements covering fiscal 1975 were released early in fiscal 1977. Publication of the statements is the result of an experimental undertaking aimed at extending accrual accounting concepts to governmental accounting. This undertaking is intended to contribute to the improvement of accounting at all levels of government and to the development of accounting standards for public financial reporting by government entities. An external Advisory Committee on Federal Consolidated Financial Statements, formed in March 1976, continued its efforts to advise and make recommendations to the Secretary and to study and identify major conceptual issues to be resolved. A fiscal 1976 prototype is being developed to include recommendations of the committee and comments of the general public on the first prototype. An interagency Advisory Committee on Consolidated Financial Statements, consisting of top-level representatives from various Government agencies headed by the Comptroller General, was formed in July 1977 and has begun work on developing practical solutions and implementation procedures for some of the major problem areas identified by the external advisory committee. These include areas such as inflation accounting, valuation of assets, pension fund liabilities, allowance for losses on accounts and loans receivable, and accrual of taxes. The first operational consolidated financial statements are planned to be published in 1978, for fiscal 1977. The goal is to furnish statements applying generally accepted accounting principles for the Federal Government in the fiscal 1982 report.

The conversion of the central accounting system from second-generation magnetic tape files to a third-generation data base environment for processing accounting transactions has reached the program development stage. The data base design has been finalized and program specifications for creation of the data base have been completed. The deposits-in-transit subsystem, a control, tracking, and reporting system designed to account for moneys received by or for the Government, is in the implementation stage, and is targeted for completion in fiscal 1978. Standardized deposit forms, suitable for automated input processing, are now in use by Federal agencies and the banking community. Several agencies having a large volume of collection activity each month are submitting detail deposit and debit data on magnetic tape, thereby reducing the time required to process deposit data. The Treasury financial communications system (TFCS) has been in operation since September 1976, and has processed a monthly average of $2.3 billion for deposit transactions and $2.1 billion for payment transactions during fiscal 1977. Utilizing a computer link to the Federal Reserve Bank of New York, this system provides access to the Federal Reserve Communications System and its associated financial data. TFCS automates the generation of nonrecurring payments and the receipt of Government deposits, and provides a comprehensive accounting and audit control mechanism for streamlining financial recordkeeping and reporting. Plans for the optimization and enhancement of TFCS have been developed and are being implemented. The Treasury asset accountability system (TAAS) automates the maintenance of Treasury cash and monetary assets held in Federal depositaries and Treasury offices. Initial analysis efforts are currently being performed. A top-down system approach toward implementation will be followed by implementing modules of the total system over a period of several years.

The Tax Reform Act of 1976 (Public Law 94–455) authorized the withholding of State and District of Columbia income taxes from the compensation of military personnel. In addition, the Tax Reduction and Simplification Act of 1977 (Public Law 95–30) provided for the withholding of county income or employment taxes from the compensation of Federal employees. To accommodate the new withholding provisions, an Executive order and a change in regulations under 31 CFR 215 were published to include a standard withholding agreement. The change in 31 CFR 215 provides a single point of reference for all State, city, and county tax officials and payroll officers regarding the withholding of such taxes.

A pilot promotional campaign utilizing the theme "BANK ON US" was developed and implemented in the Bureau, encouraging employees to authorize sending their salary checks directly to financial organizations for credit to their personal accounts. The campaign resulted in a significant increase in the number of employees utilizing the composite check procedure, with a corresponding increase in savings in the disbursing area. With the success of this BANK ON US campaign, plans are to introduce the BANK ON US theme throughout Treasury early in fiscal 1978.

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 1976, the transition quarter, and fiscal 1977 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 $11,597.8 million at the beginning of the fiscal year and $11,595.3 million at the yearend. Major transactions during the year included gold purchased from the International Monetary Fund amounting to $60.5 million and sales to the Exchange Stabilization Fund and American Revolution Bicentennial Administration amounting to $62.7 million and $0.3 million, respectively.

Stocks of coinage metal stood at $319.1 million at the beginning of fiscal 1977 and $282.8 million at yearend. 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 September 30, 1977, are shown in the following table:

Depositaries	September 30, 1977	
	Number of accounts [1]	Balance
Federal Reserve banks and branches	37	[2]$15,886,797,200
Other depositaries reporting directly to the Treasury:		
Special demand accounts	9	354,550,000
Other:		
Domestic	17	1,975,808
Foreign [3]	38	47,210,697
Depositaries reporting through Federal Reserve banks:		
General	1,355	156,659,248
Special (Treasury tax and loan accounts)	14,029	3,364,137,578
Total	15,452	19,811,330,531

[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 $147,161,625 in process of collection.

[3] 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 1976, the transition quarter, and fiscal 1977.

Deposits, withdrawals, and balances in the U.S. Treasury account
[In millions of dollars]

	Fiscal 1976	T.Q.	Fiscal 1977
Operating balance at beginning of period	7,589	[1] 14,828	17,414
Cash deposits:			
Gross tax collections (selected)	299,802	75,039	355,468
Public debt receipts	462,771	121,128	458,101
Gas and oil lease sale proceeds	1,224	1,126	1,510
Other	276,869	13,642	54,446
Total cash deposits	1,040,663	210,935	869,525
Cash withdrawals:			
Public debt redemptions	393,594	106,354	416,250
Letter of credit transactions:			
Medicare	15,903	4,178	18,790
HEW grants	20,862	5,651	23,591
Unemployment insurance	16,339	3,101	12,308
Other	586,720	89,065	396,896
Total cash withdrawals	1,033,417	208,349	867,835
Operating balance at close of period	14,835	17,414	19,104

[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 fiscal 1977, 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 1977, payments totaling $9.1 million were made to 50,567 such claimants.

A comparison of the amounts of paper currency of all classes, issued, redeemed, and outstanding during fiscal 1976, transition quarter, and fiscal 1977 follows:

[In thousands]

	Fiscal 1976		T.Q.		Fiscal 1977	
	Pieces	Amount	Pieces	Amount	Pieces	Amount
Outstanding beginning of period	6,808,126	$77,611,087	7,291,065	$84,599,973	7,341,695	$86,189,614
Issues during period	3,207,354	22,275,951	711,357	5,164,905	3,127,691	22,714,508
Redemptions during period	2,724,415	15,287,064	660,728	3,575,263	2,630,202	14,538,870
Outstanding end of period	7,291,065	84,599,973	7,341,695	86,189,614	7,839,184	94,365,252

Details of the issues and redemptions for fiscal 1977 and of the amounts outstanding at the end of the year 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 fiscal 1977, 727.4 million Treasury checks were paid and reconciled by the electronic check payment and reconciliation system. These include all checks issued worldwide by civilian and military disbursing offices.

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.

Services to the Division of Check Claims were improved during the year by the addition of an online updating capability which aids the tracking of cases through the check claims process. An average of 7,000 online transaction updates and 16,000 batch transactions are processed daily against the data base which contains the status of nearly 6 million checks on which stops have been placed.

Banking and cash management

Cash services.—The phaseout of the Division of Cash Services continued during the year and the Division was officially abolished on April 1, 1977. This change impacts the Washington, D.C., banks in that coin and currency functions provided by Treasury already have been or will be transferred to the Federal Reserve Bank of Richmond and its Baltimore Branch.

As part of the phaseout, a coin exchange program was instituted among the larger District of Columbia banks on August 8. This program has reduced Treasury's coin handling by 70 percent. It is anticipated that by December of next year, the Federal Reserve Branch at Baltimore will assume full responsibility for the coin operation.

Concurrent with the abolishment of the Division of Cash Services, the remaining functions of the Division were placed with the newly established Division of Currency Claims with major responsibility for the receipt, examination, and settlement of mutilated currency claims submitted by individuals and banks. Steps were also taken to improve service to the public with the addition of six currency examiners and the purchase of newer and more sophisticated equipment. As a result, the traditional 6-month backlog of the more difficult cases has been reduced to 3 months. During the fiscal year, the Division processed approximately 51,000 mutilated currency claims, and paid out $9.1 million in settlement thereof.

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. When the Foreign Affairs Data Processing Center in Bangkok, Thailand, becomes fully operational by the end of fiscal 1978, the automatic funding of all embassy operating accounts will be implemented worldwide. To date, balances in disbursing officers' operating accounts have been reduced by $32 million, which is resulting in recurring annual interest savings of approximately $2 million.

During fiscal 1978, the Foreign Currency Staff will request the assistance of the Department of Defense for implementation of similar cash management systems for military disbursing officers worldwide.

Federal depositary system.—The types of depositary services provided and the number of depositaries for each of the authorized services as of September 30, 1976 and 1977, are shown in the following table:

Type of service provided by depositaries	1976	1977
Receive deposits from taxpayers and purchasers of public debt securities for credit in Treasury tax and loan accounts	r13,891	14,029
Receive deposits from Government officers for credit in Treasury's general accounts	887	859
Maintain checking accounts for Government disbursing officers and for quasi-public funds	5,725	5,387
Maintain State unemployment compensation benefit payment and clearing accounts	43	44
Operate limited banking facilities:		
In the United States and its outlying areas	190	191
In foreign areas	218	215

r Revised.

Paying grants through letters of credit.—At the close of fiscal 1977, 75 Government agency accounting stations were financing with letters of credit under the Federal Reserve bank system. During the period, the Bureau processed 99,294 withdrawal transactions aggregating $60,420 million, compared with 79,690 transactions totaling $50,582 million in fiscal 1976.

At September 30, 61 Government agency accounting stations were financing with letters of credit under the Treasury RDO system. During the year, Treasury regional disbursing offices issued 65,129 checks totaling $15,069 million, in response to grantee requests, compared with 48,693 checks totaling $12,948 million in fiscal 1976.

Processing Federal tax deposits.—A new processing procedure was piloted in May 1976 by the Kansas City Federal Reserve Bank and fully implemented throughout the remainder of the Federal Reserve System by mid-December 1976. It provides for the taxpayer to present the tax payment and FTD card to his/her bank which forwards daily 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 eliminates the processing of the FTD cards by the Bureau of Government Financial Operations and is expected to result in substantial cost savings by the Department and expedite reconciliation of the FTD cards with the taxpayers' returns.

Methods of destroying unfit currency.—During fiscal 1977, the Treasury continued to encourage the use of ecologically cleaner methods of destroying currency which is no longer fit for circulation. A total of nearly 3,000 tons of unfit currency are destroyed each year by methods tested and approved by the Treasury.

Two methods, incineration and pulverization, are currently being used to destroy currency, and a third method, shredding, was approved for use on the high-speed currency-processing equipment currently being developed. Under the latter method, a shredder slices the notes into strips one-eighth of an inch wide or less. This process uses the least amount of energy of the three destruction methods.

Incineration is still the more prevalent method being used by 22 Federal Reserve offices which account for 62 percent of the currency. Although incineration effectively destroys currency, the equipment has to be very carefully controlled and correctly operated to keep its emissions within limits permitted by applicable municipal air quality standards. Consequently, the Treasury has been encouraging the Federal Reserve banks to convert to pulverization, which grinds the currency to a fibrous residue or very fine particles. Fifteen Federal Reserve offices are now pulverizing the unfit currency.

Cash management.—Treasury Department Circular No. 1084, issued on December 20, 1976, established the requirements pursuant to which Government departments and agencies are to conduct their activities involving the Government's cash so as to maximize the amount of cash available to this Department and preclude unnecessary borrowing. These regulations are applicable to all Government departments and agencies whose financial transactions affect the cash account of the Treasury. These regulations cover cash management practices relating to billings and collections, deposits, disbursements, cash advances under Federal grant and other programs by letters of credit and other means, and cash held outside the Treasury.

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 payment of recipients of recurring Federal payments by credit to their accounts in financial organizations is well underway. In 1977 the program was extended to include recipients of veterans compensation and pension payments. Planning is now underway to include recipients of Federal salary payments beginning in 1978. The Staff is also coordinating the inclusion of payments made by other Federal disbursing activities, particularly those of the Department of Defense. It is estimated that approximately 88.2 million payments will be made by EFT during fiscal 1978.

(2) The joint efforts of the Operations Planning and Research Staff and the Federal Reserve to develop a check truncation system have progressed to the implementation of a pilot program using checks issued by the Kansas City and Birmingham Disbursing Centers and processed by the Richmond and Dallas Federal Reserve Banks. Full-scale implementation of the system is scheduled for June 1978. Under this system, the flow of paid Treasury checks will stop at the Federal Reserve bank level. Magnetic tape and microfilm records will be substituted for the hundreds of millions of checks now shipped by the Federal Reserve banks to Treasury for final payment and reconciliation.

(3) The revised Federal tax deposit system was implemented nationally during calendar 1976 to expedite the flow of tax deposit data from the taxpayer to the related master file record of the IRS. The joint efforts of the Federal Reserve banks, Internal Revenue Service, and the Bureau of Government Financial Operations resulted in a smooth transition to the new system during 1977. The effect of the system change is to forward Federal tax deposit data directly to the IRS service centers from the depositary in which the taxpayer makes his normal tax deposits.

Miscellaneous fiscal activities

Auditing.—During the fiscal year, the Audit Staff issued 77 audit reports on financial, compliance, and operational matters. 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. Substantial improvements in operations, including cash savings, resulted from the audits. The audits included onsite reviews at various disbursing centers of the Bureau throughout the United States and at the Anchorage, Honolulu, and Manila disbursing offices. Also, onsite audits were made of the cancellation, verification, and destruction of unfit currency at virtually all of the Federal Reserve banks and branches.

An auditor served as chairman of the Secretary's Committee for the Audit of the Exchange Stabilization Fund. An auditor also served on the task force to phase out operations of the Division of Cash Services, and another served on the audit improvement project of the Joint Financial Management Improvement Program.

As the result of the annual Audit Staff examination of the financial statements and related supporting information of surety companies, 281 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 (Departmental 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 September 30, 1977.

Federal Financing Bank.—During the period, loans outstanding were increased by $9.5 billion, resulting in a balance at the end of fiscal 1977 of $35.4 billion (see table on page 35). Interest of $2.1 billion was collected from borrowers and $2.05 billion 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, 1975. Total unliquidated assets as of September 30, 1977, had a gross book value of $2.3 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 to be transferred to the Secretary of the Treasury for liquidation. As of June 30, 1970, a total 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 fiscal 1977 totaled $232,113. Cumulative payments amount to $58.3 million plus pro rata payments to the States and other jurisdictions of $6 million. The undistributed funds balance as of September 30, 1977, was $800,283.

Government losses in shipment.—Claims totaling $418,667 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.—The Bureau received "conscience fund" contributions totaling $120,611 and other unconditional donations totaling $428,703. Other Government agencies received conscience fund contributions and unconditional donations amounting to $500 and $3,469, respectively. Conditional gifts to further the defense effort amounted to $651. Gifts of money and the proceeds of real or personal property donated in this period for reducing the public debt amounted to $332,912.

Foreign indebtedness

World War I.—The Governments of Greece and Hungary made payments during fiscal 1977 of $328,898 and $4,337,898, respectively. The latter amount represents a payment of $4,327,271, which brings the Hungarian debt up to date, and a semiannual interest payment of $10,627. 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 deferred the principal and interest payments of $72.7 million and $46.5 million, respectively, which were due on December 15, 1976, under the Financial Aid Agreement of December 6, 1945, as amended March 6, 1957. An interest payment of $10.9 million representing interest on principal and interest installments previously deferred was made on December 31, 1976.

Indonesia, consolidation of debts.—The Government of the Republic of Indonesia made payments in fiscal 1977 of $6,097,360 in principal and $761,168 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 17th 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 fifth installment of $2,940,000 was received from the Hungarian Government under the agreement of March 6, 1973. The fifth 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, 1976, exceeded the minimum installment by $1,995,000, thereby raising the annual installment from $945,000 to $2,940,-000. All awardholders in the second Hungarian program have received equal payments to those in the first Hungarian program. An additional pro rata payment has been authorized to all entitled awardholders under both programs, and payments are now being made.

The Department of the Treasury received $3,800,000 for deposit into the War Claims Fund for payment on awards certified under the War Claims Act of 1948, as amended. A distribution of 4.5608 percent of the unpaid balance of the awards was made.

Administration

Co-op program.—Implementation of the Bureau's first cooperative education (Co-op) program coincided with the beginning of the fiscal year. The major benefits of the program are that (1) it provides college students practical yet indispensable opportunities to apply their education in actual job assignments, (2) the students obtain academic credit and are salaried during their employment under the program, (3) their assignments are commensurate with their college major, i.e., accounting, (4) the Bureau is ensured of temporary help for special projects, (5) it provides managers more time and a more realistic setting within which to evaluate the students' abilities and progress prior to appointment, (6) following graduation, the students may be converted noncompetitively to career-conditional appointments, and (7) more so than other appointment sources, it strengthens the Bureau's affirmative action recruitment efforts. Currently, there are 16 Co-op students participating in the program, with prospects of expanding both the number of students and participating colleges and universities in the next fiscal year.

Upward mobility.—This program continues to be the primary and most effective vehicle for moving lower level employees into better positions. The following figures represent accomplishments in the fiscal year: 791 employees completed a skills survey; 310 candidates received career counseling; a total of 25 positions were advertised and 19 lower graded employees were placed in upward mobility positions.

Work incentives.—The Bureau implemented the utilization of personal services through unpaid work experience programs for low-skilled persons. Twenty-two trainees were placed from the District of Columbia Work Incentive Program, and 15 trainees were recruited from the United Planning Organization.

Summer employment.—Summer employment totals for fiscal 1977 included 25 summer exam students, 3 Federal junior fellows, and 97 summer aids appointed under the Federal summer program for needy youth. Thirty of the 33 stay-in-school students from the 1976–77 school year were converted to full-time positions at the beginning of the summer. This year, the Bureau's quota of 62 needy youth appointments was exceeded by 65.

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. Successful labor contract negotiations were completed in the Philadelphia and Washington Disbursing Centers. Presently, the National Treasury Employees Union is organizing the Bureau's headquarters employees.

Labor-management relations training.—The Labor Relations Training Center of the Civil Service Commission and Bureau specialists conducted in-house labor-management relations training for field and headquarters managers and supervisors.

Labor relations training was planned in three stages. Stage I focused on sensitizing supervisors and managers to the dynamics and requirements of labor relations in the public sector. A total of 20 sessions were conducted in headquarters and field offices for 360 managers and supervisors. Under stage II, approximately one-half of Bureau management received training in their responsibilities under Executive Order 11491, as amended, covering such items as processing of grievances, unfair labor practices, daily relationships with bargaining unit employees and shop stewards, formal discussions under section 10e of the Executive order, and contract negotiations. Stage III, which has been scheduled for fiscal 1978, will concentrate on individual skills building through workshops.

Troubled employee program.—This program has been in effect for almost 2 years and covers not only alcoholism and drug abuse but all personal problems and concerns which may affect an employee's job performance. In-house training covering the program has been offered to all supervisors, and employees have been informed about the program.

Personnel management for supervisors.—During the past year, consistent with the Bureau's continuing emphasis on improving supervisory skills, 86 supervisors attended the extensive 40-hour "Personnel Management for Supervisors" training course conducted by personnel specialists. Three of the four courses were conducted in field offices in conjunction with personnel management surveys. The course will be scheduled in other field offices as future surveys are planned.

Employee orientation.—A 2-day Bureau orientation course was implemented to familiarize employees with the Bureau, its structure and mission. The course also concentrated on the various rules and regulations of the Civil Service Commission, the Department, and the Bureau in such areas as standards of conduct, time and leave, adverse actions, grievances, the troubled employee program, upward mobility, indebtedness, training, promotions, and health and life insurance. Sixteen classes were scheduled and a total of 326 employees attended. Thirteen are scheduled for fiscal 1978. An "Employee Handbook," outlining all the subjects covered in the orientation, was distributed to each participant.

Position classification/management.—During the year, Bureau (Manual of Administration) policies on position classification and management were revised. These will be issued the first quarter of fiscal 1978 and are expected to further strengthen management of resources and controls over the average grade. As reinforcements in these most important areas, two brochures were developed. The first, "Position Management and You," outlines the aim of position management and what it entails. Problems resulting from poor position management are also discussed. The second brochure, entitled "Desk Audits and You," is a guide for every employee. It not only explains the purposes of a desk audit, but also specifies the factors that are and those that are not relevant to the grading of positions and the role of the employee in a desk audit. Each of these brochures is distributed to employees and supervisors in training courses, when scheduling personnel management reviews and desk audits, and upon request.

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; maintains book-entry accounts of eligible securities for individuals; processes and adjudicates 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, U.S. savings notes, retirement plan bonds, and individual retirement bonds are handled.

Management improvement

The work of a joint Treasury-Federal Reserve task force to expand the book-entry system of issuing Government securities resulted in a program to eliminate definitive Treasury bills on a phased basis during fiscal 1977. Issuance of Treasury bills in book-entry form only began with a 52-week bill issue in December 1976. The program was extended in June 1977 to 26-week bills and in September 1977 to 13-week bills. Under this expanded book-entry system, Treasury provides, for the first time, book-entry accounts for bill investors who elect not to deal through a financial institution or securities dealer. As of September 30, 1977, Treasury was maintaining 6,690 accounts totaling $182,110,000. It is anticipated that this program will be extended to selected new offerings of other Treasury marketable securities during the latter part of 1978.

The Bureau has begun phasing over automated systems to a new Univac 1110 computer installed during fiscal 1976 in the Parkersburg office. The entire series H, or current income bond, system and a significant portion of the series E savings bonds system have been converted. This enabled the Bureau to release an IBM 1410 and Honeywell 200 previously used in Parkersburg for processing series H and E bond data. A savings of $42,977 was realized through the release of this equipment. Telecommunication circuits and remote job entry terminals linked to the Univac 1110 will also enable the Washington office to use the new facility. An administrative accounts online system used in Washington was converted during fiscal 1977 and a major conversion of all Washington office systems is planned for fiscal 1978.

Nine additional issuing agents began reporting series E savings bonds sales on magnetic tape in lieu of using registration stubs. A recurring annual savings of approximately $68,000 should be realized based on the volume of issues handled each year by these agents. Sixty-three issuing agents are now participating in this continuing program.

The Bureau has consolidated two separate accounting systems, one for Treasury securities and one for agency securities, into one automated system designed to improve timeliness and accuracy in the production of statistical data and maintenance of control accounts. Taking advantage of common processing routines existing between the two former systems and state-of-the-art programming techniques the newly implemented Treasury and agency securities accounting system (TASAS) provides the capability for accepting transaction data and monthend report data from Federal Reserve banks via magnetic tape. TASAS also provides stricter control of daily transaction input through application of stringent edits and permits greater flexibility in requesting reports necessary to audit files and transactions.

Three Federal Reserve banks and five branches are now reporting daily activity in securities transactions to the Bureau via magnetic tape. Additions during the fiscal year included the Federal Reserve Bank of San Francisco (book-entry transactions only) and branch banks at Birmingham, Nashville, and Memphis. It is anticipated that approximately 10 more banks will begin reporting transaction data during fiscal 1978 in this manner which provides for the immediate introduction of daily public debt activity into the processing cycle without data conversion.

The sale of U.S. savings bonds, series E, at U.S. post offices was discontinued effective March 26, 1977. At the time there were only 234 post offices issuing savings bonds to the public, and sales averaged about a bond per week per office. The discontinuance was prompted by cost considerations, and the fact that, with more than 39,000 financial and other institutions now issuing bonds, virtually all communities are serviced by or have access to these agents.

Several organizational changes were made in the Washington office to enhance efficiency and to better define certain activities. These changes were: (1) Creation of three new sections in the Division of Public Debt Accounts, which effected consolidation of five previously separate functions, including merger of a reporting function and decentralization of a mail and files unit; (2) establishment of the Division of Financial Management to achieve better administration and control of the Bureau's budget and administrative accounting functions; and (3) creation of the Division of Financing with responsibilities for maintaining the Bureau's liaison with Department-level officials concerned with public debt financing, and the administrative activities connected with that function.

Bureau operations

During the fiscal year, 81,000 individual accounts covering publicly held registered securities other than savings bonds, savings notes, individual retirement bonds, and retirement plan bonds were opened, and 120,000 were closed. This decreased the number of open accounts to 433,000, covering registered securities in the principal amount of $22,408 million. There were 869,000 interest checks with a value of $975 million issued during the period.

Redeemed and canceled securities received for audit, other than savings bonds, savings notes, and retirement plan bonds, included 3,761,000 bearer securities and 503,000 registered securities. Coupons totaling 10,020,000 were received.

During the period, 55,000 registration stubs of retirement plan bonds, 41,000 registration stubs of individual retirement bonds, 17,000 retirement plan bonds, and 4,400 individual retirement bonds were received for audit and recordation.

A summary of the public debt operations handled by the Bureau appears on pages 15–33 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 158 million registration stubs or records on magnetic tape and microfilm received, representing the issuance of series E savings bonds, making a grand total of 4,250 million, including reissues, received through September 30, 1977. 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 129 million series A–E savings bonds and savings notes redeemed and charged to the Treasury during the period, 123 million (95 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 $15,895,000 and an average of 12.92 cents per bond and note.

Interest checks issued on current income-type savings bonds (series H) during the period totaled 4,225,000 with a value of $498 million. New accounts established for series H bonds totaled 120,000 while accounts closed totaled 123,000.

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 61,000. In 37,000 of such cases the issuance of duplicate bonds was authorized. In addition, 20,000 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 which implement the Department of the Treasury's freezing controls.

The Foreign Assets Control Regulations and the Cuban Assets Control Regulations prohibit, unless licensed, all trade and financial transactions with North Korea, Vietnam, Cambodia, and Cuba, and their nationals. 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 shipments to the People's Republic of China of internationally controlled strategic merchandise from third countries. Such shipments may qualify under the Transaction Control Regulations (see below). Also, transactions in Chinese assets blocked in the United States as of May 6, 1971, remain prohibited.

During the fiscal year, the Foreign Assets Control and the Cuban Assets Control Regulations were amended to authorize persons who visit North Korea, Vietnam, Cambodia, or Cuba to pay for their transportation and maintenance expenditures while in those countries. The Cuban Assets Control Regulations were also amended to permit travel agencies to assist American travelers in making arrangements for authorized travel to Cuba. Another amendment to the Cuban Assets Control Regulations clarified the existing guidelines applicable to trade with Cuba by foreign affiliates of U.S. firms.

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 unlicensed dealings in strategic merchandise located outside the United States intended for ultimate delivery to Communist countries of Eastern Europe, the U.S.S.R., the People's Republic of China, North Korea, 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, Vietnam, and Cambodia) provided shipment is made from and licensed by a Coordinating Committee (COCOM)-member country. (COCOM is a NATO entity.)

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. From 1971 to 1977 an exception to the prohibition against imports of merchandise of Southern Rhodesian origin existed for certain strategic and critical materials, pursuant to section 503 of the Military Procurement Act of 1971, known as the Byrd Amendment.

On March 18, 1977, the Byrd Amendment was repealed (Public Law 95-12, 91 Stat. 22) with respect to Rhodesia. In addition to reimposing the ban on imports of strategic commodities from Rhodesia, the law provides that imports of chrome steel products produced abroad must be duly certified to the satisfaction of Treasury as not having been made with Rhodesian ore or ferrochrome.

The Rhodesian Sanctions Regulations were correspondingly changed to prohibit imports of chromium ore from any country except when imported directly or on a through bill of lading, and imports from any country of ferrochromium and steel mill products containing more than 3 percent chromium, except when properly certified.

At the end of the fiscal year, certification agreements had been concluded with 12 exporting countries, including one with the European Economic Community on behalf of its 9 member states. Notices of the availability of special certificates issued under these agreements were published in the Federal Register.

Under the Foreign Assets Control Regulations and the Transaction Control Regulations, the number of license applications received during fiscal 1977 (including applications reopened) was 283, with 348 applications acted upon.

Applications for licenses and requests for reconsideration under the Cuban Assets Control Regulations totaled 534 during fiscal 1977, with 530 applications acted upon.

During fiscal 1977, 439 applications (including applications reopened) were received under the Rhodesian Sanctions Regulations, and 458 applications were acted upon.

Nine applications (including applications reopened) were received under the Foreign Funds Control Regulations and 11 were 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 the fiscal year, one criminal case was referred to the Department of Justice involving violations of the regulations administered by the Office. No criminal fines were levied during this period. Civil penalties paid amounted to $2,800, and the total value of merchandise under seizure at the end of the fiscal year amounted to $139,640.

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).

[1] Additional information will be found in the separate Annual Report of the Commissioner of Internal Revenue.

Receipts

Gross revenue collections in fiscal 1977 rose to $358.1 billion, an increase of $47.3 billion (15.2 percent) over the preceding 12-month period. The monetary increase was the largest ever recorded, far in excess of the $34.1 billion rise in 1969. Major factors contributing to this year's strong advance were higher personal income, higher corporate profits, increases in the social security wage base, and abnormally large gift tax collections.

Income taxes accounted for over two-thirds of all tax receipts. Individual income taxes amounted to $186.8 billion, an increase of $22.9 billion (14 percent). Growth was moderated by a reduction in the amount of withholding for most taxpayers, effective June 1, 1977, to reflect an increase in the standard deduction (Tax Reduction and Simplification Act of 1977). Corporate income taxes were $60 billion, up sharply by $12.6 billion (26.6 percent).

Employment taxes (social security, unemployment insurance, and railroad retirement) of $86.1 billion gained $9.4 billion (12.2 percent). Receipts from this source were affected by higher wage and salary payments, increases in the social security wage base due to the operation of the automatic adjustment mechanism, and an increase in the net Federal unemployment tax rate from 0.5 percent to 0.7 percent.

Excise tax collections registered the smallest gain for any major tax category, rising $0.4 billion (2.5 percent) on collections of $17.8 billion. The continued phasing out of the telephone excise tax and lower alcohol and tobacco tax collections contributed to this smaller gain.

Estate and gift tax collections of $7.4 billion showed the largest rate of increase, advancing 37.3 percent ($2 billion). Much of the increase was due to a very large rise in both the number and amount of taxable gifts made prior to the January 1, 1977, effective date for gift tax revisions under the Tax Reform Act of 1976. The gift tax portion of this combined tax class amounted to $1.8 billion, up $1.3 billion (283 percent).

Refunds.—During fiscal 1977, the IRS paid refunds of $36.5 billion to 67.9 million taxpayers whose payments and credits exceeded their tax liabilities. For the preceding 12-month period, a total of 67.6 million refunds totaling $34.7 billion were paid. Included in 1977 data are 4.4 million checks totaling $0.9 billion for earned income credit (EIC). The average refund to individuals was $459.

Returns received.—IRS service centers received 133.7 million tax returns in fiscal 1977, compared with 127.7 million during the preceding 12-month period. Individual and fiduciary returns accounted for almost two-thirds of all return receipts. Nearly 87.3 million individual and fiduciary returns were received in 1977, an increase of 3.1 million over the previous 12-month period.

After declining during 1976, the number of form 1040 filers increased this year. The Service received 56.5 million forms 1040 during 1977, a 3 percent increase over the 54.7 million received last year.

The number of form 1040A filers continues to grow. More than 29 million individual taxpayers, 34 percent of all individual filers, used the short form 1040A in 1977 as compared with nearly 28 million in the previous 12-month period, an increase of 5 percent in the number of forms 1040A filed.

Information returns program.—The Service continued the information returns program (IRP) started in 1975. This program matches information returns for a portion of individual taxpayers with their income tax returns to detect nonfiling or underreporting of income.

The IRP matches all information returns filed on magnetic tape for individuals, and a percentage of those filed on paper. The Service has an active program to encourage all organizations which have tape capability or access to computers to report on tape. During 1977, the IRS received almost 470 million information returns from businesses and organizations required to report payments of wages, interest, dividends, and other forms of income, nearly 245 million of which were submitted on magnetic tape in 1977.

Assisting taxpayers

The Service is committed to maintaining and strengthening the American voluntary compliance tax system. This commitment requires the Service to inform taxpayers about the system and their responsibilities and rights under it. Aware that taxpayers do not find the process of determining their income, exemptions, deductions, and correct tax an easy task, the IRS provided substantial assistance.

During 1977, 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. In over 340,000 contacts sampled during the 1977 filing period, taxpayer assistors achieved an accuracy rate of about 97 percent, based on a review of Service-prepared returns, and the monitoring of responses to taxpayer telephone inquiries.

Taxpayer Service was reinforced in 1977 by the establishment of Problems Resolution Procedure (PRP) offices in each district. These PRP offices attempt to resolve taxpayers' complaints that have not been settled through normal channels and to identify problems in the system which need correction.

Tax assistors' training was significantly improved in 1977. A special training package was developed to acquaint tax assistors with the Tax Reform Act of 1976.

Telephone sampling continued to be a major Taxpayer Service objective for the 1977 filing period. Tax assistors sampled over 191,000 questions from 15.5 million telephone calls at 74 IRS toll-free answering sites to provide broader information to tax assistors on taxpayers problems.

The Service continued to emphasize the placement of Taxpayer Service offices in first-floor locations and convenient to public transportation. During the 1977 filing period, walk-in service was offered in about 700 permanent offices and in over 220 temporary filing-period-only offices. These offices were located in the inner city, business districts, and in suburban and rural areas. Where needed, extended hours of service were offered in 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 140 offices and over 480 employees offering tax assistance in Spanish and 148 offices and over 470 employees providing help in other foreign languages.

Under the volunteer income tax assistance (VITA) program, the Service trained approximately 20,000 volunteers who provided free tax assistance to elderly, Spanish-speaking, low-income, and other taxpayers in their communities. Over 216,000 individuals, an increase of 23 percent over 1976, attended approximately 4,000 IRS-sponsored classed on taxes conducted as part of the Service's taxpayer education institutes and workshops program.

The IRS made major efforts to raise the level of public awareness of the earned income credit, which benefits low-income taxpayers. With the cooperation of other Federal agencies (i.e., Health, Education, and Welfare, Agriculture, and Labor) notices are sent to eligible EIC taxpayers. Notices were also sent to taxpayers who filed returns without claiming EIC, but who apparently qualified for it based on their tax return information.

During the period January 1 through September 30, the EIC was allowed to approximately 6.2 million taxpayers for a total of approximately $1.2 billion, averaging out to nearly $201 per taxpayer. Tax filers, who only filed returns to receive the EIC, were allowed almost 5 percent of these credits.

During fiscal 1977, the Service received about 100,000 written, 28 million telephone, and 9 million walk-in inquiries. More than 63 percent of these inquiries occurred from January 1 through April 30, 1977, during which period the IRS received over 17 million telephone calls, over 6 million walk-in inquiries, and over 42,000 written inquiries, for a total of over 23 million requests for assistance.

Toll-free telephone service continued nationwide, representing over 90 percent of all telephone calls received during the 1977 filing period. Under this system, any taxpayer in the United States may call the IRS for assistance without having to pay a long-distance telephone charge.

Since December 1976, TV telephone and teletypewriter service for the deaf has been provided on a nationwide toll-free basis by the Indianapolis district. As a result hearing-impaired taxpayers in all States except Alaska and Hawaii now have access to the services IRS provides other taxpayers. In May 1977, two representatives from the Indianapolis district attended the President's Committee on Employment of the Handicapped Convention held in Washington, D.C., to demonstrate the TV phone and increase public awareness among the handicapped of this IRS assistance program.

The Service continued to use the mass media to furnish tax information to the public. In 1977, over 17,850 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 6,288 interviews, answered more than 19,483 media inquiries, and made 4,491 talks to citizen groups.

Nearly 7,916 news releases were issued to the media. These releases covered such topics as services available to taxpayers, appeal rights, correct filing of returns, tax advice for disaster victims, earned income credit, pension benefit plans, and various aspects of the Tax Reform Act of 1976. There also were numerous releases covering tax rulings, procedures, regulations, and certain legal interpretations.

Some of the releases, as well as radio and TV scripts, and certain IRS films, were translated into Spanish for use in areas where it is widely spoken as a second language.

The IRS made use of three color films covering the American way of taxing, audit and appeals procedures, and tax information relating to small businesses. These IRS films were shown on 97 occasions by TV outlets, and on 3,426 occasions by civic associations, service, professional, and educational groups.

Tax publications

To help taxpayers the Service distributes, free of charge, a number of publications.

During 1977, the IRS distributed 3 million copies of Publication 17, Your Federal Income Tax, 900,000 copies of Publication 334, Tax Guide for Small Business, and 800,000 copies of Publication 225, Farmer's Tax Guide. In addition, tax materials were furnished on request to 5 million individual taxpayers, to 520,000 tax practitioners, and to 400,000 employers. Over 32,000 banks and Postal Service stations assisted in the distribution of over 237 million tax forms and instructions to taxpayers. The IRS also prepares many other publications relating to more specific tax matters such as disability payments or business use of home that have been revised to reflect current law and changes in the regulations. Substantive revisions were made to the publications in 1977 to reflect changes in the Tax Reform Act of 1976, and several new publications were developed to explain new provisions enacted by the Tax Reduction and Simplification Act of 1977. Publication 560, Tax Information on Self-Employed Retirement Plans, and Publication 571, Tax-Sheltered Annuity Plans for Employees of Public Schools and Certain Tax-Exempt Organizations, have been revised to reflect the provisions of the Employee Retirement Income Security Act of 1974.

Tax forms improvements

The complexity of the Tax Reform Act of 1976 and its late enactment made the Service's job of simplifying the 1976 forms and instructions that much more difficult. Over 100 forms were affected by the new law. In spite of these obstacles, the IRS was able to achieve some degree of simplification. For example, the form 1040A instructions were printed in larger type and reduced from 3 to 2 columns, making them more legible and easier to read; space in the instructions saved by reducing the tax tables from 10 to 3 pages was used for explanatory material on the Tax Reform Act and to clarify other areas that gave taxpayers trouble in the past; the earned income credit worksheet in the Form 1040 Instructions was moved from page 8 to page 2 and expanded to a full page to give it prominence and assure taxpayers would be made aware of it; and several infrequently used lines were removed from form 1040.

As a result of concerted efforts of IRS personnel, and in conjunction with the Federal Paperwork Commission's request for a Government-wide special drive to reduce the paperwork burden, numerous other forms and form letters were simplified, eliminated, or consolidated.

The Tax Reform Act of 1976 also had an impact on income tax return preparers. Any person preparing income tax returns for compensation is now subject to disclosure requirements and penalties for negligently or fraudulently preparing returns. In addition to the signature, the identification number and address of the preparer must now be disclosed on all tax returns. Also, an annual information report must be filed by preparers before August 1.

1977 tax forms.—The Tax Reduction and Simplification Act of 1977 has enabled the IRS to develop a simplified form 1040A for 1977. The complex formula for computing the standard deduction has been eliminated and incorporated into the tax tables, along with the allowances for personal exemptions and the general tax credit. The 1977 form 1040A is designed to encourage more taxpayers to have the IRS compute their tax liability. The form has 15 numbered entries compared with 25 on the 1976 form, and has all calculations on one full-sized page. The 1976 form used both sides of a half-page form.

Form 1040 for 1977 is designed to arrange all items in a natural sequence that permits filers to start at the top of the front page and continue in sequence to the signature block on the bottom of the back page, eliminating the need for frequent reference to both sides of the form.

Other significant changes for 1977 include an agreement with the Department of Labor to eliminate duplicate filing of the annual pension plan returns, form 5500 series. Under the agreement, the IRS is developing a processing system for the returns that will satisfy the administrative needs of both agencies. The Pension Benefit Guaranty Corporation (PBGC), which was to have obtained data from Labor, will also use the system. PBGC's annual report, schedule A (form PBGC-1), will be merged into the form 5500 series returns.

Public participation in forms simplification.—In response to the public's concern over the complexity and number of Government forms, the IRS is making every effort to ease the chore of taxpayers to meet their filing obligations by eliminating forms where possible and simplifying forms in other situations. In a Federal Register notice in March 1977, the IRS asked the public to submit written comments and suggestions for improving and simplifying IRS tax forms and instructions. In response, nearly 500 written submissions were received. In addition, public hearings on forms 1040 and 1040A were held in three cities—Boston, Mass.; Portland, Oreg.; and Oklahoma City, Okla.

All recommendations were evaluated by the Service for feasibility. While many of the suggestions would require changes in the tax law by Congress before they could be adopted, others did help in improving the 1977 forms. As a result of the suggestions and changes in the law, significant improvements were made in the 1977 forms 1040 and 1040A that will reduce the public's reporting burden for IRS forms by 10 percent. The IRS will also sample public opinion on the forms by including a questionnaire in a number of the 1977 form 1040 and 1040A packages.

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.

Public availability of rulings.—The Tax Reform Act of 1976 provided that IRS rulings and technical advice memoranda will generally be open to public inspection. Prior to making these written determinations available for public inspection and copying in the National Office reading room, identifying details, trade secrets, confidential commercial or financial information, etc., will be deleted.

Written determinations requested after October 31, 1976, are generally made available within 90 days after they are issued to taxpayers. Over 100,000 written determinations requested prior to November 1, 1976, will be made available over the next two years.

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 1977, items in the Bulletin included 545 revenue rulings, 48 revenue procedures, 15 public laws relating to Internal Revenue matters and 18 committee reports, 72 Treasury decisions containing new or amended regulations, 21 delegation orders, 6 Treasury Department orders, 14 notices of suspension and disbarment from practice before the Service, 250 announcements of general interest, and 6 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 credits under 1976 Reform Act

The Tax Reform Act of 1976 continued or modified some of the credits originally established by the Tax Reduction Act of 1975. The earned income credit continued as a "negative income tax" in that it provides a refundable credit to taxpayers meeting certain criteria of income and dependents. The general tax credit replaces the previous personal exemption credit; it is a nonrefundable credit available to taxpayers based on $35 per exemption or 2 percent of taxable income. The child care expense credit was available to taxpayers for the first time in 1977; it provides a nonrefundable credit of 20 percent of employment-related expenses paid in order to enable the taxpayer to work if the taxpayer maintained a household including a child under age 15 or dependent or spouse incapable of self-care.

Presidential election campaign fund

A total of 23.2 million individual income tax returns had designations for the Presidential election campaign fund (PECF) in fiscal 1977. This was 27.5 percent of the returns processed during that period. The total amount designated in fiscal 1977 was $36.5 million. In the preceding 12-month period, there were 21.2 million individual tax returns (25.8 percent of returns processed) with PECF designations totaling $33.7 million.

Data services

A new position of Assistant Commissioner (Data Services) was created as a result of a comprehensive study to consolidate data processing support services within the IRS. The overlap of data processing responsibilities across functional lines had made it increasingly difficult to (1) develop integrated long-range goals; (2) assure a well-balanced ADP program; and (3) control the expenditure of resources. As a result of a comprehensive study of these problems, the Commissioner approved the establishment of an Office of Assistant Commissioner (Data Services) and the new organization was effective January 2, 1977.

The Office of Assistant Commissioner (Data Services) comprises the following organizational segments: The Service and Design Division, the Systems Programming Division, the Systems Analysis Division, the National Computer Center, and the Data Center. This reorganization affects only the National Office; there are no counterpart changes in the field organization.

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 and tax-exempt organizations. In the National Office, the function consists of Employee Plans, Exempt Organizations, and Actuarial Divisions. EP/EO field staff are located primarily in 7 regional offices and 19 key districts, with local service provided in numerous other offices.

Employee plans.—The Employee Plans division administers the Employee Retirement Income Security Act of 1974 (ERISA). Major emphasis has been placed on developing regulations and procedures most urgently needed by taxpayers.

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 that are compatible with those issued by such other agencies and to reduce duplication of reporting by taxpayers. For example, starting with the filing of the 1977 annual return/report (form 5500 series), plan sponsors and administrators will file only with the IRS.

To reduce the expense and burden to taxpayers in complying with ERISA, four model plans were developed for use by corporate employers along with new procedure permitting sponsors to obtain approval of their field prototype plan. Also, a new and simpler Short Form Application for Determination for Employee Benefit Plan, Form 5307, was introduced.

During 1977, 15 regulations, 10 revenue rulings and procedures, 11 delegation orders, 8 forms, and 23 news releases were issued. In addition, the National Office issued 4,128 opinion letters on master and prototype plans.

In 1977, the Service devoted an average of 841 field professional positions to carrying out its responsibility in the employee plans area. Advance determination letters regarding the qualification of pension, profit-sharing, and other employee benefit plans were issued. Examinations to determine whether plans continue to qualify in operation and to verify the appropriateness of deductions for plan contributions were conducted. During fiscal 1977, 158,473 determination letters were issued on corporate and self-employed plans, an increase of 345 percent from the 12-month period prior to October 1, 1976.

In the prohibited transactions area, five final and two proposed class exemptions, four regulations, two delegation orders, and three news releases were issued. Three hundred and fourteen individual exemption applications were processed to disposition.

Exempt organizations.—The Exempt Organizations division determines the qualifications of organizations seeking tax-exempt and private foundation status, and examines returns to ensure compliance with the Code.

During 1977, 7 regulations, 76 revenue rulings and procedures, 278 technical advice memoranda, 4 delegation orders, 21 announcements, 24 forms, form letters, and applications, 8 news releases, 6 publications, and 10 "Exempt Organization and Private Foundation Handbook" chapters were issued or revised.

In 1977, the Service devoted an average of 465 field professional positions to the examination of 9,803 exempt organizations returns and other exempt organizations activities. The Service received 50,649 applications and reapplications from organizations seeking a determination of their tax-exempt status or seeking a determination of the effect of organizational or operational changes on their status, and issued 47,067 determination and ruling letters, and 329 revocations.

As a result of a change in the filing requirements for exempt organizations, from those with gross receipts in excess of $5,000 to those with gross receipts in excess of $10,000, approximately 36,000 exempt organizations will not have to file the annual information return.

The feasibility test conducted at the Cincinnati Service Center in 1976 concerning decentralizing the processing of exempt organizations returns proved successful. During 1977, the Andover and Fresno Service Centers started processing EO returns and related documents. Previously, all return filing and processing was done at the Philadelphia Service Center.

The first exempt organizations taxpayer compliance measurement program (TCMP) covering the examination of private foundations, public charities, and social welfare organizations was completed as of December 31, 1976. Data from this survey will be used to select returns for examination.

Audit of returns

The IRS audits tax returns in order to help ensure voluntary compliance with the tax laws. While audit activity is the primary method, 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 selection.—The primary method used by the IRS in selecting returns for audit is a computer program of mathematical formulas—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 24 percent in 1977. The new DIF formulas for both individual and partnership returns were developed in 1977 and will be implemented for returns filed in 1978.

The computer selection of returns is complemented by manual selection. 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 documents (forms W-2 and 1099), and information from other enforcement activities or criminal investigations. The IRS also screens returns with adjusted gross income above certain amounts, and some returns of taxpayers who submit claims for refund or credit after filing their returns.

Results of audit activity.—The IRS audited 2,345,110 tax returns of all types in 1977. Of the total returns audited in 1977, 150,730 were examined in service centers, compared with 142,667 last year. The remainder were examined in district offices by revenue agents, and tax auditors. Examinations conducted by revenue agents under field audit techniques totaled 677,192 returns, a decrease of 37,148 returns, or 5 percent, from last year.

Examinations conducted by tax auditors under office audit procedures numbered 1,517,188 returns, a decrease of 91,118 returns, or 6 percent, under last year. Audit coverage of income, estate and gift tax returns was 2.46 percent, compared with 2.59 percent achieved in 1976.

The Service's examination program resulted in approximately $5.1 billion of additional tax and penalties recommended. Recommendations have exceeded $5 billion for the fifth straight year.

During 1977, assessments totaled $4.1 billion, including $3.4 billion in assessed tax and penalties and $650 million in interest. In 1976, assessments amounted to $4.3 billion, of which $3.6 billion represented tax and penalties and $710 million represented interest.

Examiners are required to determine a taxpayer's correct tax liability. This means that examiners observe that taxpayers neither overstate nor understate their liability. In 1977, Service examinations disclosed overassessments on 122,003 returns, accounting for refunds of $281 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 satisfactority handled by service center personnel through correspondence with the taxpayer. More than 913,000 returns were checked in service centers in 1977, a 51-percent decrease from 1976.

The decrease occurred primarily in the unallowable items program. Certain items previously included in this program, such as medical expenses not reduced by the 1-percent and 3-percent limitations, are now considered mathematical or clerical errors and are corrected during initial returns processing.

As a result, 354,916 returns were corrected by the audit activity in 1977, compared with approximately 1,474,000 in 1976.

The service centers also conduct correspondence examinations of returns, selected under district office criteria. A total of 150,730 returns in this category were examined during 1977, an increase of 7 percent over the 142,667 examined in 1976.

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. 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 10,000 applications of these computer audit techniques were performed in 1977, an increase of 2,000 over 1976. These are done by computer audit specialists, experienced revenue agents who received intensive training in computer hardware, programming languages, and audit techniques.

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.

At the end of fiscal 1977, there were 1,286 large cases in this program which averaged 2.8 open years per case. This is the fifth consecutive year the average open years in the large-case program has been less than 3 per case.

During 1977, the IRS continued its practice of conducting industrywide audits of major companies in a given industry. Nine industries are currently being audited by this approach, and two more are in the planning stage.

Tax shelter program.—In 1974, the IRS established a nationwide tax shelter program to conduct examinations of possible tax shelter abuses by investors in the oil and gas industry. The program was expanded in later years to include real estate, farm operations, motion pictures, master recordings, and coal shelters. Most of the returns examined in this program are partnership returns, as this is the vehicle commonly used by taxpayers to obtain significant tax benefits without the risk of personal liability.

Joint Committee review.—The Internal Revenue Code provides that all income, estate, gift, private foundation, and pension plan credits which exceed $200,000 must be reported to the Joint Committee on Internal Revenue Taxation. During 1977, 997 cases involving overassessments of $984 million were reported to the Joint Committee, as compared with 1,506 cases and $1 billion in 1976.

The Tax Reform Act of 1976 increased the amount for reporting such cases to the Joint Committee on Taxation from a refund of $100,000 to $200,000, effective October 4, 1976.

Audit information management system.—In 1977, the Service successfully implemented the audit information management system (AIMS) nationwide. The new system is an expansion of the existing integrated data retrieval system currently located in the IRS service centers.

AIMS allows Service personnel to promptly locate any return in the Audit Division, permitting more rapid responses to taxpayer inquiries and faster assessment and refund action resulting in improved taxpayer relations. Also, the system provides for automated control and verification of assessments from the point of origin in the district office and service center.

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 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. Opportunities for such a hearing are offered at 58 district offices and 40 regional branch offices throughout the country. Conferences are also arranged, as needed, at other IRS locations, at a place and time convenient to the taxpayer.

Proceedings are informal in both offices. Taxpayers may represent themselves or be represented by an attorney, a certified public 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. For larger amounts a written protest is required. If agreement cannot be reached during the district conference, the taxpayer is advised of his further appeal rights and then may request a regional appellate office conference.

In most cases, the taxpayers and the district conferee or regional appeals officer reach mutually acceptable agreements. Consequently, very few cases go to trial. In the past 10 years, 97 percent of all disputed cases were closed without trial. In 1977, the appeals function disposed of 56,805 cases by agreement; the Tax Court tried 1,402 cases; and the U.S. district courts and Court of Claims tried 403 cases.

District conference.—District conference staffs consider disputes involving factual questions, and whether proposed actions by a District Director's office reflect the correct interpretation of the Internal Revenue Code, as stated, and as clarified by the courts and by IRS regulations and revenue rulings. 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.

Since receiving this settlement authority, the percentage of agreed cases closed by district conference staffs has significantly increased. Where the settlement authority could be exercised, about 31 percent of the cases have been settled on that basis.

District conference staffs reached agreement with the taxpayer in about 70.5 percent of the cases they considered in 1977.

Appellate Division.—Cases considered by the Appellate Division 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 55 percent of Appellate's workload in 1977. The second category of cases are known as docketed, and these involve cases in which taxpayers have filed a petition for a hearing before the U.S. Tax Court.

In 1977, 70 percent of nondocketed cases and 73 percent of docketed cases were closed by the Appellate Division by agreement with the taxpayer.

Other appeal options.—If a tax dispute cannot be resolved at either the district or the regional level, the taxpayer is advised of the remaining appeal rights. In most cases, the taxpayer may file an appeal with the U.S. Tax Court.

If the disputed tax does not exceed $1,500 in any tax year, a simplified procedure is available under the Tax Court's small case rules. Small case Tax Court proceedings provide for informal hearings where taxpayers may present their cases before a special trial judge. A knowledge of courtroom proceedings is not required, since the objective is to provide an inexpensive forum for the taxpayer. Because of the nature of the proceedings, no provision for appeal of the Court's decision is provided.

If a taxpayer chooses to bypass the Tax Court, the tax deficiency may be paid and a claim filed for refund within 2 years from the date of payment. If the claim is denied by the IRS, or if the IRS takes no action on the claim within 6 months, the taxpayer may file suit for a refund in either a U.S. district court or the Court of Claims.

A taxpayer may appeal an adverse decision of the Tax Court or district court to the U.S. Circuit Court of Appeals having jurisdiction. Adverse decisions of the Court of Claims or the Circuit Court of Appeals may be reviewed by the U.S. Supreme Court.

Tax fraud investigations

The Intelligence Division is responsible for the enforcement of the criminal provisions of the tax laws, investigating evidence of tax evasion or tax fraud and recommending prosecution when warranted.

During 1977, the Intelligence Division completed 8,391 investigations and recommended prosecution of 3,408 taxpayers. Grand juries indicted or courts filed information on 1,636 taxpayers. Prosecution was successfully completed in 1,476 cases. In 1,063 cases taxpayers entered guilty pleas, 166 pleaded nolo contendere, and in 247 cases, the taxpayers were convicted after trial. Acquittals and dismissals totaled 55 and 110, respectively. Of the 1,532 taxpayers sentenced during 1977, 685, or 14.7 percent, received jail sentences, compared with 41.5 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 12 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 for detecting criminal violations of the tax laws. During 1977, the IRS contributed 485 staff years of direct investigative and examination time to the strike force effort.

A total of 135 organized crime members and their associates were convicted or pleaded guilty to tax charges during the year and 678 prosecution cases were pending when the year ended.

Since the inception of the organized crime program in 1966, 834 organized crime members and associates have been convicted or have pleaded guilty to various tax charges.

Tax investigations of high-level narcotics leaders and financiers.—As part of its special enforcement program, the Service continued to identify and investigate significant tax violations by high-level narcotics financiers and traffickers.

During 1977, the IRS completed 220 criminal tax investigations, obtained 72 indictments, and achieved 62 convictions of financiers and traffickers.

Delinquent accounts and compliance

During 1977, the Service emphasized the delinquency prevention program (DPP), designed to identify potentially delinquent taxpayers and help review and correct their problems. A significant development in the failure to file activity was the mailing of 1.2 million notices to all individuals who had not filed forms 1040.

Despite a budget reduction of over 800 staff-years, improved staff utilization permitted a nominal increase in the number of outstanding delinquent accounts assigned to field operations. Compared with 1976, the cases assigned to district offices in 1977 increased by 16 percent while the total dollar value of these accounts increased by 7 percent.

Program accomplishments.—The collection activity closed over 2.6 million delinquent accounts receivable during 1977. Included were some 328,000 notice cases in which taxpayers, when notified of a delinquency, contacted IRS field offices to resolve the matter. Field contact by IRS employees was required on the remaining 2.3 million delinquent accounts.

Nearly $3.1 billion in delinquent taxes was collected during the year, a decrease of approximately $700 million over a comparable period in 1976 due to a budget reduction in staff, emphasis on delinquency prevention, and investigations for failure to file returns. District personnel disposed of over 2.4 million investigations for failure to file. This is a 0.28-percent increase over a comparable 1976 period. For 1977, approximately 689,000 delinquent returns were secured, involving nearly $501 million in additional taxes.

During 1977, 16 percent of delinquent individual taxpayers were repeaters, while the rate for business taxpayers was 39 percent. Because of the high business repeater rate, the Service stresses the importance of bringing business repeaters into voluntary compliance through the trust fund compliance program. At the beginning of 1977, there were nearly 275,000 taxpayers with delinquent trust fund accounts amounting to over $635 million. Of these accounts, 2,500 had a balance of $25,000 or more. At the end of 1977, the number of taxpayers with delinquent trust fund accounts was some 325,000, with an outstanding balance of approximately $667 million, and the number of delinquent trust fund accounts over $25,000 was 2,400.

Restricting access to tax returns

Legislative actions concerning disclosure matters were significant during 1977. The Tax Reform Act of 1976 amended Internal Revenue Code section 6103, effective January 1, 1977, to provide that tax returns and tax return information are to be confidential and not subject to disclosure except as authorized by various sections of the Code. Increased criminal penalties and new civil damage provisions for unauthorized disclosures were also included in the act. The disclosure legislation was strongly supported by the IRS since it reflected Treasury legislative recommendations. It also codified most existing regulatory and policy practices concerning the disclosure of confidential tax information.

The Disclosure Operations Division provides program guidance to disclosure officers in all IRS field offices. Field officials now act on certain requests for testimony of Service employees and make initial determinations concerning freedom of information requests and process requests for information under the Privacy Act of 1974.

To implement the provisions of the Privacy and Freedom of Information Acts, and IRC 6103 amendments, the IRS decentralized some administrative responsibilities for disclosure, privacy, and freedom of information to its field offices. Disclosure officer positions were established in IRS regions, districts, service centers, the Office of International Operations, the Office of Assistant Commissioner (Inspection), and the IRS Data Center.

Tax administration abroad

The Service maintains a system of permanent foreign posts. Revenue Service representatives (RSR's) at these stations are involved in compliance and taxpayer assistance activities and maintaining contacts with foreign tax agencies under the Office of International Operations (OIO).

Since the OIO established its first office in Paris in 1948, 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 served from Ottawa. Offices in Tokyo, Manila, Kuala Lumpur, and Canberra administer OIO activities in

Japan, Southeast Asia, Australia, and New Zealand. A post in Tehran covers the Middle East, and one in Johannesburg services Africa south of the Sahara.

IRS foreign posts provide a vital link with more than 2 million Americans living abroad. In 1977, the RSR's continued to maintain personal contacts with foreign tax authorities, foreign government officials, the Department of State and other U.S. agencies, as well as the American communities abroad. The RSR's act as a liaison with foreign competent authorities in tax treaty matters when called upon to represent the U.S. competent authority.

The 1977 filing period marked the 24th consecutive year overseas taxpayers received tax assistance through the overseas taxpayer service program. In 1977, over 148,000 taxpayers were assisted, an increase of approximately 20 percent over 1976. Reasons for the increase were the Tax Reform Act of 1976 and the Tax Reduction and Simplification Act of 1977, which included important changes affecting overseas taxpayers. Twenty-three assistors were detailed abroad during 1977, providing assistance in 131 cities in 76 foreign countries.

Commissioner Kurtz met in 1977 with the Canadian Minister of National Revenue, Monique Begin, to formalize a working arrangement for simultaneous examinations of taxpayers. In accordance with the income tax treaty between the United States and Canada, the two tax authorities will exchange tax information concerning related U.S. and Canadian companies developed in the course of such examinations. The tax treaty also provides for confidentiality of taxpayer information exchanged between the two countries.

The Service has entered into coordination of tax administration agreements with American Samoa, Guam, and the U.S. Virgin Islands. These agreements allow the Service to provide taxpayer return information and to develop programs with the possessions to enhance tax administration. An addendum has been included with the U.S. Virgin Islands to provide for a mutual agreement to resolve cases of double taxation.

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 the 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 1977 the number of these audits increased over previous years.

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 39 countries and estate tax treaties with 13 countries. 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 under our system of tax treaties.

In 1977 meetings were held with tax officials from several treaty countries to improve the administration of the treaties involved. These conferences improved working arrangements for more effective exchanges of information and for resolution of recurring problems which arise from conflict of U.S. and foreign tax laws.

Technical assistance to foreign countries.—Since 1963 the Service has provided reimbursable training, technical and managerial advisory services to requesting foreign governments in cooperation with the Department of State and the Agency for International Development. The program objective is to assist friendly developing countries to modernize their tax administrations.

During 1977, the Service extended long-term onsite advisory assistance to El Salvador, Liberia, Trinidad and Tobago, and Uruguay. Short-term assistance was provided to the U.N. Trust Territory of the Pacific Islands. A short-term mobile instructor team presented audit courses in Liberia and Sierra Leone.

General tax administration surveys in the U.N. Trust Territory of the Pacific Islands and the Northern Mariana Islands were completed. Specialized surveys were conducted for Cyprus in ADP applications, for Ecuador on collection of delinquent accounts, and for Egypt as a followup to a major report in 1975. New projects are underway in Sierra Leone and the Caribbean as well as the expansion of the Liberia project.

In 1977, 330 foreign tax officials from 60 countries visited the Service to participate in study-observation programs. Over 4,600 officials from 124 countries have come to the IRS for such assistance since 1963.

Among the special visitor training projects were a 7-week middle-management seminar in tax administration for 11 tax officials from Ethiopia, Indonesia, Japan, and Nigeria; and a 9-week comparative tax administration seminar for six Korean tax officials. Twenty-three Harvard international tax program participants and 25 students from the IMF public finance course were briefed by the Service.

The Service continued support of the Inter-American Center of Tax Administrators (CIAT), the 26-country-member hemispheric organization for promoting tax administration improvement. The Commissioner's presentation on the U.S. tax simplification was one of two IRS papers presented to CIAT's 11th general assembly, Caracas, Venezuela, in May 1977. The Director, Tax Administration Advisory Services Division, was made a member of CIAT's Executive Council. The IRS advised CIAT on a new format for technical conferences. At CIAT's request, six papers were presented to related technical conferences on taxation of multinationals and the exchange of information under tax treaties by representatives of the Office of Assistant Commissioner (Compliance) and the OIO. The Service also presented two papers at the fifth annual general assembly of the Caribbean Organization of Tax Administrators (COTA), Roseau, Dominica, in August 1977.

Assistance to State and local governments

IRS assistance to States, local governments, and territories includes participation in IRS training courses, use of IRS training materials, and onsite technical advisory assistance.

In 1977, 47 tax officials from 13 States, 1 city government, Puerto Rico, and the Virgin Islands participated in IRS formal training courses, providing over 92 weeks of training assistance. The types of courses included basic revenue agent training, employee plan determination techniques, exempt organization procedures, and effective TV–radio communications.

Training materials or classroom assistance was also provided to several jurisdictions to assist them in developing their own training courses.

Also during 1977, the IRS received six requests from States and territories for onsite assistance under the Intergovernmental Personnel Act (IPA). Two formal short-term assignments were made to Guam to improve its revenue training program. A survey was made of problems in converting the American Virgin Islands revenue processing system to ADP.

Since the IPA program started in 1970, the Tax Administration Advisory Services Division has made 29 short-term assignments to 10 States, Puerto Rico, Guam, and the University of Southern California.

Planning and research

Planning is an integral and continuing management activity within all organizational components of the Service. During 1977, IRS planning activities encompassed preparation of a Service-wide long-range plan, testing of improvements in work technology and systems, organizational studies, coordination of the preparation of testimony before congressional committees, analysis of pending legislation, statistical compilation, and projections of tax return data.

Completed testing projects.—Based on successful test results, the IRS is replacing its existing computer printers with high-speed, nonimpact printers, which can print up to 25 times faster than conventional printers.

During fiscal 1978, the IRS will install in the 10 service centers remittance processing systems which perform, in a single operation, several processing steps now done separately. This innovation will accelerate remittance posting and reduce processing costs.

Alternative filing period study.—A sample of individual income-tax payers were sent questionnaires seeking information about current filing practices and opinions on two alternative filing procedures. Three-fourths of the taxpayers who responded said they would continue to file their returns in the months of January through April even if the deadline for filing were extended. A majority of taxpayers were opposed to a second alternative which would divide individual income-tax payers into two groups, one with a January 1–December 30 tax year and an April 15 filing deadline, the second with a July 1–June 30 tax year and an October 15 filing deadline.

State tax administrators were also surveyed to obtain their views concerning alternative filing procedures. Results revealed that most States would probably change their filing period for State individual income tax returns to conform with any Federal change. However, many State tax administrators expressed doubt that the changes under consideration would be beneficial.

Tax models.—Originally developed 15 years ago to meet Treasury's need for timely estimates of the revenue effects of proposed tax legislation, 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 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, these models are based on the full statistics of income sample (over 200,000 returns for 1975) instead of the subsample of about 100,000 returns used for the basic model.

Taxpayer service telephone study.—Through the use of mathematical modeling techniques, the IRS has developed alternatives indicating the optimum number, size, and location of IRS toll-free telephone sites offering taxpayer assistance. A parallel study to this IRS staff effort was made by a commercial telephone site location firm. Results from both studies are under review to provide taxpayers the best possible telephone answering service at the least cost.

Legal assistance test program.—Arrangements have been made with the law schools of three universities to conduct test programs under which law students provide free legal assistance to low-income taxpayers during the audit and administrative appeals processes. Students operate under the close supervision of practicing attorneys and law school professors. Data and evaluations from the test program are being gathered to determine whether this assistance affects the results of audits and appeals.

Legislative activities.—The planning and research function has the responsibility for continuing analysis of legislative proposals affecting the IRS and determination of their probable administrative implications. Once legislation is enacted, a plan for implementing each provision is developed and coordinated with all functions that are to be responsible for administering the legislation. During 1977, more than 90 bills were analyzed for their impact on the IRS. Implementation plans were developed for 18 enacted public laws, including two major tax bills—the Tax Reform Act of 1976 and the Tax Reduction and Simplification Act of 1977.

Impact of 1976 Tax Reform Act on IRS operations

The Tax Reform Act of 1976, which affected over 700 sections of the Internal Revenue Code, became law on October 4, 1976. The late enactment of these comprehensive changes left little time for the Service to implement the provisions that were effective for the 1976 tax year.

Development of tax forms was a special problem. To distribute tax packages by the end of the year, forms must be ready to print early in October. To meet this schedule, the Service followed the proposed legislation closely and developed alternative forms to implement new provisions. Although the act required changes in virtually every 1976 tax form, the Service was able to develop, print, and distribute the tax packages to taxpayers on time.

New Federal-State agreements executed

The Tax Reform Act of 1976 contained major revisions of the Internal Revenue Code which had the effect of nullifying all Federal-State agreements on coordination of tax administration. In order to avoid serious interruptions of information exchanges between the IRS and State tax administration agencies, it was necessary that new agreements be prepared and executed within a short period of time.

The development of new agreements was complicated by the fact that "umbrella" agreements with Governors of the States could no longer be made. Instead, agreements with the heads by individual tax agencies within each State were required, and many States have several agencies that administer taxes. In addition, the new law also imposed on the States complex limitations on the disclosure of Federal data, privacy safeguards, and accounting obligations.

The Service prepared a new standard agreement which incorporated the provisions of the new disclosure laws and contacted each State agency to work out an agreement to satisfy the State agency and comply with the Federal law.

Statistical publications

The IRS annual Statistics of Income (SOI) publications provide the public and the Government with a wide variety of data reported on income tax returns. These reports are prepared without violating taxpayers' rights to privacy. Nearly all of the data are estimates based on representative samples of returns.

Preliminary SOI publications in 1977 covered individual income tax returns for 1975, and corporation and unincorporated business income tax returns for 1974. As required by the Tax Reform Act of 1976, the 1975 report for individuals included the first SOI statistics on the tax liability of individuals with high total income. For this purpose, total income was computed using several different income concepts. Detailed statistics for 1974 and 1975 were provided to the Department of the Treasury for a special publication on high-income taxpayers. Publication of statistics on this topic is required annually by the 1976 act.

Also published in 1977 was an SOI supplemental report on individual income tax returns providing small area data for 1972. The report provides information on the number of tax returns, adjusted gross income, selected sources of income, exemptions, and tax liability for each county and for the 125 largest metropolitan areas.

As part of the international income and tax statistical studies program, data were provided to the Treasury to help evaluate the effectiveness of the domestic international sales corporation (DISC) provisions of the tax code as a means of promoting U.S. exports. These statistics were included in Treasury's annual report to Congress on DISC's.

Other tax analysis studies underway in the international area include the foreign tax credit claimed by individuals and corporations, the activities of foreign subsidiaries of U.S. corporations, and the exemption of income earned abroad by individuals. As a result of the Tax Reform Act of 1976, work is underway on two new studies needed for annual reports to Congress to provide information concerning cooperation by U.S. entities in international boycotts and the effect of the new system of taxing U.S. corporations operating in Puerto Rico and U.S. possessions.

Plans were completed in 1977 for statistical studies of the impact of the Employee Retirement Income Security Act of 1974 on pension plans. As part of the single agency filing requirement negotiated with the Department of Labor, the Service will statistically process a sample of pension plan returns starting with plan year 1977 to meet Labor requirements. Meanwhile, the IRS is proceeding with its own statistical study for the 1976 plan year.

IRS Statistics of Income publications can be obtained from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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 made also 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 economic and demographic changes.

The total number of primary returns and supplemental documents is expected to grow from 128.5 million in 1976 to 162 million in 1985. This is an increase of 26.1 percent and reflects the expected growth in population and economic activity.

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.

The Commissioner's art advisory panel held two meetings at the National Office during 1977. The panel reviewed 395 works of art with a claimed value of more than $15 million. Assistance was provided to the panel by the in-house art group which, in addition, responds to field requests for valuations on 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 IRS in-house art group for valuation recommendations.

In its 9 years of operation, the panel has reviewed appraisals of works of art valued at more than $211 million and has recommended valuation adjustments of over $63 million.

Maintaining IRS integrity and efficiency

The Inspection Service's internal audit and security programs aid IRS managers in maintaining the highest levels of efficiency and integrity.

Internal audit activities.—The Internal Audit staff reviews the operations of the IRS to ascertain the extent of compliance with established management policies and to ensure that both the revenue and taxpayers' rights are protected.

Internal Audit studies operations that have widespread impact on the Service or that are considered high risk, including controls for safeguarding tax information and assuring fair and equitable treatment of taxpayers.

Improvement and savings.—Internal Audit issued 334 reports to Service managers during the fiscal year. Management actions on the problems reported resulted in better service to taxpayers, strengthened controls, and improved operations. In addition, management actions on Internal Audit findings resulted in measurable savings and additional revenue estimated to total $88 million.

Fraud, embezzlement, or misconduct.—Internal Audit gives top priority to detection of fraud, embezzlement, or other wrongdoing on the part of Service employees or others who attempt to corrupt IRS employees. During the year, Internal Audit referred information to Internal Security indicating possible breaches of integrity by 179 employees and 28 other individuals. Also, Internal Audit spearheaded the design and participated in implementing an improved Service-wide refund scheme detection program. This program resulted in the detection of schemes claiming fraudulent refunds of approximately $6.5 million. Most refunds were stopped before issuance to the claimants.

Internal security activities.—The Internal Security Division conducts an intensive review of high-risk areas by alerting managers and employees to the integrity hazards that were identified during Inspection investigations.

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 1977, Internal Security inspectors arrested or were responsible for the indictment of 158 individuals, including 91 taxpayers and tax practitioners, and 67 employees or former employees. A total of 119 defendants were convicted during the year, including 97 defendants who pleaded guilty rather than go to trial. Fifty of these convictions were for bribery, 14 were for assault, and the remainder involved such other criminal charges as conspiracy to defraud the Government, obstruction of justice, subscribing to false returns, disclosure of confidential tax information, and embezzlement.

Bribery awareness.—During 1977, the Division developed a video-tape presentation entitled "Anatomy of a Bribe," which realistically portrays the investigation of a bribery case from the initial offer to the subsequent trial of the offender. These video tapes were distributed servicewide and used in the bribery awareness lectures.

Last year, IRS employees continued to thwart those who challenged the integrity of the Service through attempted bribery. In 1977, 157 employees reported 180 possible bribery attempts resulting in 48 arrests or indictments. At the end of 1977, 27 persons were awaiting trial on bribery charges.

Assaults and threats on IRS employees.—The protection and safety of IRS employees subjected to threats or physical assaults while performing their duty was assigned to the Internal Security Division in March 1972. Since then prosecution has been authorized in 208 cases, 107 of which resulted in convictions or guilty pleas, and 20 of which are pending trial. During 1977, 19 persons were convicted, pleaded guilty, placed in the pretrial diversion program, subject of revocation of probation, or referred for prosecution to local authorities.

Of 528 total cases investigated, most were threat investigations, which make up almost all of the instances in which prosecution is not authorized. In these instances, 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.

Investigation of employees.—The Internal Security Division completed 13,579 investigations of employees during the year. In addition, police record searches were conducted on 16,386 persons considered for temporary, short-term appointments or for positions created for special economic educational programs.

These searches resulted in the rejection of 99 job applicants and in disciplinary actions such as separations, suspensions, reprimands, warnings, or demotions against 946 employees.

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.

In a new development, an Internal Security investigation conducted in Detroit resulted in Federal indictments of 53 present and former employees for falsely claiming and collecting welfare payments, specifically aid to dependent children. The individuals were identified by comparing the Service's payroll list with the State welfare rolls. Subsequently, the Secretary of the Treasury, in a letter to the Attorney General, suggested that the

Department of Justice and the Department of Health, Education, and Welfare conduct a nationwide review to determine the possible abuse of welfare by Government employees.

Investigative teamwork.—Breaches of integrity by individuals may be investigated jointly by Internal Audit and Internal Security with the assistance of the IRS Intelligence Division in some cases.

One joint investigation disclosed that weaknesses in supervisory controls allowed a revenue agent to assign cases to himself so that he could give preferential treatment to taxpayers for personal gain. The former revenue agent pleaded guilty to accepting gratuities from a taxpayer he audited.

In each region integrity development projects initiated by Internal Audit and Internal Security probed high-risk Service operations. For example, tests were made at service centers to determine whether existing controls and procedures protect the computerized integrated data retrieval system from fraudulent or unauthorized use by employees. Also, controls over the receipt and processing of remittances were tested in cashier functions in district offices. Accountability records were verified to determine that receipts were processed timely and in accordance with procedures. Probes in the administrative area included reviews of payments to vendors of goods and services, employee travel vouchers, and the uses of travel advances.

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 18 such referrals.

Cost reduction and management improvement

During 1977, the IRS continued to give high priority to efforts aimed at improving management and reducing costs. Spearheading these efforts was the management by objectives program. This program encouraged every Assistant Commissioner to maintain a high level of cost-consciousness and to emphasize productivity savings in all operating areas.

As a result of these and other efforts involving participation of Service managers and employees at all organization levels, the Service realized savings of many millions of dollars.

Within the incentive awards program alone, employee participation in cost reduction efforts resulted in the adoption of 795 employee suggestions, with resulting tangible benefits of $987,000. In addition, 231 awards were granted for special achievements which saved the IRS approximately $1,552,000.

Space and property management.—Special emphasis has been placed on efficient utilization of space and property resources to reduce costs. Several internal management reporting systems helped the IRS to monitor and control its space and property inventories in cooperation with the General Services Administration. Computerized systems for vehicle reporting has reduced manual reporting-staff time.

Savings were also achieved by open office planning and multiple occupancy work station concepts. These concepts, in 1977, resulted in the IRS saving in excess of $1.5 million. Automated mail processing equipment was installed at 1 service center in 1977 and increased the efficiency of the mail operation, and reduced the staff time, so markedly that the equipment will be placed in all 10 IRS service centers by March 1978.

Reports management program.—During 1977, the Service continued its efforts to eliminate nonessential internal management reporting. As a result of this action, 27 reports were cancelled at an annualized savings of approximately $310,000.

Records disposal program.—Records disposal during 1977 resulted in the release of space and equipment valued at over $2.2 million. A total of 155,497 cubic feet of records were destroyed in accordance with regular programs, and 315,436 cubic feet of records were retired to Federal Records Centers.

Telecommunications.—The Service expanded its cost reduction efforts in the area of telecommunications. A cost reduction of $1.2 million was achieved in 1977 in Federal Telecommunications System (FTS) charges, by reducing local telephone equipment, and the consolidation of data transmission facilities.

Projected conversions of telephone systems from attended to unattended status will result in a net decrease of 11 staff-years by July 1978.

Administrative mail management.—Special service center zip codes will be used nationwide as of January 1, 1978, which will reduce the average transit time of mail from the taxpayer to service centers by 1 day, producing estimated interest savings to the Government in excess of $5 million by making funds available to the Treasury a day earlier.

Treasury safety award to IRS.—The IRS continued to rate as one of the top Federal agencies in safety by earning the Secretary's Safety Award of Excellence for 1976 based on its outstanding record in the occupational safety and health program areas. All bureaus of the Treasury compete for this award annually.

The IRS maintained a rate of 3.5 disabling employee injuries per million staff-hours worked in 1976, and Service personnel drove 126.3 million miles of official business in 1976 with 745 accidents, 129 less than in 1975, and an accident frequency rate of 5.8 per million miles driven, compared with 6.4 in 1975.

In both safety areas, the IRS ratios for 1976 were not only the best in Treasury, but also the best among comparable Federal agencies in the Washington, D.C., area.

Administration

Position management initiatives.—Strong management support for sound position management practices and the effective utilization of personnel resources resulted in savings of several million dollars during 1977.

For example, during 1977 over 1,200 paraprofessional positions in the audit, collection, and intelligence functions were filled in lieu of a like number of higher graded professional and technical positions. This resulted in a savings of over $6.7 million. In addition, the use of paraprofessional positions has been explored in other functional areas such as inspection, appellate, and employee plans and exempt organizations.

A further indication of management commitment to sound position management is the fact that the IRS average grade has decreased from 7.72 in 1968, to 7.56 in 1977, while the average grade for the Federal Government has increased from 7.4 to 8 over that same span.

Labor-management activities.—In December 1976, the IRS concluded negotiations with the National Treasury Employees Union (NTEU), resulting in a 4-year collective bargaining agreement covering approximately 30,000 employees in 57 out of 58 district offices. In May 1977, negotiations with NTEU involving regional offices were concluded, resulting in a 4-year agreement covering approximately 1,700 employees in 6 of 7 regions. Overall, the National Office agreement, the multicenter agreement, and the multiregional and multidistrict agreements cover over 65,000 IRS employees.

During the year, the Service conducted nationwide training in basic labor relations plus advanced courses in 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.

The unfair labor practice (ULP) caseload has dropped approximately one-third and the arbitration caseload has risen approximately one-third during the past year. The significance of the sharp drop in ULP's reflects the acquisition of expertise on the part of operating managers in the application and implementation of Executive Order 11491, as amended. The rise in the arbitration caseload is attributable to the fact that employees have become more aware of their right to file grievances and to appeal, and local management interpretation of the applicable agreement.

Employment of the handicapped.—The number of handicapped employees employed by the Service increased slightly from 1976 to 1977, from 1,642 to 1,667. There are now over 140 visually handicapped employees working as taxpayer service representatives. The IRS nominee for Outstanding Federal Handicapped Employee of the Year was Ms. Arietta Woods, a blind taxpayer service specialist from the Los Angeles district. Ms. Wood's nomination symbolizes the capability and excellence of all handicapped employees.

Equal employment opportunity.—The Service continued to make progress in the employment of women and minorities in 1977. Total employment (July 1976 to July 1977) increased by 2.99 percent while the number of women increased by 7.52 percent and the number of minorities increased by 6.19 percent.

The Service also increased numbers of women and minorities in higher grade levels, and in key occupations, including revenue agent, revenue officer, tax auditor, attorney, and criminal investigator.

Training to instruct EEO counselors in how to counsel in class discrimination complaints was developed during 1977.

In addition, course development was begun on a new training program for special emphasis program coordinators including the Federal women's program, Spanish-speaking program, and upward mobility program. The course will be completed and new coordinators will receive this training during 1978.

Special agent training.—Late in 1976, the Deputy Commissioner appointed a study group of various IRS managerial personnel to ensure that the special agent occupation was provided the proper criminal investigator training, commensurate with their tasks, duties, and assignments; and that such training be offered in a logical and timely sequence and conducted in the most cost-effective manner.

Major recommendations of the study group were adopted and the revisions to the special agent training were implemented during 1977. The restructured program has provided for more effective and efficient training with a 3-week reduction of training time ($75,000 per diem and 3,000 staff-day savings annually). Most important, the agents now receive, more timely, training directly applicable to present work assignments.

Another recommendation of the study group, that these Intelligence Division employees receive advanced training for certain specialized duties, has also been adopted. Large case training has been developed to enable the agents to conduct investigations of coordination examinations program cases. This study program, which includes such topics as case analysis and planning, corporate structure, grand juries, referrals, information, etc., will be given to about 200 special agents during the next year. Another module, intelligence computer specialist training, was initiated this year and has already proven successful for providing agents the knowledge to carry out specific enforcement activities.

Computer audit specialist training.—Most corporations and many small businesses are now using computers to generate their tax return information. The present computer preparation and recordkeeping of tax information was anticipated by IRS management several years ago. Also recognized was the need for a cadre of Service employees, highly skilled in the techniques of using computer records for examination purposes in the audit process. This led to creation of the computer audit specialist position. Presently, there are more than 120 revenue agents performing these very specialized duties.

As taxpayers employ additional and more sophisticated computerized records, training programs for computer audit specialists are expanded to match these innovations. This coming year, computer audit specialists will be instructed in such advanced techniques as Common Oriented Business Language (COBOL) "Report Writer," data base management, and distributive processing.

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 fiscal 1977, 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, 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 are in New York, N.Y., and San Francisco, Calif.; and bullion depositories are located in Fort Knox, Ky. (for gold), and West Point, N.Y. (for silver). The Old Mint, San Francisco, houses the Mint Data Center, the Mint Museum, and a numismatic order processing operation. The U.S. Assay Office at San Francisco operates as a mint. The West Point Depository continued to produce coins during the year.

The Mint security program provides appropriate and continuous protection for all employees and assets under the jurisdiction of the Bureau of the Mint. This is accomplished by 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.

During fiscal 1977, a total of 80 Mint security officers completed the 5-week course at Treasury's Federal Law Enforcement Training Center, Brunswick, Ga.

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[1] Additional information is contained in the separate Annual Report of the Director of the Mint.

The installation of closed-circuit television surveillance systems at the New York and San Francisco assay offices, the Denver Mint, and the West Point Bullion Depository were completed during the year. The alarm systems at these locations were modernized in a consolidation of security equipment and devices. Work on the installation of similar security equipment was in progress at the Philadelphia Mint at the fiscal yearend.

The Continuing Committee for the Audit of U.S.-owned gold located at various depositories at appropriate intervals was established by the Fiscal Assistant Secretary during fiscal 1976. 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, with the General Accounting Office invited to participate in the audits as an observer. Under the Committee's program, 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, 1977, more than 30 percent of the U.S.-owned gold had been audited and verified. The continuing audit is planned to provide for a complete audit of all U.S.-owned gold over a 10-year cycle ending in 1984.

The U.S. Mints at Philadelphia and Denver and the Assay Offices at San Francisco and New York were the only Government installations at which operations had to be suspended because of the energy problem of February 1977. Annual settlements of the values stored at Philadelphia, Denver, and the San Francisco Assay Office were conducted during the winter shutdown caused by the natural gas shortage. This action averted a second shutdown for settlement with a corresponding loss of production and work-force time. The annual settlement at New York was held later in the fiscal year.

It is anticipated that annual recurring savings in excess of $39,000 will be realized as a result of an audit recommendation to discontinue the unnecessary rental of warehouse space for coinage strip. The restriction of orders of commercially fabricated coinage strip to the requirements of the Philadelphia Mint and the storage capacity of an offsite warehouse are expected to result in additional savings to the Bureau of the Mint.

The Bureau of the Mint deposited a total of $458,043,170 into the general fund of the Treasury during fiscal 1977. Seigniorage on U.S. coinage accounted for $407,022,950 of the total.

Domestic coinage

During the 12-month period, U.S. mints produced cupronickel-clad dollars, half dollars, quarters, and dimes, cupronickel 5-cent pieces, and 1-cent pieces composed of 95 percent copper, 5 percent zinc for general circulation.

In fiscal 1977 the Philadelphia Mint manufactured 4,612,773,000 coins; the Denver Mint 5,567,349,495 pieces; and the West Point Depository produced 1,389,850,000 1-cent pieces and 6,376,000 quarters for general circulation.

Approximately 10.7 billion coins were shipped by the Bureau of the Mint to Federal Reserve banks and branches during the year.

Coin demand

The Bureau of the Mint continued its close liaison with the Federal Reserve in determining coin requirements. Demand for coin, as measured by the net outflow from Federal Reserve banks to commercial banks, totaled 11.5 billion coins during fiscal 1977. Coin balances at the Federal Reserve banks decreased by about 872 million coins from September 30, 1976. Joint Mint/Federal Reserve bank inventories of coins totaled 7.0 billion on September 30, 1977.

Coinage study

In December 1976 Secretary Simon transmitted to the President of the Senate and the Speaker of the House of Representatives a report prepared by the Department on "The State of the United States Coinage." The report identified two major problem areas. First, it noted the diminishing utility of the 1-cent piece in the Nation's commerce and that its increased production costs suggested giving serious consideration to its elimination from our coinage system. In addition, the report recommended the replacement of the existing dollar coin with a smaller sized dollar, as well as the elimination of the half dollar from the Nation's circulating denominations. The Congress had not taken any action on this report before the administration changed in January.

In March 1977, the chairman of the House Subcommittee on Historic Preservation and Coinage, Committee on Banking, Finance and Urban Affairs, requested the current views of the Department on the report. On April 7, 1977, Secretary Blumenthal responded by letter which set forth the position of the Treasury in this administration, as follows:

> The Treasury has not recommended to keep or eliminate the 1-cent coin at this time. While production considerations point toward elimination, a thorough analysis of consumer impact has not yet been made. We are proceeding with data gathering and assessment of the consumer impact aspects. A decision should not be made until the potential economic impact on consumers is understood. In the meantime, we recommend that the Congress proceed with its own consideration of these matters.
>
> The Treasury recommends the present dollar coin be replaced with a smaller, more conveniently-sized dollar coin and that the 50-cent piece be eliminated.
>
> The above positions are consistent with the report.
>
> Concerning timing, consideration by the 95th Congress of the 1-cent coin question is a necessity. The decision to expand mint capacity is wholly dependent on the 1-cent decision. If the 1-cent coin is retained and projected demand is to be met, 5-year capacity expansion leadtimes require commencement of facility implementation action this year.

Foreign coinage

The Bureau of the Mint is authorized to produce coinage for foreign governments on a reimbursable basis provided the manufacture of such coins does not interfere with U.S. coinage requirements. From October 1, 1976, through September 30, 1977, Mint installations manufactured approximately 385 million coins for Haiti, Panama, Peru, and the Philippines.

Production

Secretary Simon directed that the use of the special Bicentennial reverse designs and the dates 1776–1976 on coins be terminated on December 31, 1976. From fiscal 1975, when these distinctive coins were first manufactured, through December 1976 the following quantities for general circulation were produced: 220,565,274 dollars, 521,873,248 half dollars, and 1,669,902,839 quarters.

In the early months of fiscal 1977, the Mint generated a record inventory of coins, a percentage of which has been placed in long-term storage. At the fiscal yearend the Mint was holding coins in storage for an extended period at the West Point Depository, the San Francisco Assay Office, and at the Rocky Mountain Arsenal, Denver.

After a reduction in force at the Mint's production facilities in April and May

1977, a near balance in the ratio of coins produced to coins shipped was achieved.

The coin shipping load factor at the Denver Mint was increased by 10 percent, from 40,000 to 44,000 pounds on 1-cent coins. This more efficient method of transporting coins gathered savings in costs for the Mint, personnel for both the Mint and the Federal Reserve banks, and most importantly, savings of energy.

The electrostatic precipitator at the New York Assay Office was upgraded and modernized. This will improve the Mint's ability to refine gold and decrease pollutants released into the atmosphere.

U.S. coins manufactured, fiscal year 1977

Denomination	General circulation: Number of pieces	General circulation: Face value	Numismatic [1]: Number of pieces	Numismatic [1]: Face value	Total coinage: Number of pieces	Total coinage: Face value
1 dollar:						
Cupronickel	41,118,277	$41,118,277.00	3,787,152	$3,787,152.00	44,905,429	$44,905,429.00
Silver-clad			398,449	398,449.00	398,449	398,449.00
50 cents:						
Cupronickel	98,275,999	49,137,999.50	3,787,152	1,893,576.00	102,063,151	51,031,575.50
Silver-clad			398,449	199,224.50	398,449	199,224.50
25 cents:						
Cupronickel	[2] 701,689,590	175,422,397.50	3,787,152	946,788.00	705,476,742	176,369,185.50
Silver-clad			398,449	99,612.25	398,449	99,612.25
10 cents	1,216,283,525	121,628,352.50	3,787,152	378,715.20	1,220,070,677	122,007,067.70
5 cents	993,042,898	49,652,144.90	3,787,152	189,357.60	996,830,050	49,841,502.50
1 cent	[3] 8,525,938,206	85,259,382.06	3,787,152	37,871.52	8,529,725,358	85,297,253.58
Total	[4] 11,576,348,495	522,218,553.46	23,918,259	7,930,746.07	11,600,266,754	530,149,299.53

[1] All numismatic coins were made at the U.S. Assay Office, San Francisco, and included 1,582,259 1976 proof sets, 163,906 Bicentennial proof sets, 234,543 Bicentennial uncirculated sets and 2,204,893 1977 proof sets.

[2] Includes 6,376,000 quarter dollars produced at the U.S. Bullion Depository at West Point.

[3] Includes 1,389,850,000 1-cent coins manufactured at West Point.

[4] Includes 7,923,277 Bicentennial dollars, 29,073,999 Bicentennial half dollars, and 196,059,590 Bicentennial quarter dollars. Other coins of these denominations were dated 1977.

NOTE.—Dollars, half dollars, quarters, and dimes for general circulation and regular proof sets are three-layer composite coins—outer cladding 75 percent copper, 25 percent nickel, bonded to a core of pure copper. Dollars, half dollars, and quarters comprising the Bicentennial proof and uncirculated 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.

Bureau of the Mint operations, fiscal 1976, transition quarter, and fiscal 1977

Selected items	Fiscal 1976	T.Q.	Fiscal 1977
Newly minted U.S. coins issued: [1]			
1 dollar	146,400,000	12,900,000	50,600,000
50 cents	239,900,000	42,800,000	75,200,000
25 cents	1,072,000,000	193,600,000	729,200,000
10 cents	874,400,000	232,000,000	814,500,000
5 cents	618,200,000	114,300,000	673,700,000
1 cent	7,711,700,000	2,030,200,000	8,362,600,000
Total	10,662,600,000	2,625,800,000	10,705,800,000
Inventories of coins in Mints, end of period	3,248,400,000	3,741,300,000	4,611,700,000
Electrolytic refinery production:			
Gold—fine ounces			
Silver—fine ounces	5,004,140.42		3,331,771.75
Balances in Mint, end of period:			
Gold bullion—fine ounces	266,188,680	266,177,852	266,169,764
Silver bullion—fine ounces	40,197,341	39,849,021	39,401,062

[1] For general circulation only.

Technology

The Bureau of the Mint's Office of Technology completed trial strikes on three proposed versions of a new, smaller dollar coin bearing the Liberty obverse and new eagle reverse. Materials other than cupronickel clad were given detailed consideration, but the material presently used for the dime, quarter, half-dollar, and dollar coins was judged most suitable for the proposed coin.

A review was conducted of all die standardization drawings that were converted to the metric system. A 6-month introduction to the metric system was conducted by reporting assay and quality control data in both metric and conventional units. By the fiscal yearend only metric units were being reported.

The Bureau of the Mint's Laboratory in Washington continued to provide technical expertise on the authenticity of U.S. coins, examining 1,705 questioned coins submitted by the U.S. Secret Service and other law enforcement agencies, involving 161 cases.

The Mint and the Secret Service developed mutual policy and procedures for the return of gold bullion contained in counterfeit gold coins confiscated from innocent collectors.

Administration

Mint-wide classification reviews of Federal Wage System positions resulted in more than 716 employees being downgraded.

The Bureau conducted a significant reduction in force of production personnel. A total of 117 employees were released from the Denver Mint, the Philadelphia Mint, and the West Point Bullion Depository.

A satisfactory settlement was reached concerning the only previously unresolved issue (scope of the negotiated grievance procedures) of the renegotiated Bureau-wide union contract. The settlement was obtained as a result of Bureau management and union participation with the Federal Service Impasses Panel factfinder. Implementation of the contract was awaiting employee ratification on September 30, 1977.

The Mint's experimental project of preparing a zero-base budget for fiscal 1978 in conjunction with the Department's Office of Budget and Program Analysis (OBPA) served as a pilot project for the Treasury. The project applied techniques of zero-base budgeting to an existing budget to determine required timing, paperwork, and review changes. A slide-sound show on the Mint's project was developed by OBPA, which was shown to the management staffs of other Treasury bureaus.

The conversion of the payroll and related personnel information of seven Treasury bureaus to the Treasury payroll/personnel information system (TPPIS) had been accomplished by the end of fiscal 1977. The implementation of TPPIS has proceeded in accordance with the schedule established during fiscal 1976.

Marketing and statistical services

A proof bronze medal honoring President Carter was offered to the public for the first time at the American Numismatic Association convention in Atlanta, Ga., in August 1977. This 1 5/16-inch medal is the first Presidential medal to be produced in proof edition by the U.S. Mint. The medal may be purchased over-the-counter from Mint sales areas or by mail.

Between April 1 and June 10, 1977, the Mint accepted orders for 3.25

million 1977 proof coin sets. Traditionally, orders had been accepted during November and December for the next calendar year's sets. The schedule was revised this year to improve customer service by shortening the length of time people had to wait to receive their sets. Shipment of the 1977 proof sets began on May 2 and will continue through December. A schedule was developed whereby ranges of order numbers were matched against production and mailing schedules, with each order assigned an "expected receipt date," which was provided to the customer.

Following extensive remodeling, the Treasury Exhibit Hall in the Main Treasury Building, which is under the jurisdiction of the Bureau of the Mint, was formally opened to the public by Treasury officials on January 4, 1977. The Hall features many historical, mechanical, graphic, and audiovisual displays reflective of Treasury activities assembled from: The Bureau of Alcohol, Tobacco and Firearms; the Bureau of the Mint; Office of the Comptroller of the Currency; Internal Revenue Service; Office of the Secretary; U.S. Secret Service; U.S. Savings Bonds Division; and the U.S. Treasurer's Office. The Mint exhibit includes an operating coin press on which visitors may strike their own White House medal in pewter and 30 gold bars, weighing approximately one-half a ton, displayed in a unique cannonball vault-type safe. The Exhibit Hall is open Tuesday through Sunday from 9:30 a.m. to 3:30 p.m. Between January 4 and September 30, approximately 140,000 visitors toured the Hall.

OFFICE OF REVENUE SHARING [1]

The Office of Revenue Sharing is located within the Office of the Assistant Secretary (Domestic Finance) for administrative purposes. The revenue sharing staff consists of approximately 150 professional and clerical positions, with an additional 30 positions designated for the antirecession fiscal assistance (ARFA) program. Offices are located at 2401 E Street, NW. in Washington, D.C.

The Office of Revenue Sharing was made responsible for administering the ARFA program with the passage of title II of the Public Works Employment Act of 1976 (Public Law 94–369). Under the act, the Office had distributed more than $1.6 billion by the end of fiscal 1977.

With the passage of the Intergovernmental Antirecession Assistance Act of 1977 (Public Law 95–30, May 23, 1977), the civil rights and audit requirements of the ARFA program were made identical to those of the general revenue sharing program.

During fiscal 1977, $6.8 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 $33.5 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 ended December 31, 1976. The money was allocated according to formulas contained in the law which use data on population, per capita income, and general tax effort for each recipient unit of government.

[1] Additional information is contained in the separate Annual Report of the Office of Revenue Sharing.

The eighth entitlement period in the general revenue sharing program is the first such period authorized by the State and Local Fiscal Assistance Amendments of 1976 (Public Law 94–488, October 13, 1976). These amendments extended general revenue sharing from January 1, 1977, through September 30, 1980, at higher annual levels of funding than had been available during the 5-year period of operation authorized by the original act. The amendment for the eighth period authorizes $5 billion for distribution, bringing the total authorized for distribution to $35.2 billion.

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 the Census revised the 1975 population and 1974 per capita income data for revenue sharing purposes. These revised estimates were prepared by Census using the most recent information available from tax returns, vital statistics, and other data series which indicate changes since 1970.

The Office used the revised 1975 population and 1974 per capita income estimates, and fiscal 1976 adjusted taxes and intergovernmental transfer data to compute allocations, during June 1977, for the ninth entitlement period which begins October 1, 1977.

Revenue Sharing's annual data improvement program is an administrative procedure to identify and correct data errors. As part of this program, in April 1977, each government was asked to examine the data used to compute its ninth entitlement period allocation and submit proposed corrections for any data elements considered to be in error. The data notice form also provided each government with an estimated ninth-period allocation amount which was computed using the data on the form. The estimated allocation amounts were provided to aid governments in their data verification efforts.

More than 2,000 governments questioned at least 1 data element. After careful study of these challenges, data corrections were made for several hundred governments. Additional revisions resulted from ongoing data improvement efforts of the Bureau of the Census and the Office of Revenue Sharing. Altogether, a few thousand revisions were made to the data elements prior to the allocation of funds for entitlement period nine.

The unemployment rates required for the antirecession program are provided to the Office each quarter by the Bureau of Labor Statistics as required by statute. The Intergovernmental Antirecession Assistance Act of 1977 made it possible for Governors of States to supply unemployment rates prepared according to the Bureau of Labor Statistics methodology for local governments for which the Bureau of Labor Statistics did not have unemployment rates. By August 1977, 18 States had submitted unemployment rates for at least some local governments which were to be used in calculating antirecession payments for the October 1977 quarter.

The Office each quarter provides to approximately 39,000 potentially eligible general purpose governments their data factors for review and their quarterly allocation amounts. The unemployment rates assigned to each government and its general revenue sharing allocation amounts can be corrected if a government notifies the Office of any processing error within 21 days after the mailing of the payment and allocation data notices. Approximately 125 governments each quarter write to question the data factors used. The correspondence results in corrections and later adjustments in their antirecession payment.

Electronic funds transfer and direct deposit

During the year, the Office of Revenue Sharing modernized the methods used to return funds to States and local governments. All recipient governments were given the option of having their revenue sharing payments deposited directly into bank accounts. Of the 38,000 recipients of general revenue sharing offered the opportunity to participate in the new program, 25,103 elected to do so. All quarterly payments were transferred into the accounts of those governments using the new procedure.

Audit procedures

The 1976 amendments to the Revenue Sharing Act placed significant audit requirements on more than 11,000 of the 38,000-plus revenue sharing recipients. This also considerably increased the audit responsibilities of the Office. No audits were required under the original act.

However, the Office of Revenue Sharing, through agreements with State auditors and cooperative relationships with independent public accountants, obtained audits of a substantial portion of revenue sharing recipients. The 1976 amendments to the Revenue Sharing Act effective January 1, 1977, require that recipients receiving $25,000 and more annually in revenue sharing entitlements have an independent audit of their financial statements conducted, in accordance with generally accepted auditing standards, not less than once every 3 years.

The renewal legislation changed the emphasis of the audit program from making audits to monitoring the audit performance of State auditors and independent public accountants. Since the State auditors have responsibility for the largest portion of State and local government audits, the first effort of the Audit Division was directed toward reviewing the performance of State auditors. Although the recipients have until 1979 to conform with the audit requirements of the 1976 amendments, it was thought to be more constructive to review present practice to determine if it conforms to the requirements that must be met by 1979. Thus, if the practice were not acceptable, the State audit agency would have 3 years to upgrade its audit practice. Every State audit agency was reviewed in fiscal 1977. Letters were written to all State auditors advising whether their audits met the requirements of the 1976 amendments. If they did not, the State auditor was advised of the specific weaknesses that existed and what needed to be done to comply with the new audit requirements. Of the 11 State auditors whose practices were found to be unacceptable, 5 have already initiated programs to bring their practices to an acceptable standard.

The Audit Division made similar reviews of the performance of 20 independent public accountants. Letters were written to each of them advising them of the results of the review.

An audit guide for ARFA was prepared and distributed in March 1977. Most of the work of preparing a new audit guide containing the audit standards and procedures required by the 1976 amendments was performed during the year.

During fiscal 1977, the Audit Division either received or was advised of the issuance of 5,152 audit reports on revenue sharing funds. State auditors advise the Audit Division of audit reports which they issue or receive for review from independent public accountants that do not contain findings of violation of the Revenue Sharing Act or regulations. These reports are kept on file by the State auditors for review by the Audit Division as a part of the periodic reviews made of State auditors' performances. These audit reports disclosed 444 violations of the Revenue Sharing Act or regulations. In addition, 18 audits were made by the Audit Division and 46 miniaudits were made for the Office by the U.S. Customs Service. During the year the miniaudit program was phased out since recipients receiving less than $25,000 annually in revenue sharing funds are not required by the 1976 amendments to have an audit. The Audit Division also responded to 3,355 requests from independent public accountants for confirmation of entitlement fund payments.

In fiscal 1977, 495 noncompliance cases were opened and 370 were closed. This compares with 242 opened and 321 closed during the 15 months ending September 30, 1976.

Technical assistance

The Office of Revenue Sharing provides information and technical assistance to State and local governments receiving general revenue sharing and antirecession fiscal assistance funds. The past year was an especially active one, not only because of the many State and local officials who assumed public office for the first time but also due to the many new provisions of the State and Local Fiscal Assistance Amendments of 1976 and the Intergovernmental Antirecession Assistance Act of 1977.

Technical assistance was provided in the form of 2,320 letters in response to written requests for specific information and guidance. In addition, over 91,000 telephone contacts were made with recipient governments and others interested in the revenue sharing and ARFA programs. Five technical papers were prepared on various aspects of both programs and over 6,000 individual mailings were made of these and other informational materials.

The Office has established a network of liaisons within each of the 50 States and the 4 territories receiving ARFA funds. Over 40 technical assistance workshops were conducted during the year in cooperation with these liaisons and other cosponsors for the benefit of recipient governments.

Quarterly, each of the more than 39,000 recipient governments in the general revenue sharing program and each of the more than 20,000 governments which have received ARFA funds have been sent a letter which advises the government of its current status in the respective programs. The letter also provides other information to enable the recipient government to continue to participate in the program and remain in compliance with the requirements of the legislation.

Public participation

Much attention was given during the year to the development of regulations that would faithfully implement the new public participation provisions of the State and Local Fiscal Assistance Amendments of 1976. These provisions require two public hearings to be held, with attendant public notice and opportunity for examination of budget documents, by State and local governments receiving revenue sharing funds prior to the use of such funds.

During the year both interim and final regulations were promulgated. A public hearing was held on the interim public participation regulations. Nearly 60 letters of comment also were received pertaining to the interim and proposed final public participation regulations. A meeting also was held with associations representing State and local government elected officers, appointed officials, and professional staff to ensure that final regulations would be workable.

The final regulations on this subject reflect the many constructive comments received on this important feature of the 1976 amendments. They should ensure that citizens of recipient jurisdictions have an opportunity to participate in the decisionmaking processes involving uses of revenue sharing funds.

Compliance

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 subjected to discrimination under any program or activity of a State government or unit of local government, which government or unit receives funds * * *. Any prohibition against discrimination on the basis of age under the Age Discrimination Act of 1975 or with respect to an otherwise qualified handicapped individual as provided * * * shall also apply to any such program or activity. Any prohibition against discrimination on the basis of religion, or any exemption from such prohibition, as provided * * * shall also apply to any such program or activity."

Although the staff which has responsibility for monitoring and enforcing this section of the Revenue Sharing Act is relatively small, it has been successful in investigating a significant number of civil rights complaints. Of even greater significance has been the success demonstrated by the Civil Rights Division in resolving most of the complaints, mainly through negotiation and efforts to achieve voluntary compliance. In those rare instances where recipient jurisdictions have been reluctant to take those steps necessary to come into compliance, the Office has demonstrated its mandated responsibility to enforce the law and has initiated action to fulfill its responsibilities through the route of administrative hearings to compel compliance.

Shown below is a table that demonstrates the growth of the activities of the Division.

Discrimination complaints

Year	Received	Determinations	Closed	Carried over
1972	1	0	0	1
1973	32	1	3	30
1974	66	14	26	70
1975	209	8	16	263
1976	221	7	70	414
1977	186	125	93	507

NOTE.—The most significant unit of work measurement is the determinations issued, rather than number of complaints closed. The major portion of the work process is completed upon the issuance of a determination. Usually, the closure of the case is dependent upon a paper review of requested information from a recipient government after the issuance of a noncompliance determination.

To assist in conducting field investigations and to help resolve discrimination complaints, the Office continues to work in a cooperative effort with several major Federal agencies and with a significant number of State human rights agencies. The Office is currently attempting to renegotiate cooperative agreements with most of the State human rights agencies, and with the Federal agencies with which it has shared agreements.

Legal issues

During the fiscal year, the Chief Counsel participated in the initiation or defense of 29 legal actions including 2 administrative hearing actions—one against a town for alleged discrimination in employment on the basis of national origin, and the other against a State for alleged discrimination in employment on the basis of sex by a school district funded by the State with revenue sharing funds.

Several of the court suits involved discrimination charges against recipient governments in which the Office was joined as a party defendant. In *Committee for Full Employment* v. *Simon* (U.S.D.C., D.C.), the court held for the Secretary of the Treasury, agreeing that plaintiffs lacked standing to sue. *Pegues* v. *City of Oxford et al.* (U.S.D.C., N.D. Miss.) was dismissed with respect to all Federal defendants for failure to exhaust administrative remedies. *Dobbs* v. *City of Atlanta et al.* (U.S.D.C., N.D. Ga.) was dismissed on failure to state a claim. *Hendris* v. *Simon* (U.S.D.C., Conn.) was dismissed upon plaintiff's failure to prosecute.

Other revenue sharing cases in litigation involved the application of adjusted tax data for the revenue sharing allocation formula, and the procedures of the Office in making downward adjustments to a recipient's allocation.

The Chief Counsel drafted regulations for both the general revenue sharing program and the ARFA program and assisted in drafting the renewal legislation for general revenue sharing.

For the general revenue sharing program, interim regulations necessitated by the amendments were published by April 1977. Final regulations were published in September 1977, except for those regulations on nondiscrimination which have been temporarily delayed.

Interim regulations on the ARFA program were prepared in October 1976. When the ARFA Act was amended during the fiscal year by the Intergovernmental Antirecession Assistance Act of 1977, interim regulations were amended (in May 1977) to reflect the statutory changes. The Chief Counsel also assisted in drafting ARFA renewal legislation.

During the fiscal year, the Chief Counsel issued approximately 200 letter rulings to recipient governments seeking guidance for the use of ARFA funds. A digest of these letter rulings is currently being prepared for the use of recipient governments.

Antirecession fiscal assistance

Treasury distributes antirecession funds to States and local general governments based on unemployment rates and general revenue sharing entitlements. These funds supplement the general revenue sharing payments. Appropriations of funds to be distributed and of money to be used to administer the new program were first made available in fiscal 1977.

In May 1977, the Congress extended the ARFA program for four quarters beyond its original life, through September 1978, by enacting the Intergovernmental Antirecession Assistance Act of 1977. This legislation maintained the broad outlines of the original program.

In excess of $2.1 billion has been distributed to over 25,000 State, general purpose local, and several U.S. territorial governments. These funds are intended by the Congress for use to maintain basic services normally provided by governments and to help these units avoid actions which run counter to national economic policies.

OFFICE OF TARIFF AFFAIRS

The Office of Tariff Affairs, 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, was transferred in May 1977 from the Office of the Under Secretary to the Office of the General Counsel. This action was in keeping with the trade policy objectives of the Carter administration to ensure that these unfair trade practice statutes are administered consistent with the legal obligations these laws impose. In order for the Office to devote more of its attention to increasing caseload and difficulty of issues involved under these two statutes, all other responsibilities for policy review under the tariff laws were removed.

In September 1977 the Treasury was preparing the promulgation of amendments to the antidumping regulations requiring more formalized procedures governing ex parte meetings involving antidumping investigations, in order to ensure that these exchanges will contribute more meaningfully to the case resolution process.

During fiscal 1977, the Treasury initiated 19 antidumping investigations, and reached final determinations of sales at less than fair value on 13 of them. There were three dumping findings issued during that time. Over the same period, the Treasury initiated 16 investigations under the countervailing duty law, made 8 affirmative determinations and 2 negative decisions. One waiver of countervailing duties was issued during the year.

UNITED STATES CUSTOMS SERVICE

The principal missions of the Customs Service are to assess, collect, and protect the levying of import duties and taxes; to enforce customs and related laws against the smuggling of contraband; 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 these missions, 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 400 other laws and regulations of approximately 40 Government agencies relative to international traffic and trade.

5. Improved application of resources to carry out the total Customs mission, consistent with efficiency in Government and economy and service to the public.

During fiscal 1977, Customs cleared over 263 million persons arriving in the United States. More than 77 million cars, trucks, and buses crossed the country's borders; an additional 154,000 ships and 370,000 aircraft were also cleared. This involved making 71 million baggage examinations and processing 14 million customs declarations.

Customs collected a record $6.0 billion in duty and taxes and processed $150 billion worth of imported goods, which required over 3.6 million formal entries (those over $250 in value). In addition, there were 47 million foreign mail parcels to be processed in fiscal 1977, requiring over 2.3 million informal mail entries.

The Customs enforcement mission also produced tangible results during fiscal 1977. Merchandise seized, including illicit drugs, prohibited articles, undeclared merchandise, etc., was valued at almost $1.2 billion. There were over 24,000 drug seizures. These seizures included 951 pounds of cocaine, 7.8 million units of polydrugs, and 774 tons of marijuana. There were 278 pounds of heroin seized—a decrease of 24 percent over fiscal 1976. In addition, neutrality violations—smuggling arms out of the United States to other countries—jumped from 1,517 cases in fiscal 1976 to 1,676 cases in fiscal 1977.

Merchandise Processing and Duty Assessment

Merchandise processing

Processing commercial merchandise.—In fiscal 1977, Customs processed over 3.6 million formal entries. Over $6.0 billion in revenue was collected on more than $150 billion worth of merchandise.

Since not all merchandise can be allowed into the country, it is Customs task to determine the admissibility of the merchandise and then to classify the merchandise for statistical and revenue purposes. The statistical information is turned over to the International Trade Commission, through the Census Bureau, for use in negotiating international trade agreements. This provides the mechanism whereby domestic industry and jobs are protected against any unfair competition from overseas.

Customs mail operations.—During fiscal 1977, Customs mail branches processed approximately 47 million mail parcels, prepared over 2.3 million mail entries, and collected over $22 million in duty. Over 80 percent of the foreign mail is processed by Customs mail branches at locations in New York, Oakland, Seattle, Los Angeles, and Chicago.

Import statistics.—In fiscal 1977 customs officers, located at some 100 ports of entry, verified 6.7 million line items on the 3.6 million entries filed. This represents verification of approximately 43.6 million individual items. The present high quality of import statistics flows from the commodity expertise essential for the effective collection of revenue.

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 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 760 such quotas.

Customs officers also monitor specific importations to determine the quantity of a commodity being imported from a specified country or countries. This information is then used by Customs and other agencies to determine the possible need for establishing quotas or negotiating orderly marketing agreements and to detect unusual fluctuations in foreign trade. Currently being monitored are various agricultural products, certain meats, footwear, televisions, and mushrooms. Numerous other imports are subject to various international agreements.

Orderly marketing agreement (OMA)

An innovative foreign trade technique was created in fiscal 1977—the orderly marketing agreement (OMA). An OMA is an international agreement whereby a foreign government voluntarily agrees to restrict the quantity of a specific commodity it exports to the United States. Three OMA's were negotiated in 1977. Customs implements these agreements.

Stainless and alloy tool steel.—Although the U.S. Government has entered into an OMA with Japan only, on certain stainless and alloy tool steel, Customs is administering quotas on such steel from all countries.

Footwear.—Pursuant to Presidential Proclamation No. 4510, June 22, 1977, implementing OMA's, absolute quotas were imposed on nonrubber footwear from Taiwan and Korea covering 107 Tariff Schedules item numbers grouped in 3 categories for Taiwan and 2 categories for Korea. These nonrubber footwear imports must be accompanied by a proper visa from the exporting country before they can be permitted entry into the United States.

Televisions.—Pursuant to Presidential Proclamation 4511, June 24, 1977, Customs is responsible for monitoring all complete and incomplete color television receivers and subassemblies, from all countries, entered or withdrawn from warehouse for consumption into the United States on/after July 1, 1977, through June 30, 1980. The monitoring is by TSUSA item No. (14) and by country. An OMA with Japan requires that, except for a certain number each year, such Japanese merchandise entered or withdrawn for consumption into the United States shall be accompanied by an appropriate and correct certification. Therefore, Customs is required to limit the number entered without certification.

Textile agreements.—Currently, the United States has separate bilateral textile agreements with 18 countries covering trade in cotton, wool, and manmade fiber textiles and apparel. Ten of those agreements include systems under which imports from the exporting country must be visaed prior to entry. During fiscal 1977, Customs administration and maintenance of these 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. Enabling legislation is still pending. However, this legislation is not necessary for the first phase of the program, which involves monitoring only the movement of coffee. This monitoring system is designed to provide accurate statistical data on the quantities of coffee imported by consuming member nations and will serve as a base for allocations to exporting member countries if and when quotas are subsequently established.

Customs laboratories.—The Customs laboratories analyzed over 170,000 samples of imported merchandise during fiscal 1977, resulting in over 16,000 corrections in tariff classification. While the number of samples analyzed has remained virtually unchanged for 2 years, the effectiveness of the laboratory work has been improved by the partial implementation of the national commodity sampling information system. These guidelines for statistical sampling show which commodities should have a high probable change rate, thus increasing the duty collected. Full implementation of this program should ensure maximum cost-effectiveness of the laboratory analyses performed.

In bond.—Imported cargo may be transported "in bond" from the port of origin to a port of destination, where customs examination takes place. An in-bond program has been developed to provide for surety bonding and physical safeguards to assure receipt and customs entry of imported merchandise. The procedures in use have facilitated cargo movement and reduced cargo congestion at ports of entry. The resultant decentralization of cargo examination has provided better service to the importing public, which ultimately benefits the consumer.

A revised computer document control format has been developed to improve control of in-bond cargo and reduce record error, resulting in man-hour savings to Customs and the transporting bonded carriers.

Containerization program.—The current container examination program was established by the Customs Service as a national program in December 1974. The program was designed to separate containers of goods arriving from foreign countries into two categories, those on which an intensified examination was conducted and those which could be released upon a cursory examination. Almost 2 million surface-borne containers arrived in fiscal 1977; 19,150 of these were given intensified examinations.

In June of this year, the basic concepts of a container selection system were drafted. This system will utilize the Treasury enforcement communications system's search, arrest, and seizures records as a basis for violator information on shippers and consignees. The present system will be modified to provide both positive information in the event of the detection of a violation and negative information in the event of no violation detection on prior intensified examinations. A field evaluation of this system is tentatively scheduled for this winter. As experience is gained, more sophisticated violator profiles will be introduced.

A second approach developed by Regulatory Audit involves the application of scientific sampling methods and postaudit verification procedures. Field-tested on a nationwide basis during fiscal 1977, this program completed 240 miniaudits which yielded recoveries, exclusive of penalties, calculated at $250,000. This initial return was about $5 for each dollar expended.

Cargo theft prevention

Cargo security awareness.—To educate the importing community and carriers concerning the merits of cargo security, Customs has conducted cargo security miniseminars for some 5,200 executives representing importers, exporters, transportation managers, terminal operators, freight forwarders, manufacturers, and insurance agents.

Customs has distributed antitheft posters and antipilferage slogan signs, printed in Spanish and English, to field locations for display in warehouses, terminals, freight sheds, container and devanning stations, security cribs, offices, and on docks and piers.

Since 1972, Customs has conducted surveys of physical security at 581 locations where imported merchandise is handled. These surveys, usually conducted at the request of the owner or operator of the location, have stimulated the expenditure of over $26.1 million by private industry for improvements in physical and procedural security.

Imported merchandise quantity control (*IMQC*).—This program was developed to improve cargo accountability and the quality of cargo manifesting by carriers.

Theft information system (*TIS*).—Customs implemented a theft information system on January 1, 1977, to pinpoint where theft of merchandise in Customs custody takes place and the nature of these thefts. The information gathered from TIS will enable Customs to allocate its antitheft resources to those areas where they can most efficiently reduce cargo theft. The system relies on reports made by U.S. customs officers of thefts discovered during the course of their duties, rather than on reports of carriers and importers who are often unwilling to convey theft information to Customs. Through June 30, 1977, TIS revealed a nationwide total of 794 thefts of merchandise valued at $1,022,500. As the system matures, it is anticipated that an increasing amount of merchandise will be recovered and registered in the system.

Enforcement

Interdiction

Operating mainly under the authority of titles 19 and 26, U.S. Code, the tactical interdiction patrol program attempts to combat smuggling activity along the national borders by reducing the smuggler's option for choosing the method, time, and place for entering contraband into the United States. Customs seeks to accomplish this by maintaining a mobile interdiction force capable of operations on the land, sea, and in the air.

Air interdiction.—Congress, in 1969, authorized the establishment of a Customs air support program. In fiscal 1977, there were 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. However, since the southern border of the United States is more than 3,000 miles long, each air branch has responsibility for protecting a corridor that, on the average, is 500 miles wide.

This year, the most significant milestones in overall program impact were the successful utilization of the North American Radar Defense/Federal Aviation Administration (NORAD/FAA) long-range radar and the installation of supporting mobile ground-based radars for smuggler detection and tracking. Customs demonstrated that these resources could provide the information and leadtime necessary to permit the aerial interception of smuggler aircraft. During Operation Startrek, which lasted 50 days, ground-based radars detected 262 target aircraft and Customs made 43 intercepts.

Customs also began with the U.S. Air Force airborne warning and control system (AWACS) an evaluation of AWACS capabilities in support of the Customs mission. The AWACS ability to detect low-flying aircraft could greatly improve interdiction performance in areas where ground-based radar is ineffective.

In addition to radar and aircraft units, Customs employed:

1. Intelligence information on suspect aircraft available through 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 U.S. airspace and land at 1 of 14 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. Such arrival information is entered in TECS.

The combination of these elements enables Customs to concentrate on high-risk aircraft by screening out legitimate private aircraft. The Customs air support program seized 99 aircraft in fiscal 1977, an increase of more than 16 percent over last fiscal year, and 283,690 pounds of marijuana.

Border interdiction.—The United States/Mexican border absorbed pratically all of Customs land interdiction resources. These consist of mobile tactical units utilizing border intrusion detection devices (electronic sensor fields), state-of-the-art night vision devices, TECS and sector communications.

In the Laredo, Tex. district alone, marijuana seizures had exceeded 100,000 pounds by the middle of August 1977, with total seizures running approximately 100 percent over those of the previous year.

Marine interdiction.—Marine interdiction units detected and apprehended marine violators of reporting and entry requirements and smugglers of contraband in U.S. coastal, lake, and river boundary areas. These units utilized patrol boats, special reporting and inspection facilities, reports of legitimate traffic, and intelligence concerning illicit activities. Six new marine patrol stations were put into operation.

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. Customs has proposed new legislation which would require the masters of boats, including pleasure vessels, to report immediately for inspection at designated locations. These legitimate entries will then be used to screen out suspected vessels attempting to elude customs inspection.

Customs enforcement units in fiscal 1977 seized over 200 vessels with a domestic value of $75 million.

Mail interdiction.—In addition to collecting revenue, Customs mail facilities interdicted the smuggling of narcotics, weapons, explosives, stolen property, and other contraband, making over 6,500 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 used in major mail units. A "blitz" technique by Special Narcotics Identification Forces was utilized when significant shipments of contraband arrived from specific countries, with all packages from that particular country opened and thoroughly examined.

Fraud, neutrality, and currency violations

Customs agents conducted criminal, civil, and factfinding investigations involving a broad spectrum of violations covering 33 separate categories. Some of these investigations were conspiracy-type cases, international in scope. The overall enforcement strategy was balanced between fraud investigations, focusing on criminal and civil fraud with high revenue payoffs, and general investigations, focusing on general smuggling, neutrality violations, theft, currency violations, and other related categories with high enforcement payoffs in terms of arrests and seizures.

Fraud.—Violations of customs laws constitute an important part of the white-collar crime problem confronting the United States. Country-of-origin violations, undervaluation, and violations of the antidumping laws by multinational corporations not only deprive the United States of revenues, but frustrate the intent of Congress and the executive branch in directing the trade policies of the United States. Fraudulent importations to avoid the payment of customs duties adversely impact domestic industry, labor, and commerce. During fiscal 1977, Customs conducted major investigations of oil importers, automobile manufacturers, and multinational corporations dealing in every conceivable commodity.

Customs antifraud program was highly successful in terms of potential losses of revenue (LOR) discovered through field investigations, and cash collections returned to the Government resulting from recovered duties, fines, and penalties. During 1977, 125 agent man-years were expended on fraud investigations with the following results: $18,730,288 LOR attributable to fraud investigations, $149,842 LOR per fraud agent man-year, $28,646,000 total revenue collections attributable to fraud investigations, and $229,168 revenue collections per fraud agent man-year.

Customs officers investigated the alleged dumping of TV sets, steel, and chemicals. These investigations have been extremely sensitive since they relate to the volatile issues of trade restraints versus domestic unemployment versus consumer pricing structures, and have far-reaching effects on diplomatic relations and foreign economies. The investigations are being carried into fiscal 1978 and will require a major investment of agent manpower skilled in complex trade practices.

Agents completed an investigation of one large toy manufacturer charged with providing fraudulent cost information to Customs on its toy importations from Mexicali, Mexico. The fraudulent invoices undervalued the merchandise in 11 general areas, resulting in a $2.5 million loss of revenue.

On January 14, 1977, the Federal grand jury at Jacksonville, Fla., returned a 15-count indictment against an oil-importing corporation in Coral Gables. The corporation was indicted on 14 counts of violating 18 U.S.C. 542 (entry of goods by false statements), and 1 count of 18 U.S.C. 371 (conspiracy), in that the corporation falsified information in order to obtain free oil import licenses from the Federal Energy Administration. In addition, the IRS has recovered approximately $12 million based on violations uncovered during Customs investigation. A civil penalty in the amount of approximately $6.3 million will be levied on the corporation after criminal action is complete.

Neutrality violations

In response to the growing frequency of terrorist incidents, both at home and abroad, and the increased traffic in illegal arms and munitions across our borders, Customs assigned a high priority to the investigation of neutrality violations during fiscal 1977. Customs maintains jurisdiction over both criminal violations contained within the scope of the present munition control laws, and civil violations within the scope of the "War Materials Act."

In August 1977, information was developed which led to the disclosure of a planned raid against a Cuban military installation by an exile group operating out of the Miami area. The raiders' plan involved staging on a neutral island followed by an armed assault by three strike boats manned by Cuban exiles. Customs officers, assisted by other Federal and local agencies, seized the vessels and automatic weapons. These seizures occurred immediately prior to the critical period when diplomatic contacts were renewed between Cuba and the United States.

Again in August 1977, customs agents investigated attempts by South Korean interests to obtain military plans for the NIKE missile system. The investigation resulted in the arrest of a U.S.-resident Korean, another Korean national, and seizure of the plans.

In a classic "guns for dope" case with weapons being traded for marijuana, four Houston area men were apprehended in Tuxpan, Vera Cruz, Mexico, leading to the arrest and indictment of seven defendants. The case was a cooperative effort of Mexican officials, U.S. Customs Service, and the Bureau of Alcohol, Tobacco and Firearms in Houston, Tex.

Currency and foreign transactions

Since July 1976, a Customs task force has been actively investigating possible currency violations by over 400 major multinational corporations. Due to the importance of this effort, attorneys from the Justice Department have been assigned full time to work with the task force. The objective of the investigation is to determine whether any of these corporations may have violated the Currency and Foreign Transactions Reporting Act (31 U.S.C. 1051–1122) by making illegal political campaign contributions or overseas bribes with currency that was covertly transported into and out of the United States. A number of grand jury proceedings are underway.

The provisions of the Currency Reporting Act have also permitted a number of successful investigations into all forms of smuggling which involve illegal currency transfers, including the smuggling of narcotics and dangerous drugs.

In May 1977, Customs and Drug Enforcement Administration special agents arrested five individuals for violation of 21 U.S.C. 952 following an investigation which revealed that they were involved in the attempted entry into the United States of approximately 2,000 pounds of hashish concealed in 40 bales of cloth. A key factor in the case was that the Customs special agents coordinated with the IRS in placing jeopardy assessments against approximately $850,000 deposited in U.S. savings accounts belonging to the organization—the fruits of the drug smuggling.

Another major case concluded during the year established that an individual had violated the reporting requirements of the Currency Reporting Act during 1975 and 1976 by transporting over $700,000 in unreported currency between the United States and Canada and Mexico in connection with the smuggling of more than 14 tons of marijuana by aircraft from Mexico to the United States. The individual was found guilty and is currently a fugitive; criminal prosecution is pending against other defendants in the case. This investigation resulted in the seizure of several aircraft, firearms, and a major quantity of marijuana.

In addition to judicial action, violators in cases similar to those cited above are liable to civil penalties equal to the value of currency illegally transported.

Enforcement support

Detector dogs.—During fiscal 1977, Customs detector dogs screened more than 21 million units of cargo, mail, and vehicles for concealed narcotic and dangerous drugs. This same type of searching would take a customs officer many times longer.

During fiscal 1976, 110 dog teams throughout the country made approximately 27 percent of all the narcotics seizures made by Customs and showed a 50-to-1 return in terms of narcotics value to program expenditures. With 126 teams in operation, seizures during 1977 were approximately 45 percent greater than 1976.

Treasury enforcement communications system (TECS).—TECS provided instant online law enforcement information to enforcement personnel in ports of entry, to investigative offices in field and headquarters locations within Customs, and to other Federal law enforcement agencies. TECS data was instrumental in the arrests of fugitives; recovery of firearms, automobiles, and other stolen or missing property; and seizures of currency and negotiable instruments.

Aided by the flexibility of the Burroughs 7700 host computer and redesigned software, Customs began expanding the network to over 900 terminals with an integrated data base of more than a million records. The expanded TECS system will serve the needs of law enforcement officials within and outside of Treasury with a minimum of cost to the taxpayers through the economies of sharing computer and communication resources.

In addition, TECS provided enforcement-related management information systems and served as an index to all of Customs central files, which means rapid retrieval of supportive enforcement documentation. The automated central files system enables the user to enter a single query and receive a response from a multiplicity of application-oriented data bases as a summarized output. Also, a new index of stolen vehicles was created from data provided by the FBI's National Crime Information Center.

Over 280 new terminals were installed, a majority being new "beehive" displays. Some of these terminals replaced older, less reliable equipment; others served to add 35 additional users and 12 new airports to the TECS network. This raised to 28 the number of airports with enhanced law enforcement capabilities. One terminal was installed at a Coast Guard location.

Communications support program.—This program operated the nationwide radio system, the administrative teletype system, and the facsimile system which provided (a) substantially complete radio coverage around the perimeter of the United States and at all locations where customs officers operate in a mobile environment and (b) an electronics system for rapid intraservice distribution of administrative textual and graphic correspondence. Regional communication centers controlled the radio network and provided administrative message handling, centralized intelligence dissemination, and duty officer support for each regional executive staff and their field personnel. The program also was concerned with improving reliability and reducing network costs on enforcement and nonenforcement data communications systems.

Significant accomplishments for fiscal 1977 included:

(1) All preliminary actions to establish a regional communications center and sector radio system in the San Francisco region were completed. Equipment was procured, antenna sites were identified, floor plans were approved and submitted to GSA, and personnel hiring actions were initiated.

(2) The relocation of the Tampa sector into the newly implemented regional communications center, collocated with the Miami regional executive staff, was completed. Floor plans were approved and submitted to GSA for renovation of space to house regional communications centers in Houston and New Orleans.

(3) The development of an integrated, two-man, sector control console was completed. After evaluation by field personnel, a completed set of procurement specifications was initiated and requests for quotations were solicited.

Customs enforcement information system (CEIS).—CEIS has three primary components: The online (queriable) enforcement lookout system, the Customs law enforcement activity reporting (CLEAR) system, and an automated index to Customs central enforcement files. CEIS supported the interdiction and investigative missions of Customs by providing immediate information to aid customs officers in the detection of violations of laws enforced by Customs, enforcement data used to evaluate programs and performance and to identify deficiencies, statistics for projecting requirements and for determining the optimum allocation of equipment and dollars and the optimum deployment of personnel, and data that can be analyzed to produce intelligence on violation patterns, latest modus operandi, courier profiles, etc.

In a 12-month period, the enforcement lookout system aided in the seizure of heroin with a street value of more than $20 million, cocaine with a street value of more than $13 million, marijuana with a street value of more than $11 million, hashish with a street value of more than $400,000, dangerous drugs with a street value of nearly $300,000, numerous vehicles, vessels, and aircraft used to transport the above contraband into the country, more than $280,000 in cash and monetary instruments, and merchandise valued at more than $1 million.

The TECS interface with the FBI's National Crime Information Center (NCIC) enabled customs officers to apprehend 874 fugitives wanted by other Federal, State, and local law enforcement agencies. During fiscal 1977, there were more than 140,000 NCIC wanted-person records indexed in TECS and queriable at airport primary terminals as well as all secondary TECS terminals. Also initiated was the entry of the NCIC vehicles file; more than 400,000 records on stolen vehicles and those involved in felonies, enabling them to be queried at land border primary terminals.

Immediate positive results followed implementation of the preclearance alert system in fiscal 1977. This system, supported by Customs 24-hour communications center, ensures apprehension in the United States of NCIC fugitives and other law violators identified at U.S. Customs preclearance facilities in Canada, Bermuda, and Nassau.

Customs central enforcement files experienced tremendous growth; the number of records microfilmed during the year was double that microfilmed during the previous fiscal year. Entry of the records into TECS increased at the same rate.

Since narcotics traffickers and others involved in organized crime prefer to deal in cash, Customs implemented the currency and monetary instrument reporting (CMIR) file. This system, by tracking compliance with the currency transportation reporting requirements embodied in the (Foreign) Bank Secrecy Act, furnished potential investigative leads to Customs and other Federal law enforcement agencies.

Technical development and support.—The technical development and support program was responsible for the identification, development, modification, procurement, and field support of technical equipment and systems used in the interdiction of clandestine smuggling activities—by air, land, and sea.

During fiscal 1977, accomplishments included the installation and evaluation of X-ray equipment for use in cargo examination at selected land ports along the Southwest border, receipt of the prototypes of neutron backscatter devices for the detection of concealed narcotics, and letting of a contract for the development of prototype system to rapidly and reliably detect narcotics and explosives in letter mail. In addition, there was significant progress in the development of ground sensor equipment and methodology as well as an airborne detection system to be used in tracking suspect aircraft, while testing was begun on an underwater detection system using acoustics to detect boats crossing the Canadian border.

Testing of an electrochemical contraband detection system was continued during fiscal 1977 in several modes: pedestrian examination at the Southwest border, passenger examination at Miami International Airport, mail examination at the Oakland mail facility, bus passenger examination at the Canadian border, and passenger/baggage examination at the Miami International

Airport. The results were mixed and further improvements to the passenger/pedestrian interface counter are required. Additional improvements to the baggage examination device were sought by contracts to automate the unit and thus reduce its labor-intensive operational costs. Several seizures were made utilizing the equipment.

Military predeparture inspection program.—During fiscal 1977, there were over 150 predeparture inspection activities located overseas with over 2,700 full- and part-time military customs inspectors (MCI's). MCI's performed inspections of cargo; passengers, crew, and their baggage; personal and household effects; aircraft; vessels; and mail. The purpose of this overseas program was to interdict narcotics, dangerous drugs, and other contraband prior to arrival in the United States, and to expedite the movement of passengers, cargo, carriers, and mail arriving in the United States.

During the year, a revised joint Customs/Department of Defense regulation was published, clarifying some ambiguities and strengthening the program. In addition, a new workload reporting system was designed in order to determine better resource utilization and program effectiveness. Numerous significant results during 1977 were also directly attributable to the MCI's. They include: 6,000 methamphetamine pills seized in the mail in South Korea; 1 1/2 pounds of opium seized in a shipboard inspection at Rota, Spain; several currency-reporting violations discovered; 30 pounds of hashish seized in a shipboard inspection at Rota, Spain; the initiation of more than 20 investigations by Customs for commercial fraud; and 89 seizures of narcotics and dangerous drugs in 22 vessel searches at Subic Bay, Philippines, between January and March 1977.

Modernization

Customs Procedural Reform Act.—On July 28, 1977, the Subcommittee on Trade unanimously ordered that H.R. 8149, as amended, the Customs Procedural Reform Act of 1977, be reported favorably to the Committee on Ways and Means. H.R. 8149 seeks to build flexibility into the customs laws to permit the U.S. Customs Service to modernize and simplify the customs procedures, revise the penalty and fraud provisions of the Tariff Act of 1930 by providing due process safeguards and de novo judicial review in the Federal courts, and bring a new element of review and oversight over the Customs Service by providing for congressional authorization for appropriations. On September 15, 1977, the Committee on Ways and Means referred the bill to the full House for a vote.

Automated merchandise processing system (AMPS).—AMPS is an ongoing program designed to improve Customs supervision and control over all merchandise entering the United States, the collection of duties, and uniform enforcement of regulations governing importation. It uses modern technology, combined with improved manual work procedures, to handle steadily increasing international trade activity without comparable staffing increases.

AMPS, a nationwide computer-supported telecommunications and data processing system, is being implemented through a phased modular deployment plan. Functional system design and detailed functional specifications, encompassing full entry and revenue processing for Customs, were completed during fiscal 1976. Fiscal 1977 was devoted to computer system design, programming, and testing. Simultaneously, hardware specifications were identified, resulting in the issuance of a request for proposal to GSA in July 1977 for computer delivery in early fiscal 1979. AMPS is scheduled for nationwide deployment by fiscal 1981.

The first phase of AMPS, the early implementation system, which provides immediate delivery control, entry screening, and collection processing, was fully operational at Philadelphia, Chicago Seaport, Baltimore, Chicago's O'Hare Airport, Miami, Boston Seaport, Boston's Logan Airport, and Los Angeles Seaport. A total of 17 percent of all customs entries and 21 percent of all collections were handled on the automated system.

Customs accelerated passenger inspection system (CAPIS).—CAPIS was developed to improve customs facilitation and enforcement at airports. The system provides airport inspectors with an environment to selectively screen passengers whose numbers grow at an annual rate of 7 percent. Under CAPIS, approximately 80 percent of all arriving passengers are released from the area at "primary," where a brief interview, hand-luggage inspection, and TECS/NCIC check are made. The remaining 20 percent are referred to "secondary," where complete baggage inspections are conducted.

In 1977, the CAPIS configuration was improved to allow those passengers designated "free" by the primary inspectors to go straight to exits with their baggage. This "T" configuration was successfully tested at Miami Airport during February and March 1977, at Dulles Airport in April and May 1977, and Seattle Airport in July and August 1977.

Revision of vessel manifest form.—A proposed revision of Customs Regulations to provide for a modified vessel manifest form based on the standardized Cargo Declaration prepared by the Intergovernmental Maritime Consultative Organization (IMCO) was completed in August 1977 and prepared for publication in the Federal Register. Use of the form will begin on September 1, 1978.

Vessel entry and clearance bill.—This proposed legislation, which 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, was cleared by the Office of Management and Budget and prepared for submission to the 95th Congress.

International Activities and Trade Policy

Trade Act of 1974—generalized system of preferences (GSP)

Customs participated in GSP in conferences in Thailand, Hong Kong, Republic of China, and Korea to discuss reverification procedures and other mutual problems concerning GSP. In addition, various beneficiary developing countries sent government officials to meet with Customs headquarters personnel to discuss administrative and operational aspects of their governments' participation in the U.S. GSP program.

Amendments to sections 10.172 and 10.173 of the Customs Regulations were effective in January 1977. These changes relaxed the rigid requirements concerning liquidated damages and written claims under GSP.

Currently, 140 countries/territories and 2,750 major item numbers in the Tariff Schedules of the United States are eligible for GSP. During fiscal 1977, the number of GSP imports represented 3 percent of all importations reported. Also the number of GSP line items were 5 percent of the total line items reported, which partially reflects the increased Customs workload caused by GSP.

Antidumping and countervailing duties

During fiscal 1977, 19 antidumping and 16 countervailing duty cases were initiated; 16 antidumping and 10 countervailing duty determinations were published. Antidumping master lists on 183 manufacturers were circulated to field offices for their use in assessing dumping duties. Presently 67 findings of dumping are in effect.

Antidumping.—The automobile antidumping cases of fiscal 1976 resulted in discontinued investigations, which require the monitoring of assurances of no future sales at less than fair value. These assurances are being checked on a semiannual basis with regard to five companies, and on an annual basis for the remaining firms.

On September 20, 1977, an antidumping petition was received from United States Steel Corp. regarding various steel products from Japan. A full-scale investigation was commenced. This could be one of the largest such investigations ever undertaken by Customs.

Antidumping appraisement procedures.—A major effort has been made to reduce the timelag between issuance of a finding of dumping and the actual assessment of dumping duties. These delays in assessment render the relief of domestic industry less effective, often impose large yet unpredictable dumping duty liabilities on importers, and cause administrative problems for Customs. Through the use of additional manpower on a temporary basis these delays have been reduced considerably. Further reductions would be realized through procedural changes which could be effected only by amendment of the Antidumping Act.

Countervailing duties.—The most prominent occurrence in fiscal 1977 related to the fiscal 1976 negative countervailing duty determination on consumer electronic products from Japan. Acting on a complaint filed by an American manufacturer, the U.S. Customs Court, on April 13, 1977, ordered the assessment of countervailing duties on certain consumer electronic products from Japan which collectively represent a major element in United States-Japan trade. Pursuant to that mandate, Customs issued field instructions which permitted the deposit of special bonds by affected importers in lieu of actual collection of the countervailing duties while the case is under appeal. The Customs action permitted the orderly flow of the subject merchandise into the United States while at the same time ensuring the ultimate collection of all countervailing duties in the event the lower court decision is sustained. The decision of the Customs Court was reversed by the Court of Customs and Patent Appeals on July 28, 1977. However, the language of the statute permitting the manufacturer's petition requires that the finding of the lower court remain in effect until all judicial avenues of review have been exhausted. Accordingly, the Customs field procedures originally implemented will remain in effect pending consideration of review by the Supreme Court.

International enforcement activities

The Customs Service actively participates in the Customs Cooperation Council (CCC), an 81-member body with headquarters in Brussels. In pursuing its goal of facilitating international trade by improving and harmonizing the customs operations of member countries, the Council also seeks to strengthen cooperation between customs authorities in the prevention, investigation, and repression of customs offenses.

In June of this year, the Council adopted the International Convention on Mutual Administrative Assistance, prepared by the Council's Permanent Technical Committee and its Working Party on Customs Enforcement. The Convention, developed at the recommendation of the United States and the Australian customs administrations, consists of a main body of rules accompanied by 11 procedural annexes which may be adopted independently, including a special annex on assistance in action against the smuggling of narcotic drugs. In December 1976, the United States notified the Council of its acceptance without reservation of the 1975 Recommendation on the Pooling of Information Concerning Customs Fraud. Acceptance of this instrument should prove beneficial in obtaining information which will assist the Customs Service in detecting and interdicting fraud activities.

In January 1977, the agreement between the United States and Mexico regarding mutual assistance between their customs services entered into force. The agreement is similar to the ones negotiated bilaterally with the Governments of Germany and Austria in that it provides for an expanded range of cooperative effort in the enforcement of customs laws and regulations.

International narcotics control

The International Narcotics Control programs, which were formerly the Cabinet Committee on International Narcotics Control programs, were continued to train foreign enforcement officials in narcotics control areas, and U.S. Customs continued to play an important role in this training. Emphasis in both International Narcotics Control and within U.S. Customs centered around "institution building," the establishment of a self-sufficient training and narcotics control capability within foreign customs services.

U.S. Customs Inspection and Control training involved several different programs, all of which were designed to train foreign enforcement officers and upgrade foreign customs services in border control activities and narcotics interdiction capabilities. Emphasis was placed upon narcotics identification, border surveillance, cargo and passenger control, and search and seizure methods.

Another program, aimed at foreign officials at the midmanagement level of their careers, provided training to 387 officers from 56 countries. This training took place in the United States and involved both formal classroom training and field observation.

U.S. Customs also assisted other countries in the development of narcotics dog programs. Since inception of this program, 62 officers from 21 countries have participated in 3-week dog trainer and 14-week narcotics detector dog handler courses in the United States.

Under International Narcotics Control funding, Customs also stations narcotics-oriented advisory teams in various countries. In fiscal 1977 two such advisers were stationed in Ecuador and three in Thailand. In Ecuador, the advisory team working with the Customs Military Police was partly responsible for the increase in seizures of coca paste on the border between Ecuador and Peru. In Thailand, the advisory team assisted Thai Customs in establishing an effective interdiction system, particularly at Bangkok Airport. At the airport, narcotics seizures increased each year since the arrival of the advisory team. In 1973, there was a single seizure, in 1974 there were 10, in 1975 there were 20, in 1976 there were 70 narcotics seizures, and indications are that the trend will continue upward in 1977.

International trade activities

In its role of facilitating international trade, the Customs Cooperation Council developed three new technical annexes to the International Convention on the Simplification and Harmonization of Customs Procedures. This brought the total number of annexes adopted to 20. Each of these annexes covers a specific customs procedure or operation, and upon completion of the Convention there will be approximately 30 annexes encompassing the whole range of customs activities. The Council also continued 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 both U.S. Government agencies and commercial interests, and Customs has coordinated U.S. participation in the project through its chairmanship of the Interagency Advisory Committee on Customs Cooperation Council Matters.

Customs also contributed to significant projects of other international organizations in the field of trade facilitation. The United States accepted a resolution implementing the technical annexes of the 1975 Transport International Routier (TIR) Convention. This Convention, a revision of the 1959 TIR Convention, makes possible the expeditious transit of cargo across national borders and through customs by means of carnet backed by an international guarantee system. In addition, Customs gave testimony before the Senate Foreign Relations Committee on the ratification of the 1972 Customs Convention on Containers and made plans for its implementation. This Convention provides for the international approval of containers for the carriage of goods under customs seal and for the temporary entry of containers without the payment or deposit of duty.

Regulatory Activities

A comprehensive index to legal decisions issued by Customs Service headquarters and other pertinent matters (Legal Keyword Precedent Directory) was prepared in microfiche form and made available to the public in compliance with the requirements of 5 U.S.C. 552(a) (2).

Regulatory audit

The regulatory audit program was established to verify transactions and claims of importers, carriers, and exporters by means of onsite audits of their records, accounts, statements, and operating facilities in lieu of more costly physical controls or other means of verifications. By application of scientific sampling methods and use of computer analysis, companies can be selected for audit which are most likely to provide Customs with high-payoff transactions. Audits of a relatively small percentage of selected persons and firms also reduces the need for individual processing of millions of transactions. The resulting reduction of routine paperwork permits more efficient utilization of manpower.

The very existence of a regulatory audit program has had a deterrent effect on false reporting of importations which is best illustrated by the large increase in voluntary tenders of withheld duty from major importers. The importers also benefit because their entries are processed routinely and without undue delay.

During fiscal 1977, 69 auditors in 9 regional offices completed 862 audits of various types which resulted in recovered revenues for Treasury or the importing public in excess of $9 million, as detailed below:

Type of audit	Number	Amount recovered
		Millions
Customhouse brokers	147	$1.1
TSUS 806.30/807	20	2.8
Drawback	354	2.6
Agent assists	24	2.9
Containerized importations	240	.1
Other	77	.4
Total	862	9.9

Other-agency requirements.—Besides enforcement of the Tariff Act of 1930 as amended, the Customs Service was charged with assuring compliance by importers and travelers with the laws and regulations of other Federal agencies. Customs administered over 400 statutory or regulatory requirements for about 40 other agencies or administrations. Almost 40 percent of the 10,000 or more Tariff Schedule item numbers were subject to the requirements of Federal agencies other than Customs.

Approximately 36 percent of all Customs transactions and 64 percent of the total entered value represented merchandise subject to other-agency requirements, ranging from enforcing motor vehicle safety and emission standards to controlling food and drug importations.

Internal security.—Working in coordination with other agencies including the office of the U.S. attorney, 70 customs investigators closed and completed a total of 627 investigations. Of that total, 54 were either referred for criminal prosecution, or resulted in arrests and/or indictments. Also undertaken during fiscal 1977 were 107 investigations involving either administrative discipline (adverse action) or procedural change. The majority of these investigations refuted the original allegation or found that the allegation 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 to ensure that employment of any individual is in the interest of national security. An average of 1,000 full field investigations are conducted each year with each taking an average of 50 man-hours to complete.

Security clearances.—Continued efforts on the part of Customs to reduce the number of security clearances have resulted in reducing the number to 196 issued in fiscal 1977. In addition, Customs conducted reinvestigations on 464 critical-sensitive positions and has recertified the security clearances for those positions.

Internal audits.—The internal audits activity provides assurance to top management that Customs management objectives, laws, policies, and instructions are being carried out as intended, that the efficiency and effectiveness of operations are on an acceptable level, and that resources to support the operations are being judiciously spent. An important function is to ensure that the over $6 billion of revenues collected annually are properly accounted for.

In 1977, 231 audits, surveys, and special projects were completed by headquarters and regional offices, a decrease of 48 over the 279 cases completed in 1976. Some of the decrease is due to greater audit intensity in specific reports and partly to a 14 1/2-percent decrease of audit personnel over the preceding year.

Two major audit areas of the year were the review of procedures involved in the seizure, storage, and control over narcotics; and the program for training, utilization, and control over the use of firearms in the Customs patrol organization. Also included were the control of imported merchandise and accountability of customs collections and appropriation expenditures. The reports identified for management those areas in which increased efficiencies could be effected and where improved management is required.

Other Activities

Foreign trade zones.—Foreign trade zones are geographic enclaves which are not considered part of the customs territory of the United States. Importers may bring merchandise into these zones for processing without the payment of customs duties and taxes.

Although zones have existed since 1936, their number was never large until recently. The number of zones increased from 6 in 1972 to 32 at the present time. The complexity of operations conducted in the zones has also increased, with the addition of such activities as oil refining and the assembly of automobiles and specialized electronic components.

This rapid growth has increased the problems for Customs in supervising zones to protect the revenue and enforce import laws. The full impact on Customs is yet to be realized, since most of the new zones have not yet reached their full potential as trading and manufacturing centers.

Customs has responded to this change by eliminating unnecessary and outmoded procedural requirements, and by simplifying and updating customs forms used in the zones. An educational program was undertaken to familiarize more Customs personnel with the details of zone operations and with Customs responsibilities for their supervision. Customs has also improved its links with foreign trade zone operators through active participation in meetings of the National Association of Foreign Trade Zones.

Strategic petroleum reserve.—A strategic petroleum reserve (SPR) was authorized under the Energy Policy and Conservation Act of 1976 to provide a domestic stock of oil that can be drawn on in times of national emergency. Most of the oil in this reserve is to be imported from other countries and placed in underground mines, caves, and salt domes located in the southern and midwestern parts of the United States.

At the request of the Federal Energy Administration, Customs has approved salt domes on the Louisiana and Texas gulf coasts as Customs bonded warehouses. The FEA imports the oil free of duty and places it in these bonded domes for withdrawal in times of emergency, at which time import duties are to be paid. The first shipment of SPR oil was imported and placed underground in July 1977, and it is anticipated that approximately 150 million barrels will be placed in these domes by January 1978.

Paperwork improvement.—In response to the President's initiative, Customs reduced the number of forms in use by 27 percent.

Also the "Special Customs Invoice," required on many shipments, was alined to conform with the U.S. Standard Master format used by the international trade community. Traders consider this alinement a major improvement in Customs documentation requirements.

Customs bond information system.—Information users reevaluated their needs and reduced the number of computer-printed lists from 8,400 to 3,900, thus saving $45,000 a year and speeding distribution of the information.

Minority bank program.—During fiscal 1977, the Freedom National Bank, New York City, a minority bank, was designated as a depositary for customs collections, bringing the total number of minority banks designated as depositaries to 21. With the addition of this single bank, the amount of collections deposited in minority banks increased dramatically. For example, total Customs collections for July 1977 were $530.8 million. Approximately $302.6 million was deposited in minority-owned banks and of this amount $105.2 million was deposited in the Freedom National Bank.

In July 1977, Customs representatives met with representatives from the Domestic Banking Staff, Bureau of Government Financial Operations to discuss the feasibility of utilizing women-owned minority banks in Los Angeles, San Diego, San Francisco, and New York. Customs has requested Treasury approval of the Western Women's Bank in San Francisco as a despositary. In addition, Customs investigated the feasibility of using an Eskimo-owned bank in Anchorage, Alaska.

Section 15, Airport and Airway Development Act Amendments of 1976.—Enacted into law on July 12, 1976, section 15, Airport and Airway Development Act Amendments of 1976 (Public Law 94-353) limits the amount of reimbursement by owners and operators of aircraft on Sundays and holidays as required by 19 U.S.C. 267, effective January 1, 1977. Under the act, extra compensation will continue to be paid for inspection services performed by Customs on Sundays and holidays, but these costs are no longer reimbursable by the owners or operators of commercial or private aircraft if the services are provided between the hours of 8 a.m. and 5 p.m. on Sundays and holidays. This extra compensation is now being paid from the Customs appropriation. Services which begin immediately before, or continue after, the established hours are being prorated between the Government and the owners and operators of aircraft.

U.S. Customs Service exhibit and visitors center.—In the first full year of operation, the Customs Service Visitors Center played host to approximately 8,000 visitors, and distributed approximately 25,000 pieces of informational literature.

Late in the fiscal year, the Center was able to arrange a working agreement with the Department's Exhibit Hall to exchange information, and to direct visitors from one to the other.

Solar energy prototypes.—The Energy Research and Development Administration is preparing an interagency agreement to provide funds to equip the Hamlin, Maine, border station with a solar heating system. An additional solar heating retrofit project at the Westhope, N. Dak., border station hinges upon an advance of funds by Customs. The Sherwood, N. Dak., station, which was selected for construction with a solar heating system, is in the planning stages.

Administrative rulings and regulations.—A revised index to the Customs Regulations was published reflecting all of the changes made to the Customs Regulations through July 1, 1977. This project represented the first meaningful updating of the index in more than 13 years. The revised index has been distributed to users of the looseleaf Customs Regulations and will be provided to the Office of the Federal Register for publication in the April 1, 1978, edition of title 19 of the Code of Federal Regulations.

A reorganization within the regulations area of Customs resulted in the creation of two branches, one of which (the Legal Publication Branch) is charged with the task of administering the newly established rulings publication programs. Under one such program, significant rulings (including penalty decisions) are edited and published in the Customs Bulletin. These rulings are published for the information and guidance of the general public and set forth the position of the Customs Service as to the correct application of the laws and regulations to the factual situations presented. Under a separate program, other significant rulings are published in the Customs Issuance System (CIS), together with appropriate explanatory material, for the information and guidance of Customs Service personnel.

Recordations.—Approximately 200 trademarks, service marks, and copyrights, or renewals, assignments, and name changes therefor, were recorded for import infringement protection. Ten patent surveys and renewals were approved. Fees collected for these services totaled approximately $54,000.

Publication awards.—Four publications produced for public consumption received awards from two national communications societies for their design and content. Awards of Achievement presented by the Society for Technical Communication were received for "U.S. Customs Guide for Private Flyers" and "Marking of Country of Origin on U.S. Imports." "Protectors of Independence" and "Prologue '76" received first- and second-place Blue

Pencil Awards, respectively, in the contest held annually by the National Association of Government Communicators.

Collocation of customs field managers.—The object of the collocation program is to house all regional field managers in the same city, in the same building, in order to improve coordination. Within the past 2 years, the regional offices at Boston, Los Angeles, New Orleans, San Francisco, and Miami have been successfully collocated.

In selecting sites, consideration was also given to proximity to other Federal agencies, including other Treasury bureaus, law enforcement agencies, and the courts. The public, too, has the advantage of dealing with numerous governmental agencies at a central location.

Retention of customhouses.—As a contribution to the Bicentennial celebration, the Customs Service has been commemorating customhouses of architectural or historic merit and encouraging the nomination of worthy customhouses to the Interior Department's National Register of Historic Places.

Seventy customhouses have been selected for possible State or local landmark status. An extensive 6 million dollar renovation of the New Orleans customhouse is nearing the construction phase. This is one of the largest and oldest customhouses and will house all of the major Customs offices in New Orleans when the renovation is completed several years hence. A major renovation program has recently been requested for the Baltimore customhouse.

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 Treasury staff of less than 450 people with the active assistance of thousands of volunteers who are leaders in business, labor, finance, and the media. An estimated 670,000 people provide volunteer services of some kind for the program.

Sales of series E and H savings bonds totaled $7.9 billion in fiscal 1977 with 9 1/2 million people on the payroll savings plan. There were over $75.8 billion in savings bonds and savings notes held at the close of fiscal 1977, and during fiscal 1977 holders of these savings vehicles received $4.3 billion in interest.

Office of the National Director

On September 12, 1977, Mrs. Azie Taylor Morton was sworn in as the 36th Treasurer of the United States and the new National Director of the U.S. Savings Bonds Division.

During the year, Mr. Jesse Adams, Deputy National Director of the Division, and senior staff members, carried out active speaking schedules on behalf of the program.

Activities to improve the savings bonds program included:

1. Revision and automation of the field sales management information system, by which field activities are reported. The new system is expected to provide more complete information at a substantial savings in staff time.
2. A survey of citizen attitudes towards buying and holding savings bonds. This was prepared for the Division by the University of Michigan and is useful in pinpointing changing attitudes, the motivations of bond buyers, and similar information.
3. Discussions of the general savings bonds program. This is an ongoing project for product improvement.

Industrial payroll savings campaign

The U.S. Industrial Payroll Savings Committee, composed of approximately 60 top business and industrial leaders, is a principal force behind the payroll savings program for industry and a major reason why E bond sales of $25 to $200 denomination bonds have risen to over $5 billion annually.

Mr. G. William Miller, chairman, Textron, Inc., and Chairman of the 1977 U.S. Industrial Payroll Savings Committee, began the yearly campaign with a meeting in Washington, D.C., on January 12. The luncheon-meeting was highlighted by a speech from Treasury Secretary William E. Simon, remarks by Treasury Secretary-designate W. Michael Blumenthal, and reports by outgoing Committee Chairman George A. Stinson and incoming Chairman Miller.

Serving on the Committee with Mr. Miller this year were 14 former chairmen and 47 top executives of the Nation's major corporations.

Members of the U.S. Industrial Payroll Savings Committee conduct meetings of top management people, urge chief executives in their areas and industries to conduct payroll savings drives, and set strong examples by conducting campaigns in their own companies. Campaigns in the companies of Committee members alone accounted for more than 30 percent of the national goal of 2.5 million new or increased-allotment savers.

Chairman Miller contributed much of his own time and effort to the program. He traveled to 15 cities and addressed 21 meetings of business and community leaders. He also provided some excellent sales tools for savings bonds volunteers, including a brochure for top executives entitled "Take Leadership in the Nation," three newsletters to volunteers to publicize the campaign, and a full-page ad in the Wall Street Journal featuring the 1977 Committee members.

Federal worker payroll savings campaign

The annual savings bonds campaign for Federal employees was conducted between March and June 1977. This staggered campaign approach allowed the savings bonds field staff more time for personal attention to Federal agencies in their area while the headquarters staff had more time to organize and carry out the campaign.

The Interagency Savings Bonds Committee was headed by T. Bertram Lance, Director of the Office of Management and Budget. On March 29, Secretary Blumenthal, OMB Director Lance, and President Carter filmed a message to all Federal employees outlining the importance of U.S. savings bonds. A second film was made for business and industrial workers. President Carter stated, in part, "I urge all Americans to take part in the U.S. savings bonds program for the sake of your own personal and family security, and for the sake of your country's economic well-being. You cannot find a more dependable investment."

The Washington, D.C., Federal kickoff rally was held on April 13. Hubert Harris, Assistant to Director Lance for Congressional Relations, and Midge Costanza, Assistant to the President for Public Liaison, were the principal speakers, and television personality Sally Struthers was the honorary chairman. Approximately 1,600 people attended the rally.

The Federal establishment, with a work force of approximately 2 1/2 million civilian employees and another 2 million military personnel, will again produce annual sales in excess of $1 billion. Over 330,000 new savers or increased allotments were obtained during the year. At present, 52 percent of all Federal employees buy bonds.

State and county volunteers

The leadership provided by savings bonds State and county chairmen is a vital factor in meeting the goals of the program. Governors are appointed honorary chairmen by the Secretary of the Treasury. In addition, there are volunteer State chairmen who work with the more than 3,000 county chairmen who, in turn, coordinate savings bonds activities at the local level. This year, for the first time, volunteer State chairmen were appointed on a calendar year basis (instead of throughout the year) so all members, as of January 1, 1978, will serve for two full annual campaigns.

State chairmen activities are coordinated by the Volunteer Chairmen's Council, headed, in 1977, by Richard B. Sellars, New Jersey State chairman for savings bonds and former chairman of the board and chief executive officer of Johnson & Johnson Co. Mr. Sellars met with a large number of volunteers and spoke at numerous kickoff campaigns around the country. He succeeded Bland W. Worley, chief executive officer of American Credit Corp., who was the 1976 head of the Volunteer Chairmen's Council.

In calendar year 1976, 37 States exceeded their dollar sales goals. The leaders were the District of Columbia with 117.1 percent of its goal, New Jersey with 111 percent of its goal, and Georgia with 107 percent of its goal. Calendar year 1976 sales of $7.55 billion were more than 7.35 percent over 1975 sales.

In 1978 more emphasis will be placed on involving the State volunteer chairmen on all levels in savings bonds promotional activities. Communications through quarterly newsletters and reports to the council chairman by the State chairmen will be used to help highlight the role of volunteers as savings bonds spokesmen and program leaders. Emphasis will also be placed on strengthening ties between the State committee and Take Stock in America Centers to enhance statewide sales.

Banking support

Banks are the "face" of savings bonds to much of the bond-buying public. During 1977 that "face" continued to provide the public with basic services necessary for the success of the savings bonds program. More than 39,000 banks, branches, and other savings institutions made over-the-counter and bond-a-month sales possible nationwide. In addition, many banks issue bonds, as a service, to companies with a payroll savings plan.

The American Bankers Association Savings Bonds Committee was chaired by Hovey S. Dabney, chairman of the board and president of the National Bank & Trust Co. of Charlottesville, Va. He was very active, making numerous personal appearances, sending letters outlining the five-point banking program, and meeting with volunteer leaders and bankers to promote savings bonds sales. Many ABA committee members introduced resolutions supporting the program and reported on savings bonds activities to their State bankers associations.

During the calendar year 1976, the Nation's bankers sent more than 9 million letters recommending bonds to their customers. More than 48 million savings bonds leaflets were used as enclosures in statement mailings, and a number of newspaper ads in support of the bond campaign were sponsored by banks or other savings institutions.

In 1978 the ABA Savings Bonds Committee will continue to encourage bankers to support the savings bonds program, and will recognize banks, bankers, and banking associations for their aid. Emphasis will be placed on making calls on banks early in the year to introduce the new letters, leaflets, and advertisements.

Labor support

America's labor unions and their leaders continued to support savings bonds and the payroll savings plan during 1977. Letters encouraging participation in the payroll savings campaigns went to many local unions by members of the National Labor Committee for U.S. Savings Bonds.

Through the labor press, more than 15 million union members were exposed to savings bonds advertising. Other national and local unions published editorials and sent open letters of support urging their members to take advantage of the payroll savings plan. More than 2 million letters were directed to individual members during 1977.

Six AFL–CIO-affiliated national labor organizations and a seventh were honored at their national conventions for outstanding support to the program. They were: Communications Workers of America, Utility Workers Union of America, American Flint Glass Workers of North America, International Brotherhood of Boilermakers, Amalgamated Transit Union, Western Labor Press Association, and National Rural Letter Carriers Association. In addition, numerous State and central councils were recognized for their support at local meetings and conventions.

Advertising support

The public service advertising campaign for savings bonds, conducted in cooperation with The Advertising Council, was well received by all media in 1977. The council estimates that more than 25,000 ads were published in newspapers and 240,000 lines appeared in national magazines. The council estimates that there were 4 billion home impressions resulting from television use of savings bonds announcements.

The advertising campaign continued to focus on the contribution of citizen financing to the Nation's growth. Created by the Leo Burnett Co., volunteer task-force agency of the council, the ads continue to use the theme "Take Stock in America."

In the annual savings bonds awards competition for company communicators—based on payroll savings promotion appearing in company publications in 1976—Bob Gallagher of Marathon Oil Co. was named "Communicator of the Year," and Continental Group, Inc., received the grand award for a total corporate campaign. Presentation of awards was made by Under Secretary of the Treasury Bette Anderson in ceremonies at the Main Treasury Building on May 27.

Information activities of the Branch included an all-new copy kit for daily and weekly newspapers, several feature articles for newspapers, and continued publication of "The Bond Teller" and "Savings Bonds Salute," for bank personnel and volunteers, respectively. The pocket speech guide for volunteers, "In Which We Serve," was completely revised and updated.

The National Committee of Newspaper Publishers continued under the leadership of Charles R. Buxton, editor/publisher of the Denver Post. Special copy packages for the Committee were prepared and distributed at intervals throughout the year.

National organizations support

The National Organizations Committee, under the chairmanship of Valerie F. Levitan of Soroptimist International, continued its strong support of the bond program. Individual club units were asked by their national presidents to participate in the five-point program of cooperation, and results to date indicate broad participation among the Nation's civic, fraternal, and patriotic organizations.

Public affairs

The Office of Public Affairs provides information on the savings bonds program and encourages its use by newspapers, television, and other forms of media. During 1977 the Office Director strengthened contacts with the New York, Washington, and national media people resulting in increased coverage of bond programs and progress. In addition, press releases and similar types of material were provided for media use.

Staff provided speech material for the National Director and for other Government officials speaking on behalf of the bond program. This included preparing filmed remarks for President Carter.

Direct assistance was given to the industrial payroll savings campaign and the Federal campaign for payroll savings through providing speeches, press releases, media coverage, photographic services, and similar assistance.

A correspondence specialist was added to the staff to direct the handling of mail and telephone inquiries from the public on savings bonds. Public mail averages 75 to 100 cards or letters a day, much of it generated by newspaper articles on the bond program.

The Director of Public Affairs is also the Division's Freedom of Information Officer, Privacy Act Officer, and Consumer Affairs Officer.

Training

The Division continues to conduct a year's training for those selected for sales promotion. It includes a comprehensive indoctrination course, a seminar of "Principles of Professional Salesmanship," and intensive on-the-job training.

Line managers will continue to be offered various types of training—mainly in-house and interagency—to meet both organizational and individual needs.

The Division continues to operate an effective upward mobility program as well as a good EEO program. A management library is provided for staff members.

During 1977 all participants in the executive development program prepared written individual developmental plans. Six of the 14 participants have already completed developmental assignments to meet organizational and individual needs. Participants also continued planned formalized training experiences.

UNITED STATES SECRET SERVICE

The major responsibilities of the U.S. Secret Service are defined in section 3056, title 18, United States Code. 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. The protective responsibilities include protection of the President of the United States and the members of his immediate family; the President-elect and the members of his immediate family unless the members decline such protection; the Vice President or other officer next in the order of succession to the Office of the President, and the members of his immediate family unless the members decline such protection; the Vice President-elect, and the members of his immediate family unless the members decline such protection; a former President and his wife during his lifetime; the widow of a former President until her death or remarriage; the minor children of a former President until they reach 16 years of age, unless such protection is declined; 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 Secret Service to protect major Presidential and Vice Presidential candidates, unless such protection is declined; the spouse of a major Presidential or Vice Presidential nominee, except that such protection shall not commence more than 60 days prior to the general Presidential election.

Investigative operations

Counterfeiting.—During fiscal 1977, $44 million in counterfeit U.S. currency was recovered by the Secret Service. Of this amount, the Secret Service seized $39.2 million. While the total amount recovered and the amount seized prior to circulation rose 23 percent, there was a 44-percent increase in losses to the public over the preceding year.

Of the $44 million in counterfeit currency recovered, $38.6 million stemmed from counterfeiting operations which have been successfully suppressed.

However, counterfeiting operations which have not yet been suppressed were responsible for the production of $5.4 million in recovered counterfeit currency—$2.9 million which was seized by the Secret Service and $2.5 million lost to the public. In analyzing the $2.5 million in losses in these unsuppressed counterfeiting operations, $1.1 million, or 43 percent, originated with overseas counterfeiting conspiracies and $250,000, or 10 percent, were violations involving raised and altered genuine currency.

An indication of the Secret Service's ability to suppress counterfeiting activity is its success against the conspiracies which first surfaced during fiscal 1977. Of the total counterfeit currency recovered during the year, $30.6 million can be traced to fiscal 1977 conspiracies. Nearly 94 percent of the counterfeiter's output, $28.8 million, was seized before it entered circulation and the plant operations producing $28.6 million (93.5 percent) had been successfully suppressed by the end of fiscal 1977.

The following case successfully concluded during fiscal year 1977 is an example of counterfeiting investigations.

In January 1977 the local sheriff's office advised that some partially burned $50 counterfeit notes had been found west of Provo, Utah. Through the watermark on the paper used for these notes and a survey of paper supply companies for any large or unusual purchases of this type of paper, the purchaser was identified and surveillance of his activities begun.

The printer, coconspirators, and counterfeit plant were identified and located. After a search warrant was served at the counterfeit plant location, investigators concluded that the printer had taken paper scraps and spoiled counterfeit notes to a remote area and attempted to burn them. The printer and coconspirators canned the "good" counterfeit notes with a home canner and stored nine cases of cans, containing $5.5 million in counterfeit, in a warehouse. The offset plates and negatives and a partial case of counterfeit $50 Federal Reserve notes were located in the trunk of a junk car at the printer's residence. The printer and coconspirators were responsible for all passes of these notes.

Check forgery.—During fiscal 1977, the Service received 121,022 checks for investigation, a record in this activity for the fourth consecutive fiscal year and an 11.3-percent increase over 1976. Treasury paid approximately 793 million checks during fiscal 1977. The Service received 151 checks for investigation per million checks paid, or 1 check for every 6,500 checks paid.

During the year, the Secret Service made a record-setting 8,779 check forgery arrests, in contrast to 5,171 check forgery arrests in fiscal 1976 and 6,602 in fiscal 1975.

For the third consecutive fiscal year, a significant number of the forged-check investigations involved checks issued under the supplemental security income (SSI) program. The approximately 12,500 forged checks investigated is consistent with fiscal year 1976 when the Service received 12,750 forged SSI checks for investigation.

Neither the direct deposit program nor the electronic funds transfer program has had any apparent reduction effect on the check workload.

A typical case involved a primary conspirator who had been receiving stolen U.S. Treasury checks from postal employees. He and others acting on his instructions established numerous fraudulent commercial checking accounts in order to negotiate the stolen checks. The actual forgers were lower level criminals acting under his direction, and they realized little or no profit from the scheme. The leader claimed to be a successful businessman involved in various commercial activities—apartment buildings, used cars, painting companies.

An informant was placed in contact with the primary conspirator, who outlined the network of fraudulent commercial accounts used to negotiate the checks and estimated that he was realizing between $20,000 and $30,000 per month from this operation. One postal clerk was identified as being responsible for stealing approximately 600 U.S. Treasury checks. He disposed of most of the checks by selling them to an individual who, in turn, provided them to the primary conspirator.

Subsequently, agents of the Secret Service and postal inspectors arrested the leader and other significant coconspirators. All were charged with uttering forged U.S. Treasury checks, possession of stolen mail, and conspiracy.

To date, the total number of checks received in this case is 316 and the total dollar loss is $96,568.66.

Bond forgery.—Bond forgery investigations decreased during fiscal 1977, with 12,189 bonds being investigated as compared with 14,356 in 1976, 12,645 in 1975, and 13,163 in 1974.

At the end of the fiscal year, there were 874,048 stolen bonds, representing a face value of $59.2 million, entered into the National Crime Information Center (NCIC) by the Secret Service. Each of these bonds represents a potential forgery case and a possible loss to the Government if presented for redemption.

During fiscal 1977, 152 persons were arrested for bond forgery as compared with 144 persons in 1976. Known organized crime figures continued to be connected with some of those arrested.

The Secret Service recovered, prior to forgery and redemption, 14,631 stolen bonds with a face value of $1 million compared with fiscal 1976 when 5,757 stolen bonds were recovered with a face value of $487,575. This was a record recovery.

Although the incidence of bond forgery investigations decreased during fiscal 1977, the number of bonds stolen increased as indicated by the number of bonds entered into the NCIC system. The disparity between the number of bonds forged and the number of bonds stolen is attributable to enforcement efforts. The availability of agent personnel following the campaign/inauguration period enabled efforts to be increased in undercover operations and in bank teller educational programs.

In a typical bond forgery case, a woman entered a savings and loan institution in Pittsburgh, Pa., and opened a savings account in the name of a registered owner whose bonds had been stolen. A short time later, a man entered the same savings and loan and opened a savings account in the name of another registered owner whose bonds had been stolen. A total of 617 bonds with a face value of $109,750 had been stolen from these two owners. The male forger returned to the savings and loan the next day and attempted to redeem the bonds. The institution became suspicious and contacted the Pittsburgh field office, which maintained surveillance of the savings and loan and arrested the female forger as she attempted to redeem bonds. Additional investigation led to the arrest of the male suspect while in the process of redeeming bonds at a second location.

Interrogation of the 2 suspects led to the arrest of an accomplice at a local motel and the recovery of a total of 551 unendorsed savings bonds. All three suspects pleaded guilty to conspiracy to forge and utter savings bonds and to receiving stolen Government property. Each was sentenced to serve 5 years.

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 1977, members of the Identification Branch conducted examinations in 9,488 cases involving 947,090 exhibits. This resulted in 2,540 identifications of persons and a total of 208 court appearances to furnish expert testimony.

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 1977, the Force was changed from a guard series to a police series without a change in pay status. Training for new officers is now being conducted at the Federal Law Enforcement Training Center in Brunswick, Ga.

During the fiscal year, 21 felony arrests were made by officers of the Force and 31 persons were interviewed for attempted unauthorized entry into the Main Treasury Building and detained for further interview by Secret Service agents.

Organized crime

The Secret Service provides special agents to each of the 13 organized crime strike forces located throughout the United States. This activity is coordinated by the Special Investigations and Security Division at headquarters. The agent in charge of this Division is a member of the newly formed National Organized Crime Planning Council and, as such, participates in the establishment of targets for the strike forces.

Protective operations

In October 1976 the Secret Service continued protection of Presidential nominee Jimmy Carter, Mrs. Carter, Vice Presidential nominees Walter Mondale and Robert Dole, and their wives. Protection was also provided to independent Presidential candidate Eugene McCarthy. Secret Service protection continued 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 F. Kennedy, Jr.; former First Ladies Mrs. Harry S Truman, Mrs. Dwight D. Eisenhower, and Mrs. Lyndon B. Johnson; Secretary of State Henry A. Kissinger (on a reimbursable basis); and Secretary of the Treasury William E. Simon.

After the November Presidential election, the Secret Service continued protection of President-elect Carter, Mrs. Carter, Amy Carter, Vice-President-elect Mondale, and Mrs. Mondale. Protection of Senator and Mrs. Dole, and independent candidate McCarthy terminated on November 3, 1976. Protection of John F. Kennedy, Jr. was terminated on November 26, 1976, his 16th birthday. Protection of Secretary Simon was terminated on January 15, 1977.

The Secret Service, at the request of President-elect Carter, commenced protecting his sons, Jack, James, and Jeff, on January 19, 1977. The Secret Service, at the direction of the President, began protection of his grandsons, Jason on January 23, 1977, and James on June 18, 1977.

After the inauguration the Secret Service began providing security for Secretary of the Treasury W. Michael Blumenthal on a limited basis while in the Washington, D.C., area and on foreign trips.

Protection was terminated for Jack Ford on January 19, 1977, and for Mike and Steve Ford on January 20, 1977.

On January 19, 1977, a joint resolution was passed by both Houses of Congress and signed into law (Public Law 95-1) by President Ford, authorizing the Secret Service to continue protecting certain former Federal officials or members of their immediate families. In conjunction with the passage of this legislation, President Carter directed the Secret Service to continue protecting former Vice President and Mrs. Rockefeller, their children, Mark and Nelson, Jr.; former Secretary of State Kissinger; and former President Ford's daughter, Susan. The Secret Service was also directed by the Secretary of the Treasury to provide protection for Mrs. Kissinger.

Protection of these individuals was reevaluated by President Carter on a 30-day basis. After evaluation, he directed the Secret Service to terminate protection for former Vice President and Mrs. Rockefeller on February 22, 1977, Mark and Nelson Rockefeller, Jr. on February 20, 1977, Susan Ford on March 21, 1977, former Secretary of State Kissinger on May 1, 1977, and Mrs. Kissinger on January 24, 1977.

During fiscal 1977, foreign dignitary protection remained a major effort with 111 foreign dignitaries receiving protection. These included 107 visits by heads of foreign states or governments and 4 other distinguished foreign visitors to the United States. Included in the figures are 19 foreign dignitaries who received protection during the Organization of American States meetings for the Panama Canal Treaty signing ceremony held in Washington, D.C., September 6–9, 1977.

The Executive Protective Service (EPS) continued to provide protection for the White House, Presidential offices, the official Vice Presidential residence, and the foreign diplomatic missions of 132 countries at more than 380 locations in the metropolitan area of the District of Columbia. Additionally, the EPS provided protection for the annual World Bank/International Monetary Fund meetings in Washington, D.C., in September 1977.

The EPS continued to provide protective details for selected missions to the United Nations in New York City.

Additionally, a detail of EPS officers was sent to Miami Beach, Fla., on August 13, 1977, to provide security at the Miami Beach Heart Institute, where President Somoza of Nicaragua was recuperating from a heart operation.

Protective research

During fiscal 1977, the Secret Service initiated an ongoing study and reviewed other possible 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.

The Intelligence Division increased the size of the Intelligence Division duty desk. The new configuration and innovative equipment provides the capacity and capability to function as a crisis center. In conjunction with that physical renovation, the entire Division underwent a reconfiguration to allow optimum use of space regarding personnel and workflow.

Protective research study groups have initiated feasibility studies for converting handwriting specimens and other graphic images to microforms for storage in an automated microform retrieval system and for application of geoprocessing technology to intelligence files.

The Division has implemented a number of engineering improvements to the protective intelligence and events automatic data processing systems which will permit the use of computers by more employees.

Technical Security Division

With the change of administration, the Technical Security Division (TSD) reissued all White House and Executive Office Building security pass credentials to the staff and press corps. A requirement to wear a security pass while in the White House complex was established.

The TSD munitions countermeasures effort during fiscal 1977 included publication of training posters dealing with explosive components or explosive effects; instruction at over 30 regional and international conferences or schools; and the installation of 10 fluoroscopic (X-ray) machines to support various protective details, to include user training, safety, and maintenance.

The Division completed the installation of the field office intrusion alarm systems, and work is proceeding on installing or upgrading alarm systems at the LBJ Ranch, Vice Presidential residence, Ford residence, and a multibeam infrared system at the White House.

TSD installed a fire extinguisher system in all special-purpose armored vehicles, completed the new fire detection system in the west wing of the White House and at the President's residence in Plains, Ga., and began a project to install fire alarms systems in major field offices.

The Visual Information Branch of TSD installed an automatic color photo printer to increase efficiency, and set up a full-time audio visual section to meet Service demands.

Technical Development and Planning Division

In cooperation with the National Park Service, the Division completed work on four additional gates to the White House complex.

The White House computerized security system was expanded to facilitate the functions performed by Executive Protective Service control center personnel and increase the security and efficiency of processing visitors with appointments in the White House complex.

Perimeter sensors using various detection techniques were integrated into security systems at various protective sites. Additionally, a system was initiated to assist EPS Foreign Missions Division dispatch personnel in monitoring the status of patrol personnel for efficient assignment in response situations.

Communications Division

During fiscal 1977, the Communications Division completed the installation of an optical character reader and cathode ray tube editing terminal to expedite the handling of outgoing message traffic from headquarters. The Division also completed hardware and software changes necessary to enhance internal applications. The Secret Service resident agencies were added to the headquarters teletype network as well.

Installation of new radio systems in the resident agencies and upgrading of systems in the field offices continued. Also, special local and State police mobile radio units were placed in selected Secret Service field vehicles to provide emergency and cooperative law enforcement mobile radio communications capability.

In cooperation with the Office of Protective Operations, the Division equipped two trailers for use as emergency mobile command posts.

Liaison

Throughout fiscal 1977, the Liaison Division maintained personal liaison with Federal agencies to assure the proper coordination, communication, and exchange of information relating to the responsibilities of those agencies during Secret Service criminal investigative and protective missions. The Division also continued to be highly active at the U.S. Capitol, State Department, foreign embassies, and numerous Federal agencies regarding visits of protectees, both domestically and abroad.

Freedom of Information and Privacy Acts Office

During fiscal 1977, the Freedom of Information and Privacy Acts Office processed 918 FOI Act requests and 285 Privacy Act requests.

Administration

In conjunction with the Office of the Assistant Secretary (Administration), the Secret Service began participation in the Treasury payroll/personnel information system. This system provides for an expanded data base capable of fulfilling both the Department's and the Service's payroll/personnel reporting and control requirements.

An improved merit promotion plan for administrative, clerical, technical, and professional positions was put into operation. Also, a classification review of key administrative and technical positions was instituted in accordance with the Civil Service Commission factor evaluation system.

The acquisition of a single consolidated headquarters building continues to be a major goal of the Secret Service. A contractor has been selected by the General Services Administration to collect data relative to office space needs projected over the next 10 years.

Programs were initiated during the year to improve the Service's ability to judge whether a contractor has the ability to perform in accordance with the stated requirements in a contract proposal. The pre-award survey program determines whether new contractors have the personnel, tooling, plant facilities, financial capability, and operational stability to perform properly their contract responsibilities.

The contract proposals audit program involves the cognizant contracting officer and an internal auditor in evaluating a proposal from an apparently competent contractor to confirm the validity of the various cost or price elements. Labor rates, estimated labor hours required, raw materials, unit prices, anticipated quantities to be used, and overhead rates are carefully assessed as a basis for challenge or acceptance in preparation for contract negotiation.

The automated property inventory system was expanded to increase control of accountable equipment issued to individual employees.

Expansion of the data reporting systems in the Office of Administration has made significant information more readily available to managers and supervisors throughout the organization. This information includes listings of open case records on file, geographic listings of all investigations in process, and listings for identifying case records eligible for destruction or transfer to Federal Records Centers.

The Presidential Protection Assistance Act of 1976, Public Law 94–524, was enacted October 17, 1976. The major financial impact of this legislation requires that, with certain exceptions, Federal agencies be reimbursed for providing assistance in support of the Secret Service's protective duties. It also places certain limitations and conditions on the expenditure of funds at the private residences of Secret Service protectees. The initial report on expenditures made during the period October 17, 1976, through March 31, 1977, was submitted to the appropriate committees on August 8, 1977.

Training

There were 196,493 man-hours of training conducted by the Secret Service Office of Training during fiscal 1977. In addition, 9,015 man-hours of interagency training and 15,313 man-hours of non-Government training were completed for a total of 220,821 man-hours.

During the fiscal year, the basic firearms training course was fired 3,121 times by law enforcement personnel of the Secret Service. Requalification firearms training was conducted 26,272 times. Additionally, 1,283 employees of other agencies received basic firearms instruction and firearms instructor training was provided for 58 employees of other agencies.

The Uniformed Forces Training Branch provided specialized instruction for 618 members of the uniformed services.

The Secret Service's management training system intensified its instructional training, and 165 students were provided 6,220 man-hours of supervisory and management training.

With the onset of TPPIS, an intensified program of regional training was implemented to provide training to timekeepers from all Secret Service field offices. This was the first attempt at regional training and it was most successful. The objectives of the training were met, and a good deal of money was saved. The benefits of regional training are being analyzed with a view toward projected training requirements.

The Training Resource Center enrolled 791 students in individualized study courses during fiscal 1977. A total of 248 students completed their courses. The Resource Center was used a total of 6,677 times during the fiscal year.

Secret Service field offices have been equipped with audiovisual equipment enabling the Office of Training to reach all employees with standardized instruction. The staff has written training programs and directed their in-house production. These programs are customized for Secret Service employees and are more specific and provide greater motivation than commercially obtainable programs.

The Office of Training conducted a course of instruction in sign language to improve communications with hearing-impaired employees of the Service. Further, the course trained several Executive Protective Service officers assigned to the tour detail at the White House so that hearing-impaired individuals may benefit from a visit to the White House.

Six special agent training courses were offered to 212 new special agents in all aspects of investigation coincident with Secret Service jurisdiction and physical protection.

In-Service training courses designed to update participants in the state of the profession were given to 74 senior agents. This number is expected to rise significantly in fiscal 1978.

Eleven dignitary protection seminars composed of 224 command level police officers were conducted to aid the local and State officials in the protection of dignitaries. Protective operation briefings were given to 53 lower echelon police officials. These briefings, which are 2 days shorter than the dignitary protection seminars are designed for generally the same purpose but directed toward the line officer.

The 4-day advanced emergency care course has graduated 80 participants to aid in the Service's protective and investigative mission. Reports have been received of lives saved and care given by course graduates, both on and off duty.

Technical operations briefings, designed to provide expertise in modern technical equipment, have trained 36 special agents. These agents are able to maximize the use of camera and surveillance equipment in accordance with the latest legal and organizational policies.

The questioned document course, designed to aid participants in applying the basic principles of document examination and identification, was provided for 49 students from the Secret Service and other agencies.

The protective forces driving course trained 83 special agents in fiscal 1977. This course, designed especially for the Service's protective function, prepares the student for the safe operation of a limousine or security vehicle under stress situations. Improvement of normal driving skills is a collateral benefit.

In fiscal 1977, there were 28 "Attack on a Principal" exercises designed to simulate various types of attacks on protectees. These 1-day practical exercises are performed for temporary dignitary details as well as permanent protective divisions.

Numerous protective seminars have been provided for other law enforcement agencies to improve skills and enhance coordination with the Secret

Service in the area of protection. Similar 1- to 3-day programs have been offered in the area of criminal investigation.

In addition to the programmed events, the Office of Training has conducted specialized security surveys for various police agencies, directed several intraorganizational research projects, and offered individual or small group briefings when the participants' inclusion in a programmed course was impractical.

Inspection

The Office of Inspection conducted 51 office inspections during fiscal 1977. From the beginning of the fiscal year and continuing through Inauguration Day, nine inspectors, six assistant inspectors, and two special agents were assigned in various capacities to candidate-nominee protection and inauguration activities.

During the fiscal year, four inspectors and three assistant inspectors conducted an in-depth study and review of the Executive Protective Service, resulting in the restructuring of that organization. One inspector has been involved in the updating of the White House emergency plan, and continual maintenance of the classified document program and the headquarters and field emergency readiness plans. Additionally, a complete security review of the White House complex was conducted by the Office of Inspection.

Legal counsel

During fiscal 1977, 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 or successors to the presidency," to cover threats made against most protectees of the Secret Service.

The Secret Service proposed a new section 510 to title 18, United States Code, "Forgery of Government checks, bonds and other obligations," which in effect eliminates 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 any violations concerning Treasury checks, bonds, and other obligations.

A legislative proposal was also submitted to amend Secret Service's basic authority by altering its protective responsibilities, in some cases eliminating some persons currently authorized protection.

EXHIBITS

Public Debt Operations, Regulations, and Legislation

Exhibit 1.—Treasury notes

A Treasury circular covering an auction for cash with an interest rate determined through competitive bidding is reproduced in this exhibit. Circulars pertaining to the other note offerings during fiscal 1977 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 year there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new notes.

DEPARTMENT CIRCULAR NO. 13-77. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, May 18, 1977.

1. INVITATION FOR TENDERS

1.1. The Secretary of the Treasury, under authority of the Second Liberty Bond Act, as amended, invites tenders for approximately $2,000,000,000 of United States securities, designated Treasury Notes of June 30, 1981, Series J-1981 (CUSIP No. 912827 GT 3). The securities will be sold at auction with bidding on the basis of yield. Payment will be required at the price equivalent of the bid yield of each accepted tender. The interest rate on the securities and the price equivalent of each accepted bid will be determined in the manner described below. Additional amounts of these securities may be issued for cash to Federal Reserve Banks as agents of foreign and international monetary authorities.

2. DESCRIPTION OF SECURITIES

2.1. The securities will be dated June 3, 1977, and will bear interest from that date, payable on a semiannual basis on December 31, 1977, and each subsequent 6 months on June 30 and December 31 until the principal becomes payable. They will mature June 30, 1981, and will not be subject to call for redemption prior to maturity.

2.2. The income derived from the securities is subject to all taxes imposed under the Internal Revenue Code of 1954. The securities 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, any possession of the United States, or any local taxing authority.

2.3. The securities will be acceptable to secure deposits of public monies. They will not be acceptable in payment of taxes.

2.4. Bearer securities with interest coupons attached, and securities 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 securities will be available to eligible bidders in multiples of those amounts. Interchanges of securities of different denominations and of coupon, registered and book-entry securities, and the transfer of registered securities will be permitted.

2.5. The Department of the Treasury's general regulations governing United States securities apply to the securities offered in this circular. These general regulations include those currently in effect, as well as those that may be issued at a later date.

3. SALE PROCEDURES

3.1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to 1:30 p.m., Eastern Daylight

Saving time, Tuesday, May 24, 1977. Noncompetitive tenders as defined below will be considered timely if postmarked no later than Monday, May 23, 1977.

3.2. Each tender must state the face amount of securities bid for. The minimum bid is $1,000 and larger bids must be in multiples of that amount. Competitive tenders must also show the yield desired, expressed in terms of an annual yield with two decimals, e.g., 7.11%. Common fractions may not be used. Noncompetitive tenders must show the term "noncompetitive" on the tender form in lieu of a specified yield. No bidder may submit more than one noncompetitive tender and the amount may not exceed $1,000,000.

3.3. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and primary dealers, which for this purpose are defined as dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, may submit tenders for account of customers if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

3.4. Tenders will be received without deposit for their own account from commercial banks and other banking institutions; primary dealers, as defined above; Federally-insured savings and loan associations; States, and their political subdivisions or instrumentalities; public pension and retirement and other public funds; international organizations in which the United States holds membership; foreign central banks and foreign states; Federal Reserve Banks; and Government accounts. Tenders from others must be accompanied by a deposit of 5% of the face amount of securities applied for (in the form of cash, maturing Treasury securities or readily collectible checks), or by a guarantee of such deposit by a commercial bank or a primary dealer.

3.5. Immediately after the closing hour, tenders will be opened, followed by a public announcement of the amount and yield range of accepted bids. Subject to the reservations expressed in Section 4, noncompetitive tenders will be accepted in full at the weighted average price (in three decimals) of accepted competitive tenders, and competitive tenders 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 established, on the basis of a 1/8 of one percent increment, which results in an equivalent average accepted price close to 100.000 and a lowest accepted price above the original issue discount limit of 99.000. That rate of interest will be paid on all of the securities. 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 equivalent 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. If the amount of noncompetitive tenders received would absorb all or most of the offering, competitive tenders will be accepted in an amount sufficient to provide a fair determination of the yield. Tenders received from Government accounts and Federal Reserve Banks will be accepted at the weighted average price of accepted competitive tenders.

3.6. Competitive bidders will be advised of the acceptance or rejection of their tenders. Those submitting noncompetitive tenders will only be notified if the tender is not accepted in full or when the price is over par.

4. RESERVATIONS

4.1. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders in whole or in part, to allot more or less than the amount of securities specified in Section 1, and to make different percentage allotments to various classes of applicants when the Secretary considers it in the public interest. The Secretary's action under this Section is final.

5. PAYMENT AND DELIVERY

5.1. Settlement for allotted securities must be made or completed on or before Friday, June 3, 1977, at the Federal Reserve Bank or Branch or at the Bureau of the

Public Debt, wherever the tender was submitted. Payment must be in cash; in other funds immediately available to the Treasury; in Treasury bills, notes or bonds (with all coupons detached) maturing on or before the settlement date but which are not overdue as defined in the general regulations governing United States securities; or by check drawn to the order of the institution to which the tender was submitted, which must be received at such institution no later than:

(a) Tuesday, May 31, 1977, if the check is drawn on a bank in the Federal Reserve District of the institution to which the check is submitted (the Fifth Federal Reserve District in case of the Bureau of the Public Debt), or

(b) Friday, May 27, 1977, if the check is drawn on a bank in another Federal Reserve District.

Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at the applicable Federal Reserve Bank. Payment will not be considered complete where registered securities 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. When payment is made in securities, a cash adjustment will be made to or required of the bidder for any difference between the face amount of securities presented and the amount payable on the securities allotted.

5.2. In every case where full payment is not completed on time, the deposit submitted with the tender, up to 5 percent of the face amount of securities allotted, shall, at the discretion of the Secretary of the Treasury, be forfeited to the United States.

5.3. Registered securities tendered as deposits and in payment for allotted securities are not required to be assigned if the new securities are to be registered in the same names and forms as appear in the registrations or assignments of the securities surrendered. When the new securities are to be registered in names and forms different from those in the inscriptions or assignments of the securities presented, the assignment should be to "The Secretary of the Treasury for (securities offered by this circular) in the name of (name and taxpayer identifying number)." If new securities in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon (securities offered by this circular) to be delivered to (name and address)." Specific instructions for the issuance and delivery of the new securities, signed by the owner or authorized representative, must accompany the securities presented. Securities 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 securities must be delivered at the expense and risk of the holder.

5.4. If bearer securities are not ready for delivery on the settlement date, purchasers may elect to receive interim certificates. These certificates shall be issued in bearer form and shall be exchangeable for definitive securities of this issue, when such securities are available, at any Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. The interim certificates must be returned at the risk and expense of the holder.

5.5. Delivery of securities in registered form will be made after the requested form of registration has been validated, the registered interest account has been established, and the securities have been inscribed.

6. GENERAL PROVISIONS

6.1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make allotments as directed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of securities on full-paid allotments, and to issue interim certificates pending delivery of the definitive securities.

6.2. The Secretary of the Treasury may at any time issue supplemental or amendatory rules and regulations governing the offering. Public announcement of such changes will be promptly provided.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 13-77. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, May 25, 1977.

The Secretary of the Treasury announced on May 24, 1977, that the interest rate on the notes described in Department Circular—Public Debt Series—No. 13-77, dated May 18, 1977, will be 6 3/4 percent per annum. Accordingly, the notes are hereby redesignated 6 3/4 percent Treasury Notes of Series J-1981. Interest on the notes will be payable at the rate of 6 3/4 percent per annum.

DAVID MOSSO,
Fiscal Assistant Secretary.

Summary of information pertaining to Treasury notes issued during fiscal year 1977

Date of preliminary announcement	Department circular No.	Department circular Date	Concurrent offering circular No.	Treasury notes issued (all offered for cash)	Type of auction [1]	Accepted tenders: Average price	Accepted tenders: High price	Accepted tenders: Low price	Minimum denomination	Issue date	Maturity date	Date tenders received	Payment date [2]
1976		*1976*								*1976*		*1976*	*1976*
Sept. 16	24-76	Sept. 17		7 percent Series G-1981	Yield	99.641	[3] 99.894	99.557	$1,000	Oct. 12	Nov. 15, 1981	Sept. 28	Oct. 12
Oct. 15	25-76	Oct. 15		5 7/8 percent Series S-1978	do	99.842	[3] 99.991	99.787	5,000	Nov. 1	Oct. 31, 1978	Oct. 21	Nov. 1
Oct. 27	28-76	Oct. 28	29-76, 30-76	6 1/4 percent Series K-1979	do	99.704	[3] 99.811	99.677	5,000	Nov. 15	Nov. 15, 1979	Nov. 3	Nov. 15
Oct. 27	29-76	Oct. 28	28-76, 30-76	7 percent Series B-1983	do	99.891	[3] 100.000	99.891	1,000	Nov. 15	Nov. 15, 1983	Nov. 4	Nov. 15
Nov. 12	31-76	Nov. 12		5 3/4 percent Series T-1978	do	99.795	99.981	99.647	5,000	Nov. 30	Nov. 30, 1978	Nov. 18	Nov. 30
Nov. 23	32-76	Nov. 23		5 7/8 percent Series F-1980	do	99.864	100.007	99.829	1,000	Dec. 7	Dec. 31, 1980	Nov. 30	Dec. 7
Dec. 13	33-76	Dec. 13		5 1/4 percent Series U-1978	do	99.775	99.925	99.757	5,000	Dec. 31	Dec. 31, 1978	Dec. 20	Dec. 31 [4]
										1977			*1977*
Dec. 17	34-76	Dec. 17		6 1/8 percent Series D-1982	do	99.699	99.872	99.656	1,000	Jan. 6	Feb. 15, 1982	Dec. 28	Jan. 6
1977		*1977*										*1977*	
Jan. 12	1-77	Jan. 13		5 7/8 percent Series L-1979	do	99.824	99.880	99.787	5,000	Feb. 3	Jan. 31, 1979	Jan. 19	Feb. 3
Jan. 26	2-77	Jan. 27	3-77, 4-77	6 1/2 percent Series G-1980	do	99.678	[3] 99.839	99.625	5,000	Feb. 15	Feb. 15, 1980	Feb. 1	Feb. 15
Jan. 26	3-77	Jan. 27	2-77, 4-77	7 1/4 percent Series A-1984	do	100.000	[3] 100.217	99.892	1,000	Feb. 15	Feb. 15, 1984	Feb. 3	Feb. 15
Feb. 11	5-77	Feb. 11		5 7/8 percent Series M-1979	do	99.805	99.861	99.786	5,000	Feb. 28	Feb. 28, 1979	Feb. 17	Feb. 28
Feb. 15	6-77	Feb. 16		6 7/8 percent Series H-1981	do	99.968	[3] 100.073	99.898	1,000	Mar. 8	Mar. 31, 1981	Feb. 23	Mar. 8
Mar. 10	7-77	Mar. 11		6 percent Series N-1979	do	99.963	[3] 100.019	99.944	5,000	Mar. 31	Mar. 31, 1979	Mar. 22	Mar. 31
Mar. 21	8-77	Mar. 22		7 percent Series E-1982	do	99.889	[3] 100.058	99.846	1,000	Apr. 4	May 15, 1982	Mar. 29	Apr. 4
Apr. 12	9-77	Apr. 13		5 7/8 percent Series P-1979	do	100.009	100.065	99.972	5,000	May 2	Apr. 30, 1979	Apr. 19	May 2
Apr. 27	10-77	Apr. 28	11-77	7 1/4 percent Series A-1984	Price	99.81	100.00	99.76	1,000	Feb. 15 [5]	Feb. 15, 1984	May 3	May 16
May 11	12-77	May 12		6 1/8 percent Series Q-1979	Yield	99.805	[3] 99.861	99.768	5,000	May 31	May 31, 1979	May 18	May 31
May 17	13-77	May 18		6 3/4 percent Series J-1981	do	99.808	99.984	99.738	1,000	June 3	June 30, 1981	May 24	June 3
June 14	14-77	June 15		6 1/8 percent Series R-1979	do	99.972	[3] 100.028	99.972	5,000	June 30	June 30, 1979	June 21	June 30
July 13	16-77	July 14		6 1/4 percent Series S-1979	do	99.834	[3] 100.000	99.815	5,000	Aug. 1	July 31, 1979	July 19	Aug. 1
July 27	17-77	July 28	18-77, 19-77	6 3/4 percent Series H-1980	do	99.760	[3] 99.920	99.733	5,000	Aug. 15	Aug. 15, 1980	Aug. 2	Aug. 15
July 27	18-77	July 28	17-77, 19-77	7 1/4 percent Series B-1984	do	99.946	[3] 100.054	99.892	1,000	Aug. 15	Aug. 15, 1984	Aug. 3	Aug. 15
Aug. 12	20-77	Aug. 12		6 5/8 percent Series T-1979	do	99.899	[3] 99.954	99.899	5,000	Aug. 31	Aug. 31, 1979	Aug. 23	Aug. 31
Aug. 19	21-77	Aug. 22		6 3/4 percent Series K-1981	do	99.671	[3] 99.811	99.636	1,000	Sept. 7	Sept. 30, 1981	Aug. 30	Sept. 7
Sept. 13	22-77	Sept. 14		6 5/8 percent Series U-1979	do	99.788	[3] 99.843	99.770	5,000	Sept. 30	Sept. 30, 1979	Sept. 21	Sept. 30

[1] All auctions but one for issues of notes were by the "yield" method in which bidders were required to bid on the basis of an annual yield; one issue of notes was by the "price" method, in which case the interest rate was announced prior to the auction, and bidders were requested to bid a price. After tenders were allotted in the "yield" method auction 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.

NOTE.—The maximum amount that could be bid for on a noncompetitive basis for each issue was $1,000,000 except for the issues of Oct. 12, 1976, and Nov. 1, 1976, in which the maximum amount was $500,000.

[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] Final payment date of Jan. 3, 1977, for offices which were closed on Dec. 31, 1976, plus 3 days' accrued interest.

[5] Interest was payable from May 16, 1977.

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 1977 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 year there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new bonds.

DEPARTMENT CIRCULAR NO. 15–77. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, June 21, 1977.

1. INVITATION FOR TENDERS

1.1. The Secretary of the Treasury, under the authority of the Second Liberty Bond Act, as amended, invites tenders for approximately $1,500,000,000 of United States securities, designated Treasury Bonds of 1992 (CUSIP No. 912810 BY 3). The securities will be sold at auction with bidding on the basis of yield. Payment will be required at the price equivalent of the bid yield of each accepted tender. The interest rate on the securities and the price equivalent of each accepted bid will be determined in the manner described below. Additional amounts of these securities may be issued for cash to Federal Reserve Banks as agents of foreign and international monetary authorities.

2. DESCRIPTION OF SECURITIES

2.1. The securities will be dated July 8, 1977, and will bear interest from that date, payable on a semiannual basis on February 15, 1978, and each subsequent 6 months on August 15 and February 15 until the principal becomes payable. They will mature August 15, 1992, and will not be subject to call for redemption prior to maturity.

2.2. The income derived from the securities is subject to all taxes imposed under the Internal Revenue Code of 1954. The securities 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, any possession of the United States, or any local taxing authority.

2.3. The securities will be acceptable to secure deposits of public monies. They will not be acceptable in payment of taxes.

2.4. Bearer securities with interest coupons attached, and securities 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 securities will be available to eligible bidders in multiples of those amounts. Interchanges of securities of different denominations and of coupon, registered, and book-entry securities, and the transfer of registered securities will be permitted.

2.5. The Department of the Treasury's general regulations governing United States securities apply to the securities offered in this circular. These general regulations include those currently in effect, as well as those that may be issued at a later date.

3. SALE PROCEDURES

3.1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to 1:30 p.m., Eastern Daylight Saving time, Tuesday, June 28, 1977. Noncompetitive tenders as defined below will be considered timely if postmarked no later than Monday, June 27, 1977.

3.2. Each tender must state the face amount of securities bid for. The minimum bid is $1,000 and larger bids must be in multiples of that amount. Competitive tenders must also show the yield desired, expressed in terms of an annual yield with two decimals, e.g., 7.11%. Common fractions may not be used. Noncompetitive tenders must show the term "noncompetitive" on the tender form in lieu of a specified yield. No bidder may submit more than one noncompetitive tender and the amount may not exceed $1,000,000.

3.3. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and primary dealers, which for this purpose are defined as dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, may submit tenders for account of customers if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

3.4. Tenders will be received without deposit for their own account from commercial banks and other banking institutions; primary dealers, as defined above; Federally-insured savings and loan associations; States, and their political subdivisions or instrumentalities; public pension and retirement and other public funds; international organizations in which the United States holds membership; foreign central banks and foreign states; Federal Reserve Banks; and Government accounts. Tenders from others must be accompanied by a deposit of 5% of the face amount of securities applied for (in the form of cash, maturing Treasury securities or readily collectible checks), or by a guarantee of such deposit by a commercial bank or a primary dealer.

3.5. Immediately after the closing hour, tenders will be opened, followed by a public announcement of the amount and yield range of accepted bids. Subject to the reservations expressed in Section 4, noncompetitive tenders will be accepted in full at the weighted average price (in three decimals) of accepted competitive tenders, and competitive tenders 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 established, on the basis of a 1/8 of one percent increment, which results in an equivalent average accepted price close to 100.000 and a lowest accepted price above the original issue discount limit of 96.250. That rate of interest will be paid on all of the securities. 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 equivalent 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. If the amount of noncompetitive tenders received would absorb all or most of the offering, competitive tenders will be accepted in an amount sufficient to provide a fair determination of the yield. Tenders received from Government accounts and Federal Reserve Banks will be accepted at the weighted average price of accepted competitive tenders.

3.6. Competitive bidders will be advised of the acceptance or rejection of their tenders. Those submitting noncompetitive tenders will only be notified if the tender is not accepted in full or when the price is over par.

4. RESERVATIONS

4.1. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders in whole or in part, to allot more or less than the amount of securities specified in Section 1, and to make different percentage allotments to various classes of applicants when the Secretary considers it in the public interest. The Secretary's action under this Section is final.

5. PAYMENT AND DELIVERY

5.1. Settlement for allotted securities must be made or completed on or before Friday, July 8, 1977, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt, wherever the tender was submitted. Payment must be in cash; in other funds immediately available to the Treasury; in Treasury bills, notes or bonds (with all coupons detached) maturing on or before the settlement date but which are not overdue as defined in the general regulations governing United States securities; or by check drawn to the order of the institution to which the tender was submitted, which must be received at such institution no later than:

(a) Tuesday, July 5, 1977, if the check is drawn on a bank in the Federal Reserve District of the institution to which the check is submitted (the Fifth Federal Reserve District in case of the Bureau of the Public Debt), or

(b) Friday, July 1, 1977, if the check is drawn on a bank in another Federal Reserve District.

Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at the applicable Federal Reserve Bank. Payment will not be considered complete where registered securities 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. When payment is made in securities, a cash adjustment will be made to or required of the bidder for any difference between the face amount of securities presented and the amount payable on the securities allotted.

5.2. In every case where full payment is not completed on time, the deposit submitted with the tender, up to 5 percent of the face amount of securities allotted, shall, at the discretion of the Secretary of the Treasury, be forfeited to the United States.

5.3. Registered securities tendered as deposits and in payment for allotted securities are not required to be assigned if the new securities are to be registered in the same names and forms as appear in the registrations or assignments of the securities surrendered. When the new securities are to be registered in names and forms different from those in the inscriptions or assignments of the securities presented, the assignment should be to "The Secretary of the Treasury for (securities offered by this circular) in the name of (name and taxpayer identifying number)." If new securities in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon (securities offered by this circular) to be delivered to (name and address)." Specific instructions for the issuance and delivery of the new securities, signed by the owner or authorized representative, must accompany the securities presented. Securities 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 securities must be delivered at the expense and risk of the holder.

5.4. If bearer securities are not ready for delivery on the settlement date, purchasers may elect to receive interim certificates. These certificates shall be issued in bearer form and shall be exchangeable for definitive securities of this issue, when such securities are available, at any Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. The interim certificates must be returned at the risk and expense of the holder.

5.5. Delivery of securities in registered form will be made after the requested form of registration has been validated, the registered interest account has been established, and the securities have been inscribed.

6. GENERAL PROVISIONS

6.1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make allotments as directed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of securities on full-paid allotments, and to issue interim certificates pending delivery of the definitive securities.

6.2. The Secretary of the Treasury may at any time issue supplemental or amendatory rules and regulations governing the offering. Public announcement of such changes will be promptly provided.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 15-77. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, June 29, 1977.

The Secretary of the Treasury announced on June 28, 1977, that the interest rate on the bonds described in Department Circular—Public Debt Series—No. 15-77, dated June 21, 1977, will be 7 1/4 percent per annum. Accordingly, the bonds are hereby redesignated 7 1/4 percent Treasury Bonds of 1992. Interest on the bonds will be payable at the rate of 7 1/4 percent per annum.

DAVID MOSSO,
Fiscal Assistant Secretary.

Summary of information pertaining to Treasury bonds issued during fiscal year 1977

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				
1976		*1976*							*1975*		*1976*	*1976*
Oct. 27	30-76	Oct. 28	28-76, 29-76	7 7/8 percent of 1995-2000	Price	100.79	[3] 101.05	100.58	Feb. 18 [4]	Feb. 15, 2000	Nov. 5	Nov. 15
1977		*1977*							*1977*		*1977*	*1977*
Jan. 26	4-77	Jan. 27	2-77, 3-77	7 5/8 percent of 2002-2007	Yield	99.941	100.530	99.941	Feb. 15	Feb. 15, 2007	Feb. 4	Feb. 15
Apr. 27	11-77	Apr. 28	10-77	7 5/8 percent of 2002-2007	Price	98.25	[3] 98.54	98.13	Feb. 15 [5]	Feb. 15, 2007	May 4	May 16
June 20	15-77	June 21	....	7 1/4 percent of 1992	Yield	99.611	[3] 99.792	99.520	July 8	Aug. 15, 1992	June 28	July 8
July 27	19-77	July 28	17-77, 18-77	7 5/8 percent of 2002-2007	Price	98.94	[3] 99.10	98.80	Feb. 15 [6]	Feb. 15, 2007	Aug. 4	Aug. 15

[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 at a price. Other auctions were held by the "yield" method in which case bidders were required to bid at a yield. After tenders were allotted at the "yield" method auction, 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 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. 15, 1976.

[5] Interest was payable from May 16, 1977.

[6] Interest was payable from Aug. 15, 1977.

NOTE.—The maximum amount that could be bid for on a noncompetitive basis for each issue was $1,000,000. All issues had a minimum denomination of $1,000.

Exhibit 3.—Treasury bills

During the fiscal year there were 52 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), 13 52-week issues, 1 issue of 132 days, and 4 issues of short-dated ("Federal Funds") bills. Press releases dated December 2, 1976, May 19, 1977, and August 19, 1977, announcing the several phase-ins of 52-week, 26-week, and 13-week bills into a book-entry system (virtually eliminating the issuance of definitive securities) are included in this exhibit. 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 offering press release of August 31, 1977, inviting tenders for 9-day and 16-day bills is also included and 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 fiscal year appears in table 39 in the Statistical Appendix.

PRESS RELEASE OF DECEMBER 2, 1976

In a separate announcement today, the Treasury is inviting tenders for the first series of 52-week Treasury bills to be issued, with a limited exception, in book-entry form only. The auction will be held on December 8, 1976.

During recent months, the Treasury and the Federal Reserve Banks have made considerable efforts to acquaint investors and financial institutions with details of the planned conversion to an exclusive book-entry system for Treasury securities. A number of public meetings and special briefings were held in various parts of the country, and the reactions were such as to convince the Treasury that partial implementation could begin.

The Treasury has made an exception to its exclusive book-entry offering of 52-week bills for investors who are still required by law or regulation to hold securities in physical form. Definitive bills in the $100,000 denomination will be available to such investors for a limited period of time.

Although the Treasury will not initially charge any fee for establishing or maintaining book-entry accounts on its records, it reserves the right to impose charges at a later date for services provided after original issue on future Treasury offerings of book-entry securities.

The Treasury plans to convert the regular weekly issuance of 26-week bills to full book-entry form beginning in early June 1977, with the conversion of 13-week bills to follow in September 1977.

A notice of proposed rule making on the Treasury regulations which are to govern the new book-entry system was published in the Federal Register on November 1, 1976. Publication of the final regulations, which are not expected to differ materially from the proposed rules, is expected shortly.

PRESS RELEASE OF MAY 19, 1977

The second phase of the program to eliminate engraved certificates in favor of book-entry securities will begin on June 2, 1977, with the issue of 26-week bills in book-entry form only. All subsequent 26-week bill issues will be in book-entry form. The Treasury will announce the terms of the June 2 issue on Friday, May 20, and auction the bills on Friday, May 27, since the normal Monday auction date will be a holiday.

In the book-entry system, the securities are recorded in the accounts of the Treasury or a Federal Reserve Bank, or in the accounts of banks or other financial institutions acting as custodians for investors. Instead of an engraved certificate, the purchaser is given a receipt as evidence of the purchase.

On December 2, 1976, the Treasury announced the first step in a phased program to eliminate engraved certificates in new Treasury bill offerings. The 52-week bill issue of December 14, 1976, was offered in book-entry form only, with a limited exception. There have now been six 52-week bill issues in this form, without any significant problems.

The next phase of the program will begin with the 13-week bills to be issued on September 1, 1977. This and subsequent 13-week issues will complete the transition of bill issues to the total book-entry system.

A limited exception to the total book-entry offering of Treasury bills will be continued for those institutional investors required by law or regulation to hold securities in definitive form. Definitive bills in the $100,000 denomination will be available to such investors for all issues through December 1978.

PRESS RELEASE OF AUGUST 19, 1977

The third and final phase of the program to eliminate the use of engraved certificates for new offerings of Treasury bills will begin with the September 1 issue of 13-week bills. That issue, and all subsequent 13-week issues, will be in book-entry form only. The Treasury will announce the terms of the September 1 issue on Tuesday, August 23, and auction the bills on Monday, August 29.

Under the book-entry system, the securities are recorded in the accounts of the Treasury or a Federal Reserve Bank, or in the accounts of banks or other financial institutions acting as custodians for investors. Instead of an engraved certificate, the purchaser is given a receipt as evidence of the purchase.

The program to issue Treasury bills only in book-entry form began with the 52-week bill issue of December 14, 1976. In the second phase of the program, the system was extended to 26-week bills, beginning with the June 2, 1977, issue. The conversion of 13-week bills will complete the transition of all regular Treasury bill issues to the total book-entry system.

A limited exception to the offering of Treasury bills only in book-entry form will be continued for those institutional investors required by law or regulation to hold securities in definitive form. Definitive bills in the $100,000 denomination will be available to such investors for all issues through December 1978.

It is anticipated that the program will be extended to selected new offerings of other Treasury marketable securities during the latter part of 1978.

PRESS RELEASE OF AUGUST 26, 1977

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,400 million, to be issued September 8, 1977. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $5,410 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $2,200 million, representing an additional amount of bills dated June 9, 1977, and to mature December 8, 1977 (CUSIP No. 912793 L6 1), originally issued in the amount of $3,002 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,200 million to be dated September 8, 1977, and to mature March 9, 1978 (CUSIP No. 912793 P2 6).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing September 8, 1977. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,526 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive tenders.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Except for definitive bills in the $100,000 denomination, which will be available only to investors who are able to show that they are required by law or regulation to hold securities in physical form, both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to 1:30 p.m., Eastern Daylight Saving time, Friday, September 2, 1977. Form PD 4632-2 (for 26-week series) or form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches, or for bills issued in bearer form, where authorized. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches, and bills issued in bearer form must be made or completed at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt on September 8, 1977, in cash or other immediately available funds or in Treasury bills maturing September 8, 1977. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills 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 these bills (other than life insurance companies) must include in his or her 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 Circulars, No. 418 (current revision), Public Debt Series—Nos. 26–76 and 27–76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

PRESS RELEASE OF AUGUST 31, 1977

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $1,800 million, to be issued September 6, 1977, as follows:

9-day bills (to maturity date) for approximately $900 million, representing an additional amount of bills dated March 17, 1977, and to mature September 15, 1977 (CUSIP No. 912793 K2 1), and

16-day bills (to maturity date) for approximately $900 million, representing an additional amount of bills dated March 24, 1977, and to mature September 22, 1977 (CUSIP No. 912793 K3 9).

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 at all Federal Reserve Banks and Branches up to 1:30 p.m., Eastern Daylight Saving time, Thursday, September 1, 1977. Tenders will not be received at the Department of the Treasury, Washington. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. 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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. 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 of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch on September 6, 1977, in immediately available funds.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills 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 these bills (other than life insurance companies) must include in his or her 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 2, 1977

Tenders for $2,202 million of 13-week Treasury bills and for $3,200 million of 26-week Treasury bills, both series to be issued on September 8, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

Range of accepted competitive bids	13-week bills maturing Dec. 8, 1977			26-week bills maturing Mar. 9, 1978		
	Price	Discount rate	Investment rate [1]	Price	Discount rate	Investment rate [1]
		Percent			*Percent*	
High	98.604	5.523	5.68	[3]97.051	5.833	6.09
Low	[2]98.593	5.566	5.72	[4]97.042	5.851	6.11
Average	98.596	5.554	5.71	97.045	5.845	6.11

[1] Equivalent coupon-issue yield.
[2] Tenders at the low price for the 13-week bills were allotted 81 percent.
[3] Excepting one tender of $65,000.
[4] Tenders at the low price for the 26-week bills were allotted 79 percent.

Total tenders received and accepted by Federal Reserve districts and Treasury

Location	13-week bills Received	13-week bills Accepted	26-week bills Received	26-week bills Accepted
Boston	$25,085,000	$24,135,000	$14,310,000	$4,310,000
New York	3,142,060,000	1,670,265,000	5,126,155,000	2,831,595,000
Philadelphia	22,835,000	22,835,000	6,880,000	6,880,000
Cleveland	37,025,000	31,950,000	71,555,000	31,555,000
Richmond	34,565,000	28,565,000	36,415,000	17,365,000
Atlanta	24,370,000	24,370,000	26,455,000	13,355,000
Chicago	328,985,000	167,915,000	687,285,000	104,260,000
St. Louis	33,720,000	18,720,000	29,775,000	13,395,000
Minneapolis	17,395,000	17,395,000	17,300,000	17,300,000
Kansas City	20,315,000	20,315,000	16,860,000	16,860,000
Dallas	23,740,000	23,740,000	27,070,000	16,070,000
San Francisco	300,890,000	152,140,000	508,580,000	127,230,000
Treasury	115,000	115,000	70,000	70,000
Total	4,011,100,000	[1]2,202,460,000	6,568,710,000	[2]3,200,245,000

[1] Includes $303,920,000 noncompetitive tenders from the public.
[2] Includes $134,170,000 noncompetitive tenders from the public.

Exhibit 4.—Department Circular, Public Debt Series No. 26–76, December 2, 1976, regulations governing book-entry Treasury bills

DEPARTMENT OF THE TREASURY,
Washington, December 2, 1976.

ADOPTION OF REGULATIONS

On November 1, 1976, a notice of proposed rule making was published in the FEDERAL REGISTER (41 FR 47959) with respect to regulations which are to govern the issuance of, and transactions in, all 52-week, 26-week and 13-week Treasury bills and, any other Treasury bills which, after specified dates, are to be issued, with a limited exception, only in book-entry form.

The notice explained that the elimination of securities in the form of engraved certificates would provide substantial benefits to investors, the financial community, and the Treasury by protecting against losses due to theft, mishandling and counterfeiting; by reducing costs of issuing, storing and delivering securities in physical form; and, by moderating the burden of the paperwork created by the growing volume of public debt transactions.

Under the proposed regulations, book-entry Treasury bills would be maintained through accounts either at Federal Reserve Banks or at the Department of the Treasury. Definitive Treasury bills, in the $100,000 denomination only, would be available until December 31, 1978, to investors who establish that they are legally required to hold securities in physical form. By their terms, the regulations would not apply to Treasury bills issued prior to the dates on which they would be available only in book-entry form.

Interested parties were given an opportunity to submit comments on the proposed regulations until November 24, 1976. It is noted that in a series of public meetings and special briefings held during the past several months in various parts of the country, the Department of the Treasury also undertook directly to acquaint investors, financial institutions, securities dealers, etc., about the new mandatory book-entry system, and to solicit their reactions.

Following consideration of the comments submitted in response to the notice, and after reviewing the suggestions otherwise received as a result of its public information program, the Department of the Treasury has modified, where appropriate, the proposed regulations. Aside from editorial and other minor changes, the principal differences between the final regulations and those previously proposed are as follows:

1. Proposed §350.6(a)(2), relating to the identification of accounts held at or through member banks of the Federal Reserve System, was modified to replace the phrase reading "provided identification of each customer account is possible by name,

address, taxpayer identifying number, and includes appropriate loan transaction data" with a provision that permits more flexibility in the manner in which accounts may be maintained, and provides specific information as to the data that should be included.

2. Former §350.7(c), which related to the issuance of confirmations of transactions involving bills in the Treasury book-entry system, was redesignated as Sec. 350.9, and reworded to indicate that its provisions would apply to all transactions affecting bills maintained in a Treasury account. As a result, the proposed §350.9 was renumbered as §350.10, and all subsequent sections were successively redesignated.

3. Proposed §350.8, was modified to provide that book-entry Treasury bills maintained by or through member banks could be transferred through the Federal Reserve Bank communication system to an account maintained at the Treasury, provided such transfer occurred no later than one month before the maturity date of the bills, and was otherwise acceptable under the subpart.

Accordingly, the proposed regulations governing book-entry Treasury bills, as modified, are hereby adopted and added as Part 350 to 31 CFR, and designated as Department of the Treasury Circular, Public Debt Series No. 26–76.

DAVID MOSSO,
Fiscal Assistant Secretary.

AUTHORITY: R.S. 3706; 40 Stat. 288, 502, 844, 1309; 42 Stat. 321; 46 Stat. 20; 48 Stat. 343; 49 Stat. 20; 50 Stat. 481; 52 Stat. 447; 53 Stat. 1359; 56 Stat. 189; 73 Stat. 622; and 85 Stat. 5, 74 (31 U.S.C. 738a, 739, 752, 752a, 753, 754, 754a, and 754b); 5 U.S.C. 301.

SUBPART A—APPLICABILITY AND EFFECT—DEFINITIONS

§350.0 Applicability and effect.

(a) *Applicability.* The regulations in this part govern the issuance of, and transactions in, the following Treasury bills:

(1) 52-week Treasury bills issued after December 1, 1976;

(2) 26-week Treasury bills issued after June 1, 1977;

(3) 13-week Treasury bills issued on or after September 1, 1977; and

(4) Any other Treasury bills issued after September 1, 1977, including, but not limited to, tax anticipation Treasury bills.

(b) *Effect.* The Treasury bills described in paragraph (a) shall, after the date specified therefor, be issued only in book-entry form, except as provided in Subpart D.

§350.1 Definition of terms in this part.

In this part, unless the context otherwise requires or indicates:

(a) "Treasury bill" means an obligation of the United States issued under Section 5 of the Second Liberty Bond Act, as amended (31 U.S.C. 754).

(b) "Book-entry Treasury bill" means any Treasury bill issued on or after the dates specified in §350.0(a) in the form of an entry on the records of a Reserve Bank or the records of the Department of the Treasury. (See Department of the Treasury Circular, Public Debt Series No. 27–76, descriptive of the issue and sale of book-entry Treasury bills.) (31 CFR, Part 349)

(c) "Definitive Treasury bill", as used in Subpart D, means a Treasury bill of the $100,000 denomination issued in the form of an engraved certificate.

(d) "Certified request" or "certified statement", as used in Subpart C, means a request or statement signed by or on behalf of a depositor and certified by an officer authorized to certify assignments of Treasury securities under Department of the Treasury Circular No. 300, current revision, the general regulations governing U.S. securities (31 CFR, Part 306).

(e) "Bureau" means Bureau of the Public Debt, Washington, D.C. 20226.

(f) "Depositor", as used in Subpart C, means the individual, fiduciary or other entity in whose name (including, where appropriate, the title of an officer) an account is established and maintained on the books of the Treasury.

(g) "Fiduciary", as used in Subpart C, means an executor, administrator, trustee; a legal guardian, committee, conservator or similar representative appointed by a court for the estate of a minor or incompetent; a custodian under a statute authorizing gifts to minors; a natural guardian of a minor; a voluntary guardian; or a life tenant under a will.

(h) "Member bank" means any national bank, or State bank or other bank or trust company, which is a member of a Reserve Bank.

(i) "Natural guardian", as used in Subpart C, means either parent of a minor or other person acting on the minor's behalf.

(j) "Pledge" includes a pledge of, or any other security interest in, book-entry Treasury bills as collateral for loans or advances, or to secure deposits of public moneys or the performance of an obligation.

(k) "Reserve Bank" means a Federal Reserve Bank and its branches, acting as Fiscal Agent of the United States and, where indicated, acting in its individual capacity.

(l) "Taxpayer identifying number" means the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service, i.e., an individual's social security number or an employer identification number. A social security account number is composed of nine digits separated by two hyphens, for example, 123–45–6789; an employer identification number is composed of nine digits separated by one hyphen, for example, 12–3456789. The hyphens are an essential part of the numbers and must be included.

(m) "Treasury" means Department of the Treasury.

(n) "Voluntary guardian", as used in Subpart C, means the person who is acting for an individual who is incapacitated by reason of age, infirmity, or mental disability.

SUBPART B—BOOK-ENTRY TREASURY BILLS—FEDERAL RESERVE BANKS

§350.2 Authority of Reserve Banks.

Each Reserve Bank is hereby authorized, in accordance with this subpart, to (a) issue book-entry Treasury bills by means of entries on its records, which shall include the name of the Bank's depositor, the latter's employer identification number, where appropriate, and the amount and maturity date of the bills, including the CUSIP number of each loan; (b) issue a confirmation of transaction in the form of an advice (serially numbered or otherwise), which specifies the amount, maturity date and CUSIP number of the bills, as well as the date of the transaction; and (c) otherwise service and maintain book-entry Treasury bills.

§350.3 Scope and effect of book-entry Treasury bill accounts maintained by Reserve Bank under this subpart.

(a) *Scope and effect of accounts maintained by Reserve Bank.* Except as provided in Subpart D, each Reserve Bank, as Fiscal Agent of the United States, is authorized to maintain book-entry Treasury bills in accounts held in its individual capacity, under terms and conditions which indicate that the Reserve Bank will continue to maintain such deposit accounts in its individual capacity, notwithstanding application of the book-entry procedure to such bills. This paragraph is applicable, but not limited to, book-entry Treasury bills maintained:

(1) As collateral pledged to a Reserve Bank (in its individual capacity) for advances by it;

(2) For a member bank for its sole account;

(3) For a member bank held for the account of its customers (see §350.6 of this subpart);

(4) In connection with deposits in a member bank of funds of States, municipalities, or other political subdivisions;

(5) In connection with the performance of an obligation or duty under Federal, State, municipal, or local law, or judgments or decrees of courts; or

(6) The maintenance by a Reserve Bank of book-entry Treasury bills under this paragraph shall not derogate from or adversely affect the relationships that would otherwise exist between a Reserve Bank in its individual capacity and the entities for which accounts are maintained. The Reserve Bank is authorized to take all action

necessary in respect of book-entry Treasury bills to enable such Reserve Bank in its individual capacity to perform its obligations as depositary with respect to such bills.

(b) *Use as collateral under Treasury circulars.* Each Reserve Bank, as Fiscal Agent of the United States, shall hold in book-entry form Treasury bills pledged as collateral to the United States under current revisions of Department of the Treasury Circulars No. 92 and No. 176 (31 CFR, Parts 203 and 202).

§350.4 Transfer or pledge.

(a) *Reserve Bank records.* A transfer or a pledge of book-entry Treasury bills to a Reserve Bank (in its individual capacity or as Fiscal Agent of the United States), or to the United States, or to any transferee or pledgee eligible to maintain an appropriate book-entry account in its name with a Reserve Bank under this subpart, is effected and perfected, notwithstanding any provision of law to the contrary, by a Reserve Bank making an appropriate entry in its records of the Treasury bills transferred or pledged. The making of such an entry in the records of a Reserve Bank shall (1) have the same effect as the delivery of Treasury bills in bearer definitive form; (2) have the effect of a taking of delivery by the transferee or pledgee; (3) constitute the transferee or pledgee a holder; and (4) if a pledge, effect a perfected security interest therein in favor of the pledgee. A transfer or pledge of Treasury bills effected under this paragraph shall have priority over any transfer, pledge, or other interest, theretofore or thereafter effected or perfected under paragraph (b) of this section or in any other manner.

(b) *Member banks and others.* A transfer or a pledge of book-entry Treasury bills, or any interest therein, maintained by a Reserve Bank (in its individual capacity or as Fiscal Agent of the United States) in a book-entry account under this subpart, including book-entry Treasury bills in accounts at the Reserve Bank maintained under Sec. 350.3(a)(3) of this subpart by member banks for the account of their customers, is effected, and a pledge is perfected, by any means that would be effective under applicable law to effect a transfer or to effect and perfect a pledge of the Treasury bills, or any interest therein, if the Treasury bills were maintained by the Reserve Bank in bearer definitive form. For purposes of transfer or pledge hereunder, book-entry Treasury bills maintained by a Reserve Bank shall, notwithstanding any provision of law to the contrary, be deemed to be maintained in bearer definitive form. A Reserve Bank maintaining book-entry Treasury bills either in its individual capacity or as Fiscal Agent of the United States is not a bailee for purposes of notification of pledges of those bills under this paragraph or a third person in possession for purposes of acknowledgment of transfers thereof under this paragraph. A Reserve Bank will not accept notice or advice of a transfer or pledge effected or perfected under this paragraph, and any such notice or advice shall have no effect. A Reserve Bank may continue to deal with its depositor in accordance with the provisions of this subpart, notwithstanding any transfer or pledge effected or perfected under this paragraph.

(c) *Filing and recording unnecessary.* No filing or recording with a public recording office or officer shall be necessary or effective with respect to any transfer or pledge of book-entry Treasury bills or any interest therein.

(d) *Transfer by Reserve Banks.* A transfer of book-entry Treasury bills within a Reserve Bank shall be made in accordance with procedures established by the Reserve Bank not inconsistent with this subpart. The transfer of book-entry Treasury bills by a Reserve Bank may be made through a telegraphic transfer procedure.

(e) *Timeliness of requests.* All requests for transfer or any authorized transaction must be received prior to the maturity of the bills.

§350.5 Reserve Bank discharged by action on instructions—delivery of Treasury securities.

A Reserve Bank which has received book-entry Treasury bills and effected pledges, made entries regarding them, or transferred or delivered them according to the instructions of its depositor is not liable for conversion or for participation in breach of fiduciary duty even though the depositor had no right to dispose of or take other action in respect of the securities. A Reserve Bank shall be fully discharged of its obligations under this subpart by the transfer or delivery of book-entry Treasury bills upon the order of its depositor.

§350.6 Book-entry Treasury bill accounts.

(a) *Scope and effect of book-entry Treasury bill accounts.*—(1) *Classes of accounts.* Reserve Banks are authorized to maintain book-entry Treasury bills for member banks for bills the member banks hold for their own account, or hold for the account of their customers, and as otherwise specified in §350.3. Purchasers of book-entry Treasury bills, on original issue or otherwise, may have such bills maintained at member banks, or in accounts maintained at entities providing securities safekeeping services for customers (*e.g.*, nonmember banks or thrift institutions, or securities dealers) which have related accounts at member banks.

(2) *Identification of accounts.* Book-entry accounts may be established in such form or forms as customarily permitted by the entity (*e.g.*, member bank, or other banking or thrift institution, or a securities dealer) maintaining them, except that each account should include data to permit both customer identification by name, address and taxpayer identifying number, as well as a determination of the Treasury bills being held in such account by amount, maturity date and CUSIP number, and of transactions relating thereto.

(3) *Pledges and transfers.* Where book-entry Treasury bills are maintained on the books of an entity for account of the pledgor or transferor thereof, such entity shall, for purposes of perfecting a pledge of such Treasury bills or effecting their delivery to a purchaser under applicable provisions of law, be the bailee to which notification of the pledge of the bills may be given or the third person in possession from which acknowledgment of the holding of the bills for the purchaser may be obtained.

(b) *Servicing book-entry Treasury bills—payment of book-entry Treasury bills at maturity.* Book-entry Treasury bills governed by this part may be transferred between accounts prior to maturity through a wire transfer arrangement maintained by Reserve Banks. At maturity, the bills shall be redeemed and charged by a Reserve Bank in the account of the United States Treasury as of the date of maturity, and the redemption proceeds shall be disposed of in accordance with the instructions from the member bank or other Reserve Bank depositor for whose account the Treasury bills shall have been maintained.

SUBPART C—BOOK-ENTRY TREASURY BILLS—DEPARTMENT OF THE TREASURY

§350.7 Establishing a book-entry Treasury bill account.

(a) *General.* Treasury bills may be held as book-entries in accounts maintained by the Treasury. Such accounts may be established, either upon the original issue of book-entry Treasury bills or upon the subsequent transfer of such bills to the Treasury, but no later than one month prior to their maturity date. Each account shall consist of an entry showing the amount, maturity date and CUSIP number of the bills, the name of the individual, fiduciary or other entity (including, where appropriate, the title of an officer) for whom the account is held, the address, and the taxpayer identifying number. The records shall also include appropriate transaction data.

(b) *Recordation.*—(1) *Individuals.* Accounts for book-entry Treasury bills may be held in the names of individuals in one of two forms: single name, i.e., "John A. Doe (123–45–6789) (address)"; or two names i.e., "John A. Doe (123–45–6789) (address) or (Mrs.) Mary B. Doe (987–65–4321). No other form of recordation in two names, whether individuals or others, will be permitted, except in the case of co-fiduciaries.

(2) *Others.* Accounts for book-entry Treasury bills may be held in the names of fiduciaries and other entities in the forms indicated by the following examples:

John A. Smith and First National Bank, executors of the will of James B. Smith, deceased (12–3456789) (address).

May A. Queen, trustee under agreement with Thomas J. King, dated June 1, 1971 (12–3456789) (address).

Smith Manufacturing Company, Inc., James C. Brown, Treasurer (12–3456789) (address).

Grey and White (12–3456789), John D. Grey, General Partner (address).

J. Francis Doe, Secretary-Treasurer of Local 100, Brotherhood of Locomotive Engineers, an unincorporated association (12–3456789) (address).

John R. Greene, as natural guardian of Maxine S. Greene (123–45–6789) (address).

John A. Jones, as voluntary guardian of Henry M. Jones (123–45–6789) (address).

§350.8 Transfer.

Book-entry Treasury bills maintained under this subpart may not be transferred from one account maintained by the Treasury to another such account, except in cases of lawful succession, as provided in this subpart. They may be withdrawn from an account maintained by the Treasury hereunder and transferred through the Federal Reserve Bank communication system to an account maintained by or through a member bank under Subpart B, which transfer shall be made in the name or names appearing in the account recorded on the books of the Treasury. Such withdrawal may be effected by a certified request therefor by, or on behalf of, the depositor, provided the request therefor is received no earlier than ten business days after the issue date or the date the securities are transferred to the Treasury, whichever is later. The request must: (a) identify the book-entry account by the name of the depositor and title, if any, the address, and the taxpayer identifying number; (b) specify by amount, maturity date and CUSIP number the book-entry Treasury bills to be withdrawn and transferred; and (c) specify the name of the member bank to or through which the transfer is to be effected and, where appropriate, the name of the institution or entity which is to maintain the book-entry account. In the case of book-entry Treasury bills held in the names of two individuals, a certified request by either will be accepted, but the transfer shall be made in the names of both. A transfer after original issue of book-entry Treasury bills from an account maintained by or through a member bank to one maintained by the Treasury may be made through the Federal Reserve Bank communication system, provided the account is to be held in a form authorized by this subpart, and provided the transfer is made no later than one month prior to the maturity date of the bills.

§350.9 Confirmation of transaction.

The Treasury will issue to each depositor following any transaction affecting book-entry Treasury bills maintained for such depositor under this subpart a confirmation thereof in the form of an advice (serially numbered or otherwise) which shall describe the amount, maturity date and CUSIP number of the bills, and include pertinent transaction data.

§350.10 Attorney-in-fact.

A request by an attorney-in-fact for any transaction in book-entry Treasury bills after their original issue will be recognized in accordance with this subpart if supported by an adequate power of attorney. The original power or a photocopy showing the grantor's autograph signature, properly certified, must be submitted to the Bureau. A request for transfer for the apparent benefit of the attorney-in-fact will not be recognized unless expressly authorized.

§350.11 Succeeding fiduciaries, partners, officers—succeeding corporations, unincorporated associations, partnerships.

(a) *Death of fiduciary, partner or officer.* In case of the death, removal or disqualification of a fiduciary, partner or officer of an organization in whose name book-entry Treasury bills have been recorded, the successor or other authorized person will be recognized as the depositor under this subpart. Proof of death, resignation, removal or disqualification, as the case may be, and evidence that the successor or such other person is fully authorized to act must be submitted to the Bureau. Proof of death shall be in the form of a death certificate or photocopy thereof showing the official seal. Evidence of authority should be in the form of a certified statement by: (1) the surviving fiduciary or fiduciaries, if any, stating that application for the appointment of a successor has not been made, is not contemplated and is not necessary under the terms of the trust instrument or otherwise, (2) a surviving partner or partners that the partnership is being continued in the same, or another name, which must be identified, or (3) the secretary or other authorized officer of the corporation or unincorporated association as to the name and title of the successor officer. If there is more than one surviving fiduciary, a request for transfer of the bills must be signed by all, unless evidence is submitted to the Bureau that one is authorized to act for the other or others. If there is more than one surviving partner, evidence should be submitted to the Bureau as to which survivor is authorized to act in behalf of the partnership; otherwise, the signatures of all surviving partners will be required for transfer of the bills.

(b) *Succeeding corporations, unincorporated associations or partnerships.* If a corporation has been succeeded by another corporation, or if an unincorporated association or partnership has been succeeded by a corporation, and such succession is by operation of law or otherwise, as the result of merger, consolidation, reincorporation, conversion or reorganization, or if a lawful succession has occurred in any manner whereby the business or activities of the original organization are continued without substantial change, an authorized officer or partner, as the case may be, of the successor organization will be recognized as the depositor under this subpart upon submission to the Bureau of satisfactory evidence of such succession.

§350.12 Termination of trust, guardianship estate, life tenancy—dissolution of corporation, partnership, unincorporated association.

(a) *Termination of trust, life tenancy or guardianship estate.*—(1) *Trust or life estate.* Upon the termination of a trust or life estate, the beneficiary or remainderman will be recognized as the depositor under this subpart. The trustee will be required to submit to the Bureau a certified statement concerning the termination of the trust and the respective shares, if there is more than one beneficiary. In the case of a life estate, proof of death in the form of a death certificate or photocopy thereof showing the official seal will be required, together with a certified statement identifying the remainderman, and, if there is more than one, specifying the respective shares.

(2) *Guardianship.* A former minor or incompetent will be recognized as the depositor under this subpart upon submission to the Bureau of a certified statement, or other evidence showing, in the case of a minor, attainment of majority or other removal of the legal disability, and, in the case of an incompetent, his restoration to competency.

(b) *Dissolution of corporations, unincorporated associations and partnerships.* The person or persons (other than creditors) entitled to the assets upon dissolution of a corporation, unincorporated association or partnership will be recognized under this subpart upon proof of dissolution. If there is more than one person entitled and the book-entry Treasury bills have not matured, no change in the book-entry account will be made pending transfer or redemption at maturity.

§350.13 Death of individual (natural person in own right).

Upon the death of an individual in whose name an account is held and who was not acting as a fiduciary or in any other representative capacity, the following person(s), in the order shown below, will be recognized under this subpart as entitled to the book-entry Treasury bills:

(a) The surviving joint designee of an account in the names of two individuals, if any;

(b) Executor or administrator;

(c) Widow or widower;

(d) Child or children of the decedent and descendants of deceased children by representation;

(e) Parents of the decedent or the survivor of them;

(f) Surviving brothers or sisters;

(g) Descendants of deceased brothers or sisters;

(h) Other next-of-kin as determined by the laws of the domicile at the time of death.

(i) Any person or persons entitled in the above order of preference may request payment or other disposition to any person or persons related to the decedent by blood or marriage, but no payment will be made prior to maturity of the bills. The provisions of this section are for the convenience of the Treasury and do not purport to determine ownership of the bills or of their redemption proceeds.

§350.14 Reinvestment or payment at maturity.

(a) *Request for reinvestment.* Upon the request of the depositor, book-entry Treasury bills held therein will be reinvested at maturity, i.e., their proceeds at maturity will be applied to the purchase of new Treasury bills at the average price (in three decimals) of accepted competitive bids for such Treasury bills then being offered. The request for a reinvestment may be made on the tender form at the time of purchase; subsequent requests for reinvestment will be accepted if received by the Bureau no later than ten business days prior to the maturity of the bills. The difference between the par value of the maturing bills and the issue price of the new bills will be remitted to the subscriber in the form of a Treasury check. Requests for the revocation of the reinvestment of bills will also be accepted if received no later than ten business days prior to the maturity date.

(b) *Reinvestment in cases of delay.* Where a delay occurs in the submission or receipt of evidence to support a request for transfer, payment or other authorized transaction of book-entry Treasury bills, and such delay is likely to extend beyond the maturity dates of the bills, upon request or prior notice, the bills will be redeemed, at maturity or thereafter, and their proceeds reinvested in new book-entry Treasury bills. The bills purchased upon such reinvestment shall be those having the shortest term to maturity then being offered, and will be issued at the average price (in three decimals) of the accepted competitive bids therefor. The discount representing the difference between the par value of the maturing or matured bills and the issue price of the new bills will be remitted in the form of a Treasury check.

(c) *Payment.* If reinvestment is not effected pursuant to this section, book-entry Treasury bills will be paid as of maturity in regular course.

§350.15 Conclusive presumptions.

For the purposes of this subpart and notwithstanding any State law or any regulation or any notice to the contrary, it shall be conclusively presumed (a) that any depositor in whose name, or name and title, book-entry Treasury bills are recorded, is a competent adult, (b) that recordation in two names, as prescribed in Sec. 350.7(b)(i) of this subpart, is intended, if there is an attempt to create some other form of recordation in two names, (c) that recordation in the names of the first two is intended, if there is an attempt to name more than two individuals, and (d) that the first name is the depositor in any case (not authorized and not otherwise provided for in this subpart) wherein an attempt is made to have book-entry Treasury bills recorded in two or more names, e.g., two officers of an organization or two partners.

§350.16 Transactions in regular course—notices not effective—unacceptable notices.

(a) *Transactions in regular course—notices not effective.* Transfers of book-entry Treasury bills, payment thereof or reinvestment at maturity or any other transaction therein will be conducted in the regular course of business in accordance with this subpart, notwithstanding notice of the appointment of an attorney-in-fact, or a legal guardian or similar representative, or notice of successorship, the termination of an estate, the dissolution of an entity, or the death of an individual, unless the requisite request, proof, and the evidence necessary to establish entitlement under this subpart is received by the Bureau no later than ten business days prior to the maturity date of the bills.

(b) *Unacceptable notices.* The Treasury will not under any conditions accept notices of pending judicial proceedings, or of judgments in favor of creditors or others, or of any claims whatsoever, for the purpose of suspending or modifying any book-entry account or any transaction in book-entry Treasury bills.

SUBPART D—DEFINITIVE TREASURY BILLS

§350.17 Definitive Treasury bills—available where holding of definitive securities required by law—termination date December 31, 1978.

(a) *General.* Each Reserve Bank is authorized to issue definitive Treasury bills, in the $100,000 denomination only, upon original issue or otherwise (1) to any entity described in paragraph (b), and (2) for the account of any such entity described in paragraph (b), to a securities dealer or broker or any financial institution which in the regular course of its business purchases securities therefor.

(b) *Eligible entities.* Entities eligible to have definitive Treasury bills are those required by or pursuant to Federal, State, municipal or local law to hold or to pledge securities in definitive form, which may include, but are not limited to: a State, municipality, city, township, county or any other political subdivision, public corporation or other public body, an insurance company, and a fiduciary so required to hold securities in definitive form.

(c) *Conversion of book-entry Treasury bills.* Each Reserve Bank is hereby authorized to effect, upon the order of its depositor, conversions from and to book-entry Treasury bills of definitive bills issued pursuant to this subpart.

(d) *Evidence of eligibility.* In order to obtain a definitive Treasury bill on original issue or thereafter (1) an authorized officer on behalf of the entity must furnish to the Reserve Bank a statement that it is required by, or pursuant to, law to hold or pledge securities in definitive form; or (2) a financial institution, dealer, or broker purchasing definitive Treasury bills hereunder for the account of any such entity must submit to the Reserve Bank a statement that the entity has declared that it is required by or pursuant to law to hold or pledge securities in definitive form.

(e) *Redemption requirements.* Where a definitive Treasury bill issued pursuant to this subpart is presented for payment at or after maturity, it must be accompanied by a statement (1) by an authorized officer of the entity making the presentation that such entity is eligible under this subpart to hold definitive securities, or (2) by the institution making the presentation identifying the entity to whose account the redemption proceeds of the bill have been, or are to be credited, and affirming that such entity had declared that it is eligible under this subpart to hold definitive securities.

(f) *Termination date.* The provisions of this subpart will apply only to definitive Treasury bills issued to, or for the account of, eligible entities prior to December 31, 1978.

§350.18 Sanctions for abuse of definitive Treasury bill privilege.

The Secretary of the Treasury reserves the right to disqualify any eligible entity described in paragraph (b) of Sec. 350.17 from purchasing or holding definitive Treasury bills if he determines that such entity has disposed of such definitive Treasury bills solely for the purpose of accommodating another party, including a bank, broker, dealer, or other financial institution, or a customer of such institution.

Exhibit 5.—Department Circular, Public Debt Series No. 26–76, First Amendment, December 20, 1976, regulations governing book-entry Treasury bills

DEPARTMENT OF THE TREASURY,
Washington, December 20, 1976.

Department of the Treasury Circular, Public Debt Series No. 26–76, dated December 2, 1976 (31 CFR Part 350), is hereby amended:

(1) To indicate that the provisions of §350.6(a)(2) describing how book-entry Treasury bill accounts should be maintained thereunder represent Department of the Treasury recommendations relative to the maintenance of such accounts;

(2) To clarify the provisions of §350.14(a) to indicate that requests for reinvestment of maturing Treasury bills held under Subpart C would be made by the depositor "in whose name the account is maintained"; and

(3) To change the provisions of §350.17(f), pertaining to the issuance of definitive Treasury bills to eligible investors, to make clear that such bills would be available for periods co-extensive with their maturity dates.

As amended, the above sections read as follows:

31 CFR Part 350 is amended as follows: Section 350.6 is amended by revising paragraph (a)(2) as set forth below:

§350.6 Book-entry Treasury bill accounts.

* * * * * * *

(a) * * *

(2) *Identification of accounts.* Book-entry accounts may be established in such form or forms as customarily permitted by the entity (e.g., member bank, or other banking or thrift institution, or a securities dealer) maintaining them. The recommended identification for each such account would include data to permit both customer identification by name, address and taxpayer identifying number, as well as a determination of the Treasury bills being held in such account by amount, maturity date and CUSIP number, and of transactions relating thereto.

* * * * * * *

Section 350.14 is amended by revising paragraph (a) as set forth below:

§350.14 Reinvestment or payment at maturity.

(a) *Request for reinvestment.* Upon the request of the depositor in whose name the account is maintained, book-entry Treasury bills held therein will be reinvested at maturity, i.e., their proceeds at maturity will be applied to the purchase of new Treasury bills at the average price (in three decimals) of accepted competitive bids for such Treasury bills then being offered. The request for a reinvestment may be made on the tender form at the time of purchase; subsequent requests for reinvestment will be accepted if received by the Bureau no later than ten business days prior to the maturity of the bills. The difference between the par value of the maturing bills and the issue price of the new bills will be remitted to the subscriber in the form of a Treasury check. Requests for the revocation of the reinvestment of bills will also be accepted if received no later than ten business days prior to the maturity date.

* * * * * * *

Section 350.17 is amended by revising paragraph (f) as set forth below:

§350.17 Definitive Treasury bills—available where holding of definitive securities required by law—termination date December 31, 1978.

* * * * * * *

(f) *Termination date.* The provisions of this subpart will apply only to definitive Treasury bills whose issuance in such form was authorized prior to December 31, 1978, and whose availability will be co-extensive with their maturity dates.

The foregoing amendment was effected under authority of sections 5 and 20 of the Second Liberty Bond Act, as amended (40 Stat. 290, as amended; 31 U.S.C. 754 48 Stat. 343, as amended; 31 U.S.C. 754b; and 5 U.S.C. 301). Notice and public procedures thereon are deemed unnecessary as the fiscal policy of the United States is involved.

DAVID MOSSO,
Fiscal Assistant Secretary.

Exhibit 6.—Department Circular, Public Debt Series No. 27–76, December 2, 1976, issue and sale of book-entry Treasury bills and of definitive Treasury bills to eligible bidders

DEPARTMENT OF THE TREASURY,
Washington, December 2, 1976.

The regulations in Department of the Treasury Circular, Public Debt Series No. 27–76, set forth below, are descriptive of the issue and sale of the 52-week, 26-week and 13-week Treasury bills, and other Treasury bills, which, after specified dates, will be available, with a limited exception, only in book-entry form. The regulations governing such book-entry Treasury bills, following a notice of proposed rule making, have been finally adopted and are being published simultaneously herewith.

Treasury bills issued in book-entry form prior to the dates when they will be available only in such form are maintained under, and will continue to be subject to, the regulations set out in Subpart 0 of Department of the Treasury Circular No. 300, current revision (31 CFR, Part 306). That subpart prescribes an optional book-entry procedure, and the sale and issue of Treasury bills to which it, in part, applies are generally provided for in Department of the Treasury Circular No. 418, Second Revision, dated October 5, 1976 (31 CFR, Part 309). The Treasury bills held under Subpart 0 will continue to be convertible to definitive bills at the request of the party for whose account they are maintained.

As the fiscal policy of the United States is involved in the issue and sale of Treasury securities, it is found unnecessary to issue these regulations with notice and public procedure thereof under 5 U.S.C. 553(b), or subject to the effective date limitation of 5 U.S.C. 553(d).

DAVID MOSSO,
Fiscal Assistant Secretary.

Chapter II of Title 31 of the Code of Federal Regulations is amended by adding Part 349 as set forth below.

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, 754b.

§349.0 Authority for issue and sale.

The Secretary of the Treasury is authorized under 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, but not exceeding one year from the date of issue; 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.

§349.1 Description of Treasury bills—general—book-entry—definitive.

(a) *General.* Treasury bills are obligations of the United States, issued at a discount, promising to pay a specified amount on a specified date. They are issued only by Federal Reserve Banks and Branches, acting as Fiscal Agents of the United States, and by the Bureau of the Public Debt, Washington, D.C. 20226, pursuant to tenders accepted by the Department of the Treasury.

(b) *Book-entry Treasury bills.* Book-entry Treasury bills under this part are bills issued only in the form of entries on either the records of a Federal Reserve Bank or of the Department of the Treasury, as follows:

(1) 52-week Treasury bills issued after December 1, 1976;

(2) 26-week Treasury bills issued after June 1, 1977;

(3) 13-week Treasury bills issued on or after September 1, 1977; and

(4) Any other Treasury bills issued after September 1, 1977, including, but not limited to, tax anticipation Treasury bills.

(c) *Definitive Treasury bills for eligible entities.* Treasury bills in the form of engraved certificates will be issued on or after the dates specified in paragraph (b) of this section, and for the series shown, in the denomination of $100,000 only, and only until December 31, 1978, solely to entities required by or pursuant to, Federal, State, municipal, or other local law to hold securities in definitive form. Such entities may include, but are not limited to a State, municipality, city, township, county or any other political subdivision, public corporation or other public body, an insurance company, and a fiduciary so required to hold physical securities.

§349.2 Regulations.

The Treasury bills, the issue and sale of which are herein provided, shall be subject to the book-entry Treasury bill regulations set forth in Department of the Treasury Circular, Public Debt Series No. 26–76 (31 CFR, Part 350), and, to the extent applicable, to Department of the Treasury Circular No. 300, current revision (31 CFR, Part 306), the general regulations governing United States securities. Copies of the circulars may be obtained from a Federal Reserve Bank or Branch, or the Bureau of the Public Debt.

§349.3 Public notice of offering.

When Treasury bills are offered, tenders therefor will be invited, on a competitive and noncompetitive basis, through public notice given by the Secretary of the Treasury in the name of "The Department of the Treasury". In such notice, there will be set forth the amount of Treasury bills for which tenders are being invited, the date of issue, the CUSIP number, 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 the Department of the Treasury, and the date on which payment for tenders must be made or completed.

§349.4 Amount of tender; price.

Tenders in response to the public notice must be for a minimum of $10,000, and tenders over that amount must be in multiples of $5,000. Definitive Treasury bills will be available, as set forth in §349.1(c), only in the $100,000 denomination and only for the account of eligible investors. In the case of competitive tenders, the price or prices offered by the bidder for the amount or amounts applied for must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used. Noncompetitive tenders will be accepted at the average price of the competitive tenders accepted.

§349.5 Form of tenders.

Tenders may be submitted on printed forms and forwarded in special envelopes available from any Federal Reserve Bank or Branch. If a special envelope is not available, the inscription "Tender for Treasury Bills" should be placed on the envelope used. The instructions on the forms with respect to the submission of tenders should be observed. Tenders for book-entry Treasury bills to be maintained on the accounts of the Department of the Treasury should be submitted on special forms available for that purpose.

§349.6 Tenders for customers and for own account.

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 the accounts 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.

§349.7 Deposits with tenders submitted to Federal Reserve Banks.

Tenders submitted to Federal Reserve Banks and Branches by incorporated banks and trust companies, and 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 prescribed in the public notice, except that such deposit will not be required if the tenders are accompanied by an express guaranty of payment in full by an incorporated bank or trust company. Forfeiture of the deposit may be declared by the Secretary of the Treasury, if payment is not completed, in the case of accepted tenders, on the prescribed date.

§349.8 Payment with tenders submitted to Treasury.

Tenders for Treasury bills to be issued and maintained on book-entry accounts of the Treasury must be accompanied by full payment of the face amount of the bills applied for. A cash adjustment will be made for the difference between the par payment submitted and the actual issue price of the bills.

§349.9 Submission of tenders.

Tenders must be received on or before the time fixed for closing, as set forth in the public notice, at Federal Reserve Banks and Branches, and at the Bureau of the Public Debt, Washington, D.C. 20226. Tenders not timely received will be disregarded.

§349.10 Reservation of right.

The Secretary of the Treasury expressly reserves the right on any occasion to accept noncompetitive 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.

§349.11 Acceptance of tenders.

The Department of the Treasury will determine from the tenders received the amount and price range of the accepted bids. Those at 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. Public announcement of the acceptance will then be made. Those submitting tenders will be advised of the acceptance or rejection thereof by the Federal Reserve Banks or by the Treasury, depending on where such tenders were received.

§349.12 Payment of accepted tenders.

Settlement for accepted tenders submitted to a Federal Reserve Bank must be made or completed at such Bank in cash or other immediately available funds on or before the date specified, except that the public notice inviting tenders 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 settlement in maturing Treasury bills is authorized, a cash adjustment will be made for the difference between the par value of the maturing bills and the issue price of the new ones.

§349.13 Acceptance of book-entry Treasury bills for various purposes.

(a) *Acceptable as security for public deposits.* Book-entry Treasury bills will be acceptable at maturity value to secure deposits of public monies.
(b) *Acceptable in payment of taxes where authorized.* The public notice inviting tenders for book-entry Treasury bills may provide that such bills will be acceptable at maturity value, whether at or before maturity, under such rules and regulations as may be prescribed, in payment of income taxes payable under the provisions of the Internal Revenue Code.
(c) *Discounting by Federal Reserve Bank of notes secured by Treasury bills.* Notes secured by book-entry 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.

§349.14 Taxation.

The income derived from Treasury bills, issued pursuant to this part, 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.

§349.15 Relief on account of loss.

Relief on account of the loss of any Treasury bills issued pursuant to this part 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 issued pursuant thereto, as set forth in Department of the Treasury Circular No. 300 (31 CFR, Part 306), insofar as applicable.

§349.16 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.

§349.17 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 7.—Department Circular, Public Debt Series No. 1–63, January 10, 1963, amended, regulations governing United States retirement plan bonds

DEPARTMENT OF THE TREASURY,
Washington, April 22, 1977.

SUMMARY: Certain operations regarding U.S. Retirement Plan Bonds have been transferred from the Division of Securities Operations in the Washington Office of the Bureau of the Public Debt to the Division of Transactions and Rulings in the Parkersburg Office of the Bureau. Accordingly, it is necessary to amend the regulations governing U.S. Retirement Plan Bonds to make appropriate address changes.

EFFECTIVE DATE: This amendment is effective on April 28, 1977.

Accordingly, Department of the Treasury Circular, Public Dept Series, No. 1–63, is amended as follows:

§§341.8 and 341.12 [Amended]

1. In the Sections listed below, the references to "The Bureau of the Public Debt, Washington, D.C. 20226" are changed to read: Bureau of the Public Debt, "Division of Transactions and Rulings", Parkersburg, West Virginia 26101.":
   1. Paragraph (b) of §341.8.
   2. Footnote 1 to paragraph (c) of §341.8.
   3. Section 341.12.

§§341.8–341.11 [Amended]

2. In the Sections listed below, the references to "The Bureau of the Public Debt, Washington, D.C. 20226" are changed to read: Bureau of the Public Debt, "Securities Transactions Branch," Washington, D.C. 20226 or Bureau of the Public Debt, "Division of Transactions and Rulings", Parkersburg, West Virginia 26101."
   1. Paragraph (c) of §341.8.
   2. Paragraph (c)(2) of §341.8.
   3. Paragraph (a)(5) of §341.9.
   4. Paragraph (b) of §341.9.
   5. Paragraph (a) of §341.10.
   6. Paragraph (b) of §341.11.

This amendment is issued under the authority of 5 U.S.C. 301, 31 U.S.C. 752. As it is entirely administrative in nature and involves the fiscal policy of the United States, notice and public procedures thereon are found to be unnecessary.

DAVID MOSSO,
Fiscal Assistant Secretary.

Exhibit 8.—Department Circular No. 530, Tenth Revision, December 5, 1973, amended, regulations governing United States savings bonds

DEPARTMENT OF THE TREASURY,
Washington, May 13, 1977.

SUMMARY: These amendments of the regulations governing U.S. savings bonds eliminate the requirement that women named as coowners or beneficiaries on such bonds must be identified by a courtesy title if their social security numbers are not furnished.

EFFECTIVE DATE: May 19, 1977.

Accordingly, Department of the Treasury Circular No. 530; Tenth Revision, dated December 5, 1973, as amended (31 CFR Part 315); Department of the Treasury Circular No. 653, Ninth Revision, dated April 23, 1974, as amended (31 CFR Part 316); and Department of the Treasury Circular No. 905, Sixth Revision, dated April 19, 1974 (31 CFR Part 332), are amended as follows:

§315.5 [Amended]

Section 315.5 of 31 CFR, Part 315 is amended by the deletion of the twelfth sentence which begins with the words, "If a woman * * *"

DAVID MOSSO,
Fiscal Assistant Secretary.

Exhibit 9.—Department Circular No. 653, Ninth Revision, April 23, 1974, amended, offering of United States savings bonds, Series E

DEPARTMENT OF THE TREASURY,
Washington, May 13, 1977.

SUMMARY: These amendments of the regulations governing U.S. savings bonds eliminate the requirement that women named as coowners or beneficiaries on such bonds must be identified by a courtesy title if their social security numbers are not furnished.

EFFECTIVE DATE: May 19, 1977.

Accordingly, Department of the Treasury Circular No. 530, Tenth Revision, dated December 5, 1973, as amended (31 CFR Part 315); Department of the Treasury Circular No. 653, Ninth Revision, dated April 23, 1974, as amended (31 CFR Part 316); and Department of the Treasury Circular No. 905, Sixth Revision, dated April 19, 1974 (31 CFR Part 332), are amended as follows:

§316.2 [Amended]

Section 316.2 of 31 CFR, Part 316 is amended by the deletion of the first two sentences of Footnote 2.

DAVID MOSSO,
Fiscal Assistant Secretary.

Exhibit 10.—Department Circular No. 905, Sixth Revision, April 19, 1974, amended, offering of United States savings bonds, Series H

DEPARTMENT OF THE TREASURY,
Washington, May 13, 1977.

SUMMARY: These amendments of the regulations governing U.S. savings bonds eliminate the requirement that women named as coowners or beneficiaries on such bonds must be identified by a courtesy title if their social security numbers are not furnished.

EFFECTIVE DATE: May 19, 1977.

Accordingly, Department of the Treasury Circular No. 530, Tenth Revision, dated December 5, 1973, as amended (31 CFR Part 315); Department of the Treasury Circular No. 653, Ninth Revision, dated April 23, 1974, as amended (31 CFR Part 316); and Department of the Treasury Circular No. 905, Sixth Revision, dated April 19, 1974 (31 CFR Part 332), are amended as follows:

§332.2 [Amended]

Section 332.2 of 31 CFR, Part 332 is amended by the deletion of Footnote 1.

The foregoing amendments are issued under the authority of 5 U.S.C. 301, 31 U.S.C. 757c. As they involve the fiscal policy of the United States, notice and public procedures thereon are found to be unnecessary.

DAVID MOSSO,
Fiscal Assistant Secretary.

Exhibit 11.—Department Circular, Public Debt Series No. 1–75, January 3, 1975, First Amendment, regulations governing United States individual retirement plan bonds

DEPARTMENT OF THE TREASURY,
Washington, June 27, 1977.

Miscellaneous Amendments

SUMMARY: This amendment to the regulations governing United States Individual Retirement Bonds makes the changes necessitated by the Tax Reform Act of 1976. This is being accomplished by the addition of a $75 bond denomination and the revision of the annual purchase limitation. Certain addresses contained in the regulations are also being changed to reflect a transfer of operations within the Department.

EFFECTIVE DATE: July 21, 1977.

SUPPLEMENTAL INFORMATION: Individual Retirement bonds have been offered for sale since 1975 as one of the investments that eligible individuals may utilize to fund an individual retirement account (IRA) under the Internal Revenue Code. Since the Code prescribes a maximum amount that may be annually deducted for contributions to such an account, the regulations governing Individual Retirement Bonds have contained an annual purchase limitation equal to this maximum amount. Until passage of the Tax Reform Act of 1976 (Pub. L. 94–455), this annual limitation was 15 percent of earned income up to a maximum of $1,500.

Under section 1501 of the Tax Reform Act, however, certain married individuals eligible to purchase Individual Retirement Bonds are entitled to elect a higher annual deduction limitation. Under this new limitation, if the spouse of an individual eligible for IRA participation has no earned income during the year, the working eligible spouse may purchase bonds for tax deduction in that year up to either of the following two limitations:

(1) The working spouse may purchase bonds in his or her own name up to a maximum of 15 percent of earned income or $1,500, whichever is less, the deduction therefor to be taken under section 219 of the Internal Revenue Code; or

(2) Bonds may be purchased in each spouse's name, up to a total maximum of 15

percent of the working spouse's earned income or $1,750, whichever is less, the deduction therefor to be taken under section 220 of the Code.

Section 220 of the Code also requires that the IRA contributions made in each spouse's name for deduction under the 15 percent/$1,750 limitation must be in equal amounts. Thus, an eligible married couple desiring to fund their IRA solely with bonds can only obtain the maximum $1,750 deduction by purchasing $875 in bonds in each spouse's name. In order to make such purchases possible, the Department is providing a new $75 bond. This will now make bonds available in denominations of $50, $75, $100, and $500. The annual limitation on purchases of bonds is also being revised to make provision for the new Code Section 220 alternative limitation.

The Department is also making several address changes in the regulations to reflect a transfer of certain operations. Certain bond transactions previously handled by the Division of Securities Operations in the Washington Office of the Bureau of the Public Debt will now be handled by the Division of Transactions and Rulings in the Parkersburg Office of the Bureau.

The primary author of this document is Albert E. Martin, Attorney-Adviser, Bureau of the Public Debt.

Accordingly, to accomplish these changes, Department of the Treasury Circular, Public Debt Series, No. 1–75 (31 CFR Part 346) is hereby amended as follows:

1. In §346.1, the first sentence of paragraph (c) is revised to read:

§346.1 Description of bonds.

* * * * * * *

(c) *Denominations-issue date.* Individual Retirement Bonds will be available only in registered form and in denominations of $50, $75, $100, and $500.

2. Section 346.5 is revised to read:

§346.5 Limitation on holdings.

(a) Except as provided in paragraph (b) of this section, the amount of Individual Retirement Bonds which may be registered in any one individual's name is limited to the amount for which an annual deduction may be taken under either section 219 or 220 of the Internal Revenue Code.[1] These limitations are as follows:

(1) In the case of an individual electing to deduct his or her bond purchase under section 219, the face amount of bonds purchased for tax deduction in any given year may not exceed 15 percent of the individual's earned income for that year or $1,500, whichever is less.

(2) In the case of an individual electing to deduct his or her bond purchases under section 220, the total face amount of bonds purchased for tax deduction in any given year in the name of the individual and in the name of his or her nonworking spouse may not exceed 15 percent of the working spouse's earned income for that year or $1,750, whichever is less.[2]

(b) The above limitations do not apply to rollover bond purchases, as described in sections 402(a)(5), 403(a)(4), or 408(d)(3) of the Internal Revenue Code.

§346.8 [Amended]

3. Footnote 1 to paragraph (d)(2) of §346.8 is redesignated as footnote 3.

§§346.8, 346.9, 346.10, and 346.12 [Amended]

4. The references in the sections listed below to "Bureau of the Public Debt, Division of Securities Operations, Washington, D.C. 20226" are changed to read: "Bureau of the Public Debt, Division of Transactions and Rulings, Parkersburg, West Virginia 26101."

[1] NOTE.—Under the Internal Revenue Code, bonds issued during any given year or within 45 days thereafter may be deducted in that year.

[2] NOTE.—Code section 220 requires, in effect, that the total IRA contributions in each spouse's name to be deducted in any one year be in equal amounts. While it is permissible for an eligible married couple to utilize several different forms of IRA investments within the same year, this means that couples investing solely in bonds must purchase equal amounts of bonds in each spouse's name.

(1) Section 346.8(b)(2); (2) footnote 3 to §346.8(d)(2); (3) section 346.9(a); (4) section 346.10(a); (5) section 346.10(b); and (6) section 346.12.

* * * * * * *

5. The Table of Redemption Values following §346.15 is replaced by the new Table set out below:

Table of redemption values providing an investment yield of 6 percent per annum for bonds bearing issue dates beginning Jan. 1, 1975

NOTE.—This table shows how Individual Retirement Bonds bearing issue dates on or after Jan. 1, 1975, by denomination, increase in redemption value during the successive half-year periods following issue. The redemption values provide an investment yield of approximately 6 pct/annum, compounded semiannually, on the purchase price from issue date to the beginning of each half-year period. No increase in redemption value is shown, however, until 1 year after issue date since no interest may be paid on bonds redeemed before that time. The period to maturity is fixed in accordance with the provisions of §346.1(b) of this circular.

Issue price	$50.00	$75.00	$100.00	$500.00
Period after issue date	Redemption values during each half-year period (values increase on 1st day of period shown)			
1st yr	$50.00	$75.00	$100.00	$500.00
1 to 1 1/2 yr	53.05	79.57	106.10	530.50
1 1/2 to 2 yr	54.64	81.95	109.28	546.40
2 to 2 1/2 yr	56.28	84.41	112.56	562.80
2 1/2 to 3 yr	57.96	86.95	115.92	579.60
3 to 3 1/2 yr	59.70	89.55	119.40	597.00
3 1/2 to 4 yr	61.49	92.24	122.98	614.90
4 to 4 1/2 yr	63.34	95.01	126.68	633.40
4 1/2 to 5 yr	65.24	97.86	130.48	652.40
5 to 5 1/2 yr	67.20	100.79	134.40	672.00
5 1/2 to 6 yr	69.21	103.82	138.42	692.10
6 to 6 1/2 yr	71.29	106.93	142.58	712.90
6 1/2 to 7 yr	73.43	110.14	146.86	734.30
7 to 7 1/2 yr	75.63	113.44	151.26	756.30
7 1/2 to 8 yr	77.90	116.85	155.80	779.00
8 to 8 1/2 yr	80.24	120.35	160.48	802.40
8 1/2 to 9 yr	82.64	123.96	165.28	826.40
9 to 9 1/2 yr	85.12	127.68	170.24	851.20
9 1/2 to 10 yr	87.68	131.51	175.36	876.80
10 to 10 1/2 yr	90.31	135.46	180.62	903.10
10 1/2 to 11 yr	93.01	139.52	186.02	930.10
11 to 11 1/2 yr	95.81	143.71	191.62	958.10
11 1/2 to 12 yr	98.68	148.02	197.36	986.80
12 to 12 1/2 yr	101.64	152.46	203.28	1,016.40
12 1/2 to 13 yr	104.69	157.03	209.38	1,046.90
13 to 13 1/2 yr	107.83	161.74	215.66	1,078.30
13 1/2 to 14 yr	111.06	166.60	222.12	1,110.60
14 to 14 1/2 yr	114.40	171.59	228.80	1,144.00
14 1/2 to 15 yr	117.83	176.74	235.66	1,178.30
15 to 15 1/2 yr	121.36	182.04	242.72	1,213.60
15 1/2 to 16 yr	125.00	187.51	250.00	1,250.00
16 to 16 1/2 yr	128.75	193.13	257.50	1,287.50
16 1/2 to 17 yr	132.62	198.93	265.24	1,326.20
17 to 17 1/2 yr	136.60	204.89	273.20	1,366.00
17 1/2 to 18 yr	140.69	211.04	281.38	1,406.90
18 to 18 1/2 yr	144.91	217.37	289.82	1,449.10
18 1/2 to 19 yr	149.26	223.89	298.52	1,492.60
19 to 19 1/2 yr	153.74	230.61	307.48	1,537.40
19 1/2 to 20 yr	158.35	237.53	316.70	1,583.50
20 to 20 1/2 yr	163.10	244.65	326.20	1,631.00

These amendments are being issued under the authority of 5 U.S.C. 301, 26 U.S.C. 220, and 31 U.S.C. 757. As they either involve the fiscal policy of the United States or are administrative in nature, notice and public procedures thereon are found to be unnecessary. These amendments are effective upon publication.

DAVID MOSSO,
Fiscal Assistant Secretary.

Domestic Finance

Exhibit 12.—Statement by Assistant Secretary Gerard, November 10, 1976, before the Economic Stabilization Subcommittee of the House Banking, Currency, and Housing Committee, the Task Force on Tax Expenditures and Off-budget Agencies of the House Budget Committee, and the Subcommittee on Oversight of the House Ways and Means Committee, on loan guarantee programs

I am happy to be here today to assist you in your consideration of the guaranteed loan programs of the Federal Government, and I applaud your efforts in this very important area. I am hopeful that these efforts by three such distinguished committees of the House will contribute to more efficient and effective means of financing and controlling guaranteed loans as well as improvements in the budget and accounting procedures for guarantee programs.

Background

The special financing and budgeting problems in the guaranteed loan area have been studied over the past 30 years by a number of groups including the Hoover Commissions established by the Congress in 1947 and 1953, the private Commission on Money and Credit in 1961, the President's Committee on Federal Credit Programs in 1962, and the President's Commission on Budget Concepts in 1967. It is clear from a review of the reports of those groups that the problems in the guaranteed loan area are exceedingly complex and are not amenable to simple solutions.

The President's Commission on Budget Concepts stated in its 1967 report that "One of the most difficult questions the Commission has faced is how Federal loan outlays should be reflected appropriately in the budget." The Commission recommended that direct loans be included in the new unified budget totals and that guaranteed loans be excluded from the totals, and these recommendations were adopted by the President in 1968. However, the Commission recognized the need for coordinated surveillance of guaranteed loans, and the Commission stated:

> The Commission believes further study should be made of the need for greater coordination of guaranteed and insured loan programs. The executive branch and the Congress may wish to consider the desirability of establishing new procedures for reviewing the authorizations and ceilings on insured and guaranteed loan programs in view of the growing importance of this type of program.

Yet, little progress has been made over the past decade toward developing new congressional procedures for reviewing guaranteed loan authorizations, and in the Congressional Budget and Impoundment Control Act of 1974 guaranteed loans were specifically exempted from the new congressional budget process.

While the problem of budget treatment of guaranteed loans has remained unsolved, considerable progress has been made over the past decade with respect to the financing of guaranteed loans. Although there were some problems in connection with the sale and budget treatment of participation certificates, in the Participation Sales Act of 1966 the Congress recognized the importance of consolidation and coordination of Federal agency sales of guaranteed loans in the market. That act authorized the pooling of loans sold in the market by various agencies and required that loan sales be approved by the Secretary of the Treasury. Thus, the Congress recognized that sales of guaranteed loans, including certificates of participation in pools of loans, were similar in their market effects to issues of direct agency securities, which were generally subject to Treasury approval under the Government Corporation Control Act of 1945.

Then, in 1973, the Congress established the Federal Financing Bank, which provided a mechanism to consolidate the financing of obligations issued, sold, or guaranteed by Federal agencies. Also, in recent years the Congress has enacted a number of statutes requiring that the financing of certain new guarantee programs be subject to Treasury approval or handled exclusively by the Federal Financing Bank. Examples of such legislation enacted in 1976 are new loan guarantee programs for coastal energy impact assistance (Public Law 94–370, July 26, 1976), the Virgin Islands (Public Law 94–392, August 19, 1976), the Guam Power Authority (Public Law 94-395, September 3, 1976), and construction of waste treatment works (Public Law 94-558, October 19, 1976).

Definition of guaranteed loans

In attempting to deal with guaranteed loan problems, it is essential at the outset to define guaranteed loans. In the Federal Financing Bank Act of 1973 the Congress defined "guarantee" to mean "any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any obligation * * *." In keeping with this definition, the FFB has purchased a wide variety of obligations guaranteed or insured by Federal agencies, including obligations secured by Federal agency lease payments and obligations acquired directly by Federal agencies and then sold to the FFB subject to an agreement that the selling agency will assure repayment to the FFB in the event of default by the non-Federal borrower. We also interpret the FFB Act definition of guaranteed obligations as including obligations supported by Federal agency commitments to make debt service grants; e.g., to support public housing authority bonds, or other commitments such as price support agreements or commitments by Federal agencies to make direct "take-out" loans in the event of default on a private obligation.[1] However, the FFB has uniformly pursued a policy of purchasing obligations guaranteed under these various arrangements only if there is a full guarantee of both principal and interest, even though partially guaranteed obligations would technically be eligible for FFB purchase under the definition of "guarantee" in the FFB Act.

FFB financing of guaranteed loans

Simply stated, the purchase of guaranteed obligations by the FFB can be viewed as changing guaranteed loans to direct loans. One of the key issues facing Congress and the executive branch, and one on which there is disagreement within the executive branch, is whether such conversions on a large scale are sound as a matter of public policy.

It is the Treasury's view that FFB financing is in the best interests of the Government. Permitting 100 percent Government-guaranteed obligations to be issued in the market in direct competition with the Treasury's own securities and at higher interest rates than those paid by the Treasury would be undesirable from the standpoint of Treasury debt management policy and clearly not in accord with the intent of Congress as expressed in the Federal Financing Bank Act of 1973.

If access to the FFB were denied in the case of a fully guaranteed loan, the ultimate borrower would bear higher costs equivalent on average to one-half percentage point. While these higher costs mean that the benefit provided by the guarantee is worth less to the borrower, it would not mean that the burden to taxpayers would be less.

Fully guaranteed obligations would be equivalent to Treasury obligations in terms of risk to investors, but the market would require the borrower to incur higher borrowing costs because investors would be unfamiliar with the issue and because of market factors; e.g., less liquidity. Accordingly, sales of guaranteed obligations in the market normally require far more in the way of legal and financial services involving payment of fees of investment bankers or other financial intermediaries, fees of attorneys and accountants, and printing costs for prospectuses and other related documents. None of these costs is incurred when the FFB is employed.

Moreover, if substantial amounts of guaranteed borrowing are effected through numerous market transactions rather than through the FFB, the entire market for Government securities—of which private obligations guaranteed by the Federal Government are, of course, a part—can be disrupted. The result of such disruption is higher borrowing costs for all participants in the market, and the resulting higher costs will exert upward interest rate pressures on consumer loans, mortgage rates, small business loans, and all other financial instruments.

[1] The broad definition of guaranteed loans in the Federal Financing Bank Act of 1973 is also the approach taken in the tabulation and analysis of guaranteed loans in Special Analysis E of the President's Budget, which shows a total of $200 billion in guaranteed loans outstanding at the end of the fiscal year 1975 and an estimated $235 billion at the end of fiscal year 1977.

The FFB was created by Congress expressly to deal with these concerns. Its establishment reflected Congress view that obligations backed by the full faith and credit of the United States should be financed as efficiently as possible, with the lowest possible transaction costs and with the least disruption to our capital markets. It is to serve these objectives that we believe the bank should be available to finance fully guaranteed obligations.

The two principal arguments against FFB purchases of fully guaranteed obligations are (1) the resulting interest cost savings to the guaranteed borrower will provide an additional and unwarranted incentive to borrow and may add to demands for expanded and new guaranteed programs, and (2) the additional direct Treasury securities issues to finance the FFB will add to the total volume of Treasury issues and will thus add to the cost of Treasury borrowing. Taking the second argument first, while it is unlikely that any interest rate effect will be material, the precise effects of shifting borrowing from one sector of the Federal securities market to another sector of that market cannot be predicted with certainty. Yet, it is clear to us that the interest savings realized by the guaranteed sector from financing through the FFB outweigh any higher interest costs to the Treasury.

As to the former contention, if Congress determines that the savings made possible by access to the FFB should not be passed on to the guaranteed borrower, then we believe that the benefits should be realized by the taxpayers, through increased guarantee fees or similar offsetting devices, rather than by bondholders, financial intermediaries, and other unrelated third parties.

Budget treatment of guaranteed loans

Regardless of whether guaranteed loans are financed through the FFB or directly in the private market, guarantees should clearly be subject to overall coordination and review in the annual budget and appropriation process. While loan guarantees are different from outright grants, guarantees do in fact involve very substantial costs to the taxpayer and to the economy. These costs vary considerably from one guarantee program to another, depending upon the structure of the more than 100 loan guarantee programs which have been enacted by the Congress and the different types of subsidies provided by the Congress in these programs.

Principal subsidies.—In some cases the Federal Government enters into loan guarantee arrangements with the expectation of paying part or all of the principal amount of the loan, so that the guaranteed loan is equivalent to an outright grant of taxpayer funds. For example, the $14 billion of guaranteed public housing loans outstanding will probably have to be repaid by the Federal taxpayer, because it is not expected that public housing projects will generate enough receipts to cover current operating costs. As a result, the entire $14 billion of their debt will be paid off by annual contributions by HUD and thus by the Federal taxpayer.

Interest subsidies.—Many guaranteed loan programs, in fact, involve a double subsidy because direct interest subsidies—e.g., loans for students, rural community facilities, and subsidized private housing—are provided in addition to the large subsidy implicit in the guarantee. The Federal budget shows an estimate of $2 billion for the present value of these subsidies on guaranteed loan commitments in fiscal year 1977.

Default costs.—In addition to direct principal and interest subsidies on certain guaranteed loans, all guaranteed loans involve Government assumption of credit risks and thus potential costs to the Federal taxpayer in the event of default.

Administrative costs.—While some loan guarantee programs involve fees charged by Federal agencies to cover the Government's expenses of processing loan applications, loan servicing, and other administrative expenses, in other programs there are no such fees, or the fees are not adequate to cover the administrative costs because of provisions of law which prohibit fees or limit the fees which may be charged. These are only the costs which lend themselves to ready quantification.

In the long run, the most burdensome costs of Federal credit programs are their adverse effects on our prosperity and future economic growth caused by the allocation of capital away from its potentially most productive uses. Every time we create a guarantee program we are denying other private borrowers access to much-needed capital funds. And without such capital resources, the private sector will be unable to fulfill its responsibility to create jobs and provide a better standard of living for all citizens. It is this reality, above all, which Congress must consider each time it is asked to extend further the full faith and credit of the United States.

Distinction between direct and guaranteed loans

Direct loans are, unless explicitly excluded by law, included in the budget totals, and it is difficult to see how direct loans differ in substance from guaranteed loans. Rather than classifying loans for budget and appropriations purposes on the basis of whether the loans are guaranteed or financed directly by the Government, I think it is essential to look at the substantive aspects of these Federal credit programs and to determine on the basis of their substance how they should be financed or treated in the budget process.

In this regard it is helpful to recognize that all loans involve three basic functions: (1) The risk function, (2) the financing function, and (3) the processing function. A popular concept of guaranteed loans is that the Government assumes part or all of the credit risk and that the private sector performs the functions of financing the loan and the paperwork involved in loan applications, appraisals, servicing, and default procedures. Yet, two examples serve to highlight the thin and often invisible line between guaranteed and direct loan programs. First, certain agencies are empowered to make direct loans—incurring the costs of origination, servicing, et cetera—but then can remove the loans from the budget totals by reselling them with a guarantee to a private party.

The line can be as easily crossed in the other direction. For example, under the HUD urban renewal program, which provides for direct loan authority, a commitment to make a direct loan is treated as a guarantee, and the actual obligations are sold in the market by non-Federal entities.

Possible changes in the budget appropriations process

A number of suggestions have been made over the years as to how the budget appropriations process might be improved with respect to the treatment of guaranteed loans.

One alternative is to require all guaranteed loan disbursements and repayments to be treated in the same way as direct loans and thus included in the budget totals, perhaps in a separate loan account. A more complicated approach would be to include in the budget totals only the estimated present value of the costs to the Government for program administrative expenses, interest subsidies, or loan defaults.

Should Congress determine that guaranteed loans should not be included in the budget, Congress may still wish to consider more effective means of reviewing each guarantee program in the regular annual budget appropriations process. I would also suggest that consideration be given to including the total volume of annual loan guarantee commitments in the budget resolution each year.

Exhibit 13.—Statement by Assistant Secretary Altman, August 1, 1977, before the House Ways and Means Committee, on the public debt limit

I am pleased to be here today to assist you in your consideration of the public debt limit. As you know, on September 30, 1977, the present temporary debt limit of $700 billion (enacted on June 30, 1976) will expire and the debt limit will revert to the permanent ceiling of $400 billion. Legislative action by September 30 will be necessary, therefore, to permit the Treasury to borrow to refund securities maturing after September 30 and to raise new cash to finance the anticipated deficit in the fiscal year 1978.

In addition, we are requesting an increase in the $17 billion limit (also enacted June 30, 1976) on the amount of bonds which we may issue without regard to the 4 1/4-percent interest rate ceiling on Treasury bond issues.

Finally, we are requesting authority to permit the Secretary of the Treasury, with the approval of the President, to change the interest rate on U.S. savings bonds if that becomes necessary for purposes of assuring a fair rate of return to savings bonds holders.

Debt limit

Turning first to the debt limit, our estimates of the amounts of the debt subject to limit at the end of each month through the fiscal year 1978 are shown in the attached table. The table projects a peak debt subject to limit of $780 billion at September 30, 1978, which assumes a $12 billion cash balance. The usual $3 billion margin for contingencies would raise this amount to $783 billion. We are thus requesting an increase of $83 billion from the present temporary limit of $700 billion.

This $83 billion increase reflects the administration's current estimates of a fiscal 1978 unified budget deficit of $61.5 billion, a trust fund surplus of $13.1 billion, and a net financing requirement for off-budget entities of $8.5 billion. The trust fund surplus must be added to the debt requirement because the surplus is invested in Treasury securities which are subject to the debt limit.

The debt of off-budget entities which affect the debt limit consists largely of obligations which are issued, sold, or guaranteed by Federal agencies and financed through the Federal Financing Bank. Since the Federal Financing Bank borrows from the Treasury, the Treasury is required to increase its borrowing in the market by a corresponding amount. This, of course, adds to the debt subject to limit.

As indicated in the table, it is assumed that the Treasury's operating cash balance will be at $12 billion on both September 30, 1977, and September 30, 1978. On this basis, no net increase in the debt will be required to finance the cash balance in the fiscal year 1978. We believe that our $12 billion projection is reasonable in light of current needs and the actual balances maintained by the Treasury in recent years. Over the past decade, the Treasury's cash balances at the end of each fiscal year have been as follows:

	Billion		Billion
1968	$5.3	1974	$9.2
1969	5.9	1975	7.6
1970	8.0	1976	14.8
1971	8.8	T.Q.	17.4
1972	10.1	1977	12.0 est.
1973	12.6	1978	12.0 est.

The trend to larger cash balances in recent years reflects the overall growth in Government receipts and expenditures. Also, there is a heavy drain in cash from Government expenditures in the first half of each month, and there is a sharp increase in cash from tax receipts in the second half of the tax payment months. Thus, large monthend cash balances, which must be financed from additional borrowing, are essential to the efficient management of the Government's finances.

Our requested increase in the debt subject to limit is slightly lower than the $784.9 billion agreed to in the House-Senate conference on May 11, 1977, on the first concurrent resolution on the budget for fiscal 1978. This means that the targeted amount of debt subject to limit in the May concurrent resolution will be adequate to meet the administration's estimated requirements of $783 billion.

Bond authority

I would like to turn now to our request for an increase in the Treasury's authority to issue long-term securities in the market with regard to the 4 1/4-percent statutory ceiling on the rate of interest which may be paid on Treasury bond issues. We are requesting that the Treasury's authority to issue bonds (securities with maturities over 10 years) be increased by $10 billion from the current ceiling of $17 billion to $27 billion.

As you know, the 4 1/4-percent ceiling predates World War II but did not become a serious obstacle to Treasury issues of new bonds until the mid-1960's. At that time, market rates of interest rose above 4 1/4 percent, and the Treasury was precluded from issuing new bonds.

The Congress first granted relief from the 4 1/4-percent ceiling in 1967 when it redefined, from 5 to 7 years, the maximum maturity of Treasury notes. Since Treasury note issues are not subject to the 4 1/4-percent ceiling on bonds, this permitted the Treasury to issue securities in the 5- to 7-year maturity area without regard to the interest rate ceiling. Then, in the debt limit act of March 15, 1976, the maximum maturity on Treasury notes was increased from 7 to 10 years. Today, therefore, the 4 1/4-percent ceiling now applies only to Treasury issues with maturities in excess of 10 years. Concerning amounts exempted from this ceiling, in 1971 Congress authorized the Treasury to issue up to $10 billion of bonds without regard to it. This limit then was increased to the current level of $17 billion in the debt limit act of June 30, 1976. As a result of these actions by the Congress, the Treasury has been able to achieve a better balance in the maturity structure of the debt and has reestablished the market for long-term Treasury securities.

Today, however, Treasury has nearly exhausted the present $17 billion authority. Including the $1 billion new bond issue announced on July 27, the amount of remaining authority to issue bonds is $1 billion. Since the last increase in this limit on June 30, 1976, the Treasury has offered $6.3 billion of new bonds in the market. This includes $2.5 billion issued in the current quarter. While the timing and amounts of future bond issues will depend on current market conditions, a $10 billion increase in the bond authority would permit the Treasury to continue this recent pattern of bond issues throughout the fiscal year 1978. We believe that such flexibility is essential to efficient management of the public debt.

Savings bonds

In recent years, Treasury recommended on several occasions that Congress repeal the 6-percent statutory ceiling on the rate of interest that the Treasury may pay on U.S. savings bonds. The 6-percent ceiling rate has been in effect since June 1, 1970. Prior to 1970, the ceiling has been increased many times. As market rates of interest rose, it became clear that an increase in the savings bond interest rate was necessary in order to provide holders of savings bonds with a fair rate of return.

While we do not feel that an increase in the interest rate on savings bonds is necessary at this time, we are concerned that the present process of requiring legislation for each increase in the rate does not provide sufficient flexibility to adjust the rate in response to changing market conditions. The delays encountered in the legislative process could result in inequities to savings bond purchasers and holders as market interest rates rise on other competing forms of savings. Also, the Treasury has come to rely on the savings bond program as an important and relatively stable source of long-term funds, and we are concerned that participants in the payroll savings plan and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with other comparable forms of savings.

Any increase in the savings bond interest rate by the Treasury would continue to be subject to the provision in existing law which requires approval of the President. Also, the Treasury would, of course, give very careful consideration to the effect of any increase in the savings bond interest rate on the flow of savings to banks and thrift institutions.

To sum up, we are requesting an increase in the debt limit to $783 billion through September 30, 1978, and an increase in the bond authority to $27 billion, and a repeal of the interest rate ceiling on savings bonds. I will be happy to try to answer any questions regarding these requests.

Public debt subject to limitation, fiscal year 1977, based on budget receipts of $358 billion, budget outlays of $404 billion, unified budget deficit of $46 billion, off-budget outlays of $10 billion

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1976		ACTUAL	
Sept. 30	17.4	635.8	
Oct. 29	12.0	638.7	
Nov. 30	8.7	645.8	
Dec. 31	11.7	654.7	
1977			
Jan. 31	12.7	655.0	
Feb. 28	14.6	664.5	
Mar. 31	9.0	670.3	
Apr. 29	17.8	672.2	
May 31	7.0	673.2	
June 30	16.3	675.6	
July 27	9.8	673.0	
		ESTIMATED	
Aug. 31	12.0	690	693
Sept. 30	12.0	696	699

Public debt subject to limitation, fiscal year 1978, based on budget receipts of $401 billion, budget outlays of $463 billion, unified budget deficit of $62 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
1977		ESTIMATED	
Sept. 30	12	696	699
Oct. 31	12	708	711
Nov. 30	12	716	719
Dec. 30	12	721	724
1978			
Jan. 31	12	720	723
Feb. 28	12	733	736
Mar. 31	12	749	752
Apr. 17	12	757	760
Apr. 28	12	745	748
May 31	12	763	766
June 15	12	770	773
June 30	12	758	761
July 31	12	764	767
Aug. 31	12	775	778
Sept. 29	12	780	783

Exhibit 14.—Remarks by Special Assistant to the Secretary (Debt Management) Niehenke, September 13, 1977, before the Greater Philadelphia Money Marketeers Club, Philadelphia, Pa., on Treasury financing operations

I think it might be appropriate at this time as we are about to close the 1977 fiscal year to reflect on some of the developments which have impacted Treasury financing operations, review the strategy currently utilized, and speculate a bit on the outlook for fiscal 1978 for Treasury financing and the market as a whole.

Certainly the 1977 fiscal year will be remembered as one of the more volatile in terms of constantly changing budget deficit estimates and the resulting impact on Treasury financing operations. We began this fiscal year with the basic Ford administration budget which indicated a deficit of $57.2 billion which compared to a deficit of $66.5 billion during fiscal 1976 and $12.9 billion during the transition quarter. As the Carter administration took office, the current fiscal year budget was revised to reflect concerns over the perceived rate of growth in the economy and the determination to improve the unemployment situation. An economic stimulus package was prepared and was to be implemented over 2 years. The first phase consisted primarily of a tax rebate to stimulate consumer spending and the second or longer term one would reduce business taxes, expand training and employment programs, and increase public works spending and countercyclical revenue sharing.

This program proposal had the effect of increasing the budget deficit from $57.2 billion to $68 billion for the 1977 fiscal year, and this group will no doubt recall the effects of this development which immediately followed the severe price reversal at the end of December and early January. However, at the same time, it was becoming apparent that the expenditure shortfall phenomenon first witnessed in early 1976 was continuing into the 1977 fiscal year and at an extraordinary rate. In fact, by the end of January, outlays were already tracking $8 billion below budget, or at an annual rate of $24 billion; this pace accelerated in February, as they increased by an additional $2.7 billion.

Aside from financial transactions such as asset sales which can be specifically isolated, these expenditure shortfalls continued to mystify administration budget analysts who continue to monitor them very closely to understand their cause. It is my personal view that these shortfalls will eventually be attributed to program cost overestimates following the hyperinflationary experience in 1974 and some timing differences and will be gradually corrected.

As we progressed into the year the economy began to register impressive gains and the rebate proposal came under question. After considerable debate, the administration decided that the proposal should be withdrawn, thereby reducing $11 billion of the budget deficit. By the end of April, the combined rebate withdrawal and actual expenditure shortfalls reduced the deficit from $68 to $48 billion, and considerable speculation ensued as to whether any of the shortfall would be made up. As it turned out, outlays continued to erode but at a more gradual rate with the result that the deficit should approximate $45 billion on September 30.

As a result of the continually reduced budget deficits and corresponding financing needs, the Treasury found that the regular note cycle and quarterly refundings provided more than ample borrowing opportunities to raise needed cash. I don't think I need to review in any great detail for this group the evolution of "regularization" or the systematic offering of coupon securities designed to give the Treasury frequent borrowing opportunities with minimum market disturbance. The current regular note cycle has been in place since January 1976 and consists of a monthly 2-year note offering, a 5-year note offering in the first month of the quarter, the usual quarterly refunding in the second month of the quarter, and a 4-year note in the last quarter of the month. The benefits of regularization are several:

1. This cycle, repeated each quarter, offers the Treasury two coupon borrowing opportunities which may be utilized, passed, or, in the case of maturities, paid down depending on projected cash requirements.
2. Therefore, it reduces the market uncertainty regarding Treasury financing. And while the precise amount of a forthcoming announcement is uncertain, the market is nonetheless on notice of a possible financing.

3. It permits investors to anticipate Treasury offerings and facilitates the implementation of their investment programs.
4. As it consists of coupon financing, it addresses the problem of the maturity of the public debt which would contract without some initiative such as the regular coupon cycle which, I might note, does not lengthen the average maturity but rather holds it constant.

As I stated earlier, the regular note cycle provided sufficient borrowing opportunities to satisfy the fiscal year 1977 cash requirements; in fact, it provided over $43 billion in new cash from coupon offerings which we estimate to have been 6–8 billion below the cash-raising potential of this cycle. Fiscal year 1977 financing requirements, while large, were manageable enough to permit us the luxury and opportunity of some debt extension. Specifically, the rebate withdrawal in April created the first cash surplus in a quarter since 1974 and confronted the Treasury with the unusual but welcome problem of paying off debt. After much debate and discussion, we decided to maintain the regular note cycle and pay down Treasury bills with the result that we were able to add 2 months to the average life of the privately held marketable debt, bringing it to 2 years and 11 months. In addition, we took the opportunity during this period to issue the long-awaited 15-year bond in early July by substituting the bond for the regular 5-year cycle note. We found the price results of this financing very gratifying although a market rally immediately preceding this auction faltered and did not make this feeling universal. Nonetheless, we were sufficiently pleased to consider offering additional 15-year securities again sometime in the future. However, the timing of such an offering will depend on our cash requirements at that time and prevailing market conditions.

Financing operations during the 1977 fiscal year were strongly influenced by two investor groups: official foreign institutions and State and local governments. Combined, these governmental units supplied over $16 billion or 29 percent of the total budget and off-budget financing requirements for the fiscal year. This compares to $2.8 billion or 4 percent of the fiscal 1976 budget and off-budget financing deficit.

The foreign purchases, which are referred to as "add-ons" due to the fact that we increase any publicly offered issues of 52-week bills or coupon securities by the amount of foreign interest, are expected to exceed $8 billion for the 1977 fiscal year, or over five times the amount of such purchases during fiscal 1976. This add-on facility was originally designed for a Middle East government in 1974 and has been extended to all foreign official institutions which may wish to acquire Treasury securities. And while it is not the only facility offered foreign investors, it is the most visible and commonly used vehicle.

Foreigners began to step up purchases of Treasury securities in the second and third quarters of 1976 when these purchases averaged just under $1 billion for each of those periods. They then accelerated in the final quarter to $1.4 billion, to $2 billion in the first quarter of 1977, and then stabilized at $2 1/4 billion for the second and third quarters. During this period foreigners also altered their portfolio strategy and maturity preferences. Initially they concentrated their investments in maturities of 1 to 2 years; however, by the end of the current fiscal year, foreign purchases were spread equally among the 2-, 4-, and 5-year cycle notes with moderate purchases of the 7-year maturities offered in the last two quarterly refundings. While it is difficult to predict future foreign demand due to changes in interest rates, maturity preferences and foreign exchange rates, recent experience suggests that foreign demand is stable.

The second source, investment by State and local governments in special Treasury issues custom-designed to provide a rate of return on funds raised to refund outstanding and higher cost municipal securities without violating Internal Revenue arbitrage regulations, has also contributed approximately $8 billion over the current fiscal year (compared to $1.2 billion in fiscal 1976). The reasons for the substantial increase in this area are twofold. First, the continued and dramatic recovery of the municipal market through 1976 and 1977 as evidenced by a reduction in the BBI from 7.13 percent to 5.48 percent provided significant incentive to municipal finance officers to refund securities issued during the adverse market conditions surrounding the New York City financial crisis in 1975. Second, the ongoing process of tightening revenue code regulations to eliminate arbitrage opportunities and the accompanying abuses has served to legitimize, encourage, and facilitate municipal refundings.

Unlike foreign purchases which are difficult to predict from one month to the next, it appears that the issuance of State and local special issues may continue as several large issuers such as the State of Massachusetts and the NY Power Authority are planning major refundings and many more issuers are considering refundings.

While we expect new arbitrage schemes to emerge and, in fact, have just turned the latest over to our tax policy people, our current capture rate appears to be over 95 percent and we expect that with some diligence we will be able to count on these refundings proceeds as a fairly stable financing source.

Hopefully that will be the case as our fiscal 1978 financing requirements will be considerably higher than those of the current fiscal year. As you are aware, Congress is currently deliberating the final budget figures. Last week the House passed a budget resolution which results in a $61.6 billion deficit. The Senate followed on Friday with a bill creating a deficit of $65.1 billion; the differences are primarily related to estimated tax collections and the economic assumptions which underpin them. A conference committee will now create a compromise which should result in a deficit in the neighborhood of $63 billion. While the precise figure is not yet available, it is obvious that Treasury's cash requirements for the upcoming fiscal year will be significantly higher, approximately one-third higher (including off-budget financing) than the current fiscal year. However, they will modestly lower the record fiscal 1976 financial operations.

I might acknowledge at this time that the usual but cordial disagreements between Treasury and Wall Street economic forecasters over financing requirements continue, as several of the more prominent projectors estimate our financing requirements for fiscal 1978 to be comparable to the current fiscal year with no significant increase. As we lack the luxury to second-guess the administration budget as they do, I will address the higher financing estimate.

Looking ahead to the fiscal 1978 borrowing opportunities, it immediately becomes apparent that as regularization matures, the amount of a total financing increases but the new cash raised may decline as cycle securities previously issued must be rolled over.

For example, the amount of funds that could be potentially raised in the 2-year note cycle in the coming fiscal year is smaller than the current year. In addition, the amount of securities to be rolled over in the quarterly refundings is much larger for the coming year than the current one, thereby again minimizing the new cash potential. A quick survey of the borrowing opportunities in the quarterly refundings and regular note cycle spots, assuming modest to full-sized issues, produces approximately $40 billion. This figure obviously excluded any allowance for foreign add-ons. If the amount of foreign add-ons and State and local issues over the next fiscal year approximate this year's issues, then those categories would certainly help close the financing gap. However, as I suggested earlier, the two sources may prove difficult to forecast.

What other options might be considered? First, expanding the size of the regular cycle notes. Many dealers have offered the view that the shorter maturity cycle might be increased and indicate that the 2-year note in particular is a prime candidate for increases. The increases in this note cycle need not be restricted to the short-term area as the Treasury's increased financing in the intermediate and longer term market has been very well received. The increase in the maximum noncompetitive allotment from $1/2 to 1 billion has also facilitated larger longer term note and bond issuance.

I might note that we testified just prior to the August recess before the House Ways and Means Committee on the debt limit and received an excellent reception. In addition to acquiring an increase in the debt ceiling which should carry us through most of the 1978 fiscal year, the committee reported out a $10 billion increase in our long bond authority to $26 billion, which increase should provide considerable flexibility in our long-term financing operations.

Another possible financing option would be the fixed-price subscription which was very successfully utilized three times in 1976; this technique is usually held for those periods requiring extraordinarily large financing operations.

A third option would be bills, which could be accomplished in a variety of ways: Short and longer term cash management bills, bill strips and recently we have taken a fresh look at reinstating a 9-month type or 39-week bill and merging it and the present 52-

week cycle into the weekly bill maturity dates. And while we have not as yet formed any conclusion on this later option, I believe it could be an effective vehicle for raising large amounts of new cash and enhance bill market liquidity. And lastly, increases in weekly bills.

As the market has grown phenomenally over the past 2 years in terms of trading volume, I don't believe that moderate increases to weekly bills will prove too disruptive and given the structure of the debt, the Treasury is certainly conscious of the effects of short-term rate increases on our own interest expense.

I certainly don't mean to appear too complacent over the financing chore ahead; the task is indeed formidable. In addition, the market climate during the next several quarters should be different from the financial environment of 1976 and early 1977, when rates were declining or more stable.

The continual but now gradual expansion in economic activity in prospect for the next year is likely to entail further moderate increases in the demands for funds in the credit market with the increases fairly well distributed between major borrowers and types of borrowings. Alternatively, savings flows should be well maintained, and with expansion of bank credit gaining momentum, the higher demands are likely to be met fairly smoothly, without more than temporary ruffles in the credit market and with a gradual but moderate climb in interest rates.

The increases in the funds raised by business in the aggregate in 1977 and 1978 will be concentrated in the short-term area. The volume of long-term funds raised will level off as nonfinancial corporations cut back their bond and stock borrowings by much more than financial corporations raise theirs. External borrowings of nonfinancial corporations have picked up markedly in 1977; while long-term bond borrowings have declined, short-time borrowing are expected to continue growing at an increased rate as corporations are once again turning to their commercial banks. Furthermore, in 1978, emphasis on commercial bank loans (including term loans) is likely to become even more pronounced.

Finance companies doubled their bond borrowings in 1976 and, with their consumer and business credit operations expanding, are expected to further increase their drafts on the bond market in both 1977 and 1978.

Despite record issuance in 1977, the market for State and local securities will probably remain relatively strong. Municipal bond funds as well as unit trusts should continue to enjoy growing acceptance among individual investors. Also, the funds available to fire and casualty insurance companies will probably rise further and their operations become more profitable, thereby providing additional funds for investment in tax-exempts. Also, commercial banks have once again begun acquiring tax-exempts.

In summary, the combination of short-term credit demands and Treasury financing, which is concentrated primarily in the short maturity coupon area, should increase short-term rates, while a relatively moderate long-term calendar, combined with excellent availability of long-term investment funds, should flatten the yield curve further. The increase in yields, however, should not be excessive and should generally occur in an orderly fashion.

Exhibit 15.—Statement by Assistant Secretary Altman, September 20, 1977, before the Subcommittee on Oversight of the House Ways and Means Committee, on loan guarantee programs

I welcome this opportunity to present the views of the Treasury Department on H.R. 7416. The bill would place the Federal Financing Bank (FFB) within the budget and would, in effect, require that certain loan guarantee programs be financed through the FFB. This would mean that loan guarantee programs which are financed through the FFB would be included in the budget. Guaranteed loans which are not financed through the FFB would continue to be excluded from the budget.

We support the basic objectives of this bill from the standpoint of Treasury's debt management interests. I have a number of technical suggestions relating to the bill, which I will discuss later in my statement. H.R. 7416 also raises a number of complex issues from the standpoint of overall budget policies and procedures, however, which are of concern to the administration.

Mr. Chairman, I would like to turn first to the broader question of control over guarantee programs. Following that, I will discuss the specific provisions of H.R. 7416.

Control over guarantee programs

In testimony before the House Banking Committee on March 30 of this year, I discussed the rapid growth of loan guarantees, their large costs and impacts on credit markets, and the need for more effective controls. I suggested two approaches to improve control: (1) Establishing tighter standards covering the ways in which guarantees should be used and not used and (2) setting ceilings on total guarantees. Much attention has been given to the second approach of setting ceilings either by including guarantees in the budget or by other means. Yet, all of us need to focus more on the need for better standards under which guarantee authority is provided by Congress in the first place.

It seems to me that program agencies must be given much more specific guidelines on the circumstances under which guarantees are to be provided and the related terms and conditions of them. Giving these agencies broad guarantee authority and then expecting them to resist the inevitable demands for guarantees unavoidably leads to serious problems of control over guarantee totals and general misallocation of our limited credit resources.

Let me discuss the basic circumstances in which guarantees are issued and make some suggestions for tightened loan guarantee standards and how they would help deal with the broader problem of controlling loan guarantee programs.

Credit need test.—Most loan guarantee programs are intended to facilitate the flow of credit to borrowers who are unable to obtain credit in the private market. The needs of more creditworthy borrowers are expected to be met in the private market without Federal credit aid. To achieve this purpose more effectively, and to provide a built-in control over program growth, enabling legislation should be more specific on requiring evidence that borrowers cannot obtain credit from conventional lenders. Specifically, we think that legislation should require the guarantor agency to certify that, without the guarantee, borrowers would be unable to obtain credit on reasonable terms and conditions.

Coinsurance.—In addition, guarantee programs are often intended to induce private lenders to extend loans on more favorable terms to marginal borrowers. The borrowers involved generally can obtain loans on their own, but only on costly and otherwise disadvantageous terms. In these cases, 100 percent guarantees don't make sense because they would lower the interest rate below that paid on unguaranteed loans to creditworthy borrowers for the same purposes. Doing so would stimulate a demand for guaranteed loans by creditworthy borrowers who do not need Federal credit aid.

To avoid such excessive demand for guarantees, we favor a much greater use of partial, rather than 100 percent guarantees. In the future, legislation generally should limit the guarantees to assume, say, 90 percent of the loan. Private lenders then would charge a higher rate of interest commensurate with project risk and with the rates charged on unguaranteed loans. Such risk sharing, or coinsurance, by private lenders would contribute to the development of more normal borrower-lender relationships, would prompt lenders to exercise greater surveillance over the loans, and would stimulate increased conventional lending for the economic activities involved.

Interest rate ceilings.—All of us also should be more attentive, Mr. Chairman, to the effects of statutory interest rate ceilings on the problem of controlling guarantee programs. We oppose fixed interest rates because they usually are either too high or too low at any particular moment. On the one hand, if a guaranteed lender is permitted to charge high rates relative to his risk, then he will seek guarantees in cases where he might otherwise make loans without them.

On the other hand, if the interest rate ceiling is below reasonable market rates, and the Government pays the difference between the ceiling rate and the higher rate required by the lender, then demands by both borrowers and lenders for guaranteed loans will be excessive. For example, loan guarantee legislation often stipulates that the interest rate paid by the borrower not exceed a fixed rate of, say, 5 percent. This has the effect of stimulating demand for guaranteed loans (and Federal interest rate subsidy payments) as interest rates rise. In cases like this, the amount of the subsidy fluctuates with interest rate movements, and not with the needs of the borrowers. Such interest rate provisions frustrate efforts to control overall program levels and can also result in an inequitable allocation of credit resources. To avoid these problems, we think that interest rate ceilings should float in relation to interest rate movements.

Equity participation.—Many guarantee programs involve circumstances where borrowers could take equity positions in the projects being financed, and these guarantee programs should encourage them to do so. Requiring borrowers to have such a stake would help avoid excessive demands for guarantees, help assure more efficient projects, and help protect the interests of the Federal Government as guarantor. This could be accomplished by a legislative requirement that the amount of guaranteed and unguaranteed loans not exceed, say, 90 percent of the value of the project being financed.

Other loan terms and conditions.—Demands for guarantees will also be excessive if the legislation does not contain specific restrictions on such terms and conditions as maximum maturities, guarantee fees, reasonable assurance of repayment, default procedures, and other conditions which are common to commercial loan practice but are often overlooked or neglected in Federal credit programs.

This is not to say that Federal credit assistance programs should not contain subsidies—indeed, that is their purpose—but the legislation should be carefully drafted so that the subsidies provided are by design, not chance, and are directed at specific needs.

In short, I believe that more effective congressional control over loan guarantee programs can be accomplished by adopting standards which build that control into the structure of each guarantee program. I recognize that this is not an easy task, particularly since there are more than 100 different loan guarantee programs which fall under the jurisdiction of many different subcommittees of the Congress.

In the executive branch, the Office of Management and Budget and the Treasury Department strive to assure a uniform application of standards in the process of reviewing proposed guarantee legislation. Within Congress, however, it may be unrealistic for each interested subcommittee to develop the intense focus on guarantee standards which is essential to this improved control. Accordingly, it may be worthwhile for such a responsibility to be lodged in one committee of the Congress. Alternatively, the Congress could take the approach taken in the Federal Financing Bank Act or the Government Corporation Control Act and enact omnibus legislation to establish credit program standards.

In addition to the adoption of more effective standards for all credit programs, including loan guarantee programs, congressional control over loan guarantees could be improved by requiring that appropriations acts include ceilings on the total amount of guarantee commitments which can be issued under the related program, regardless of whether the program is included or excluded from the budget totals.

H.R. 7416

I would like to turn now to the provisions of H.R. 7416. This bill would amend the Federal Financing Bank Act of 1973 to: (1) Include the receipts and disbursements of the Federal Financing Bank in the Federal budget totals, (2) limit the bank's purchases of obligations in any fiscal year to such amounts as may be provided in appropriation acts, and (3) require guaranteed obligations which would otherwise be financed in the securities markets to be financed by the FFB. Thus, the principal effects of the bill would be: (1) To expand the FFB to include the financing of certain guaranteed securities which are now financed directly in the securities markets, and (2) to broaden the budget appropriations process by including in the budget totals, and subjecting to the appropriations process, those guarantee programs which are financed through the FFB.

Budget treatment.—Section 11(c) of the FFB Act currently provides:

> (c) Nothing herein shall affect the budget status of the Federal agencies selling obligations to the Bank under section 6(a) of the Act, or the method of budget accounting for their transactions. The receipts and disbursements of the Bank in the discharge of its functions shall not be included in the totals of the budget of the United States Government and shall be exempt from any general limitation imposed by statute on expenditures and net lending (budget outlays) of the United States.

The first section of H.R. 7416 would amend the second sentence of section 11(c) of the FFB Act to read: "The receipts and disbursements of the Bank in the discharge of its functions shall be included in the totals of the budget of the United States Government."

To our knowledge, this would be the first time that statutory language has been used to expressly require the transactions of a particular Federal agency to be included in the budget totals. For example, the Export-Import Bank was returned to the budget by simply repealing language in the Bank's charter act which had excluded its transactions from the budget, not by enacting a requirement that its transactions be included in the budget. The intent of this requirement is not clear.

We presume that the intent is to follow normal budget accounting whereby transactions between Federal agencies are not reflected in the budget totals. Thus, when the Treasury lends to a Federal agency, the transaction is not reflected in the budget until the borrowing agency disburses the funds to the public. If the explicit requirement that FFB transactions be included in the budget is intended to override this normal accounting arrangement, then this would cause double counting in the budget totals. Specifically, FFB loans to on-budget Federal agencies such as the Export-Import Bank and Tennessee Valley Authority would be counted twice in the budget—thus inducing these agencies to resume their previous arrangement of borrowing directly in the market—and FFB purchases of obligations of off-budget agencies such as the Postal Service and USRA, assets sold by Federal agencies, and guarantees by Federal agencies would be counted once.

On the other hand, if the intent of the amendment to section 11(c) is not to override normal budget accounting rules, then FFB loans to on-budget and off-budget Federal agencies and FFB purchases of agency assets would be treated as intragovernmental transfers and not reflected in the budget. Only FFB purchases of obligations guaranteed by Federal agencies would be included in the budget totals. These totals also would increase by the amount of asset sales to the FFB, however, since such sales no longer would be treated as negative outlays. This same effect could be achieved simply by repealing section 11(c) of the FFB Act.

Appropriations process.—H.R. 7416 would limit FFB purchases of obligations in any fiscal year "to such extent as may be provided in appropriations acts." Yet, situations may well arise in which the total demand for bank financing would exceed the limitation specified in an appropriation act. There would be a need, therefore, to allocate FFB credit among competing Federal programs. Furthermore, the bill would require the bank to purchase guaranteed obligations, but would give it discretion concerning purchases of Federal agency debt. On this basis, when demands for bank financing exceeded the appropriations act limit in the bill—which applies to both agency debt and guaranteed obligations—there would be pressures for agencies borrowing from the bank to shift to borrowing in the market.

The role of credit allocator would not be a proper role for the FFB. Within the executive branch, that function should be performed by OMB. The original FFB bill sent to the Congress in 1971 contained provisions which would have authorized the Secretary of the Treasury, in effect, to require guarantees to be financed through the bank. That bill also would have authorized the President to limit the total amount of guarantees issued in any year, regardless of whether the guarantees were financed by the bank or in the market. The Congress rejected these provisions.

If H.R. 7416 is enacted, we would expect that each agency's entitlement to use the FFB would be determined by the President and by the Congress annually in the normal budget appropriations process. Thus, the FFB would continue to function as an instrument of Treasury debt management, but neither the FFB nor the Treasury would assume the function of allocating budget or credit resources.

FFB expansion.—H.R. 7416 would effectively require guaranteed obligations which would otherwise be financed in the securities markets to be financed by the FFB. This would be accomplished by adding a new subsection (d) to section 6 of the act as follows:

> (d)(1) Except as provided in paragraph (2), any guarantee by a Federal agency of an obligation shall be subject to the condition that if such obligation is held by any person or governmental entity, other than such agency or the Bank, such guarantee shall thereafter cease to be effective.

(2) Paragraph (1) shall not apply in the case of any obligation—

(A) which the Secretary of the Treasury determines is of a type which is not ordinarily bought and sold in the same markets as investment securities, as defined in the seventh paragraph of section 5136 of the Revised Statutes, as amended (12 U.S.C. 24), or

(B) which is issued or sold by the Bank.

Before making any determination under subparagraph (A), the Secretary of the Treasury shall consult with the Director of the Office of Management and Budget, the Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System.

We strongly support the intent of these provisions. That is, if the FFB is included in the budget, it is essential to require that certain guaranteed obligations be financed through the FFB. Otherwise, there would be a budget incentive to return to the inefficient practice of financing guaranteed obligations directly in the securities market. This would undermine the purpose of the FFB Act and would add needlessly to the program financing costs and to the direct costs to the Government.

Yet, we are concerned with one or two adverse, and perhaps unintended, effects of these provisions. Specifically, the FFB apparently would be explicitly required to purchase partially guaranteed obligations, since H.R. 7416 does not distinguish between "partially" and "fully" guaranteed obligations. This contrasts to the present FFB legislation which authorizes but does not require purchases of such securities. As you know, we do not think that the FFB should purchase partially guaranteed obligations, and the bank has not done so since its inception.

Section 3 of the Federal Financing Bank Act defines "guarantee" as "any guarantee, insurance or other pledge * * * of all or part of the principal or interest." In the past, the FFB has interpreted this to include, and has thus purchased, a wide variety of obligations guaranteed or insured by Federal agencies, including obligations secured by Federal agency lease payments and obligations acquired directly by Federal agencies. These have been sold to the FFB subject to an agreement that the selling agency will assure repayment to the FFB in the event of default by the non-Federal borrower.

We also have interpreted this definition of guaranteed obligations to include those supported by Federal agency commitments to make debt service grants; e.g., to support public housing authority bonds, or other commitments such as price support agreements or commitments by Federal agencies to make direct "take-out" loans in the event of default on a private obligation. Yet, Mr. Chairman, the FFB purchases obligations guaranteed under these various arrangements only if there is a full guarantee of both principal and interest.

The bank has not purchased partially guaranteed obligations, even though they would technically be eligible for purchase under the "guarantee" definition, for the following reasons.

By purchasing the nonguaranteed portions of partially guaranteed obligations, the FFB would be required to make judgments as to the creditworthiness of borrowers guaranteed by other Federal agencies and thus duplicate the functions of the guarantor agencies. Such purchases would also place the Government at risk more than was contemplated by Congress in enacting provisions which limit guarantees to less than total principal and interest.

A second problem with partially guaranteed obligations concerns the methods of financing them which have developed in the private market. The loan guarantee programs of Small Business Administration and Farmers Home Administration provide good examples. In these programs, where the guarantee is limited to 90 percent of the loan, practices have developed where the lending bank will sell the 90-percent-guaranteed portion in the securities market, treating it as 100 percent guaranteed paper, and retain the 10-percent-unguaranteed portion in its own portfolio, while servicing the entire loan. FFB financing may be appropriate for the fully guaranteed securities market portion of the financing, but FFB financing would not be appropriate for the unguaranteed portion held by the originating bank lender.

In other cases, fully guaranteed obligations such as small FHA and VA mortgages are originated and serviced by mortgage lenders or acquired by Federal agencies and resold into the mortgage market. Here, FFB financing could have adverse effects on the mortgage market by having the Federal Government perform functions which today are well handled by mortgage lenders. On the other hand, certain of these mortgage-backed obligations are sold directly into the securities markets, not in the mortgage market, and FFB financing might well be appropriate there.

The appropriateness of FFB financing of particular obligations should thus be determined on the basis of both the nature of the guarantee and the method of financing the obligation. We believe that such determinations should be made by the Secretary of the Treasury in keeping with his overall responsibilities for both debt management and the markets for Government-backed securities.

We are also concerned with possibly unforeseen and adverse effects on the financing of a number of programs under which Federal agencies enter into contracts, rentals, leasing, billing, and other arrangements which are, in effect, pledged to secure the repayment of loans made by private lenders to companies or other private institutions. These arrangements would generally fall within the definition of "guarantee" in the FFB Act, but the bank does not currently purchase many of the private loans secured by such commitments. Yet, under H.R. 7416, such new "guarantees" would not be operative unless the FFB purchased them or the Secretary of the Treasury determined that these loans were of a type "not ordinarily bought and sold in the same market as investment securities." This requirement for a prior determination by the Secretary could cause serious administrative problems and could create a cloud of uncertainty over the legal status of a wide variety of Government contractual arrangements.

Finally, the provision of proposed subsection 6(d)(2)(B) of H.R. 7416 may encourage the FFB to resell guaranteed obligations it holds, into the securities markets. This subsection would exempt such reselling from the provisions of subsection 6(d)(1) which, in effect, removes the guarantee from other obligations sold into the market. Since these sales would continue to be treated as negative budget outlays, pressures to make such sales could become irresistible under H.R. 7416 and the budget purposes of the bill could be defeated.

Exhibit 16.—Other Treasury testimony published in hearings before congressional committees

Secretary Blumenthal

Testimony before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs, on S. 1664, financial reform legislation, June 20, 1977.

Statement before the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, on the public debt limit, September 22, 1977.

Economic Policy

Exhibit 17.—Remarks by Secretary Blumenthal, March 3, 1977, at the Waldorf Astoria in New York City, on the Government's role in the capital formation process

In analyzing what the Federal Government can do to promote capital formation, it is best to begin at the beginning.

And the beginning, in my view, is to remind ourselves of the simple, yet oft-overlooked proposition that our free enterprise economy can grow and remain healthy, can do the job of providing enough employment for all, only if we ensure that enough private capital flows into financial markets to finance the plant and equipment, the research and development, and the entrepreneurial activities of large and smaller companies alike.

If that is not the case—and there is increasing concern that it may not be—nothing else that the Government can do in shaping an economic program will succeed. An adequate flow of capital is the lifeblood of our economy. Without it, our economy cannot function for long, and our many political, social, and cultural goals will remain unfulfilled.

Has there been a shortage of capital? There is no simple answer to that question. To begin with, difficulties arise simply in defining what we are talking about. There has been a lot of debate in recent years as to whether there is or will be a "capital shortage." But it's not always clear what kind of capital the participants in these debates are referring to. Is it a shortage of financial capital—of means of financing outlays for bricks and mortar? Or is it a shortage of the physical capital itself—the stock of physical assets with which to produce the stream of goods and services called the gross national product? Too often, the debate slips back and forth between the two without regard for the fact that they are distinct—albeit interrelated—concepts.

Turning first to physical capital and looking at current numbers on capacity utilization—imperfect as they are—one might be tempted to describe our current stock of plant and equipment as adequate. With operating rates for manufacturing as a whole in the low 80-percent range, there is little to suggest a present shortage. Moreover, the share of total output dedicated to new business fixed investment has been somewhat higher in the past decade than in the preceding two decades—10 percent of real GNP as against 9 percent earlier.

What, then, suggests a shortage of physical capital required to sustain the balanced, noninflationary growth we all are seeking?

To begin with, some industries appear to be nearing the point at which capacity could constrain production. There are at least half a dozen, including food processing, petroleum refining and mining, in which current operating rates are edging close to those that prevailed during the most recent period of high utilization (1973). Moreover, a number of studies have pointed to potential capacity problems in other industries, where even moderate sustained growth in economic activity can push them to their capacity ceilings, creating "bottleneck" situations long before the total economy was fully utilizing its resources.

Second, we have to look to the changing balance between factor inputs; that is, the balance between growth in the stock of physical capital and growth in the stock of human capital. Respectable though recent growth rates in physical capital may be by historical standards, capital stock has not grown commensurately with growth in the labor force. In the first half of this decade, the average amount of business capital per worker grew at only half the rate at which it had been growing in the fifties and sixties. In other words, we were not providing tools of production as fast as the growth in workers to use them.

This shortfall in the availability of capital for the growing labor force has unpleasant ramifications for the economy. It has contributed in an important degree to the slowing of productivity gains in recent years, a period when output per worker has risen far more slowly than in the 1950's and 1960's. Diminishing rates of gain in productivity put upward pressure on prices, limit improvement in living standards, adversely affect profits, lower incentives for capital investment, and reduce the possibilities for creating jobs in the private sector.

Therefore, if we are to move toward a full-employment economy over the balance of this decade, investment in productive capacity will have to absorb a higher proportion of our national output. We will have to achieve a better balance in distributing the results of economic growth between current consumption and investing for even greater future growth.

How do we accomplish this? The first prerequisite for an adequate volume of capital formation, as we see it, is to ensure a sound economy overall, stable and growing, one in which investors can have confidence.

There appears to have been some nervousness lately as to whether our policies will meet this need, that efforts to reduce unemployment will be pursued without sufficient regard for the need to reduce inflation, to bring the Federal budget into balance and to provide the predictability and stability that is the sine qua non for the Nation's economic health.

Well, I am here to say to you today that you need not have the slightest doubt about our intentions and policies in this regard. President Carter is not a spender—far from it. He is dedicated to a policy of prudence, frugality, and the elimination of wasteful expenditures at all levels. He firmly believes in the need for a vigorous attack on inflation, and he sees this need as just as important as the attack on unemployment.

As for myself, I assure you that I did not take this job to participate in an administration that fails to address itself vigorously to the danger of inflation. I accepted this assignment precisely because I viewed licking inflation and unemployment as linked: because I saw in this my greatest challenge as Secretary of the Treasury; because I believe that it is possible to do the job; because I believe that the time to do it is now; and—above all—because we now have a President who will fully back and, indeed, insist on sound policies to make it happen.

The time has come, I believe, to separate myth from reality, to focus attention on the realities of the administration's emerging economic policies, instead of on slogans and fears unsupported by facts.

Since this is so vital a matter, allow me to state a few points with clarity:

1. *This is an administration dedicated to eliminating budget deficits.* The deficits for FY 77 and FY 78 are largely inherited. Their cause lies in large measure in a sluggish level of economic activity. For example, if industrial capacity utilization were now at, say, 86 to 88 percent instead of the present 80 percent; if, then, unemployment were not 7 1/2 to 8 percent but more like 5 1/2 to 6 percent; then $20 billion or so in additional revenues would be available.

Three further comments about the budget:

First, I regard the FY 77 and FY 78 deficit targets as representing outside limits. I expect the actual numbers to come in below them.

Second, work on the FY 79 budget is beginning. With zero-base budgeting as a tool, it is our firm intention that the FY 79 budget deficit will be appreciably lower than the previous year's. New programs will not be funded through increased deficit spending, but rather through the growth in revenues from an expanding economy. Our goal is budget balance by FY 81.

Third, the projected deficits of $68 billion and $58 billion for FY 77 and FY 78, and significantly less in FY 79, need not be inflationary in an economy with much unused capacity, nor need it lead to appreciably higher interest rates in an economy currently awash in liquidity.

2. *This is not an administration that talks about inflation but will do nothing about it.* We are putting in place an anti-inflation program which the President and the Secretary of the Treasury and the rest of the Carter administration team will back with vigor. This program will be announced within a matter of weeks, but the outline of the program is becoming clear.

First of all, let me say what it will not be:

A. *It will not be based on controls—actual, standby, or any other kind.* I know of nothing less likely to give us growth with stability than saddling this country and our free market economy with that kind of bureaucratic nightmare.

If anyone had any doubts on that score, the previous administration's efforts—and failures—in this regard in the early seventies should have dispelled them. The Carter administration has no intention whatsoever of repeating that folly.

B. *It will not be a program concentrated largely on other forms of incomes policy.* Management, labor, and consumers must cooperate with the Government in the anti-inflationary fight—that is as clear as it is in their self-interest to do. But in our view this is best achieved if neither direct controls nor indirect coercion is involved.

It is missing the point, therefore, to get involved in debates over buzzwords and catch phrases which divert attention from the realities. I don't know what "jawboning" means precisely. No doubt it implies different things to different people. Rest assured on one point: If it means that labor or management is to be strongarmed or pressured into complying with arbitrary Government guidelines, we will have none of it.

Nor do I believe that it is useful to waste our energies on fruitless arguments about the pros and cons of imprecise concepts such as "prenotification" on wages and prices—voluntary or otherwise. What is there to argue about? The expiration date of the major labor contracts is a matter of public record. Doesn't this give all the prenotification needed?

On the price front, I am equally confident that major U.S. industrial leaders, who see the importance of containing inflation as clearly as anyone, will, in the kind of cooperative program we plan to develop, weigh carefully and be prepared to discuss with us the implications of various price options. As you have heard, this pattern has already begun and it can continue if we all keep our wits about us.

What, then, will our anti-inflation program involve?

First, a prompt review of all Government regulations which create bottlenecks, restrict output, or are otherwise inflationary. This has already begun. We are exploring alternatives to regulations which impose on industry exceptionally stringent technological standards without regard to economic criteria, which indeed may prove perverse in result because they inhibit industry in adopting more efficient technologies. We are examining the need for cost-plus or cost-reimbursing contractual arrangements in Government purchases, which tend to reduce normal business cost-minimizing incentives. We are examining Government price-fixing, which protects inefficient producers against competition and reduces consumers' ability to choose between lower prices and extra services. And we are trying to put a quantitative cost tag on all Federal actions which affect prices, so that better cost/benefit analyses can be derived.

Second, a policy on international trade that provides help and protection to industries and workers hurt by imports, but does so in ways which do not result in inflationary price increases borne by the consumer. We plan to develop new ideas of how to improve our competitiveness, emphasizing programs of structural reforms that will lower costs and increase productivity. This, rather than price-raising restrictions which hurt the consumer, is the right approach and the one we intend to promote.

Third, the presentation to Congress this year of a comprehensive proposal for major tax reform, designed to promote business investment to achieve increased productivity.

Fourth, a review of unnecessary and costly reporting requirements imposed on business by the Government, requirements which raise costs without really meeting any vital needs. Lawyers and accountants do not need this kind of lifetime employment guarantee to keep them busy and productive.

Fifth, an effort to create an effective system to analyze the economic impact of each major new Federal legislative or regulatory effort. This has not worked adequately in the past—and we aim to do something about it.

Sixth, improvement of the operation of the Council on Wage and Price Stability, not to control or coerce but to provide the data and the research to identify bottlenecks and economic problem areas ahead of time, particularly those which limit productivity and fuel inflationary flames.

Seventh, the administration has decided to organize a labor-management committee, consisting of outstanding representatives from the ranks of both labor and management who, together with members of the administration, can serve as a forum where their perspectives on the major issues relating to inflation, productivity, employment, and related economic questions can be candidly and thoroughly discussed. We are also encouraging the establishment of similar committees for major industry areas, so that problems specific to particular segments of the economy are not overlooked.

Eighth, along with all this, a clear identification of the goals and targets to be achieved as we strive to balance the budget and simultaneously reduce unemployment and inflation. This set of objectives can then form the basis for enlisting labor, management, consumers, and all levels of government in a common commitment and a cooperative effort to achieve our economic goals.

We are now beginning to put the parts of this program into effect. One thing is certain: We are in dead earnest. To succeed, it will require a common effort and, no doubt, a common sacrifice. But we will work hard at it, and we aim to succeed.

If we can do the things I have just outlined, one of the critical prerequisites for ensuring a much greater flow of capital will have been achieved.

But, of course, that will not be enough.

After all, the rate of capital investment depends in the final analysis not as much on inflation rates as on the rate of return anticipated for that investment.

In this regard, we appreciate the pressure on business executives to halt the decline in profits and profit margins. The record is quite clear: Whether measured in terms of share of national income, or in terms of ratios to sales, corporate profits and profit margins have been declining since the midsixties. We are aware of this erosion, and we understand that last year's rise in profits and margins was a cyclical response characteristic of the early stages of a cycle recovery, and not necessarily a permanent reversal of the downward trend.

But we do not believe that the way to break this trend is through inflationary price markups; indeed, price markups of that sort would, in all likelihood, have the opposite effect. The path to sustained recovery in profits is through investment in more efficient production techniques, for gains in productivity are highly correlated with gains in profits.

Our stimulus program addresses this problem directly, through the proposed increase in the investment tax credit. As you know, the stimulus package would, if enacted, increase the investment tax credit by two percentage points. The businessman who takes advantage of the credit can anticipate cost reductions and commensurate profit increases from two sources: reduced cost of capital, and greater productivity from more modern plant.

Now let us turn to the other major concern about the capital formation process, the adequacy of the flow of financial capital to support the required growths in investment.

Our financial system is justifiably renowned for its capacity, scope, richness of form, and resiliency. It functions with remarkable efficiency in gathering the savings of the public and transforming these into the means of financing private investment. Nevertheless, there are areas in which improvements can be made to ensure that the availability of financing—in both amount and form—does not become an impediment to the necessary growth in our capital stock.

One fundamental problem is the tilt of the system toward financing through debt instruments. Savers appear, in general, to prefer acquiring financial assets of fixed nominal value and fixed income return—a preference that persists despite the postwar erosion in the purchasing power of fixed-value claims. Moreover, our tax system encourages the financing of investment through debt instruments.

Over the longer run, this is not the ideal arrangement; there are limits to which it is prudent or even feasible to pile increasing amounts of debt on a very slowly growing equity base. A debt-heavy financial structure increases the vulnerability of the business enterprise to cyclical fluctuations in income. It limits the venturesomeness of investment, for lenders cannot in good conscience underwrite the risks appropriate to an equity participant. And it inhibits economic growth because growth depends very much on willingness to risk investment in new products and new processes.

Moreover, the emphasis on debt financing raises particular problems for smaller and newer enterprises, which often lack the track record necessary to attract adequate amounts of financing from lenders, and must therefore fight for access to pools of equity financing.

Many proposals have been advanced to modify the tax structure in order to achieve more evenhanded treatment of alternative means of financing investment, and to improve the functioning of securities markets with respect to small businesses. These proposals are all under active study, and we solicit your advice on how best to achieve our objectives.

Any review of the adequacy of our system for financing capital formation must, of course, address the operations of the principal channels through which savings flow into investment—financial intermediaries and public securities markets.

The transformation of savings into investment in our country occurs principally through the intermediation of financial institutions. In 1976, over two-thirds of the $250 billion advanced in credit markets was supplied by banking, thrift, and insurance institutions. The question is whether the panoply of Government legislation and regulation is helping or hindering achievement of maximum efficiency in the allocation of these funds.

What we must do now is reevaluate the complex of Government rules, regulations, and procedures affecting financial intermediaries to ensure that there is not, in our regulatory structure, some things inhibiting the sustained flow of financing for investment. We do not need yet another commission or another round of extensive studies. We will, however, seek your counsel as our own ideas develop.

At the same time, we will be reevaluating the efficiency with which our public securities markets meet the needs of savers, borrowers and risk-takers. Our country is fortunate to have such well-functioning securities markets, very much the product of the leadership provided by the Securities and Exchange Commission for more than four decades. The reputation the SEC has earned for fiercely guarding the rights of the investing public is a major element in our success in transforming the savings of individuals into the financing of private investment.

The SEC's expertise and insights into the operations of the securities markets will be an important contribution to our review of the savings/investment process. Shortly a new Chairman of the Commission will be appointed, and we in the economic policy group look forward to working closely with him, the other Commissioners, and the SEC staff in this review.

Let me then summarize quickly how I see the capital formation problem today, and what this administration proposes to do about it.

First of all, we do have a capital shortage, in the sense that growth of physical plant and equipment is lagging behind the rate of expansion required to reach a full-employment economy. That situation must be corrected, for, unless it is, we can expect to experience persistently unsatisfactory productivity increases, rising unit costs, and a continuation of the unemployment which in large measure is a result of these two factors.

We do not intend to let this happen, and the administration has already acted on two fronts to avert it. We have asked for tax relief sufficient to stimulate enough final demand so that businessmen will find markets for their increased production. We have asked for an increase in the investment tax credit, which we believe is essential to achieve increased productivity. Those of you who have been following our actions probably already appreciate those two thrusts of our policy. In addition to the courses of action already announced, we will be reexamining the impact of tax and regulatory structures on investment and on the financial system, to make certain that there is nothing that we in Washington are doing that might act as an inhibition to the financing of the investment we all want to see occur.

I thank you for your attention. If there are things I have just said with which you disagree, or points on which I have not made myself clear, I would be happy to discuss them with you now.

Exhibit 18.—Remarks by Secretary Blumenthal, May 11, 1977, before the Economic Club of Chicago at the Palmer House, Chicago, Ill., on national economic policymaking

Last weekend the leaders of seven major industrial nations of the world met in London at the summit. A meeting of seven heads of state together in one room for 2 days of frank discussion is a good thing in itself. It allows these men, with their awesome responsibilities, and their individual national preoccupations, to get to know each other, to learn about each other's problems, and to exchange ideas on how to solve them by working together.

As always, a summit makes news all over the world, because it touches so many vital issues of concern to people everywhere. This summit was no exception—particularly because it was the first one for President Carter. It provided him an important opportunity to get a firsthand understanding of the issues and problems facing his colleagues in other countries.

What strikes me as significant is that the principal problems these leaders had to focus on were economic.

This focus on economic problems is not accidental. It reflects the general realization that the health, happiness, and welfare of all peoples, and the future of each nation and of each government, depends on our individual and collective economic well-being. These issues are intensively discussed among the leaders of industrial countries because each recognizes that their national economic problems are inextricably intertwined; that national economic policies depend on the international economic climate; that the solutions which each leader must seek in his own country are most easily achieved when a way is found to work together for the benefit of all.

National economic policymaking in the context of a cooperative and sound international economic environment is a prerequisite for the political stability of our countries and the survival of democracies. In that sense, economics and politics are part and parcel of the same challenge.

I recall that this point was made to me many years ago when I first went to work as a deputy to former Secretary of State Christian Herter, who had just been appointed President Kennedy's Special Representative for International Trade Negotiations. Chris Herter had had a long and distinguished political career; he had been a Congressman, a Governor, and the Secretary of State.

Considering this career as a political leader, his new job as Trade Representative—dealing with shoes and textiles, with machinery and farm products, with tariffs and quotas and the like—seemed an odd assignment. I remember asking him one day why he had taken the job, and I recall his answer only too vividly. "Mike," he said, "I suspected it before, but I know it now. There is more politics wrapped up in this business of world economics and trade than in anything else I have ever done before."

So, inflation, jobs, trade, international finance, money, exchange rates, commodity prices, and the relation between the rich and the poor countries of the world constitute much of what economic and political policy is all about. And that is why this is the stuff of which summit meetings are made.

The President's position at the Downing Street summit was strong, not only because he is a leader of the world's largest and richest industrial nation, not only because he has the solid support and admiration of the American people, not only because he is a new leader with a strong and secure mandate for a 4-year period. More important than these factors in establishing President Carter's ability to speak with strength and conviction at the meetings was the fact that he was seen as a head of government who quickly moved to tackle honestly and openly the difficult task of fashioning a rational and sound economic policy for his country.

President Carter has been willing to face the many contradictions and uncertainties that underlie the complex economic issues of our day. He has not glossed over them or hidden them, or denied the complexities that exist. He has been willing to make hard decisions that are for the long-term benefit of all of us, even if they mean sacrifice. And he has not been afraid to make it clear that our resources are limited, that we must husband them and allocate them carefully among our many worthwhile objectives.

Over the next several months, we will be debating and studying a variety of these economic issues. Congress will take final action on the President's proposals for an initial economic stimulus. The President's recommendations for a national energy program, for fundamental reform of the tax system, for assuring the financial soundness of social security, for transforming the welfare system, and for the handling of trade issues will be assessed and debated in the Congress and in the country. In this process, all of us will learn with him the hard realities and choices that must be faced.

Our economic policy must serve multiple objectives. It must provide jobs for all Americans. It must come to grips with the difficult and puzzling phenomenon of persistent inflation. It must give us economic growth and foster social justice for all our citizens. And it must provide for collaboration with other nations in their quest for the same goals in their countries.

Economic policymaking in each of these areas is not an easy or a certain task. For to be honest, and regardless of what the academic economists or the commentators in the media tell us, there is much that we don't know about how to reach our economic goals.

Perhaps we should ask ourselves why after the bicentennial of Adam Smith's "Wealth of Nations," after centuries of economic thought dating back to the Biblical Joseph, after all the modern developments in econometrics and model building—why after all this are we so ignorant about so much in economics?

I could easily spend the evening on that topic. I will not do so, but it is worth at least noting some of the main sources of our uncertainty. We are experiencing great changes in our economy and our society—the growth of very large organizations in business and labor, the expansion of government, rapid changes in technology, almost instantaneous communications and an expansion of the role and impacts of the media. We have come to realize that a rapidly growing world does face resource limitations, a fact brought home by the rapid increase in the price of energy. And with this has come a transformation of the world monetary system. All this, and more, confronts policymakers with new challenges and the need to navigate in uncharted waters.

Neither the Keynesians nor the Monetarists, nor any other particular school of thought alone can show us the way. And no computer, however well programmed or sophisticated, is able to foretell all the economic effects of alternative policies.

For perhaps the largest barrier to certainty—one that will not go away—is that we are dealing in large measure with the reactions and the interreactions of people operating in a changed setting. Nothing is harder to comprehend and predict.

For example, take the elusive question of confidence. The other day the Washington Post in one of its editorials gently chided the administration for too vigorous a pursuit of what the Post called the "will of the wisp of business confidence." At about the same time there were others who spoke up in more direct ways to voice their anxieties over what they consider irrelevant concern with business confidence, a concern which they feel undermines or stands opposed to the achievement of social justice, or job creation, and of economic stability and security.

The confidence of consumers and of business is indeed a difficult and insufficiently understood ingredient in economic policymaking. Economists find it particularly puzzling because it is, inherently, qualitative. It defies quantification via the computer or by any other reliable means. Yet its elusive nature should nonetheless not mislead us. Unless consumers and business alike can have confidence, none of our other goals for economic policy are likely to be met.

How much consumers spend depends on their confidence in the future. How much business invests in new plant and equipment equally depends on its level of confidence. Consumer and business spending patterns in turn create the demand for goods and services. And business in organizing its production to meet these demands creates the jobs we need, determines the efficiency of our production and ultimately the resources that are available for our personal and collective goals.

So the pursuit of confidence is not antagonistic to our social goals. Confidence is not something we gain at the expense of social objectives. On the contrary, we seek confidence precisely because it is a precondition for the social progress we mean to achieve.

Over the last several months, the Carter economic program has, I believe, generated a steady increase in the level of confidence.

It has done so because this administration has set clear and sensible economic goals and has pursued coherent and consistent policies for their achievement. We seek an acceleration of economic growth in 1977 at a yearend to yearend rate of 6 percent. We seek continuing growth that will average 5.2 percent annually through 1981. We seek a steady reduction of unemployment to around 4 1/2 percent by 1982. And as a matter of equal importance, we are striving to contain inflation and to bring it down—cutting the underlying rate by two points by 1979 and making further reductions in the following years.

These goals have been matched by policy decisions that show that we mean what we say. The President's action in withdrawing the tax rebate when it was no longer needed was not easy. But it was an action that supports our goals and will help reduce the budget deficit for fiscal year 1977 from the $68 billion originally anticipated to less than $50 billion.

We intend to meet our commitment to budget balance by 1981. Tough steps to reduce waste and foster efficiency in Government have been taken. The well-known water projects are only a prominent example. Zero-based budgeting is being implemented, and programs that have outlived their usefulness are on their way out.

Actions, not words, have borne out our commitment to avoid protectionism and to find ways of helping American workers and industries hurt by imports without unduly boosting prices to consumers or endangering export jobs. The decisions on shoes and sugar have set a pattern that points down this road.

And in combating inflation we have developed a program that will be effective, that recognizes inflation as the complex, multifaceted problem it is, that provides for longer term structural remedies and for cooperation now among business, labor, and Government to avoid self-defeating wage-price spirals.

In all of our policies we have avoided Government coercion and controls. We have sought to develop a climate within which the free market can work and in which Government, business, and labor can act responsibly in the national interest.

There has been criticism. Our voluntary programs have been called weak or toothless—even though the only "teeth" anyone could propose were the controls that have so miserably failed in the past. Now there is evidence that our voluntary policy is working. The recent decisions on steel price increases do, I believe, prove this point.

Because of the Carter administration goals backed by clear and consistent policies, evidence of growing confidence is increasing. Consumers must have confidence before they will spend their incomes and this, in turn, implies that they expect to have jobs. The stimulus package which is about to become law will help more Americans join the one and a half million who have gotten jobs since January. Unemployment has declined from 8 to 7 percent, thereby reaching considerably ahead of schedule the target we had set for the end of the year. There is no reason why the unemployment rate should not drop comfortably below 7 percent, possibly closer to 6.7 percent by yearend. The fact that consumer spending is at an alltime high, and correspondingly, the consumer savings rate of 5 to 5 1/2 percent is at the low end of the historical range reveals that the average American does have a feeling of security about the way the economy is moving.

Similarly, business must have confidence in its markets, in its ability to make a profit, and in the prospect that inflation will be handled responsibly before it will spend on new investment. While business spending on plant and equipment has been lagging until recently, there are now new signs of growth. The recent McGraw-Hill survey indicates an 18-percent current dollar increase in plant and equipment spending in 1977. Actual figures on real business capital outlays have shown a similar upturn, rising at a 14-percent annual rate during the first quarter of 1977. Order backlogs for the machine tool industry have been moving up rapidly, and the cutting tool backlog, a good indicator of things to come, has increased by 13 percent since December.

So business confidence also is on the rise.

And it is the spending of consumers and business, which depends so much on confidence, that creates the private sector jobs this country needs. It is this spending that allows for the productivity growth that will keep up our competitiveness in world markets and give us a bigger pie to divide and allow us to be done with fighting for shares of a static or inadequately growing GNP. So let no one call confidence a will-o'-the-wisp. Let us all recognize that a climate of confidence is critical to the success of any economic policy.

I have talked tonight of some formidable problems. But I must mention one more, because it will soon become a major part of the national economic debate. In a few months, the Carter administration will propose major tax reforms that can be an important factor in determining the future course of our economy.

The three goals of this reform can be summed up in the words "simplification," "equity," and "capital formation."

We have already taken the first step toward tax simplification. The proposed flat standard deduction for individuals, which should soon be approved by Congress, will enable 95 percent of all taxpayers to use new tax tables. No longer will they have to subtract their personal exemptions, figure their standard deduction, or subtract out their general tax credit. But the complexity of the tax system will still place an excessive burden on the ordinary taxpayer. So, while I cannot tell you the details of our proposal, we are studying ways of taking further steps that will simplify the system by limiting certain deductions and allowing reduced tax rates over the entire range.

The need for a new effort toward greater tax equity is apparent in the data revealing that taxpayers at the same income levels now pay quite different taxes. We will recommend new measures so that taxpayers in like circumstances are treated more alike. This means that we have to reexamine all of the existing tax exemptions, exclusions, and credits, with a view toward identifying those that are not so integral to our tax system or economy that their elimination would mean economic hardship.

And to encourage the higher rate of capital formation this country needs, we shall recommend important new incentives to savings and investment.

We have to consider steps to eliminate the double taxation of corporate income that now characterizes our tax system. We expect that action on this front would increase the propensity of our citizens to invest in American industry, and thereby provide business with the capital it needs to invest in order to increase its own productivity. At the same time, equity demands that we carefully examine some of our current business tax policies to insure that they do not unwisely affect the spending or investment behavior of our corporations and our financial system.

As we debate our tax package, which is bound to be controversial, I hope we shall keep a few critical facts in mind.

First, we must have a tax system that raises enough revenue to meet our major social needs. Those needs are enormous. Over the next decade, we could easily spend billions to improve our housing and neighborhoods, reduce violent crime, and improve health, to mention a few. While we cannot meet all these needs, we must preserve public resources to finance the high-priority programs that we choose.

Second, we must have taxes that are progressive but not so progressive as to undermine our economic system or eliminate the incentive for individuals and for business to produce what we need. Thus, lowering taxes may be part of the longer run answer.

And finally, before we rush to the barricade over shifts in business and individual taxation we should pause. Because in taxes, things are not always what they seem. Business may pay the tax but it is borne by an individual as a consumer, a worker, or an owner of capital. So rather than repeat old slogans, we should look at the distribution of tax burdens on individuals and business alike and work with open minds for a tax system that will serve our collective needs and our national economic goal of stable, noninflationary growth.

I warned you tonight that the economic problems we face are not simple ones. But I have argued that this administration is committed to goals, to policies, to a fundamental attitude that can meet our economic needs and, thereby, advance our broader social objectives. It is an effort in which we must succeed. It is an effort in which I ask for understanding and support.

Exhibit 19.—Statement by Assistant Secretary Brill, May 16, 1977, before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee, on incentives for economic growth

It is indeed a privilege to appear before this committee today to lead off a discussion of the problems of incentives for economic growth, particularly incentives to increase the rate of capital formation so essential for sustaining economic growth.

In addressing these issues, we all recognize, of course, that we are not invading virgin territory. The problem has been the subject of intensive examination by economists, lawyers, business and labor leaders and by officials in the executive and legislative branches of Government over an extended period.

Having followed the course of these discussions over the years, from several different perspectives, I am encouraged by the growing coalescence of views on some key aspects of the problem. I think it fair to say that there is today much wider acceptance of the theses that—

(a) There is a need to accelerate the rate of growth of our capital stock;

(b) Government policies—not only the general tools of economic stabilization such as monetary and fiscal policies, but also regulatory and tax policies—play a key role in determining the rate of capital growth;

(c) Encouraging the rate of capital growth involves, importantly, the removal of impediments in the saving/investment process as well as the development of new inducements to higher levels of saving and investment.

Before turning to aspects of the problem on which there is less agreement, let me address what I think are the principal factors underlying these three generally accepted theses.

Recognition of the need to accelerate the rate of capital formation has been spurred, in recent years, by increasing evidence that productivity in the U.S. economy has deviated significantly below the earlier long-term growth trend. Ultimately, the increase in real returns to the factors of production, that is, the possibility of raising everyone's living standards, depends on the growth of output per unit of input. This sets the limits for our society as a whole. Disturbingly, in the past decade, the rate of gain in productivity has slowed significantly, limiting the possible growth in living standards and contributing to upward pressure on prices.

A substantial growth in productivity, averaging 2.9 percent annually in the nonfarm business sector, was a major contribution to the low inflation rate of the 1956–66 period. The data for the last decade, however, indicate that productivity increased at an average of only 1.5 percent per year. For the private sector as a whole, labor productivity growth was slightly more rapid because of a continued shift of employment out of agriculture into the nonfarm sector, where labor productivity is higher. However, a significant decline is equally evident for the private sector as a whole.

Of course, the decade of the mid-1950's through the mid-1960's was a period of rapid economic growth, terminating in a year of exceptionally high resource utilization. In contrast, the latest decade includes two severe recessions, and terminates in a year of low resource utilization. But even after adjustment for cyclical influences, it appears that the secular rate of productivity growth slowed perceptibly after 1969.

This slowdown in productivity growth has been attributed to a variety of causes—reduction in the workweek, slower growth in productive capital per worker, shifts in the composition of output to low productivity sectors, shifts in the composition of the work force toward workers with less experience and fewer skills, and to a miscellany of other causes. For the most recent years, the drop in productivity after 1973 can be explained by the impact of the energy crisis, and the subsequent rebound in productivity in the past 2 years to the normal cyclical effects accompanying the economic recovery that began in early 1975. But these fluctuations have occurred around a level far below the long-term trend growth rate extrapolated from the experience of the 1950's and 1960's.

It is clear that no one factor satisfactorily explains the slowdown in productivity gains. But I am persuaded that the slower growth in the capital stock per worker has been one of the most important factors. I should hasten to emphasize that this has not been so much the result of a slowing in the rate of growth in the capital stock per se. There is some evidence that in recent years, the capital stock has grown at a somewhat slower pace than earlier, but the principal factor in the declining capital/labor ratio since 1969 has been the sharp acceleration in the growth of the labor force. In other words, we haven't been creating the tools of production as rapidly as we have been creating workers willing to use them. The amount of capital per member of the labor force grew by 3 percent per annum in the first two postwar decades. So far in the 1970's the amount of capital per worker has grown at only half that rate.

The implications of such a trend are disturbing, not only for the effect on inflation of reduced productivity but also for the sustainability over the longer term of an adequate growth rate for the economy as a whole. The benchmark study of the capital requirements of the U.S. economy, undertaken by the Department of Commerce 2 years ago, concluded that to assure a 1980 capital stock sufficient to meet the needs of a full-employment economy, business fixed capital investment would have to absorb some 12 percent of real GNP in the second half of this decade. So far into the period, that is, in 1975 and 1976, fixed investment has been less than 10 percent of real GNP, so the gap to be filled in the remaining years would require an even faster rate of growth in addition to our capital stock than was postulated in the study.

In summary, then, we need more capital formation, both to restore productivity to the growth track of the 1950's and 1960's, and also to provide the tools of production for a full-employment economy in the 1980's.

What private and public policies can facilitate the needed growth in capital formation? The answer was best put, in my judgment, in a report issued last October by the Fifty-first American Assembly, when a distinguished group of academic, business, labor, and government leaders met to consider the capital needs of the United States. The final report of the Assembly noted: "The single most important means of encouraging investment expenditures is to combat economic instability and inflation."

Wide fluctuations in economic activity induce excessive caution in investment decisions. After all, whatever else may be done to increase the cost-effectiveness of new investments, entrepreneurs have to have confidence that a market will be there for the products that will be produced in the plants in which they are investing. Instability in the economy breeds uncertainty, and uncertainty diminishes investment propensities.

Inflation and expectations of inflation are also adverse to investment. Businessmen no longer rush to accelerate expansion plans to "beat the price rise"; the experience of recent years has taught that by the time a new facility launched in the feverish atmosphere of inflationary momentum is likely to come on stream, a postinflation recession will probably have dried up the intended market. And consumers have long displayed the wisdom of reducing major outlays when inflationary forces gather momentum.

The major contribution of public policy to capital formation, then, is the creation of a stable and noninflationary economic environment. The Carter administration has expressed its dedication to this objective. The actions taken by the President to date to insure noninflationary growth, and the President's commitment to pursue this course into the future, should provide confidence to businessmen and consumers that the economic environment will be propitious for capital formation.

There are, in addition to the pursuit of macroeconomic policies conducive to investment, specific policy areas addressing the capital formation problem. Principal among these is the tax structure. As this committee knows, the Treasury has under way a major reexamination of our tax system, with the view to proposing to the Congress significant revisions. That study is not yet complete. However, it will be submitted sometime this summer or early fall; every effort is being made to reach conclusions as soon as possible.

Over the years, there have been many proposals for modifying the tax structure to enhance incentives for adding to our capital stock. The excellent study prepared by the Joint Committee on Taxation, released last month, classifies these proposals under six broad headings: Proposals for the integration of corporate and individual income taxes, investment tax credits, modification of depreciation allowances, changes in the corporate tax rate, deduction of losses, and indexing for inflation. Each of these approaches, individually and in various combinations, is being carefully assessed.

The criteria that are being applied in the Treasury's evaluation of all revision options relate to three general considerations: Simplification, equity, and economic effectiveness, particularly in enhancing capital formation. The need for simplification is self-evident to anyone who has struggled through the preparation of an income tax return. It is only about a month since many of us have had to suffer through this annual exercise in frustration. But the complexity of the return is a function of the complexity of the law; simplification of the law will permit the design of a form more easily comprehended by the bulk of taxpayers.

The need for equity is also self-evident. Our tax system is unique in the extent to which it depends, successfully, on the voluntary participation of those subject to the system. That success can be maintained only if all taxpayers are convinced that the burden is being shared on an equitable basis. Equity considerations require correction of imbalances in the present tax structure that may be penalizing one form of income-generating income as against another, individual taxpayers as against businesses, small enterprises as against larger firms.

The need for an economically effective system, particularly one that facilitates capital formation, is evident from the analysis advanced earlier as to the economy's need for an accelerated rate of investment. One aspect of the tax structure with particular relevance to the problems of adding to our capital stock is the impact of taxes on the form of financing new investment. Our financial system is justifiably renowned for its capacity, scope, richness of form, and resiliency. It functions with remarkable efficiency in gathering the savings of the public and transforming these into the means of financing private investment. Nevertheless, there is concern that the availability of financing—in both appropriate amount and form—is, or could become, an impediment to the necessary growth in our capital stock.

One fundamental problem is the tilt of the system toward financing through debt instruments. Savers appear, in general, to prefer acquiring financial assets of fixed nominal value and fixed income return—a preference that persists despite the postwar erosion in the purchasing power of fixed-value claims. Moreover, our present tax system encourages the financing of investment through debt instruments.

Over the longer run, this is not the ideal arrangement; there are limits to which it is prudent or even feasible to pile increasing amounts of debt on a very slowly growing equity base. A debt-heavy financial structure increases the vulnerability of the business enterprise to cyclical fluctuations in income. It limits the venturesomeness of investment, for lenders cannot in good conscience underwrite the risks appropriate to an equity participant. And it inhibits economic growth because growth depends very much on willingness to risk investment in new products and new processes.

Moreover, the emphasis on debt financing raises particular problems for smaller and newer enterprises, which often lack the track record necessary to attract adequate amounts of financing from lenders and must, therefore, fight for access to pools of equity financing.

Many proposals have been advanced to modify the tax structure in order to achieve more evenhanded treatment of alternative means of financing investment. These proposals are all under active study.

As the committee can well imagine, such a comprehensive assessment of the tax structure as is now underway is no mean task. Within each broad category of tax modification proposals mentioned earlier there are many variants to be pursued. There is a decided lack of unanimity among economists as to the economic "payoff" of the various alternatives, and reasons for these differences in view must be explored. Foreign experience with some of the alternative approaches must be evaluated in terms of their possible relevance to U.S. problems. The relationship of the various alternatives to the tax measures and innovations incorporated in the national energy plan must be assessed.

Finally, the consistency of various alternatives must be established with the administration's goals of reduced unemployment, reduced inflation, and a balanced budget by fiscal 1981. I might note, in concluding, that achievement of these goals depends importantly on maintaining a high rate of growth in investment over the balance of the decade. The committee can be assured, therefore, that the tax revisions recommended will contribute to this objective.

Exhibit 20.—An address by Assistant Secretary Brill, June 9, 1977, to the 14th annual Economic Outlook Conference, Chicago, Ill., entitled "Lessons of the Seventies"

I realize that it's presumptuous at this point, only three-quarters of the way through the decade, to claim the insights that would permit such a profound title as "Lessons of the Seventies." The justification—if there is one—for the pomposity of this title is my confidence in the economy's performance over the balance of the decade. I happen to think we are going to do quite well over the next several years.

This confidence is based on my observation that policymakers, both public and private, show clearly that at least some of the lessons of the seventies have indeed already been learned.

The principal lesson is caution. If stagflation has any redeeming quality, it is the humility it has induced among economic policymakers. This is evident in the more widespread realization that the business cycle is not dead. This is evident in the more widespread realization that economic shortfalls are not remedied simply by throwing money at them. This is evident in the equally widespread realization that economic excesses are not cured by depriving the economy of money or lengthening the unemployment lines. This is evident in the more widespread realization that inflation is not simply a question of excess demand in the United States and the increasing awareness that world demand and supply constraints are also important variables impacting upon U.S. prices. Moreover, economists have come to know that fear of inflation can be as great a danger as actual inflation. They have also learned—relearned—that inflation cannot be outlawed by fiat, or permanently suppressed by controls.

Economists have also come to realize that steady productivity growth, which in the past has been a buffer against increasing wage costs, is not a foregone and inevitable conclusion, that clean air and clean water, a safe and healthy work environment, and decreasing dependence on foreign energy sources are not free goods, and that attainment of these goals will of necessity impose some costs on our economy.

All of these realizations are healthy, because they lead to the conclusion that we still have a lot to learn about economic stabilization, that neither complete dependence on the marketplace nor overly ambitious fine tuning provide adequate or socially acceptable solutions to the economic problems of our times.

This is not a conclusion of intellectual despair. With apologies to my hosts, I must emphasize that I do not share the nihilism that underlies the economic philosophy usually identified with this city—that of the so-called Chicago school of economics. I believe in both the perfectability of man, and of his intellectual achievements. But I don't feel that this state of perfection was reached in either the general theory or in the monetary history of the United States. Neither provides us with adequate answers for the complex problems of the day.

Of all the lessons of the seventies, perhaps the most critical lesson is that neither a high unemployment rate nor a low utilization rate are sufficient to stop inflation, and that causes other than demand-pull are becoming increasingly important determinants of inflation.

This point can best be illustrated by contrasting the behavior of prices in the current business cycle with the behavior in previous cycles. A recent paper by Geoffrey Moore notes that in the earlier postwar cycles the rate of inflation (as reflected in the CPI) not only decelerated during contractions, but showed actual declines. Thus, while a peak inflation rate (measured as changes over a 6-month span) of +13.5 percent was achieved in October 1947, a trough rate of −4.2 percent was reached in November 1948. This was a peak-to-trough drop of almost 18 percent over only a 13-month span.

This record of sensitivity of prices to downward demand pressures was never again achieved in subsequent postwar cycles, with the record showing progressively smaller declines in price movements during periods of contraction. According to the analysis of Moore, the low point in the present price cycle was reached in April 1976, when the change in the Consumer Price Index (measured over a 6-month span) averaged +4.7 percent, a far cry from the minus three-tenths of a percent average for the other postwar troughs in prices. And this change represented a drop of only 8 percent from previous peak levels.

There is no simple explanation of the apparent reduction in the cyclical sensitivity of prices. Clearly market structure must be a factor, and to some extent it is related to a similar development in wages, which appear to be responding less to cyclical upturns in unemployment.

But this is only part of the price story. The reduced price sensitivity, particularly on the downward side, is undoubtedly related to the changed behavior of productivity. In the early postwar years through 1968, fluctuations in productivity in the private business economy hovered around an average rate considerably above the zero line, rarely dipping into negative rates. In other words, even during economic downturns, productivity growth occurred, although at reduced rates. After 1968, however, fluctuations in productivity not only have shown a more pronounced cyclical pattern, but have frequently dipped below the zero line.

How does this all contribute to greater price rigidity? Lower levels of productivity during recent economic downturns, in addition to smaller downside reaction of wages to increases in unemployment, add up to less cyclical decline in unit labor costs. These developments, along with other factors discussed below, have imparted an inflationary bias to the economy and are major reasons for caution in formulating policies, both public and private. In other words, in calculating the risk/reward ratio, the social costs of overshooting in a situation calling for economic stimulation have increased. And the chances of success in compensating for an overshoot through a reversal of macroeconomic policies has diminished. Perhaps that is why the recent episodes of fierce monetary restraint have taken a tremendous social toll but still haven't succeeded fully in reversing inflation or inflation expectations.

Perhaps, also, we've been fighting the wrong war with the wrong tools. Granted that the economy seems more resistant to the macropolicies traditionally used in defusing excess demand, the problem has not been excess demand as much as inadequate supply.

Certainly, we've suffered from a sequence of events limiting supply, particularly in the food and energy areas. Starting with the famous "anchovy disappearance" in 1972 and continuing through several weather disasters and political upheavals, the world food, feed, and fuel situation has been plagued by supply constraints. The oil situation is too well known to be recounted here. And shortage of capacity in basic materials processing industries was an important contributory factor to the price developments of 1973–74.

Supply problems are not amenable to the conventional tools of demand management. One can screw down as hard as one wishes on M_1, without adding one bushel of soybeans or one barrel of oil or one drop of rain to parched fields in Kansas. It seems to me one of the policy mistakes of recent years was in treating inflation resulting, in large measure, from supply shortages with tools designed to cope only with excess demand.

That is why I'm more confident about the years ahead. It seems to me that the choice of policy instruments used to cope with such problems will be influenced by the lessons learned from the earlier 70's. The energy program is one example, with its incentives to substitute more abundant sources of energy, which can be developed under our own control, for diminishing resources controlled by a foreign cartel. It will undoubtedly involve much smaller social and economic costs than a policy of trying to offset price rises that could be invoked by an unchallenged monopoly by the throttling down of all demands.

The agricultural program, which will build up reserve stocks to meet unforeseeable, uncontrollable effects of adverse weather, is another example. In both the energy and agricultural areas, it seems to me we are trying to fit the right tools to the problem. I'm not defending every last provision of either program, but the approach is clearly preferable to dealing with the underlying problems through blunderbuss policies.

And where macroprograms are appropriate, Government policies also seem to be exhibiting the right degree of caution. The withdrawal of the tax rebates was a difficult decision. Yet it was made in recognition of the dangers of overstimulation. I am fully aware of the cynics who would like to attribute all sorts of political motivation to the action, because it has not been customary for administrations to have the candor to admit that the economic scene changed sufficiently in 3 or 4 months to warrant withdrawing an announced policy recommendation. I am willing to accept the action at face value, and am pleased to see the prompt vindication of this governmental prudence and caution in the current flow of economic statistics.

Let me also acknowledge the increased prudence and caution of the consumer sector and the business community. Despite the fact that the economy has made a significant recovery from the low point in March 1975, with industrial production, real GNP, and employment all exceeding their previous peak levels, the expansion in business fixed and inventory investment has been quite modest and restrained. Except for a brief rise during the economic pause of mid-1976, the inventory/sales ratio has been declining steadily from the swollen levels of early 1975. Business fixed investment, while recovering steadily from its trough in the third quarter of 1975, is still considerably below its 1974 peak.

All of this caution is not surprising if one traces through the impact on profits of the sluggish adjustments in unit labor costs and other costs, particularly the cost of raw materials whose prices have been dominated by erratic supply factors. Although aggregate corporate profits have made a good recovery from the depressed levels of mid-1974, and recently equaled their 1972 peak levels (even after an allowance for inventory and capital consumption valuation adjustments), the same cannot be said for profit rates, or the profit share of GNP. This share is considerably below the 1972 level and substantially lower than the halcyon days of the mid-60's. In view of these facts, businessmen have learned that increased growth does not necessarily mean increased profitability.

To generalize a bit, it seems to me that the increased frequency and amplitude of cyclical fluctuations have conditioned responses of businessmen and consumers toward greater risk aversion. The severity of the 1974–75 recession is captured adequately in the numbers, but perhaps we forecasters tend to overlook the impact of so severe a recession on the subsequent decisionmaking process, just because some of the recession symptoms were, fortunately, mitigated by the insurance and welfare systems created earlier.

But just because 10 million unemployed did not riot in the streets does not mean that we should have expected an immediate return to earlier response patterns in consumption and investment as the economy climbed out of the trough. The memory of layoffs, even in executive suites, has been all too fresh.

The violent adjustments in financial markets, imposed to stem the inflationary momentum, also contributed to greater caution on the recovery leg of the cycle. A 12-percent prime rate is not easily forgotten, neither by the industrial executive faced with the problem of financing a rebuilding of inventories or expansion of plant facilities, nor by the financial institution manager who has narrowly escaped fatal hemorrhaging of his deposits.

We have moved from a go-go era of the sixties to a go-slow era in the midseventies, in both industry and finance, and I don't think the lessons of the recent recession have worn off. To put it in the framework of a cost/benefit analysis, the costs of the risks involved in new investment weigh substantially heavier today, and this must be factored into our forecasts, as well as in our policy advice on how to get to desired levels of private investment. Nor should we overlook the greater risks in international business transactions, as businessmen learn—often painfully—the true costs of operating in a regime of floating exchange rates.

It is simple enough for an economist to suggest that if the risks of doing business increase, then prices must be raised to compensate for the higher risk. In the long run, that may indeed be the adjustment process. In the shorter run, however, the adjustment is not that easy; it may be that such risks are avoided completely.

After suffering from the shock of seeing apparently filled order books melt away rapidly, it is understandable that industrial executives are exceptionally cautious in expanding production and facilities in response to early signs of rejuvenated customer demands.

That is why I am neither surprised—nor overly disappointed—in the latest Department of Commerce survey of business plans for capital spending this year. Admittedly, it is somewhat below the 9- to 10-percent range of increase we feel necessary to attain to achieve our medium-term objectives for budget balance, unemployment, and inflation. But it is still a respectable pace, strong enough to add support to the economy in the months ahead without raising any specter of runaway expansion and inflation. I expect similar prudence in business additions to inventories.

In conclusion, let me reiterate that my optimism over the future course of the U.S. economy stems from a belief that business and government have learned the lessons of the seventies well. I'm glad that everyone is cautious and concerned; the danger occurs when everyone is convinced there are no pitfalls to pellmell expansion.

Enforcement and Operations

Exhibit 21.—Exchange of letters between Attorney General Bell and Secretary Blumenthal establishing policy for Justice Department review of certain reports received by Treasury under the Currency and Foreign Transactions Reporting Act

MARCH 25, 1977.

The Honorable W. MICHAEL BLUMENTHAL
Secretary of the Treasury
Washington, D.C. 20220

DEAR MR. SECRETARY: The Currency and Foreign Transactions Reporting Act (P.L. 91–508; 31 U.S.C. 1051–1143) and Treasury Department regulations implementing its provisions require reports of certain domestic currency transactions and of the import and export of monetary instruments in excess of certain amounts. In enacting this legislation Congress expressly recognized that such reports would have a "high degree of usefulness in criminal, tax, or regulatory investigations or proceedings" (31 U.S.C. 1051).

In order to realize more fully the potential of the Act and to facilitate broader access to these reports by the Department of Justice, I suggest that on a continuing basis the

Treasury Department furnish this Department with copies of all reports that appear to merit review. The Justice Department will work with your Department in developing guidelines appropriate for this purpose.

In the case of requests for reports pertaining to specific persons who the Justice Department has reason to believe are engaged in illegal activities, it would facilitate matters if such requests were acceptable when signed by an Assistant Attorney General on my behalf.

I believe this approach is consistent with the objectives of the Act.

Yours sincerely,

(Signed) GRIFFIN B. BELL,
Attorney General.

APRIL 29, 1977.

The Honorable GRIFFIN B. BELL
The Attorney General
U.S. Department of Justice
Washington, D.C. 20530

DEAR MR. ATTORNEY GENERAL: This is in further response to your letter dated March 25, 1977, requesting access to certain reports required under the Currency and Foreign Transactions Reporting Act (P.L. 91–508; 31 U.S.C. 1051–1143) and the implementing Treasury regulations.

Since your request is consonant with 31 U.S.C. 1061 and 31 CFR 103.43, the Treasury Department will be pleased to work with your representatives to make pertinent information from the required reports filed on IRS Form 4789 or Customs Form 4790 available to the Department of Justice. Requests, signed on your behalf by an Assistant Attorney General, for reports pertaining to specific persons will be acceptable.

Please have a member of your staff contact Deputy Assistant Secretary James J. Featherstone to arrange the necessary procedures.

Sincerely,

(Signed) W. MICHAEL BLUMENTHAL.

Exhibit 22.—Statement by Under Secretary Anderson, March 29, 1977, before the Commerce, Consumer, and Monetary Affairs Subcommittee of the House Committee on Government Operations, on the Bank Secrecy Act

Thank you for the opportunity to appear before you to testify concerning the implementation of titles I and II of Public Law 91–508, which is commonly referred to as the Bank Secrecy Act. It is my understanding that the current hearings are, to a certain extent, a continuation of the hearings the subcommittee held last summer. Therefore, I will attempt to confine my statement to those areas which were not fully discussed in the testimony that Assistant Secretary Macdonald gave on June 28, 1976.

The Treasury Department shares the subcommittee's apparent concern about the misuse of foreign financial facilities to further violations of U.S. laws, including, among others, tax fraud, drug trafficking, securities violations, and corruption.

Misuse of foreign financial facilities in tax violations

A series of investigations are now being conducted by the Internal Revenue Service in close coordination with the Department of Justice. These investigations involve one "private" bank in the Bahamas with an office in the Cayman Islands. There are hundreds of so-called private banks which appear to owe their existence to the tax advantages they afford U.S. taxpayers. Often a private bank is chartered in a tax haven country to transact business only with nationals of other countries. The tax advantages involve tax avoidance and tax evasion schemes. The biggest obstacle in sorting out the avoidance schemes from the evasion schemes is the difficulty in obtaining information from the foreign tax havens involved. The lack of information also makes it impossible to determine the amount of tax dollars which are being lost to the U.S. Treasury.

The following are some of the schemes the IRS has uncovered. It is obvious that the success of each scheme depends almost entirely on the bank secrecy and commercial secrecy laws of the tax haven countries.

Use of foreign bank accounts or trusts.—The depositor deals with the foreign bank or trust through a representative in the United States. Funds are deposited to a correspondent account of the foreign bank or trust in the United States. The depositor requests the foreign bank's representative to issue checks to others on his behalf, and instructs those issuing checks to him to make them payable to the foreign bank. These checks are then forwarded to the foreign bank's representative for deposit to the bank's correspondent account in the United States. The control and direction of the account are maintained by the taxpayer within the United States; however, the records of the account are maintained outside the United States.

Use of brokerage accounts.—Brokerage accounts for numerous foreign trust clients are maintained by U.S. brokers in the name of the foreign trust. These accounts are managed either by one of the foreign trust's representatives in the United States or by the particular clients themselves. Where clients do not directly communicate with their brokers, it is suspected that they give them instructions through a representative of the foreign trust. Substantial capital gains taxes are thus evaded.

Use of foreign trusts.—1. Foreign situs trusts have been set up for use as a vehicle to divert U.S. income. In effect, these trusts are nominees. Income diverted to these trusts is returned to the taxpayer in the form of loans which may or may not be interest bearing and in most instances are not repaid. It is also believed that cash is disbursed from a viable trust for the benefit of the taxpayer, resulting in a taxable transaction. The beneficiary may be another individual who has been named by the grantor. It is significant that all income and expenses of a grantor trust is includable in income, whether distributed or not.

2. A series of manipulated transfers and exchanges of income-producing assets through foreign trusts and other foreign entities which produce a stepped-up basis to such assets when brought back to the United States. The U.S. taxpayer depreciates the asset on this stepped-up basis and the capital gains resulting from these transactions escapes U.S. taxes by attributing such gains to the foreign entities.

Use of foreign entities.—Foreign entities such as partnerships, joint ventures, or corporations are used as nominees for U.S. taxpayers. Funds are returned to the U.S. taxpayers in the form of loans. In some instances, the taxpayers actually control the bank accounts for these entities. Records relating to these accounts are segregated from records used by the taxpayers to prepare income tax returns.

Assignment of rights to future income.—The taxpayer assigns rights to future income through the purchase of an annuity from a foreign entity. After the basis is recovered, the payments to the taxpayer are recorded as loans. They are not repaid and taxation of the annuity income is evaded. The future income, as earned, passes untaxed to the foreign entity.

Transfer of ownership of an income-producing asset.—A series of transactions is contrived to transfer the ownership of an income-producing asset, usually a going business, located within the United States to a foreign entity. This income is then brought back to the United States for the benefit of the seller in the form of loans made to him either by the foreign entity involved in the purchase, another foreign entity, or a domestic entity; these so-called loans are usually not repaid. The U.S. taxpayer claims an interest deduction for the interest allegedly paid as a result of these "loans," offsetting other income.

Treasury policy: striking balance between benefits of foreign investment versus dangers of tax abuse

Although the foregoing examples clearly indicate the opportunities for abuse, the Department does not want to create the impression that there is anything inherently sinister in the use of foreign financial institutions by U.S. persons or companies or others. In fact, I believe that most foreign financial institutions function very much like banks and securities dealers in this country in that they serve a legitimate and vital economic purpose. Many of them have facilitated foreign investment in the United States and, as a result, have had a very beneficial effect on our economy.

Our August 1976 "Report to the Congress on Foreign Portfolio Investment in the United States" states that foreign portfolio investments in U.S. securities amounted to about $67 billion at the end of 1974, of which about $25 billion was in stocks and about $42 billion in bonds and other long-term debt. While most of the debt (about 62 percent) was held by official institutions, almost all of the stock (about 96 percent) was recorded in the names of the private persons. Most of this stock (about 89 percent) was held by European or Canadian residents. Of the $4.5 billion of U.S. stock held by individuals residing abroad, half was held by Americans residing abroad.

Foreign banks, brokers, and nominees held $13 billion of foreign investments in U.S. stocks and $12 billion in long-term debt instruments, primarily corporate bonds, a total of $25 billion. One cannot assume that all of this was in nominee accounts, in that overseas banks and broker-dealers hold substantial amounts of securities for their own account. As the holder of record of such securities is a bank or securities firm, it is not possible to determine how much of the $25 billion was for nominee accounts and how much for the banks' and broker-dealers' own accounts.

While determining the source of money inflows is important for investigations relating to tax evasion and other criminal acts, such information is not necessary for conducting an effective monetary policy. For purposes of developing domestic and economic policy, the volume and rate of capital inflows and outflows is much more important than the identities of the persons or corporations owning such funds.

Treasury Department policies strongly attempt to discourage U.S. owners of capital from trying to disguise such capital as foreign investment in the United States. Sections 6035, 6038, 6046, and 6048 of the Internal Revenue Code require information returns as to the shareholdings of U.S. persons in foreign corporations and the creation of or transfer of money to foreign trusts by U.S. persons. Moreover, as a result of the Tax Reform Act of 1976, the income of a foreign trust created by a U.S. person will generally be taxed to the grantor. The investment income of foreign corporations without substantial operations is currently includable in the income of their U.S. shareholders regardless of whether the income is distributed.

In view of the above, elimination of withholding taxes on dividends and interest paid by U.S. entities to nonresident aliens or foreign corporations would not prevent taxation of the U.S. owners. Moreover, the Treasury has not made a commitment to eliminate withholding tax on interest and dividends paid to foreign persons.

Dividends paid by U.S. persons to foreign entities are not exempt from withholding unless the corporation paying the dividends derives 80 percent or more of its income from outside of the United States. Interest derived by foreign persons from bank deposits, unless such interest is connected with the conduct of a U.S. business, is exempt from U.S. tax. The same is true of discount on short-term Treasury bills.

The exemption encourages foreign entities to keep spare funds in the United States rather than in other countries, which generally offer similar tax exemptions with respect to such investments. Again, the fact that the foreign entity is exempt from U.S. tax on such interest or discount does not mean that the U.S. owner is exempt from immediate taxation on such income.

Treasury favors foreign investment in the United States while at the same time attempting to combat tax evasion. Investment in the United States through tax haven jurisdictions, such as the Cayman Islands and the Bahamas, will (except as to bank interest and Treasury bills) incur a withholding tax of 30 percent. That rate is generally reduced (in the case of interest sometimes to zero) if the United States has a tax treaty with the country in which the recipient is resident. Tax treaties provide for cooperation and exchange of information between the two governments. For example, if a U.S. corporation withholds tax from a dividend at the reduced Swiss treaty rate, but the addressee in Switzerland is not the real owner of the stock, the Swiss tax authorities collect the additional U.S. tax. The Swiss annually pay substantial amounts of U.S. tax collected on our behalf to the Treasury Department.

U.S. business profits are taxed by the United States regardless of whether earned by foreign entities or U.S. entities. U.S. dividends and interest, subject to the exceptions discussed above, are taxed at a 30-percent rate in the absence of treaty. Where treaties exist, information as to the recipients of the dividends and interest is available through exchange of information provisions. Moreover, even if the foreign entity is itself exempt from tax on such nonbusiness income as dividends and interest, U.S. shareholders in avoidance situations are generally required by law to include that investment income currently in their own tax returns even if the amounts are retained by the foreign entity.

International tax enforcement by IRS

The Internal Revenue Service long ago recognized the need for specialization in the enforcement of its tax laws in the international area. The IRS Office of International Operations (OIO) has primary jurisdiction over foreign corporations doing business in the United States, nonresident aliens and foreign corporations receiving income from the United States, U.S. corporations, and U.S. persons making payments of investment and other types of income to foreign persons. OIO has over 500 employees and maintains posts of duty in 14 foreign countries. OIO has many enforcement tools available to it as means of identifying the earnings and profits flowing to foreign corporations and other entities. Most important among these are:

1. Chapter 3 of the Code which requires the filing of a return with respect to all items of U.S. source income flowing to foreign persons.
2. Those sections of the Internal Revenue Code which require the filing of information returns by U.S. persons having an interest in or who are officers, directors, or shareholders of foreign corporations.
3. The exchange of information provisions of the income tax treaties which the United States has covering 39 countries.

These provisions enable us to identify ownership in foreign corporations doing business in the United States or receiving income from the United States.

Listed below are examples of information presently submitted by U.S. persons to the U.S. Internal Revenue Service on an *automatic* basis *as required by law*. They relate only to international transactions or activities by U.S. persons and are in addition to the information which may be required to be submitted by a U.S. taxpayer on his annual income tax return.

1. Information concerning the creation of and/or transfer of property to a foreign trust by a U.S. person. (Form 3520)
2. Information regarding interests of U.S. persons in foreign personal holding companies. (Forms 957 and 958)
3. Information regarding foreign corporations organized or reorganized by U.S. persons or whose stock has been acquired by U.S. persons. (Form 959)
4. Information regarding foreign corporations controlled by U.S. persons. (Form 2952)
5. Information regarding stock transferred to a foreign corporation by a U.S. person. (Form 926)

Illegal financial transactions

Although narcotics investigations are primarily the responsibility of the Drug Enforcement Administration (DEA), we understand that large international financial transactions are common in major drug cases. For example in one case, boxes of U.S. currency were carried into Mexico to pay for drugs. The U.S. currency was deposited in Mexican banks. Banking records in this country indicate that millions of dollars of the same currency were later shipped by a Mexican bank to its correspondent banks in the United States. The leader of the drug ring, who was in Mexico, then used the U.S. banks to move more than $1,500,000 of this money to one of his Swiss bank accounts.

We are also aware that narcotics traffickers have been using U.S. financial institutions and facilities for "laundering" currency. That is to say, their illicit narcotics trafficking normally results in accumulation of large quantities of currency in small denominations. In order to facilitate handling and transportation of the currency they attempt to induce banking officials or employees to exchange the small denomination bills without filing the required currency transaction reports which would identify the violators.

The Internal Revenue Service's investigation of a large banking institution in New York is an example of this technique in action. The bank and four individuals have been indicted and it is a matter of public record. Two narcotics traffickers made arrangements with several bank officials and employees to "launder" currency for a fee. The bank was charged with failure to report more than 500 cash transactions totaling $8.5 million during one fiscal year; a bank official was charged with perjury before a Federal grand jury; 2 bank employees were charged with filing false income tax returns which did not include fees from the narcotics traffickers; and an individual was charged with income tax evasion for failing to report $600,000 in income from the proceeds of the sale of heroin.

We are aware of attempts by international currency dealers to circumvent regulations which require the filing of reports wherein $5,000 or more in currency is taken into or taken out of the United States. However, this is attempted more often by schemes which only involve paper transactions without currency either entering or leaving the country. An example is a case in which the Government returned indictments last fall against two individuals involving a foreign bank account in the Bahamas. The setup was such that all deposits and transactions took place in the United States in a domestic bank, but in the name of the foreign bank rather than the individual. The individual was charged with falsely answering "No" to a question on his income tax return relating to interest in a foreign bank account. An officer of the Bahamian bank was charged with furnishing a false affidavit regarding the depositor's interest in a foreign bank account.

Lastly, we are aware of coin dealer schemes in exchanging currency which seem to occur most frequently within the United States. Narcotics traffickers allegedly purchase coins for the twofold purpose of "laundering" their currency and getting it back in larger denominations when they sell the coins, as well as making a profit on the sale.

Corporate misconduct

In 1966, IRS initiated the coordinated examination program which today includes 100 percent audit coverage of approximately 1,200 of the Nation's largest corporations. Under this program, the audit plans for these large corporate examinations include specific checks for areas of noncompliance, including fraud. In 1973, the large case audit program was updated to include compliance checks in the area of political contributions. This was followed up in August 1974 by a political campaign contribution compliance project which received and disseminated information of possible tax violations to the field. Also, in 1974, the IRS issued new and expanded guidelines regarding the examination of political organizations, candidates, and contributors.

During this period, investigations of some major corporations by the Service and other enforcement agencies disclosed intricate corporate schemes designed to generate large amounts of cash for illegal or improper use and to reduce taxable income unlawfully.

In a group of over 800 large case examinations, there have been approximately 280 with indications of slush funds or illegal activity. However, after obtaining all of the facts surrounding the illegal or questionable activity, some of these cases have been determined to have no U.S. tax consequence.

As of December 31, 1976, 80 coordinated examination program cases were under active criminal investigation by the IRS Intelligence Division or at some point in the prosecution pipeline, i.e., in the offices of IRS Regional Counsel, Attorney General, U.S. attorney, or on the docket in Federal district courts. Over 50 of these 80 cases involve the issue of questionable payments or political contributions. This is a high percentage of criminal investigation cases when compared to other classes of returns.

For many years, the Internal Revenue Service has had an international enforcement program which focuses on the foreign-sourced income of U.S.-controlled foreign corporations. From a staff of 72 international examiners in 1965, it has expanded to approximately 150 this year and additional growth is expected.

The increase in staffing was necessitated by the increased workload of identified cases with substantial international transactions, the IRS's growing knowledge of foreign operations, and the large amount of tax involved in these cases.

Obviously, in some instances, the IRS's ability to regulate and trace corporate financial activities is affected by the international nature of these examinations. When third-party records are located in foreign countries they generally are not as readily available as domestic records. This problem can best be overcome through mutual assistance treaties with the countries in which our multinationals do business.

Implementation of the Bank Secrecy Act

The Assistant Secretary (Enforcement, Operations, and Tariff Affairs) (EOTA) has the overall responsibility for coordinating the procedures and efforts of the agencies which have been given compliance responsibilities under the implementing regulations. Consequently, EOTA has worked with the bank supervisory agencies to develop a system for monitoring compliance with the regulations and for referring instances of apparently willful noncompliance to Treasury. Treasury serves as the focal point for inquiries from the law enforcement community with respect to the recordkeeping and reporting requirements in the regulations. The IRS, for example, has a special form for its field agents to use to report apparent violations by banks. The reports are forwarded to Treasury. EOTA reviews them, makes further inquiries, and refers the matter to the appropriate bank supervisory agency when a followup seems to be warranted. In some instances where the supervisory agency confirms that a serious violation may have occurred, the Assistant Secretary has asked the IRS to conduct a criminal investigation.

The Office of the Assistant Secretary (EOTA) has been actively interested in the regulations and the forms from the time that the act was signed. It was at the request of EOTA and Treasury's Office of the General Counsel that the IRS took primary responsibility for the design of Form 4789, Currency Transaction Report, and Form 4790, Report of International Transportation of Currency or Monetary Instruments. The Customs Service had substantial input with respect to form 4790. In March 1972 EOTA and the General Counsel released both forms for comment together with the governing regulations which became effective in July 1972.

We are very interested in obtaining the maximum benefit from the forms 4789 and 4790 that are being filed. I understand that the IRS and Customs have made arrangements for exchanging the data from them. In addition, the Office of the Assistant Secretary (EOTA) has been in communication with the Criminal Division at the Department of Justice concerning steps which could be taken to make that information more readily available to various organizational elements within Justice. In instances where DEA would have an obvious interest, Treasury has also offered DEA investigators information from the reports of the international movement of currency.

As you may recall, Mr. Chairman, when former Assistant Secretary Macdonald testified before the subcommittee on this matter in June 1976, he indicated that his office had developed a system for processing the forms 4789 and 4790 that would integrate IRS and Customs efforts in this area. However, now that the Tax Reform Act of 1976 is in effect, much of the analysis and cooperation that was planned would be illegal.

While it is not possible to provide comprehensive statistics concerning the effectiveness of the reports in combating "white collar" crime, organized crime, gambling, racketeering, tax evasion, and narcotics trafficking, in our opinion, the reporting requirements serve two valuable functions. First, they are in themselves a deterrent. They make crimes involving large currency transactions more difficult to conceal and, in some instances, provide additional penalties for failure. Second, some of the reports that are filed pertain to questionable or illegal activities and can help investigators to identify criminal activities that might otherwise go undetected.

In addition, the reports have been of considerable value to Treasury agencies in carrying out their law enforcement functions. During the period from July 1973 through December 1976, the IRS Intelligence Division initiated a total of 195 criminal tax investigations in which currency transaction reports (form 4789) were involved. Thirteen cases were recommended for criminal prosecution during this period; 177 cases were forwarded to the Audit or Collection Divisions for civil tax consideration or closed to the files; and 10 defendants were sentenced. It should be noted that these counts include cases which were in inventory prior to July 1973. Thirty-six cases relating to form 4789 were open as of December 31, 1976.

The IRS also recently implemented a procedure that will permit them to determine the number of cases initiated as the result of information obtained from Form 4790, Report of the International Transportation of Currency or Monetary Instruments.

The forms 4790 are required to be filed with the U.S. Customs Service. Customs has been responsible for more than 100 convictions under the act—some of them related to drug violations. In addition, Customs has been able to determine that many of the reports have been filed by persons suspected of illegal activities including drug trafficking and smuggling.

The question regarding foreign bank accounts has been reinstated on tax forms for 1976. While it would probably not be answered by those individuals engaged in illegal activities, the question can be an investigatory lead.

We recognize the need to resolve, clarify, and simplify a number of provisions in the current regulations. As the subcommittee staff has indicated, one of the areas that needs immediate attention is the procedure for remitting the seizures of currency and other monetary instruments that are made under the act when persons fail to report the transportation of currency in excess of $5,000. In the past, there has been a question as to which Treasury element should make the required decisions. I am uncertain as to why the matter has not been resolved, but I can assure you that it will be in the near future.

The new restrictions on the disclosure of tax-related information for nontax purposes may also pose a problem with respect to the dissemination of forms 4789 to other Federal agencies. The subjects of the investigations in which the forms are used may claim that the forms, which are filed with the IRS, are tax-related or that the IRS action to alert another Government agency to an unusual transaction may have been partially based on tax information. For example, if the IRS were to receive a report pertaining to a $150,000 currency transaction, recognize the person involved as a leading drug trafficker, and refer the report to DEA, it is very possible that the information would be tainted. Furthermore, the IRS employee who released the information might be subjected to criminal prosecution by the Department of Justice and sued for damages by the drug trafficker.

Treasury has not, as yet, assessed civil penalties in connection with violations of the reporting requirements of the act. This is primarily because EOTA is not aware of any instances in which a penalty would have been appropriate. Treasury has received no recommendations for penalties from IRS or the bank supervisory agencies. While no "penalties" have been assessed in Customs cases, more than $800,000 has been collected by Customs from persons who violated the regulations. The civil penalty provisions are practical only when it can be documented that an unreported shipment left or entered the United States without being detected by Customs. If Customs seizes a shipment of currency, the entire amount is subject to forfeiture and a penalty can be assessed. The total of both the forfeiture and the penalty, however, cannot exceed the amount of the shipment. So, obviously, there is a very limited need to assess civil penalties.

We have also played a limited role with respect to criminal proceedings. Treasury has not made any recommendations to the Department of Justice concerning criminal prosecution for violations of the Bank Secrecy Act because there has not been a need to do so. Customs routinely refers its cases directly to the appropriate U.S. attorney who makes the decision regarding criminal prosecution. In other instances where it appears that a criminal violation may have occurred, we have referred the matter to the appropriate U.S. attorney before the outcome of the investigation was apparent. In my opinion, it is quite likely that future investigations will be handled in the same manner. The Justice Department or local U.S. attorneys should ordinarily have complete freedom in deciding whether prosecution is warranted.

IRS investigations have resulted in seven indictments, and the IRS currently has several banks under investigation for possible criminal violations.

We have been working with the bank supervisory agencies to have increased emphasis placed on the examinations for compliance with the currency reporting requirements. However, to date there has been no indication that noncompliance is widespread. In our opinion, the vast majority of domestic banks are in substantial compliance with the act.

The Customs Service has referred 254 persons who were arrested for violation of the currency reporting requirements or related statutes to the Department of Justice for the consideration of criminal action. Further, other investigations, which did not culminate in arrests, have been referred to the Department of Justice. Of these, Customs records show 138 complaints or indictments have been filed by the Department of Justice.

We understand that some U.S. attorneys have been reluctant to prosecute more currency cases because the law permits the imposition of severe civil penalties, while criminal violations generally are misdemeanors. Furthermore, these cases are difficult to prosecute because the Government is required to show specific knowledge of the act and intent to violate the reporting requirements. We believe that there also may be some reluctance on the part of local U.S. attorneys to seek indictments due to their general unfamiliarity with the Currency and Foreign Transactions Reporting Act.

Exhibit 23.—Remarks by Under Secretary Anderson, May 17, 1977, before the American Importers Association, Plaza Hotel, New York City, on customs procedural reform

It is indeed a pleasure for me to be speaking to you, knowing that I represent an administration which has pledged itself to continued efforts at liberalizing world trade. At the economic summit meeting, President Carter and the other leaders of the large industrial democracies stated that:

> We are committed to providing strong political leadership for the global effort to expand opportunities for trade and to strengthen the open international trading system. Achievement of these goals is central to world economic prosperity and the effective resolution of economic problems faced by both developed and developing countries throughout the world.

In sharp contrast to the unhappy history of the thirties, the leaders of the countries that produce most of the world's output and account for most of its trade have rejected protectionism. They rejected any effort to export their unemployment and other problems to their trading partners. Instead, they called for significant new reductions of tariffs and nontariff barriers—with the full recognition that by expanding trade, by working together to strengthen the world's economic system each country will be better able to solve its problems at home.

This commitment is important. But it is only the beginning. Now it must be translated into reality in the Tokyo Round of trade negotiations and in the actions of individual countries. I do not underrate the difficulties. When growth lags, when unemployment is high, protectionism grows stronger. That is why Carter's administration's efforts to speed economic growth in the United States, while controlling and then reducing inflation, are critically linked to our trade policy.

So we need your understanding and support not only for measures specifically concerned with maintaining and expanding the open trading system, we need it also for the other domestic and international economic policies that must accompany our trade policy.

Within this broad policy setting, the Treasury Department is planning innovations that will facilitate commercial trade and make life simpler for travelers returning with foreign goods.

Since the last customs procedural reform in the early 1950's, the value of U.S. imports and the amount of duties collected has increased fivefold and the workloads of import specialists and customs inspectors have increased substantially. Customs has modernized and simplified its procedures wherever possible. But, faced with a law that reflects business and travel conditions of the 19th century, legislative change is essential if Customs is to keep pace with today's conditions.

Most of you, I am sure, carefully followed the progress of H.R. 9220, the customs modernization and simplification legislation in the 94th Congress. The AIA, along with other interested organizations and business associations, commented on that bill at the hearings before the trade subcommittee in August 1976. Early this year, your association had the opportunity to review and discuss with customs officials various drafts of a new customs procedural reform bill. The proposed legislation, currently under consideration in the Department, is, we believe, responsive to many of your concerns. Procedural reform is needed to help increase the productivity of the Customs work force in the face of increased workloads and to assure compliance with the laws. Here are some of the measures we will propose to Congress.

First, we will propose to eliminate the simultaneous filing of entry documentation and payment of customs duties, thus permitting separation of entry documentation and reporting from the duty collection procedure. This will allow full implementation of the automated merchandise processing system (AMPS) which is already in effect in Philadelphia, Chicago, Baltimore, Boston, and Miami and will be initiated soon in Los Angeles. With the flexibility provided by this change, transactions between Customs and importers could be expedited, duty payments could be made periodically at local banks, and periodic statements of account could replace individual bills and refunds. And we would gain the double benefit of simultaneously reducing the amount of paperwork between Customs and importers and increasing the amount of information available on Customs transactions.

Second, we will propose recordkeeping requirements that allow improved verifications without requiring any records that would not be maintained for ordinary business purposes. The provision would only require records to be kept which pertain to importations of merchandise or support the correctness of information contained in the entry documents submitted to Customs.

Bearing in mind the President's concern about the costs of Government recordkeeping requirements, we have taken care to avoid imposing any undue hardship or needless costs and to carefully strike the proper balance between the needs of the Government and the impact on importers. Another set of specialized records would not have to be created and kept for Customs purposes. At the same time, these revised procedures should strengthen the generally amicable and cooperative relationship that exists between Customs and importers concerning audits and inquiries.

Third, we will propose an administrative summons that will provide a better and fairer means of compelling testimony or the production of books and records after reasonable notice has been given. This administrative summons would be enforceable in a U.S. district court, giving the person summoned an opportunity to contest the summons in a judicial setting and protecting his or her rights as well as those of the Government.

Fourth, to ease the processing of international travelers, we will propose that the personal exemption be increased to $300 from the $100 allowance permitted since 1962. And we will propose a flat duty rate of 10 percent on dutiable articles valued between $300 and $600 carried by a returning traveler or in his or her baggage.

Fifth, as another measure that will benefit returning travelers, as well as small importers, we will propose to extend informal entry procedures to shipments valued up to $600, instead of the current level of $250. Informal entry procedures, which can be likened to the short-form tax return, would produce significant savings to travelers and other small importers, and reduce formal customs entries by over 230,000, resulting in substantial savings in processing costs.

Of course, no piece of customs legislation could rightfully be called "procedural reform" unless it contained an amendment to the so-called fraud and penalty provision of the Tariff Act, section 592. In recent years, this provision of law has been the subject of mounting criticism primarily because the required penalty, equal to the forfeiture value of the merchandise, has no relationship to the loss of revenue suffered by the Government. The great majority of violations of this section, nearly 90 percent, result from the negligence of the importer rather than any intention to defraud the Government. Nevertheless, whether the violation is due to fraud or negligence, the same penalty is assessed in the first instance. Although the intent of the violator can later be considered by Customs and the penalty reduced or canceled, the initial penalty can often result in severe injury to business.

Another criticism of existing section 592 is that judicial review of the alleged violation is for all intents and purposes precluded because the Government is required to sue for the full amount of the initial penalty, if the mitigated amount is not paid. In concrete terms, if the initial penalty is $1 million and the mitigated penalty is $50,000, it is unlikely that a businessman would risk $1 million to seek judicial review.

Accordingly, our sixth proposal will authorize the Secretary of the Treasury to assess a monetary penalty up to the value of the merchandise with the proviso that the Secretary could only apply the full penalty in those rare instances involving intentional actions or omissions designed to defraud the Government. The Secretary would establish levels of penalty which would reflect the present standard administrative practice of distinguishing between various degrees of negligent behavior. Such variations allow penalties to equal a multiple of the loss of revenue or a percentage of the value of the merchandise.

By reducing the initial penalty assessment, the unintentional damage to business would be eliminated and access to the courts for review of the penalty assessment would be made available.

Seventh and last, we will offer two proposals to set reasonable time limits for the settlement of most Customs matters. We will propose to amend section 621 of the Tariff Act to place a 5-year limit, measured from the date of entry, for assessment of a penalty under section 592 caused by the negligence of the importer. In cases of fraud, however, we would reserve the right to assess a penalty within 5 years of discovery of the violation as is now provided by law.

In response to comments of the AIA, customhouse brokers, customs' attorneys, and surety companies, we will also propose a statute of limitations on the liquidation of entries.

I hope that the many stories I've heard of entries being unliquidated for over 20 years will soon be a thing of the past. Since the enactment of the Customs Courts and Administrative Act of 1970, it is no longer possible for an entry to be tied up in the courts for many years before it is finally returned to Customs to be liquidated. I also understand that wherever the automated merchandise processing system has been installed, the average time between entry and liquidation has been reduced significantly. Nevertheless, despite improvements in this area, there are benefits to importers and Customs alike from a statute of limitations on the time in which to liquidate entries. Of course, a statute of limitations would have to provide adequate time for a complete examination of the import transaction and a fair liquidation, and authority for its suspension in circumstances where liquidation is delayed by statute or an investigation cannot be completed within the required time.

In addition to the proposals we will make, there are two areas that are receiving further study. In the legislation we will propose, title III of H.R. 9220, the amendment to the customhouse brokers provision of the Tariff Act, has been deleted. This should not be interpreted as a lack of interest in the conduct of the customs brokerage industry. To the contrary, we are very seriously examining the concept of self-regulation by the customs brokers. We understand that some customs brokerage associations are now considering a code of ethics for their members. We applaud this movement.

However, self-regulation must be sufficient to protect the interests of all concerned. Discussions with your association and the customs brokers are anticipated as our study progresses.

The Department is also looking into the Customs ruling process, including current staffing and backlogs, the publication of classification rulings, and possibilities of strengthening the Customs Information Exchange to improve communications with the importing community and assure uniformity of action in Customs districts throughout the country.

Now let me briefly mention our enforcement of the antidumping and countervailing duty statutes. In the interests of customs enforcement, I have instructed Customs to assign additional staff in order to bring all dumping master lists up to date as soon as possible. We intend to establish a consistent and predictable approach in our enforcement of the antidumping and countervailing duty laws. Predictability is essential if importers, exporters, and domestic manufacturers are to be able to plan their future business in a rational manner.

Finally, I would like to refer to a matter which I am sure is on all your minds: the *Zenith* case. You have probably heard that the Customs Court has decided in favor of Zenith Radio Corp. and adversely to the Government's position. This ruling means that the court considers the rebate of the Japanese commodity tax to be a bounty or grant, and that our countervailing duty law requires the imposition of a duty equivalent in amount. If upheld, this precedent could affect a substantial portion of our imports. Of course, this decision we find to be at complete odds with the liberalized trading policies so necessary to world economic health.

Therefore, the case was immediately appealed to the U.S. Court of Customs and Patent Appeals, and the Government's brief was filed last week, on May 12. The argument is scheduled for June 8. We are hopeful that a finding will be in the Government's favor, and we expect it will be handed down in early fall or possibly sooner. In the meantime, liquidation of imports of Japanese electronic products has been suspended, and bonds averaging 15 percent will have to be posted. We understand the uncertainty in which this state of affairs puts you, but everything I have said today should assure you that the Government is doing all that it can to correct this difficult situation.

As I mentioned earlier, this is an exciting time to be in the Treasury Department. We have an opportunity to make a major improvement in the procedures which affect international trade. With your assistance, it is my hope that we can work for customs procedural reform which will be responsive to the needs of the Government and the importing public now and in the future.

Tax Policy

Exhibit 24.—Statement by Secretary Blumenthal, January 27, 1977, before the House Budget Committee, on the President's economic stimulus program

It is a pleasure to appear before you this morning. Although this is my first opportunity to appear before a committee of Congress since becoming Secretary of the Treasury, I expect that you and your colleagues will make a veteran of me in short order.

Mr. Schultze has indicated to you the reasons why we believe a stimulative package is needed for the economy at the present time and the impact the package will have on the economy.

Let me explain the strategy behind this stimulative program. First, this program has a 2-year time perspective—the years 1977 and 1978. By the end of this period, we expect to be making significant progress toward achieving full employment and to be experiencing generally high rates of economic activity. Secondly, the program is designed to have a great degree of flexibility. As we continually monitor the improvement in the economy, we can either add additional stimulus or cut back as economic conditions warrant.

I will outline for you the tax aspects of this stimulative package and indicate what we believe will be the effect on the capital market of not only the tax features of the package but also of the entire stimulative program that we are presenting. I will also outline the impact the program will have on the international economy.

The tax features of the program have a twofold purpose: To provide a quick injection of spending into the national economy and also to take the first step in a tax simplification and tax reform program.

In broad terms, stimulus to the economy will be provided by a payment of $50 per capita to almost everyone. This will be accomplished by a general refundable rebate of 1976 taxes of $50 for each taxpayer, spouse, child, and other dependent. In the case of individuals or of families who have either no dependents or no earned income, this rebate will not exceed the amount of 1976 tax liability. Also, a payment of $50 per beneficiary will be made to social security beneficiaries, those receiving supplemental security income payments (SSI), and those receiving railroad retirement payments.

The $50 per person rebate and social security payment will amount to about $11.4 billion. The payments will be made this spring in the months of April, May, and June. The total rebate payments, therefore, should fall entirely in fiscal year 1977.

The second tax feature in the program is a tax simplification measure designed to substantially simplify the tax laws for those presently using the standard deduction. I will describe the tax simplification aspects of this proposal subsequently. Let me say at the present this involves enlarging the standard deduction for joint returns with incomes of $17,500 or less and single returns with incomes of $15,000 or less. This is accomplished by substituting a flat deduction of $2,400 for single people, and $2,800 for married couples, for the present complex set of standard deduction provisions.

This increase in the standard deduction will apply for the entire calendar year 1977 as well as subsequent years. However, this tax reduction cannot be reflected in lower withholding until approximately a month after the date of the enactment of the bill. We are assuming that the required withholding changes can become effective as of the first of May. Since the lower withholding will not be in effect for the first 4 months of the year, there will be either smaller tax payments or larger refunds when the individuals involved file their tax returns by April 15 of next year.

In terms of tax receipts, therefore, the standard deduction simplification measure will result in a reduction of receipts of $1.5 billion in fiscal year 1977 and $5.4 billion in fiscal year 1978. At current income levels the full-year effect is a tax reduction of $4 billion.

The third feature of the tax reduction in the economic stimulus package is a business tax reduction. Here we are proposing that business be given the option of a 2-percentage-point increase in the present generally applicable 10-percent investment credit or, alternatively, a refundable 4-percent credit against income tax based upon the payroll taxes paid for social security (FICA) tax purposes. Taxpayers will have their choice of the payroll tax credit or the investment credit increase but cannot take both. They will be required to elect between these two options and stay with their choice for a number of years.

The full-year effect of this business tax change at current income levels is expected to be $2.6 billion a year. In fiscal year 1977 this will result in a tax reduction of $0.9 billion and in fiscal year 1978, a reduction of $2.7 billion.

To summarize, the tax features of the proposal have a budget cost of $13.7 billion in fiscal year 1977. Most of this represents the cost of the tax rebate. The public works, public service employment, expanded training of youth program, and countercyclical revenue sharing expenditure programs are expected to add to this cost an additional $1.7 billion. For fiscal year 1977 this represents an overall cost of the program of $15.5 billion.

In fiscal year 1978 the components of the program shift substantially. The tax costs in that fiscal year are expected to be about $8 billion. There is no tax rebate in that year. On the other hand, the expenditure programs for public works, public service, and countercyclical revenue sharing will by that time have filled up the "pipeline" and can be expected to result in expenditures of $7.6 billion. The combination of these tax measures and expenditure programs involves a budget cost in fiscal year 1978 of $15.7 billion. Table 1 summarizes the budget costs of this program.

TABLE 1.—*Budget costs of the administration's stimulus and tax simplification and reform proposals*
[$ billions]

	Fiscal years	
	1977	1978
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns[1]	1.5	5.5
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	.9	2.7
Other expenditures programs:		
Increased countercyclical revenue sharing	.5	.6
Public service employment	.7	3.4
Public works	.2	2.0
Expanded training and youth programs	.3	1.6
Total other expenditures programs	1.7	7.6
Total administration proposals	15.5	15.7

[1] Includes extension of the $35 general tax credit to exemptions for age and blindness.

Impact of program on credit markets

I want to turn now to the question of the effect of the enlarged deficits for fiscal years 1977 and 1978 implied by these economic initiatives on the capital markets. The entire expenditure program is currently being reviewed and as a result it is impossible for us at this time to come up with an exact deficit figure for fiscal year 1977. However, it is believed that the fiscal year 1977 deficit will be in the range of $67 billion to $69 billion. This includes the effect of the stimulus proposal. Together with about $10 billion of off-budget financing, this would mean a draft by the Treasury on the credit markets in fiscal year 1977 of $77 billion to $79 billion. Some have questioned whether this prospective Treasury financing will "crowd out" other investments in the market.

Let us review our experience. It is true that non-Federal demands for funds have been rising from their recession lows since the latter part of 1975. We expect these trends to continue in 1977 and 1978. These demands, combined with total Treasury financing requirements, suggest a record level of total financing in the credit markets during calendar year 1977 of nearly $300 billion.

The supply of funds available to meet this large demand, including the Treasury's financing requirements, appears ample. Consumer savings should expand further, and it is likely that savings flows to investors will strengthen to about $150 billion. In addition, because this stimulus package is clearly not inflationary, it appears reasonable to anticipate that throughout 1977 and 1978 commercial and Federal Reserve banks will have the resources to purchase substantial amounts of credit market instruments. These sources of funds together with funds supplied by business corporations, State and local governments, the Federal Government, and foreign investors will meet these demands without the need for substantial purchases by individuals.

In summary, my judgment is that the larger Federal deficits will not have a serious effect on the availability of financing for the private sector and will, therefore, have only a moderate impact on interest rates. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and the rate of real growth will not reach an unsustainable level. Thus, we are unlikely to be confronted with a situation of "crowding out."

International economic considerations

The present policies of the major nations suggest some slackening in the rate of growth among the industrial countries. As a result, the developing nations will also encounter weaker markets for their products. Japan and Germany are expected to grow at a rate only somewhat less than in 1976, but in several of the other major economies such as the United Kingdom, France, Italy, and Mexico stabilization measures will lead to slower growth in the period immediately ahead.

It is important that those countries which are in a relatively strong financial position expand as rapidly as is consistent with sustained growth and the control of inflation. Expansion in those countries will provide stimulus for the weaker countries. But, it is easy to overestimate the magnitude of the contribution that faster growth in Japan, Germany, and the United States can make in fostering the needed adjustments of weaker countries. A 1-percent rise in the real GNP of the Big Three would result in an increase in their combined import demand on the order of $4 billion in 1977, of which only 60 percent, or about $2.4 billion, could directly benefit the financially weak countries.

In the period ahead when oil-exporting countries are in a very large surplus position, the financially weak countries must reduce their deficits to preserve their creditworthiness. As a result, this will tend to bring about a deterioration in the trade balances of the stronger countries. This means that the United States must expect a larger deficit in its current account balance. The key point here is that the weaker countries will of necessity reduce their current account deficits in accord with their ability to obtain financing.

To provide a better international economic climate, the United States is encouraging the major countries abroad which are in a strong financial position to follow a course of stimulating their economy much as we are proposing for the United States in this package.

Tax rebate provision

Let me now turn to the specifics of the tax rebate program. The rebate program of $50 per person as I indicated previously is designed to be as broadly applicable as it is administratively possible to provide. First, there is a general rebate of $50 for each taxpayer, spouse, child, and other dependent included on an income tax return for 1976. For those who had little or no tax liability the rebate will generally be refundable, along the lines of the present earned income credit. In other words, the $50 per person rebate will be paid in full even though this may exceed a family's tax liability. The only groups for whom the rebate will not be refundable will be single individuals, married couples with no dependents, or married couples with dependents but no wage and salary income. For this group, the $50 credit will be available only to the extent of 1976 liability. Table 2 shows the distribution of this rebate by adjusted gross income class at 1976 levels of income. The total amount of the tax rebate is $9.6 billion distributed to more than 70 million tax return filers.

The second component of the stimulus package is aimed at those who may not be required to file tax returns. This conponent provides a payment of $50 to all beneficiaries under the social security, supplemental security income, and railroad retirement programs. Thirty-six million beneficiaries will receive these payments at a total cost of $1.8 billion.

Some have argued that a one-shot stimulus such as a tax rebate will have little or no stimulative effect. They argue that consumers, seeing that the tax credit is just temporary, will not change their spending patterns but will instead save the entire rebate. I believe that the effect of a rebate depends significantly on the condition of the economy and that under present circumstances a rebate will be rapidly spent. It may be true that when economic conditions have been good for some time, consumer spending and saving plans are relatively stable as families adjust their spending appropriately to their income, both present and anticipated. Under such circumstances, people receiving a windfall in the form of a temporary tax cut probably will spend only a portion of it, saving the rest.

TABLE 2.—*Estimated effects of the administration's tax rebate program, distributed by adjusted gross income class*

[Calendar year 1976 levels of income]

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate: Amount	Percentage distribution	Cumulative percentage distribution
	Millions	*Percent*	
Less than $5,000	−$984	10.3	10.3
$5,000 to $10,000	−2,010	21.0	31.2
$10,000 to $15,000	−2,223	23.2	54.4
$15,000 to $20,000	−1,904	19.9	74.3
$20,000 to $30,000	−1,695	17.7	92.0
$30,000 to $50,000	−564	5.9	97.9
$50,000 to $100,000	−169	1.8	99.6
$100,000 or more	−36	.4	100.0
Total	−9,585	100.0	

But recent economic circumstances have been neither good nor stable. We have had combined inflation and stagnation for several years, with unemployment at its highest levels in decades. Most families' real income expectations have been repeatedly disappointed. Even when wage increases have been achieved, inflation has rapidly eroded these increases, leaving many families worse off than they were before. This has two consequences: First, most consumers have not been able to keep their consumption spending at a level which they consider satisfactory. There is, in my judgment, a significant willingness to consume that the rebate program will tap. Second, because the economy is recovering, consumer confidence is also on the rise. This provides a further reason for spending rather than saving the rebate.

Tax simplification and reform

Another part of this package is designed not only to provide a stimulus for the economy but also to simplify the tax laws. This is the first step in our long-range tax reform and simplification proposals.

One source of complexity under present law is the standard deduction provision. Presently the standard deduction for single people is 16 percent of adjusted gross income, but not less than $1,700 or more than $2,400. In the case of married couples the standard deduction is 16 percent of adjusted gross income, but in this case not less than $2,100 or more than $2,800. Everyone claiming the standard deduction, even though using the tax table, must make this calculation.

The proposal which the administration is presenting would substitute for the complicated set of standard deduction provisions a flat dollar amount of $2,400 for single people and $2,800 for married couples. These are the present maximum standard deductions for single and married persons, respectively. The flat dollar standard deduction not only is easier to compute than the variable credit but in addition makes it possible to fold the standard deduction into the tax tables and rate structure. This in effect means that there would not even be a separate computation of the standard deduction as there is at present. Instead, the tax tables will incorporate the new standard deduction.

Even taxpayers who itemize their deductions will be able to use the tax tables, or rate structures, with the standard deduction built in. They will simply subtract from their income the excess of their itemized deductions over the flat standard deduction and then turn to the tax tables.

In addition, the new tax tables will have built-in computations of personal exemptions and the general tax credit. Under present law, taxpayers must make all of these calculations themselves. For example, the general tax credit involves a choice between a per capita credit of $35 and an alternative credit of up to $180 based on the first $9,000 of taxable income.

The new tax tables will not require any of these calculations. The tables will have different columns for the different numbers of exemptions. After having added up his income, an individual with three exemptions would simply look down the tax table in the column referring to three exemptions and read off from the table his tax liability. For a taxpayer who had no special credits, this would be his final tax. To determine his tax payment or refund then due, he would only have to subtract the tax which he had already paid by way of withholding or in some other form. The tax tables will be available to all taxpayers with incomes under $25,000 or $30,000, the bulk of all taxpayers. To make this simplification possible, exemptions for the aged and blind will qualify for the $35 credit.

This change in the standard deduction will result in an annual revenue loss of about $4 billion a year. However, because the provision will be effective for only a portion of fiscal year 1977 and also because withholding changes with respect to this standard deduction probably cannot be made until about the first of May, the revenue impact in fiscal year 1977 is expected to be only about $1.5 billion. In fiscal year 1978, the revenue loss is expected to be about $5.4 billion, which exceeds the full-year cost because of refunds generated by the late start in withholding.

The tax reduction as a result of the change in the standard deduction affects only those with incomes of $17,500 or less in the case of married couples, or $15,000 or less in the case of single persons. As is shown in table 3 a very large portion of the reduction resulting from the standard deduction change is concentrated in the lower income levels. This table shows that 65 percent of the reduction goes to those with income below $10,000. Table 4 shows the reduction in tax liabilities for representative taxpayers who use the standard deduction. For example, a family of four with earnings of $10,000 will have its taxes reduced by $133 (from $651 to $518).

The new standard deduction will exceed the itemized deductions of approximately 4 million taxpayers who currently itemize. Accordingly, we expect the percentage of all filers using the standard deduction to rise from approximately 69 percent to 74 percent.

These tax changes will also insure that persons at or below the poverty level will pay no income tax. Table 5 shows the levels of tax-free income and the projected poverty levels for the years 1977 and 1979. While the standard deduction changes raise the tax-free level somewhat above the expected poverty level in 1977, generally this will no longer be true by 1979.

TABLE 3.—*Estimated effects of the administration's flat standard deduction proposal, distributed by adjusted gross income class*
[Calendar year 1976 levels of income]

Adjusted gross income class	Tax change resulting from $2,400/$2,800 standard deduction [1]		
	Amount	Percentage distribution	Cumulative percentage distribution
	Millions	*Percent*	
Less than $5,000	−$616	15.6	15.6
$5,000 to $10,000	−1,953	49.4	65.0
$10,000 to $15,000	−1,245	31.5	96.5
$15,000 to $20,000	−137	3.5	100.0
$20,000 to $30,000	−1	*	100.0
$30,000 to $50,000	−*	*	100.0
$50,000 to $100,000	−*	*	100.0
$100,000 or more	−*	*	100.0
Total	−3,951	100.0	

* Less than $500,000 or 0.05 percent.
[1] Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

TABLE 4.—*The flat standard deduction proposal for 1977—tax changes for representative taxpayers*

Filing status	Adjusted gross income	1976 tax law	Proposed 1977 tax [1]	Tax change
Single:	$3,000	$42.50	0	−$42.50
	5,000	363.50	$247.50	−116.00
	7,000	714.50	584.50	−130.00
	10,000	1,331.00	1,177.00	−154.00
Joint return:	5,000	130.00	28.00	−102.00
	7,000	448.00	332.00	−116.00
	10,000	948.00	829.00	−119.00
	15,000	1,882.00	1,794.00	−88.00
Family of four:	7,000	[2] 35.00	[2] −70.00	−105.00
	10,000	651.00	518.00	−133.00
	15,000	1,552.00	1,464.00	−88.00

[1] The proposal would increase the minimum standard deduction to $2,400 or, for joint returns, $2,800.
[2] Assumes use of the earned income credit.

NOTE.—Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

TABLE 5.—*Tax-free levels and projected poverty levels*

	Tax-free levels		Projected poverty levels [1]	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	$2,700	$3,400	$3,107	$3,439
Couple without dependents	4,100	4,800	4,018	4,448
Family of four	6,100	6,800	6,110	6,763

[1] Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

Business tax reductions

To provide further stimulus for economic expansion, we also provide a program of business tax reductions.

Each firm will choose, but on a long-term binding basis, between two tax credits: (1) A refundable credit against income taxes of 4 percent of the employer's share of social security payroll taxes (currently 5.85 percent of taxable payrolls); or (2) an additional 2-percent investment tax credit (generally from 10 to 12 percent) for all investment outlays which are currently eligible. The self-employed will choose between the additional investment tax credit or 2 percent of the self-employed payroll tax (currently 7.9 percent) plus, of course, 4 percent of any other payroll taxes they have. These credits will apply to eligible equipment placed in service after January 1, 1977, or to social security taxes on payroll costs incurred after January 1, 1977.

It is well known that business firms do not benefit uniformly from the current investment tax credit. Relatively labor-intensive firms, those engaged primarily in the service trades, and nonprofit institutions paying the social security tax may not be eligible for the investment tax credit and therefore derive few or no benefits from this provision of tax law. It is partly for this reason that the alternative credit against payroll taxes is proposed for such firms or organizations. Another reason is that the new device should directly encourage increased employment. The payroll tax credit will be fully refundable so that all firms, whether or not they have current income tax liability, will be able to reduce their payroll costs through this program.

In 1977, this program will reduce business tax liabilities by $2.6 billion. Of this total $1.1 billion would result from the use of the payroll tax credit and $1.5 billion from the use of the higher investment credit.

Countercyclical revenue sharing

Existing law, in addition to general revenue sharing, makes provision for the expenditure of $1.25 billion (for the period which began last July) for countercyclical revenue sharing. Under this program, funds are allocated on a quarterly basis of $125 million plus $62.5 million for each half percentage of national unemployment over 6 percent. When national unemployment falls to 6 percent, this latter part of the program turns off. At the national unemployment rate of about 8 percent for the fourth quarter of the calendar year 1976, all funds appropriated by Congress for this program will be exhausted by April of 1977.

Under this program, funds are distributed to over 20,000 State and local governmental units on the basis of their unemployment rates in excess of 4 1/2 percent and the fiscal year 1976 general revenue sharing amounts. One-third of these amounts are distributed to State governments and two-thirds to localities.

It appears that the current allocation formula has targeted funds effectively. For example, three-quarters of all local funds in the third quarterly payment went to governmental units with unemployment rates in excess of 8 percent. Similarily, central cities and governments in States with higher unemployment rates receive larger per capita antirecession payments. Compared to general revenue sharing, allocations are more heavily concentrated in cities of 100,000 or more population and counties of 200,000 or more population.

The President's economic stimulus package both expands and modifies somewhat the operation of the countercyclical revenue sharing program. Under the stimulus package, this program would first of all be given a 4-year authorization with annual appropriations as compared to the current authority which covers only five quarters.

Second, an additional $1 billion would be made available for distribution beginning in July of 1977. These new funds would be triggered only in response to national unemployment in excess of 6 percent.

Finally, the indexing of the total quarterly funding would be made more sensitive to changes in the unemployment rate under the stimulus proposal. Instead of increasing $62.5 million for every full half percentage point of unemployment over 6 percent as is currently true, each change of one-tenth of a percentage point would result in the increased funding of an additional $29.2 million.

While it is difficult to forecast exactly how the additional $1 billion of countercyclical revenue sharing funds will be spent in fiscal years 1977 and 1978, our current estimates suggest that this will result in an increase in spending in the fiscal year 1977 of $500 million and in fiscal year 1978 of $600 million. If unemployment is higher than anticipated, the expenditures in fiscal 1977 might be larger than indicated.

Conclusion

Let me conclude by emphasizing both the balanced nature of this program as well as the flexibility of our overall stimulus package in meeting the needs of the economy. Our proposals are balanced in that they provide an immediate injection of spending into the economy while at the same time taking the first step towards tax simplification and tax reform. Moreover, the stimulus provided from lower taxes and accelerated spending can be flexibly adjusted to economic conditions as we recover from the worst recession in 40 years.

Exhibit 25.—Statement by Secretary Blumenthal, May 16, 1977, before the House Ways and Means Committee, on the President's energy program

Mr. Chairman and members of this distinguished committee, it is an honor to appear before this committee again and to have an opportunity to discuss a matter as important as the President's energy program. Dr. Schlesinger is discussing the general setting of the program with you, and I would like to focus attention on the tax aspects.

Introduction

Let me begin by pointing out that tax aspects of the energy program before this committee are a major portion of the energy program—a carefully integrated package designed to reduce the annual energy growth to less than 2 percent per year by 1985.

These proposals are a balanced program. Some may be surprised that so comprehensive a program—involving as it does billions of dollars of additional tax collections and billions of dollars of disbursements—is projected to have such relatively small net impact on the Nation's output and prices. The answer is that the plan is designed that way.

The tax proposals I will discuss today are intended, without the building of a vast regulatory bureaucracy, to encourage the conservation of scarce fuels, and at the same time to redirect energy use to alternative fuels—primarily coal—which are widely available. The principal mechanism for achieving these objectives is the use of the tax system, through a combination of tax penalties and tax incentives. The plan has been designed so that, for the economy as a whole, the revenues collected under the proposed tax penalties about equal related elements of the energy conservation program.

I would like to discuss first the pricing policy for oil and how an excise tax is used to achieve this effect.

Crude oil and gas equalization tax and credits

One of the principles of our energy policy is a rational pricing policy for scarce energy sources to reflect world prices. This is necessary to assure that our scarce natural resources reflect the price which represents their true cost. The crude oil equalization tax is intended to bring the domestic refiner price of crude oil up to the world market price over a 3-year period without providing an unjustified windfall to producers of existing oil wells.

Under the crude oil equalization tax, domestic crude oil will be subject to an excise tax equal to the difference between the current controlled price and the 1977 world market price adjusted for inflation. The tax will be brought into effect in three stages, beginning in 1978. The full tax will be in effect by 1980.

This tax assures that all consumers of petroleum pay prices that reflect the true marginal cost of foreign imports. These prices should provide incentives both to reduce consumption and, where possible, to switch to alternative fuels. This tax also assures that consumers of relatively inexpensive oil will not gain an undue advantage over other consumers.

Both from the standpoint of fairness and to assure that the tax will not have an adverse effect on the economy, the net revenues derived from this tax will be recycled to users of oil. First, a refund of the tax is made to sellers of residential heating oil. But for this to be available the rebate must be flowed through to home heating oil customers. The balance of the revenues, less administrative costs and income tax reductions associated with business deduction of the tax, are to be returned to virtually all consumers on a per capita basis. All income-tax payers, including those receiving the earned income tax credit, would receive the per capita credit. The same per capita amount would be made available to those not paying tax but receiving social security payments, to those receiving SSI payments, railroad retirement payments, and those on the AFDC program.

The gross crude oil equalization tax collections are estimated to amount to about $2.8 billion in 1978, rising quite rapidly to $11.9 billion in 1980 and then rising to $12.3 billion by 1985. Out of these gross tax receipts there will be paid tax refunds to jobbers to compensate them for the cost of residential heating oil exemptions. These are expected to amount to $48 million in 1978, rising to $966 million in 1981 and then staying at about that level thereafter. The remainder of the receipts are either estimated as reductions in income tax receipts or paid out on a per capita basis to income-tax payers and to those on social security, AFDC, or similar programs. The estimated amount going to income-tax payers in 1978 is $1.9 billion, rising to $7.5 billion in 1985. The amount going to those on social security, AFDC, or similar programs on this same per capita basis is estimated at about $500 million in 1978, rising to $1.9 billion in 1985.

Residential and business conservation

To provide a further stimulus to energy conservation, we have also proposed a series of residential conservation and business energy tax credits. These credits will provide individuals and businesses the incentives they need to make necessary efficiency improvements in their homes, factories, and business establishments.

The residential energy credit consists of the credits for insulation and the solar energy equipment. For home insulation a credit is provided against income tax to the individual taxpayer of 25 percent of the first $800 of expenditures of this type plus 15 percent of the next $1,400 of these expenditures (up to a maximum cumulative credit per taxpayer of $410). The expenditures for energy-saving equipment are those for wall and ceiling insulation, storm windows, clock thermostats, and energy-saving furnace modifications. Expenditures for caulking and weather stripping qualify only if made in connection with other energy-saving expenditures. This incentive will go a long way towards achieving the President's goal of making as many as possible of the Nation's homes thermally efficient.

In addition, we propose a significant incentive be provided for homeowners to tap our only nondepletable resource—the Sun. We will provide in 1978, for example, a solar energy equipment credit of 40 percent, on the first $1,000 of solar equipment expenditures and 25 percent of additional expenditures (up to a maximum credit of $2,000). This covers both solar hot water and solar space-heating installations. After 2 years, lower levels of the credit will apply through 1984. This kind of credit will enable many Americans to look beyond fossil fuels as the primary way of heating their homes and will enable them to employ the new solar-heating technologies that are emerging.

We have proposed a similar program of tax credits which expand the present investment tax credit provisions for business investment in certain energy-saving equipment such as insulation, double-glazed windows, energy control systems, and efficient heat exchangers. These investments will be eligible for an additional 10-percent business energy property credit on top of the regular investment credit.

Solar heating equipment for commercial and industrial application and cogeneration property also would be eligible for this additional 10-percent credit. Cogeneration is the process by which waste heat generated in the process of making electricity is recycled and used in an industrial application, or vice versa. Cogeneration used to be fairly common, but today only 5 percent of total electrical generation capacity has this capability. This is an area where a tax incentive can make a significant contribution towards helping the Nation conserve our energy supplies.

We estimate the cost of these residential and business credits to be $754 million in 1978 and to be $616 million in 1985. Most of this—$666 million in 1978 and $517 million in 1985—is attributable to thermal efficiency. Cogeneration accounts for most of the remainder—$52 million in 1978. (The program has expired by 1985.)

Transportation taxes

The two primary proposals designed to encourage improved fuel use in transportation are the automobile fuel inefficiency tax and rebate and the standby gasoline tax and per capita credits and payments.

The automobile fuel inefficiency tax (commonly referred to as the "gas guzzler tax") and rebate mechanism will supplement existing law and regulation in this area, which already provide standards of fuel economy for the fleet in the years ahead and civil penalties on the automobile companies for failure to comply. The tax and rebate should result in a higher average fuel efficiency of new cars than that achievable under the EPCA standards alone. We believe the existing mechanism alone will not achieve the level of conservation we have established as a national goal.

The fuel efficiency tax and rebate is geared to a specific fuel efficiency standard already promulgated for new cars each year. For the 1978 model year, for example, the target level of automobile fuel efficiency is 18 miles per gallon. Cars just achieving that standard would pay no tax and would not be eligible for a rebate. Cars surpassing that standard would be eligible for a rebate based on their gasoline efficiency as determined by EPA testing. In 1978 cars with an average efficiency of 25 m.p.g., for example, would get a rebate which is five times the amount for which cars achieving only 20 m.p.g. would be eligible. Conversely, cars not achieving the target efficiency would pay a tax of up to $450, depending on how far below the standard they rank. The standard and the tax is increased gradually so that for the 1985 model the standard is 27.5 m.p.g. and the maximum tax is about $2,500.

No net effect is expected on the budget surplus or deficit from the gas guzzler tax and rebate because the taxes collected on inefficient vehicles. Rebates on 1977 model year cars sold after May 1, 1977, along with rebates on 1978 model year cars will be paid out of 1978 model year taxes. The program is structured this way to help and encourage the automobile industry to convert from gas guzzlers to efficient small cars. The intent is to provide an incentive to purchase fuel-efficient automobiles, not to collect tax revenues. The rebate mechanism will also minimize the inflationary impact of the program by reducing the net cost of fuel-efficient vehicles to balance off the increases in cost of the fuel-inefficient cars. The gas guzzler tax is expected to bring in receipts of $500 million in 1978, increasing to $1.9 billion by 1985. This, however, will be offset by expenditures of like amounts to cover the rebates.

Rebates will be made to foreign manufacturers on the basis of executive agreements entered into between the individual countries and the United States. These agreements will be designed to assure that domestic manufacturers are not disadvantaged by the tax and rebate system.

The standby gasoline tax in no event would go into effect before 1979 and in no year could amount to more than a 5-cent increase. It is keyed to a series of gasoline consumption targets which allow for continued increases through 1980 to a level of 7.45 million barrels a day. The present level is between 6.7 and 7 million barrels a day. After 1980 the targets assume that the energy program generally will result in economies in the use of gasoline and, thus, in subsequent years the consumption targets will gradually decrease to a level of 6.5 million barrels a day by 1987.

In 1979 or any subsequent year, the tax would go into effect if gasoline consumption in the preceding year exceeded the target by at least 1 percent. The amount of the tax would equal 5 cents for each percent that gasoline consumption exceeded the target in the preceding year. The tax could be reduced by 5 cents a year based on the formula in the legislation. The tax could not increase or decrease more than 5 cents per year and it could never exceed 50 cents per gallon.

In 1979, the standby gasoline tax, if imposed, would bring in revenues of $4.1 billion. This amount less reduced business income tax receipts associated with payment of higher gasoline taxes would be rebated either to income-tax payers or those on the various social security and related programs. By 1985, if every increase possible were provided, this could amount to $39.8 billion in that year; but again it would all be rebated to income-tax payers or those covered under social security or similar programs.

Two other lesser elements of the program concerned with transportation are the repeal of excise tax on buses and an increase in fuel excises paid by general aviation and motorboats.

The repeal of the 10-percent excise tax on buses is a step forward in promoting the use of this efficient mode of transportation. The higher excises on general aviation (increased by 4 cents per gallon) and motorboats (repeal of a 2 cents per gallon rebate) should achieve reductions in the use of fuel by these relatively inefficient and often nonessential modes of transportation. These higher excises will only apply to noncommercial uses of aircraft and motorboats; commercial fishermen and airlines will be exempt from the increased tax.

Since the automobile efficiency taxes and the standby gasoline taxes are designed to collect no net revenue, the budgetary impact of these transportation programs is quite small. The net impact of these two taxes is a gain of $32 million in fiscal 1978, and the impact in 1985 is estimated to be a gain of $71 million.

Oil and gas consumption tax

The oil and gas consumption tax is designed to encourage industrial and utility users of oil and gas to convert to coal and other desirable fuels. Oil and gas consumption taxes would be imposed beginning in 1979 for industrial use and in 1983 for utility use of oil and gas. The tax on nonutility use is phased in gradually through 1985. The oil and gas consumption tax is intended to be a permanent tax.

These taxes would be rebated, however, to the extent that oil and gas users convert their plants to fuels other than oil or gas. This rebate will take the form of a dollar-for-dollar offset of conversion expenditures against the taxpayer's oil and gas consumption tax liability. Conversions include both modification of existing units and construction of new units. We expect a large percentage, over 50 percent in some years, of the taxes to be rebated because the higher prices of oil and gas and the lower capital costs of alternative fuels will make conversion investment economically attractive.

The oil and gas consumption taxes will apply only to those users for whom it is economically feasible to convert. A small-business exemption from tax is provided for the first 500 billion Btu's a year. For an average user, this amounts to about $1.5 million in fuel costs per year. This size cutoff for taxable use will tax only the top 2,000 firms in the country which consume 90 percent of industrial oil and gas. We have also provided an exemption from these taxes for aircraft, railroads, ships, farming, and use of oil or gas in the production of fertilizer and for nonfuel use by a refinery.

The expected net cost of these programs after all rebates is estimated at $1.4 billion in 1978 and about $11.9 billion in 1985.

Energy development incentives

Finally, we propose to provide two incentives to insure the future supply of oil, gas, and geothermal resources. In regard to oil and gas intangible drilling expenses, we propose limiting the application of the minimum tax to those individuals sheltering other income through oil and gas losses. We would exempt from the minimum tax the many independent oil and gas drillers whose investments generate oil and gas income. Our amendment accomplishes this by restricting the minimum tax to intangible drilling expenses which exceed a taxpayer's oil and gas income.

In addition, we propose to provide an incentive that will aid in the development of our largely untapped geothermal resources. This is a relatively new industry, and because of this we believe that providing the industry with the opportunity to expense its intangible drilling costs will provide a needed stimulus to development. These expensed costs will be subject to the minimum tax to the extent that they exceed income from geothermal operations.

The revenue cost of these two initiatives is $24 million in 1978 and $128 million by 1985.

There has been criticism that the President's program has stressed energy conservation at the expense of development. This is not based on a close analysis of the program. Not only are there the two supply incentives just discussed, but we have what in the free enterprise system should be viewed as the most important incentive of all: a free price. After 3 years, newly found oil will receive the 1977 world price of about $13.50 a barrel adjusted for general price increases. One remembers that crude oil sold for $3 a barrel only a few years back. This should be a great incentive. It is true that already existing discoveries will not get such a price. We see no reason for allowing windfall profits in this area.

I hope that this will provide the committee with an outline of the major tax aspects of the energy program.

The energy program and tax simplification

From my prior testimony before this committee, you are aware that one of Treasury's main concerns in the tax reform area is simplification. The proposals I have just described will certainly increase, not reduce, the volume of tax law.

We believe, however, that the administration's energy tax proposals will add little in the way of complexity to the income tax laws, especially in regard to individual taxpayers. The bulk of our proposals take the form of excise taxes to be collected by businesses who are already well equipped to handle this form of tax. The business energy credit proposal simply expands the already existing investment tax credit provisions. The residential energy credit proposal may result in one additional line on tax returns, but it is anticipated that the other individual tax credits in the proposal will, each year, be folded into the current general tax credit.

In closing, let me reemphasize that these tax proposals form only part of a broad energy plan. Through the tax system we have tried to provide incentives for individuals to alter their consumption and production plans to meet our national objectives. The nontax proposals in the plan are also directed to this goal. The overall result is a coordinated package which will significantly reduce the rate of growth of energy demand while at the same time providing energy supply incentives.

Estimated revenue impact of the energy program on fiscal year receipts
[$ millions]

	Fiscal years								
	1978	1979	1980	1981	1982	1983	1984	1985	1978-85
Auto efficiency tax (effective Sept. 1, 1977) [1]	500	500	500	700	900	1,200	1,500	1,900	7,700
Crude oil equalization tax, net of rebates (effective Jan. 1, 1978) [2]	552	1,180	1,894	2,030	1,974	1,960	1,916	1,879	13,385
Standby gasoline tax (effective Jan. 1, 1979) [3]	....	....	....	....	....	....	....	....	....
Residential energy credits (effective Apr. 20, 1977, through Dec. 31, 1984):									
a. Thermal efficiency (insulation, etc.) [4]	-360	-445	-469	-494	-520	-550	-581	-517	-3,936
b. Solar energy	-32	-68	-75	-59	-68	-66	-81	-99	-548
Business energy credits (effective Apr. 20, 1977, through Dec. 31, 1982):									
a. Thermal efficiency	-306	-307	-349	-428	-488	-317	....	....	-2,195
b. Cogeneration [5]	-52	-62	-106	-157	-214	-139	....	....	-730
c. Alternative energy [6]	-4	-9	-19	-33	-46	-28	....	....	-139
Oil and natural gas consumption taxes—rebate for investment in alternative energy facilities:									
a. Tax, net of rebate: electric utilities (effective Jan. 1, 1983)	....	....	....	....	....	86	123	101	310
b. Tax, net of rebate: other businesses (effective Jan. 1, 1979)	....	1,403	3,444	4,169	4,918	6,529	8,278	11,862	40,603

Tax incentives for certain energy resources supplies (effective Apr. 20, 1977):									
a. Expensing of intangible drilling costs, geothermal discovery and development	−5	−10	−17	−21	−20	−20	−32	−54	−179
b. Limitation of minimum tax on intangible drilling costs to amount in excess of net related income	[7]−19	−32	−37	−42	−48	−56	−65	−74	−373
Aviation fuels tax revision (effective Oct. 1, 1977)	44	47	50	55	61	66	71	76	470
Revision of tax on gasoline for use in motorboats (effective Oct. 1, 1977)	1	4	4	4	4	4	4	4	29
Repeal excise tax on buses (Apr. 20, 1977)	−13	−9	−9	−9	−9	−9	−9	−9	−76
Total, excluding standby gasoline taxes	306	2,192	4,811	5,715	6,444	8,660	11,124	15,069	54,321

[1] Taxes shown will be fully rebated on the expenditure side of the budget.

[2] Taxes shown are net of refunds and income tax rebates and offsets and will be fully rebated on the expenditures side of the budget.

[3] Tax collected, if any, will be fully rebated. Collections after income tax rebate each year will range between zero and the following maximum allowable amounts: 1979, $0.9 billion; 1980, $2 billion; 1981, $3.2 billion; 1982, $4.4 billion; 1983, $5.6 billion; 1984, $6.8 billion; and 1985, $8 billion.

[4] In order to achieve the desired level of conservation, it may prove necessary to have mandatory standards affecting homes sold. The absence of any experience with the insulation incentives provided by this bill makes it difficult to estimate the level of insulation investment. The estimates presented here are relatively conservative. It is assumed that mandatory standards, effective Jan. 1, 1980, would give rise to the following tax loss:

	Fiscal years						
	1980	1981	1982	1983	1984	1985	1980–1985
Additional revenue effect	−43	−302	−395	−532	−835	−835	−2,942

[5] Includes effects of elimination of declining block rates.

[6] Coal conversion and solar equipment.

[7] The conference agreement on H.R. 3477 includes this provision, effective for 1977 only. Thus, if the bill is enacted, this provision will have no revenue effect in calendar year 1977 or fiscal year 1978.

Oil and natural gas consumption taxes [1]
(Relationship of tax without investment rebate to final tax)
[$ millions]

	Fiscal years							
	1979	1980	1981	1982	1983	1984	1985	1979-85
Tax without rebate for qualified investment	2,745	7,555	10,499	12,467	16,467	19,235	21,566	90,534
Qualified investment rebate	−1,201	−3,675	−5,736	−6,880	−8,974	−9,700	−8,040	−44,206
Reduced industry income tax [2]	−141	−436	−594	−669	−878	−1,134	−1,563	−5,415
Net effect on receipts	1,403	3,444	4,169	4,918	6,615	8,401	11,963	40,913

[1] Industry and utility taxes.
[2] Results from less than full passthrough of tax to prices.

Crude oil equalization tax
(Relationship of gross excise to energy credits and payments)
[$ millions]

	Fiscal years								
	1978	1979	1980	1981	1982	1983	1984	1985	1978-85
Gross crude oil equalization tax collections	2,834	7,173	11,933	13,637	13,259	12,875	12,569	12,329	86,609
Refund for residential heating oil	-48	-361	-666	-966	-942	-913	-889	-871	-5,656
Reduced refiners' income tax [1]	-295	-1,059	-1,853	-2,329	-2,265	-2,156	-2,102	-2,060	-14,119
Estimated per capita energy credits	-1,939	-4,573	-7,520	-8,312	-8,078	-7,846	-7,662	-7,519	-53,449
Net effect on receipts	552	1,180	1,894	2,030	1,974	1,960	1,916	1,879	13,385
Amount available for energy payments (outlays)	552	1,180	1,894	2,030	1,974	1,960	1,916	1,879	13,385

[1] Results from less than full passthrough of tax to prices.

Exhibit 26.—Statement by Assistant Secretary Woodworth, June 15, 1977, before the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, on capital formation

My colleagues today are making a persuasive case for promoting a higher rate of capital formation in the U.S. economy. There is no need for my repeating it. In view of our disappointing record regarding economic growth, and gains in productivity and real income, the important question is, what can public policy do about it? From my position, the question is even more specific: What can tax policy do about it?

I should first note that capital formation is not solely or perhaps even primarily a tax issue. We must look to more fundamental reasons to understand why our present rate of investment is deficient. In the aftermath of a major bout with both inflation and recession, it perhaps is not surprising that business confidence has not yet fully recovered. Uncertainty concerning opportunities for expansion of markets as well as the thrust of future government policies is not easily dispelled. In this climate, general monetary and fiscal policies to reinforce the recovery of the economy in a noninflationary manner may be more important than specific structural program changes. Nonetheless, it is still possible to define a more specific role for tax policy in stimulating capital formation. This can best be appreciated by considering that investment will not be undertaken unless the after-tax rewards are commensurate with the risks of adding to productive capacity. Tax policy can affect investment decisions by changing these after-tax rewards.

In fact, as I shall discuss in more detail, there are various ways in which tax policy can improve the after-tax returns to investment and risk taking. We are now critically evaluating these alternatives as part of the process of developing tax reform proposals to submit to Congress later this year. No final decisions have been made as yet on the specific components of the tax reform program. I would like to share with you, however, some of our thinking on tax incentives for capital formation. I will also address the question of the relationship between the need for additional capital formation and the other goals of the tax reform program.

The tax reform program we are now working on has two other important goals in addition to providing adequate incentives for capital investment. The first is tax simplification to which we assign a much more important role than it has generally been assigned in the past. Simplification involves making tax returns easier for the average person to prepare, reducing the burdens of financial recordkeeping, and generally making the tax law more understandable for taxpayers. The second goal is to improve the equity of the tax system so that the laws are regarded as fair. This can be accomplished by removing opportunities for tax gamesmanship with high payoffs to expert legal advice and shrewd tax planning, and by making sure that individuals with equal incomes are taxed the same while those with higher incomes are taxed at progressive rates. In providing incentives for expanding productive facilities, we must continue to keep in mind the other goals of simplification and fairness.

Designing tax proposals to stimulate capital formation as well as to be consistent with tax simplification and tax equity is no simple task. I might also add that we have not yet discovered any new ways of achieving all these goals simultaneously. The problem, as always, is one of choices and tradeoffs.

Alternative ways to stimulate capital formation

The particular instruments that may be used to increase the after-tax returns to investment and thereby stimulate additional capital formation are generally familiar to all of us. They include the investment tax credit, alternative methods of depreciation, and changes in corporate tax rates. In addition, there is a device which has not been used in this country but has been adopted by our major trading partners including Canada, England, France, Germany, and Japan. This is eliminating the double tax on corporate income, or integrating the corporate and personal income taxes.

Each of these may be discussed briefly in turn.

Investment tax credit.—The investment tax credit now stands at 10 percent for eligible property which generally includes depreciable equipment, but not buildings, used in a production process. Equipment with useful lives of less than 3 years does not receive the investment tax credit, that with lives of more than 3 years but less than 5 years receives one-third of the credit, and equipment with useful lives of greater than 5 years but less than 7 years receives two-thirds of the credit. In addition, the credit cannot exceed $25,000 plus 50 percent of the tax liability over $25,000. However, special higher limitations are temporarily provided for public utilities, railroads, and airlines. Unused credits may be carried back 3 years and carried forward 7 years. One alternative for stimulating additional capital formation is to increase the investment credit above its current level or to relax the general 50 percent of tax liability limitation.

Depreciation allowances.—Under current law, property held for the production of income in a trade or business is allowed a reasonable deduction for exhaustion, wear and tear, and obsolescence. Depreciation deductions are calculated for tax purposes by first determining the life of the property and then applying a depreciation method allowed by law. Lives may be justified by taxpayers on the basis of either facts and circumstances or by reference to the class lives established by the asset depreciation range (ADR) system for taxpayers electing to use that system. Those electing ADR are also permitted to use 20 percent shorter lives than the published class lives. Once the asset life has been determined, the actual tax depreciation deductions are calculated by using either the straight-line method or a more accelerated method such as double declining balance.

As a mechanism for reducing taxes on capital income, it is possible to allow taxpayers larger depreciation deductions. This could be accomplished by various combinations of changes in either asset lives, more accelerated methods, or indexing depreciation for inflation.

Corporate tax rates.—Alternatively tax burdens on capital income could be reduced by direct corporate rate cuts. Currently, the first $25,000 of corporate income is taxed at the 20-percent rate, the next $25,000 at 22 percent, and income in excess of $50,000 at 48 percent. Any or all of these rates could be reduced as a measure to stimulate investment.

Eliminating the double tax on corporate income.—Although the idea of eliminating the double tax on corporate income has received considerable attention in recent years, it may nonetheless be worthwhile to review the various approaches which might be used to achieve this result. There are essentially three alternatives. One is full integration of corporate and personal income taxes and the other two are alternative variants of partial integration. Full integration is equivalent to treating the corporation as a partnership. Each corporate shareholder, as does a partner under current law, would include in his own income for tax purposes his proportionate share of the corporation's income whether or not it is distributed. The corporate tax then becomes a withholding tax credited against the shareholder's final individual tax liability. In effect, the corporation pays no separate tax at all in this case but merely serves as a collection agent for the Treasury.

The two variants of partial integration eliminate the corporate tax only on distributed earnings. The corporate tax would remain on undistributed corporate income. One version of partial integration involves a deduction for dividends paid at the corporate level in the same way that interest is currently deducted by corporations. The alternative version treats corporate taxes attributed to dividends as a withholding tax. The individual shareholder grosses up his cash or "take-home" dividends the same way that take-home pay is grossed up to include taxes withheld by the employer. Then in determining final tax liability, grossed-up dividends are taken into total income but a credit against tax is allowed for the corporate tax attributable to the dividends received. Again, this is similar to our current withholding system for wages and salaries where tax liability is based on "grossed-up" or before-tax wages, and a credit is taken for taxes withheld by the employer.

The choice among alternative ways of eliminating the double tax in the event that some proposal of this kind is recommended must also be based on considerations of simplicity and equity as well as on possible differences in revenue costs.

Criteria for choosing among investment stimulus alternatives

It is important to specify the criteria to apply in choosing among alternative ways of stimulating investment. Let me enumerate these criteria and then briefly evaluate the alternatives.

Nondiscriminatory or efficient incentives.—Where possible, incentives for capital formation should be provided in a nondiscriminatory manner. This means that market forces rather than the opportunity for specific tax advantages should determine the particular kinds of investment to be undertaken as well as the particular firms and industries which undertake it. The allocation of investment will be much more efficient when investors respond to market signals which reflect the wishes of consumers for particular goods and services.

Since the double tax on dividends in current law tends to distort the allocation of investment between corporate and noncorporate enterprise, some form of integration may make a significant contribution to economic efficiency. Other capital formation measures, to the extent that they reduce the relative taxation of corporations, have similar effects but not nearly to the same degree.

Debt versus equity finance, and corporate dividends versus retained earnings.—Also, tax incentives should ideally be neutral with respect to the way in which investment is financed and the extent to which corporations distribute or retain their earnings. There is considerable concern that in our present tax structure the corporation income tax biases the financing choice toward debt rather than equity financing and toward retentions rather than distributions of earnings. To the extent that debt financing is encouraged, an unbalanced financial structure can develop with too much debt piled on a limited equity base. The result could be an economic system increasingly vulnerable to cyclical fluctuations, and investors increasingly less willing to assume risk. Similarly, tax incentives to retain earnings can lead to corporate conglomerates as large firms seek outlets for their retained earnings.

Eliminating the double tax on dividends deals directly with the bias toward debt financing since returns to debt capital—that is, interest—and returns to equity capital—that is, dividends plus corporate retentions—would be taxed more nearly alike. The other measures for stimulating capital formation have no substantial effects in removing this bias. Similarly, by eliminating the double tax it is possible to achieve neutrality in the corporate decision to retain or distribute earnings.

Timing effects.—Alternative devices for stimulating capital formation may also have quite different effects on the timing of investment per dollar of revenue loss. These differences in timing may be important since we are concerned about investment to eliminate potential shortrun bottlenecks as well as to provide an expanding productive capacity to sustain longrun growth.

The investment tax credit and changes in depreciation measures tend to have a larger shortrun effect on investment per dollar of foregone revenue than either corporate rate cuts or eliminating the double tax on dividends. This occurs because in the short run the investment tax credit and accelerated depreciation have a greater effect on investment decisions. In contrast, a significant portion of the tax reduction from rate cuts and eliminating the double tax accrues to capital already in place rather than to new capital formation.

It is difficult to determine how heavily to weigh the timing differences of alternative proposals to stimulate investment. In the long run, it seems to me that proposals which equally increase the after-tax profitability of investment are likely to have about equal effects in increasing the capital stock. The extent to which shortrun differences should be given priority depends in part on one's evaluation of the shortrun constraints currently impeding capital formation. If tax considerations are exerting a significant constraint on current investment decisions, then a stronger case could be made for the investment tax credit or an acceleration of tax depreciation. On the other hand, if investment is currently constrained by a concern about whether markets will be available for the additional output produced by a larger capital stock, then structural tax policy may be less effective in the short run and should perhaps be directed towards longer term objectives.

The overall objectives of tax reform—simplicity and equity—also enter into the evaluation of investment stimulus alternatives.

Simplicity.—Of the various investment stimulus alternatives, the simplest would be a straight cut in the corporate rate, although no significant complexities would generally be involved in increasing the investment tax credit or in allowing more accelerated depreciation methods. Also, although integration may be less familiar, it could be designed so that all the shareholder would have to do would be to copy onto the tax return information supplied by his corporation. This is particularly true for partial integration. Full integration could involve more complexity at the shareholder level since in this case shareholders would have to increase their basis in the stock for the earnings which corporations retain on their behalf.

Equity.—Corporate and personal tax integration would be consistent with the goal of taxing all income only once and would also be more progressive than other ways of providing an investment stimulus. This result occurs because under integration, corporate income—dividend income only in the case of partial integration and all corporate income in the case of full integration—are taxed at individual marginal tax rates rather than at a flat corporate rate. Eliminating the corporate rate with respect to dividends therefore confers greater benefits per share to shareholders in lower tax brackets than to those in higher tax brackets. In other words, the effect is the same as increasing by a constant factor the dividends of all shareholders. While before-tax income goes up proportionately, after-tax income goes up more for lower income than higher income shareholders because of the progressive tax rate schedule.

The other stimulus measures—the investment tax credit, accelerated depreciation, or corporate rate cuts—also provide initial relief to owners of corporate shares, since these shareholders claim the higher after-tax income stream earned by the corporation. However, unless the cash-flow gains to the corporation from lower taxes are completely paid out in the form of higher dividends, the distribution of the after-tax benefits from corporate tax cuts will tend to be proportional to dividend income. This occurs because the additional income available at the corporate level will not immediately be taxed at the marginal rates of shareholders. If these cash flows are retained by the corporation, the values of corporate stock may increase and while corporate shareholders have experienced a gain in wealth as a result, there is no immediate increase in tax liability. Thus, the greater progressivity from eliminating the double tax is due to the fact that the additional income accrues at the shareholder level, rather than at the corporate level, and, therefore, it is subject to a progressive structure of marginal tax rates.

It should be pointed out, however, that while eliminating the double tax on dividends may be more progressive among shareholders than are cuts in taxes on corporations, nonetheless, all investment stimulus measures which reduce taxes on capital income are regressively distributed in general. This is true because capital income tends to be concentrated among higher income taxpayers as a whole. It need not follow, of course, that a complete tax reform package cannot be progressive if stimulating capital formation is to be one of its objectives. But in order for the program to be progressive in its total impact, it must take into account the effect of measures to stimulate investment.

Here again there are tradeoffs. While eliminating the double tax may be more progressive per dollar of revenue loss, the investment tax credit and accelerated depreciation may require fewer dollars of revenue loss to achieve a given shortrun investment effect. In any event, the longrun effects of higher rates of capital formation on the distribution of income will be quite different from the immediate impacts. Over time, the benefits associated with real productivity gains will be generally distributed throughout the economy.

Let me conclude by assuring you that this administration is greatly concerned about the failure of our economic system to perform up to its potential over the past 10 years. We have taken seriously the need to provide adequate incentives for capital formation and risk taking. In the tax program which we shall later be presenting, this objective will be addressed in a significant way. At the same time we are also committed to developing a tax system which is more equitable and simpler. I shall look forward to working with you in the future as we present our proposals to achieve these ends.

Exhibit 27.—Remarks by Secretary Blumenthal, June 29, 1977, to the Financial Analysts Federation, Washington, D.C., on tax reform

Tonight I want to talk to you about tax reform. President Carter has made a major commitment to improve the American tax system. Work on the administration's proposal is moving ahead and we expect to present a program to Congress toward the end of the summer. So I would like to take this opportunity to share some of our thinking on this important subject.

Our minds are open to a very wide variety of options for tax reform. But we have limited ourselves to this extent: We will retain the income tax as the centerpiece of the American tax system, without any thought of substituting a value-added tax, a consumption tax, or other exotic possibilities. We have a tax system that works—imperfectly, to be sure, but at that better than most. It is preferable to correct its faults and build upon our knowledge and experience with it than to embark on fundamental change with an untried system whose effects we could not fully foresee.

Government, as Hobbes taught us long ago, is essential to restrain and mediate the passions of men and to provide that order without which not only civilization but life itself is in jeopardy. And taxes in turn must support government.

No matter how much we complain about paying taxes, it is still a lot cheaper than buying one's own army and navy.

Modern societies have, of course, assigned government much wider responsibilities than external defense and maintenance of internal order. For most of our history, the United States got along with only customs and excise taxes. The corporate income tax did not appear until 1909. The individual income tax, apart from temporary levies during and just after the Civil War and in the 1890's, was enacted in 1913. And even then for the next 30 or so years it affected relatively few Americans. Payroll taxes came along in 1935.

Our requirements have now changed. For today's needs we must have broadly based taxes capable of raising the revenues required by the many social responsibilities of government and the state of the economy. But the tax system of a free and democratic people must do more than merely raise the revenue that government requires. It must be equitable in the sense that the taxation is reasonably related to people's ability to pay and in the sense that people with like incomes pay the same amount of tax. It must be simple enough to be understood and to be respected. And it must operate efficiently to foster those social goals that it is called upon to promote.

How does our present Federal income tax system stack up against these criteria?

In some respects it performs rather well, but in other important aspects it falls short of our ideals—fully justifying the heavy emphasis this administration is placing on tax reform.

As a revenue system, Federal income taxation is flexible and productive. In 1975, it generated $163 billion in revenues—representing nearly 60 percent of total Federal tax collections.

It is remarkable that we raised this huge sum through a tax system that largely depends upon, and obtains, voluntary compliance, a tax system that is administered with honesty and integrity, and one that functions with minimal administrative and enforcement costs. In these respects, and others as well, the American tax system is the best in the world.

If we examine its fairness, we see that, as a whole, it is reasonably progressive. Nominal Federal income tax rates range from 14 percent on taxable income under $500 to 70 percent on taxable income over $100,000. And when we look at the rates actually paid on expanded income—a concept which adds capital gains and certain preference income to adjusted gross income—we find rates ranging from 1.1 percent on income under $5,000 in a steady, if somewhat uneven graduation to 32.6 percent on incomes over $200,000.

And if we look back, we can see that our tax system has become more progressive over the last dozen years. The top half of all taxpayers had effective rates that were 1 1/2 to 2 percentage points higher in 1975 than in 1965. In the same period, effective tax rates on the lowest 10 percent dropped to virtually zero and on the next 20 percent declined from 4.1 to 2.4 percent.

But there is more to tax fairness than reasonable progressivity. We also believe that people with the same income should pay the same amount of tax. Here the performance of our tax system is mixed. All taxpayers with incomes between $5,000 and $10,000 are taxed at effective rates between zero and 15 percent—a range of 15 percent. Ninety-two percent of the taxpayers with incomes between $25,000 and $50,000 are taxed at effective rates between 10 and 25 percent—again a range of 15 percent. But for taxpayers with incomes of $200,000 and over, the differences are far wider, with some paying as low as 2 percent and others as high as 58 percent. Substantial numbers pay at rates of less than 20 percent and more than 45 percent.

The present structure of our tax system allows these large differences among higher income taxpayers. The high marginal tax rates they face provide them with a strong incentive to find imaginative ways to lower their taxes. At the same time, opportunities for them to do so are available because of our piecemeal approach to tax legislation and regulation and as a byproduct of efforts to promote social objectives. When we attempt to deal with a single problem in the tax code, we often find that the provisions can be used in unexpected ways to shelter income from taxation. When we seek to promote a social goal such as housing development, we may also create real estate tax breaks for those with reason to seek them.

Part of the problem is the sheer complexity of the tax system. By now our tax code totals 1,100 pages. Related tax regulations account for many thousands of additional words and the Federal Tax Reporter runs to 14 volumes. With this great mass of rules, it is little wonder that nearly half of our taxpayers either cannot complete their returns unaided or believe that they can gain by hiring professionals who purport to understand the complexities of the law. The inability to understand what the tax laws are, and the belief that there is money to be made through tax planning and gamesmanship, undermine the confidence and trust that we require for a system based primarily on voluntary compliance.

We have sought to use our tax system to promote many social goals—charitable giving, home ownership, investment in productive equipment and in specific industries, environmental improvement, and much else. It is difficult to generalize about the results of these incentives. But there are reasons to doubt that some, perhaps many, of these so-called tax expenditures are the most efficient means available to the government to achieve its objectives. On the other hand, in some cases, it appears that present tax incentives are not strong enough to serve our purpose.

For example, our current deductions for medical and casualty losses might well be superfluous if we had a national health insurance program.

And we may ask whether in a world of flexible exchange rates the tax code should promote exports through a device such as DISC, the so-called domestic international sales corporation.

On the other hand, incentives to investment in productive equipment require strengthening to encourage the higher rate of capital formation that our economy needs. In recent years, the rate of capacity growth in manufacturing has slowed—from 4.6 percent over the period between 1948 and 1968 to 4 percent from 1968 to 1973 and 3 percent from 1973 to 1976. One consequence of this lagging investment is a decline in productivity growth that means less growth in real incomes and an increased propensity to inflation.

In these circumstances, criticism of our tax system can come as no surprise. Americans from many different points of view are saying that the tax system is too complicated, that its effects are often inequitable, and that it is failing to contribute effectively to our social objectives.

The Carter administration will respond to these concerns. Our goals are to make the American tax system simpler, fairer, and better able to foster growth and efficiency in the American economy. By simplicity, we intend that the average taxpayer should be able to readily understand what the law requires and to complete his own tax return without professional aid. By greater equity, we intend that taxpayers with like incomes should pay like taxes in a system that remains reasonably progressive. And to foster growth and efficiency, we intend to create incentives to work, to investment and savings, and to eliminate the waste and resource misallocations that accompany efforts at tax planning.

At the strategic level, we face a choice between a radical and reformist approach. By "radical" I do not mean a far-right or a far-left proposal. I mean a solution that goes to the root of the problem. We could achieve vast simplification, great equity, and at least eliminate the inefficiencies associated with tax planning by wiping out all exemptions and deductions and taxing all income from whatever source at much lower rates. The rates could, of course, be lower because the taxable base would have been greatly enlarged. At the same time, the level at which income would be free of tax could be raised significantly.

This solution would mean, however, that such items as black lung benefits, social security payments, capital gains, and every other form of income would be taxed along with wages and salaries.

The uniform tax treatment under this system would provide few opportunities for perceived inequities. It would also mean that the tax system would be used for nothing but raising revenue. The social purposes we now seek to advance through the tax code would have to be promoted in other ways—ways that would be more direct and obvious and subject to scrutiny. Promotion of these purposes through budgeted expenditures would result in review, debate, and legislative action different from the kind of review given to the tax expenditures that we now use.

But quite apart from the problems of adjustment to such a drastic change—and it could certainly not be done from one day to the next—there is a crucial question of whether some purposes can be promoted in our system except through tax incentives. For example, the alternative to tax incentives for investment would seem to require unacceptable Government controls over capital outlays and the allocation of investment, with attendant inefficiency and misallocations of resources.

The radical approach is clean and decisive. A strong theoretical case can be made for it, but it makes some people tremble.

The strategic alternative is to develop a package of specific steps that will take us in the same direction, but without the wholesale change in existing law. Without implying that any decisions have been made—because none have—let me describe some of the possibilities along this line.

The largest single source of tax complexity is the preferential treatment of capital gains. Forty-one sections and fifty-one subsections of the tax Code are devoted to capital gains taxation. And efforts to convert ordinary income into capital gains are probably the largest area of tax planning, leading to many activities of little or no social value but productive of ample private gain.

Other sources of complexity in present law are the existence of both exemptions and credits, the recordkeeping requirements related to certain deductions, and the option for a credit or deduction for political contributions. The $750 exemption for the taxpayer and each dependent and the general tax credit that can be determined by optional methods could be simplified and combined. The recordkeeping requirements associated with itemized deductions could be lessened if certain deductions were limited or if standard deductions were permitted for certain items in conjunction with itemized deductions for others. By broadening the tax base, limitations on certain deductions would permit general reductions of rates with the same revenues.

With the flat standard deduction included in the President's economic stimulus program, steps such as these could make tax preparation much easier for nearly all Americans. We should be able to make it possible for more than three out of four Americans to use the standard deduction and determine their tax from a simple rate table.

Fortunately, many of the steps that would simplify the tax system would also make it fairer. A large part of the variation in taxes paid on like incomes stems from the preferential taxation of capital gains. Other equity problems stem from other kinds of preference income and from the freedom from taxation of certain fringe benefits and alleged business expenses such as the $50 martini lunch.

There are several options open to us for increasing growth and efficiency in the economy. Tax policy can affect investment decisions by increasing its after-tax return.

We could reduce or end the double taxation of corporate income by any of several methods. One possibility is full integration, which is equivalent to treating the corporation as a partnership. Each corporate shareholder, as a partner does under current law, would include in his own income for tax purposes his proportionate share of the corporation's income whether or not it is distributed. The corporate tax then becomes a withholding tax which can be credited against the shareholder's final individual tax liability.

Or, corporate and individual taxation could be partially integrated. In one approach, the individual shareholder grosses up his cash or "take-home" dividends in the same way that take-home pay is converted to total pay by adding taxes withheld by the employer. In determining final tax liability, the dividends are included in total income, but the taxpayer takes a credit for his share of the corporate tax.

Alternatively, corporations might be permitted a deduction for the dividends they pay just as interest deductions are allowed at present.

There are other methods of encouraging investment:

Larger deductions for depreciation of income-producing property can be allowed by various combinations of changes in asset lives, more accelerated methods, or by indexing depreciation schedules for inflation.

The investment tax credit, now at 10 percent for eligible property including depreciable equipment but not buildings, could be increased by raising the rate or relaxing the restriction that generally limits it to 50 percent of tax liability.

Corporate tax rates could be cut.

We will look at these options in terms of their effect on the freedom of investment to respond to market demands, their neutrality concerning the way investment is financed, and their impact on the timing and amount of investment that results from each dollar of revenue lost.

At the same time, we mean to promote growth and efficiency in other ways. The reduction of very high marginal rates could lessen the incentive for unproductive activities aimed at reducing taxes. The elimination of capital gains and other preference income could have a similar result.

In developing a comprehensive tax package, there are obviously conflicts and trade-offs among our goals. But there is ample opportunity to offset these effects and fashion a program that, in its entirety, fulfills all three of our objectives and gives this country the kind of tax system that it should have. It will be one that retains its present good qualities of integrity and voluntary compliance. But it will also be a better system, fairer and simpler, and one that provides adequate incentives for growth and efficiency.

We are getting much advice on how to accomplish these goals. We welcome it and we want more, from you and from Americans across the country. We know that in translating our goals into realities there are difficult choices and complex issues. We want to know what you think.

Exhibit 28.—Statement by Secretary Blumenthal, August 9, 1977, before the Senate Finance Committee, on the national energy plan

It is an honor to appear before you to discuss the national energy plan.

The need for an energy plan

The plan answers a clear need for a concerted national attack on our energy problems.

Our dependence on imported crude oil has been rising steadily. Today almost one-half of the oil consumed in the United States is imported. Much of our imported oil comes from insecure foreign sources. Importing this amount of oil also has serious balance of payments effects: The estimated $25 billion trade deficit for the current year would be a surplus of about $20 billion if we imported no fuel.

Even disregarding these international considerations, we face an obvious peril: Our consumption of oil and gas is growing considerably faster than are proven domestic and foreign reserves. Unless restraint is shown now, and we prepare to shift to alternative energy sources, we risk potentially severe shortages of oil and gas.

The national energy plan aims to encourage energy conservation, the substitution of alternative fuels for oil and gas, and increased production of all forms of energy.

Conservation lies at the center of the plan. We are not seeking an absolute reduction in energy consumption. Rather, we are aiming to reduce the rate of increase in energy consumption to less than 2 percent per year. This is a feasible, prudent, and essential objective. It poses no threat to our equally important economic objectives.

Conservation is to be achieved by making consumers of oil products pay the replacement cost of their consumption, by substituting more efficient modes of transportation for less efficient ones, by taxing businesses on their use of oil and gas, and by providing tax incentives for insulation and for other improvement outlays to improve energy efficiency.

The substitution of coal and other fuels for oil and gas is to be achieved by providing an incentive in the tax system for businesses to convert to these alternative fuels. Solar, wind, and geothermal energy sources will also be favorably treated to encourage greater residential and industrial use.

Additional production will be stimulated by allowing newly discovered oil to be priced at world price levels and by providing an incentive price for newly discovered natural gas.

The plan's provisions

In general, the House did an admirable job with the energy bill. However, there are some areas where additional measures need to be considered. Additional energy savings can be accomplished by changes that I would like to offer to the committee for their consideration.

Crude oil equalization tax.—The importance of the crude oil equalization tax cannot be overestimated. The tax would insure that by 1980 consumers of oil pay the true replacement cost of their consumption. This is clearly necessary to achieve conservation and to stem imports.

While promoting conservation, the national energy plan will also encourage the development of domestic oil and gas resources. This is because newly discovered oil—so-called new new oil—can be sold, free of the tax, for the world market price of $13 a barrel, or more. This price factor is a powerful incentive and provides domestic oil producers a profit margin that is among the highest in the world for the production and exploration of new oil.

The bill provides a similar incentive to remove a higher percentage of oil from existing fields. This results from allowing oil from stripper wells and oil obtained by tertiary production to be sold at the world price, without the payment of any crude oil tax.

These price incentives are fully adequate to encourage and reward new production. The House wisely rejected all attempts to give the oil producers part of the crude oil tax to plow back into oil and gas production. The administration strongly opposes a plowback. A plowback would unbalance the program both economically and in terms of equity. Such a scheme would defeat the purpose of the crude oil tax, which is to raise the price of new oil to consumers but at the same time to reimburse the average consumer for his consequent loss of purchasing power. The prospect of $13 a barrel oil will bring forth exploration, discovery, and production of new oil. A plowback provision would simply be a windfall to producers, who currently have adequate capital for exploration and development.

The House version of the crude oil tax does need some improvement. First, it would be better if the tax were extended beyond 1981; we should not leave producers and consumers in a state of uncertainty about our long-term policy in this vital area. Second, the rebate of net proceeds of the tax should be a permanent feature, rather than stopping after 1 year. Finally, it would be better if the credit system were on a per capita rather than a per taxpayer basis: The tax affects the purchasing power of all consumers of oil products, not merely those consumers who pay income tax.

The House credit oil tax is expected to raise $38.9 billion during the period 1978 through 1982. However, for 1 year at least, the amount collected under the House bill will be repaid to the consumers. On a net basis, this brings the collections down to $27.5 billion. The energy savings associated with this tax is estimated at about 230,000 barrels of oil per day by 1985.

Transportation.—In the transportation sector, the administration's objective is to encourage the shift away from energy inefficient means of transportation. Our major proposal in this sector was the gas guzzler tax and rebate. We are not suggesting the restoration of the rebate. We do ask the Senate to strengthen the House version of the gas guzzler tax itself. We ask the committee to consider imposing somewhat higher taxes than does the House bill.

We believe that a strong gas guzzler tax is the key to achieving more rational and efficient use of automobiles. Reducing the number of gas guzzlers on the road will make the gasoline available for domestic consumption provide more transportation than is true with our current fleet of automobiles.

Strengthening the gas guzzler tax is important to our program, since we believe the current standards will not achieve the necessary savings. We need to keep the pressure on gas-guzzling automobiles until the national automobile stock is truly fuel efficient. We also need to apply the gas guzzler tax to the smaller trucks, which can be inefficient and contribute to the problem along with gas-guzzling automobiles.

In the transportation area, the House added several provisions. It extended the current 4 cents per gallon excise tax on gasoline beyond 1979, repealed the personal deduction for State and local gasoline taxes, repealed the excises on buses and bus parts, revised the tax on motor boat fuels, removed the discriminatory tax on new oil used in rerefined lubricating oil, and provided a credit for the purchase of electric cars. We consider these reasonable measures to promote more efficient modes of transportation and better use of oil.

The energy saving for these provisions is estimated at 275,000 barrels of oil per day. The total revenue gain of the various transportation proposals is $29.5 billion for the period 1978 to 1985. However, $21.2 billion of this amount merely represents an extension of the present 4-cent tax on gasoline scheduled to be reduced 1 1/2 cents in 1979. Presently, this is a source of revenue for the highway trust fund.

Tax on business use of oil and gas.—The oil and gas use tax on industry and the utilities was designed to achieve energy conservation and conversion to energy sources other than oil and gas. Industries and utilities consume oil and gas in many activities where coal and other nonfossil fuels could be used. The House use tax, while providing incentives for conversion and conservation, falls short of the use tax we would like to see enacted. The level of use tax on oil passed by the House varies depending upon whether the industrial process has conversion potential, conservation potential, or is a utility.

The gas tax passed by the House is a variable tax based on the difference between the user's acquisition price and the cost of a Btu equivalent amount of distillate oil. For utilities, however, the gas tax would be a flat tax such that the price of gas to a utility including the tax cannot exceed the price of residual oil.

To encourage conversion to coal and other fuels, a rebate of this tax up to the annual user tax liability is allowed for qualified expenditures in boilers, burners, and other equipment which do not use oil or gas. In lieu of the rebate, an additional 10-percent investment tax credit would be allowed.

Where a utility elects to use the rebate option, a State utility commission could require a utility to pass the benefit of this rebate on immediately to consumers. On the other hand, if the utility elects the investment credit, the benefit of the credit can be passed on to the consumer only over the life of the asset.

There are several areas where the use tax passed by the House should be improved. *First*, all industrial gas should be taxed at a rate which makes the price of gas in all cases equivalent on a Btu basis to distillate fuel oil, without exemptions. When applied in this fashion, the use tax works as a pricing mechanism, which makes industrial users pay the replacement cost of gas rather than an artificially low price, which encourages excessive use. This tax should apply to all users without any exceptions except for the small user (50,000 barrels of oil equivalent per year) exemption.

Second, we believe that a rebate of the utility tax should be conditioned on the benefit of the rebate not being passed on to the consumer any faster than ratably over the life of the asset. This would make the treatment consistent with the treatment provided for the investment credit, which the utilities at their option may take in place of the rebate.

Third, in place of the industrial oil use tax proposed by the House, we suggest a simplified single tier tax on boilers, turbines, and kilns, incorporating the House's tax schedule, which starts at 30 cents a barrel and in 1985 goes up to $3 a barrel. The only special exemption would be for current facilities unable to convert for environmental reasons.

The House bill on a net basis—after the rebate—would collect $2.9 billion over the period 1979 to 1985. There would also be a revenue pickup from the denial of the regular investment credit on that financed out of the rebate. Finally, it is estimated the bill will save 1 to 1.4 million barrels of oil equivalent per day by 1985.

Residential energy credit.—The residential energy credit provides incentives for homeowners and renters to buy energy conservation equipment and solar and wind energy equipment.

The President has set a goal of insulating, by 1985, 90 percent of the homes that presently have insufficient insulation. The credit provided by the House bill goes a long way toward the fulfillment of this objective. Expenditures for insulation, storm doors and windows, clock thermostats, exterior caulking and weather stripping, and certain modifications to furnaces qualify for the credit.

The solar and wind credit is designed to interest more homeowners in alternative energy sources. Both the solar and wind energy industries are in their infancy. The potential benefits to all Americans from developing use of solar and wind devices are great and justify a temporary tax incentive. The present cost of solar and wind energy installations is high because demand is currently low. This tax incentive will encourage more Americans to turn to these inexhaustible energy sources and will help these industries develop to the point where Government incentives are no longer necessary.

The cumulative cost for the residential credits will amount to $4.8 billion for the period 1978 through 1985. It is projected that these proposals will save about 500,000 barrels of oil per day by 1985.

Business energy tax credits.—The House also approved a series of business energy tax credits. These credits are designed to promote the use of energy-efficient insulation, to encourage commercial and industrial use of solar and other alternative resources, and to promote recycling and cogeneration. Expenditures in these areas will qualify for an additional 10-percent investment tax credit above the credit for which they otherwise qualify. The House also conserved energy at the same time it also reduced the revenue loss by denying accelerated depreciation and the investment tax credit to air conditioners, space heaters, and boilers fueled by natural gas or oil. We endorse these House initiatives.

The expected net revenue cost of these credits is $2.5 billion from 1978 through 1985. The energy savings is about 350,000 barrels of oil equivalent per day.

Supply incentives.—The House adopted two proposals in the national energy plan relating to the supply of energy resources. First, the House accepted a proposal to make permanent a provision that applies the minimum tax to intangible drilling costs for oil and gas only to the extent that such costs exceed the sum of the taxpayer's income from oil and gas production plus the result of 10-year amortization of these costs.

The second provision allows the expensing of geothermal intangible drilling costs, which extends to geothermal resources the treatment accorded oil and gas. Also, the House provided percentage depletion for geothermal resources, but only at a 10-percent rate, and only to the extent of basis in the property.

Together these provisions will cost $600 million through 1985. The geothermal provisions should save 60,000–110,000 barrels of oil per day.

Conclusion

Mr. Chairman, the national energy plan is in large measure a tax program. There are nontax aspects also, but the plan relies crucially on a battery of net taxes and new tax credits to move our economy away from its present, dangerous position of overconsumption of oil and gas.

As you know, I am generally opposed to using the tax code to further nontax objectives. In the not-too-distant future, I will be back before you to urge a major simplification of the income tax code. But in the case of energy, the basic problems are so urgent, and the alternative solutions so unsatisfactory, that resort to tax incentives is clearly proper, indeed essential.

We could have relied entirely on market incentives coupled with total deregulation of oil and natural gas prices. But, given the present distortion of world markets, this approach would have created enormous and unjust windfalls throughout our economy. The American people, with justification, would have rejected such an approach out of hand. The other alternative was to rely solely on physical controls, directives, and regulations. But this would have created a giant bureaucracy and injected the heavy hand of Government regulation into every facet of the economy.

Thus, the only reasonable, fair, and effective solution lies with the tax system. The administration and the American people are now looking to this committee, with its well-known expertise, experience, and sense of responsibility in matters of taxation, for a solution to the most serious problem facing the Nation. I hope to work closely with you in dealing with this challenge.

Crude oil and natural gas liquids equalization tax under title II of H.R. 8444, the National Energy Act, as passed by the House of Representatives: relationship of the gross tax to amounts available for credits and payments
[$ millions]

	Fiscal years					
	1978	1979	1980	1981	1982	1978-82
Gross crude oil equalization tax collections	1,897	6,349	11,294	14,596	4,802	38,938
Reduced refiners' income tax	−305	−971	−1,720	−1,944	−900	−5,840
Refund for oil used to produce natural gas liquids at refineries	−29	−97	−168	−211	−68	−573
Refund for heating oil:						
Homes	−82	−476	−688	−793	−181	−2,220
Hospitals	−9	−54	−80	−91	−20	−254
Per taxpayer credits	−1,819	−780	....	....	....	−2,599
Net receipts effect	−347	3,971	8,638	11,557	3,633	27,452
Special payments to qualified recipients	....	−866	....	....	....	−866
Net budget effect	−347	3,105	8,638	11,557	3,633	26,586

Excise tax on business use of oil and natural gas under title II of H.R. 8444, the National Energy Act, as passed by the House of Representatives: [1] relationship of tax without investment rebate to final tax
[$ millions]

	Fiscal years							
	1979	1980	1981	1982	1983	1984	1985	1979-85
Tax without rebate for qualified investment	—	1,734	2,796	3,642	4,678	7,574	8,524	28,948
Qualified investment rebate	—	−1,298	−2,686	−3,421	−3,990	−6,651	−7,506	−25,552
Reduced industry income tax [2]	−25	−38	−22	−57	−96	−110	−140	−488
Net effect on receipts	−25	398	88	164	592	813	878	2,908

[1] Industry and utility taxes.
[2] Results from less than full passthrough of tax to prices.

Estimated receipts effects of title II of H.R. 8444, the National Energy Act, as passed by the House of Representatives
[$ millions]

	Fiscal years								
	1978	1979	1980	1981	1982	1983	1984	1985	1978-85
Part I, residential energy tax credits:									
Credit for insulation and other energy-conserving components	-361	-466	-491	-518	-546	-576	-608	-541	4,107
Credit for solar and wind energy expenditures	-26	-54	-62	-71	-87	-111	-140	-169	-720
Total, Part I	-387	-520	-553	-589	-633	-687	-748	-710	-4,827
Part II, transportation tax provisions:									
Gas guzzler tax	—	100	100	100	135	150	160	170	915
Repeal of deduction for State and local tax on gasoline	115	780	859	944	1,039	1,143	1,257	1,383	7,520
Extension of existing tax rate on gasoline and other motor fuels	—	—	3,302	3,404	3,496	3,585	3,677	3,772	21,236
Amendment of motorboat fuel provisions	1	4	4	4	4	4	4	4	29
Repeal of excise tax on buses	-13	-9	-9	-9	-9	-9	-9	-9	-76
Repeal of excise tax on bus parts	-3	-3	-3	-3	-3	-3	-3	-3	-24
Removal of excise tax on certain items used in connection with buses	-13	-13	-13	-13	-13	-13	-13	-13	-104
Credit for qualified electric motor vehicles	(*)	(*)	-1	-1	-2	-4	—	—	-8
Total, Part II	87	859	4,239	4,426	4,647	4,853	5,073	5,304	29,488
Part III, crude oil equalization and natural gas liquids tax[1]	-347	3,971	8,638	11,557	3,633	—	—	—	27,452
Business use of oil and natural gas									
Parts IV, V: Excise tax on business use of oil and natural gas:[2]									
Industry	—	-25	398	88	164	592	715	784	2,716
Utility	—	—	—	—	—	—	98	94	192
Total, Parts IV, V	—	-25	398	88	164	592	813	878	2,908

Part VI, denial of investment credit on property financed with credit:									
Industry	—	57	184	238	231	261	298	345	1,614
Utility	—	—	—	—	—	34	73	69	176
Total, Part VI	—	57	184	238	231	295	371	414	1,790
Total business use of oil and natural gas	—	32	582	326	395	887	1,184	1,292	4,698
Business credits, Part VI, excluding denial of investment credit on property financed with credit:									
Alternative conservation and new technology credits	−409	−415	−516	−673	−789	−491	—	—	−3,293
Investment credit denied, and depreciation limited to straight line on oil or gas burning equipment, and air conditioning and space heaters	93	111	121	114	103	99	93	88	822
Total business credits	−316	−304	−395	−559	−686	−392	93	88	−2,471
Part VII, miscellaneous provisions:									
Treatment of intangible drilling costs for purposes of minimum tax	—	−32	−37	−42	−48	−56	−65	−74	−354
Option to deduct intangible drilling costs on geothermal deposits	−5	−10	−17	−21	−20	−20	−32	−54	−179
Ten percent depletion in case of geothermal deposits	−1	−1	−1	−2	−2	−2	−2	−2	−13
Rerefined lubricating oil	−3	−3	−3	−3	−3	−3	−3	−3	−24
Total, Part VII	−9	−46	−58	−68	−73	−81	−102	−133	−570
Total receipts effects, Parts I-VII	−972	3,992	12,453	15,093	7,283	4,580	5,500	5,841	53,770

* Less than $500,000.

[1] Tax not of business income tax offset and refunds and after per taxpayer credits.

[2] Tax not of income tax offset and rebates.

SUMMARY OF TAX PROVISIONS OF H.R. 8444

A. Residential energy credit

1. *General provisions.*—A nonrefundable Federal income tax credit is provided for individuals who make certain energy-related expenditures. The credit is available for installations of qualified property made from April 20, 1977, through December 31, 1984. Qualifying installations may be made only with respect to the principal residence of the taxpayer and only if that residence is located in the United States. Thus, installations made with respect to vacation homes will not qualify. If less than 80 percent of the use of a residence is solely for residential purposes, a proportionate allocation of expenditures must be made to the nonresidential use. The amount of expenditures eligible for the credit must be reduced by any prior expenditures taken into account in determining the credit.

Owners (including co-op and condominium owners) as well as renters are eligible for the credit. A change of principal residence restarts the amount of qualified expenditures eligible for the credit. The credit must be allocated where a single principal residence is jointly occupied. For administrative convenience, no credit of less than $10 per return will be allowed. All eligible property must meet performance and quality standards prescribed by the Secretary of the Treasury which are in effect at the time of acquisition. The original use of the property must commence with the taxpayer. To the extent that the tax basis of the residence is increased by the qualifying expenditures, the basis must be reduced by the amount of any credit allowed.

2. *Energy conservation credit.*—This portion of the credit is available only for residences substantially completed before April 20, 1977. The amount of the credit is equal to 20 percent of the first $2,000 of qualified expenditures on insulation and other energy-conserving components (including original installation thereof) for a maximum credit of $400. Insulation means any item that is specifically and primarily designed to reduce the heat loss or gain of the residence or a water heater therein, and which may reasonably be expected to remain in operation for at least 3 years. This would include attic, floor, and wall insulation made of fiberglass, rock wool, cellulose, or styrofoam. Energy-conserving components include a replacement burner for a furnace that provides increased combustion efficiency, devices to modify flue openings, furnace ignition systems that replace a gas pilot light, exterior storm or thermal doors or windows, clock thermostats, and exterior caulking or weather stripping of windows and doors. The Secretary of the Treasury may add to the list of energy-conserving items other items that are designed to increase energy efficiency.

3. *Solar and wind energy credits.*—This portion of the credit is available for new as well as existing residences. The amount of the credit is equal to 30 percent of the first $1,500 and 20 percent of the next $8,500 (for a maximum total credit of $2,150) of qualified expenditures on solar and wind energy equipment, including certain labor costs allocable thereto. Expenditures on new and reconstructed dwellings are treated as having been made when original use begins. Eligible property must reasonably be expected to remain in operation for at least 5 years.

Qualified solar energy property uses solar energy for the purpose of heating or cooling the residence or providing hot water for use therein. Qualified wind energy property uses wind energy for any nonbusiness residential purpose. Backup systems of conventional heating or cooling equipment and expenditures properly allocable to swimming pools are not included in this credit.

B. Transportation

1. *Gas guzzler tax.*—A manufacturer's excise tax is imposed upon the sale of new automobiles based upon their EPA-certified fuel efficiencies. The tax first applies to 1979 model year automobiles with fuel efficiencies of less than 15 miles per gallon. The minimum fuel efficiency above which no tax is imposed increases each year so that, for model years 1985 and thereafter, the tax applies to automobiles whose fuel efficiency is less than 23.5 miles per gallon. (These threshold levels range from 3 to 5.5 miles per gallon below the fleetwide average standards imposed under the Energy Policy and

Conservation Act.) The tax applies to automobiles with gross vehicle weights of not more than 6,000 pounds, but does not apply to trucks with a cargo capacity of at least 1,000 pounds.

The tax on automobiles with a given fuel efficiency increases each year. For example, the tax on a 14 mile per gallon automobile starts at $339 for the 1979 model year, increases to $428 the next year, and increases further to $2,688 for 1985 and later model years. The maximum rate of tax applies to automobiles with less than 13 or 12.5 mile per gallon efficiencies, and ranges from $553 for the 1979 model year to $3,856 for the 1985 model year.

The tax applies to new and used imported cars, according to their model year, and is imposed on the importer. Where automobiles are leased by the manufacturer, the first lease is treated as a sale subject to the tax. The amount of the gas guzzler tax may not be included in the owner's tax basis for the automobile for any purpose. Thus, no income tax benefit may be derived from payment of the gas guzzler tax, thereby excluding investment tax credit and depreciation benefits.

All gas guzzler tax revenues are to be deposited into a public debt retirement trust fund, the proceeds of which are to be used to retire obligations of the United States that are included in the national debt.

2. *Repeal of personal deduction for State and local taxes on gasoline and other motor fuels.*—Effective after December 31, 1977, the personal deduction for State and local taxes on gasoline and other motor fuels is repealed.

3. *Extension of excise tax on gasoline and other motor fuels.*—The Federal excise tax of 4 cents per gallon on gasoline and other motor fuels will be continued at that rate through September 30, 1985. This tax is currently scheduled to be reduced to 1 1/2 cents per gallon after September 30, 1979. The committee took no action with respect to the highway trust fund, which is scheduled to be phased out after September 30, 1979. Accordingly, after that date, gasoline tax receipts will be paid over into the general fund of the Treasury.

4. *Amendment of motorboat fuel provisions.*—The act repeals the 2 cents per gallon refund payment to the purchaser of gasoline and special motor fuels used in a motorboat. The motorboat fuel payment is presently made because this is a nonhighway use of gasoline. The act conforms the tax on motorboat use of fuel to the tax on highway use. Following the treatment accorded to the current 2 cents per gallon tax, the increased tax on motorboat fuel will also go into the land and water conservation fund.

5. *Repeal of excise tax on buses and bus parts.*—The 10-percent excise tax on sales of buses and the 8-percent excise tax on sales of bus parts and accessories will be repealed. Floor stocks refunds (as of the date of enactment) and consumer refunds (as of April 20, 1977) are provided where the 10-percent excise tax has already been paid. Parts and accessories that may be interchangeable between trucks and buses will continue to be taxed on sale unless the purchaser provides an exemption certificate which indicates that the part or accessory is purchased for use on a bus.

6. *Removal of excise taxes on items used with certain buses.*—The act repeals the excise taxes on tires, inner tubes and tread rubber, gasoline and other motor fuels, and lubricating oil sold for use with intercity, local, and school buses. With respect to these excise taxes, this action places private transit and private schoolbus operators on a par with governmental and nonprofit schoolbus operators.

This action applies to an intercity or local bus, and a schoolbus. The term "intercity or local bus" means a bus used predominantly in furnishing passenger land transportation to the general public for compensation if such transportation is scheduled and along regular routes or the passenger seating capacity of the bus is at least 20 adults, not including the driver. The term "schoolbus" means a bus substantially all the use of which is in transporting students and employees of schools.

7. *Tax credit for electric motor vehicles.*—New electric cars acquired for personal use after April 20, 1977, and before January 1, 1983, will be eligible for a Federal income tax credit of the first $300 of the purchase price. A qualified electric motor vehicle is a four-wheeled vehicle manufactured primarily for use on public roads that is powered primarily by an electric motor which draws current from rechargeable storage batteries or other portable sources of electric current.

C. Crude oil equalization taxes and rebates

1. *Crude oil equalization tax.*—An excise tax is imposed on the first purchase (generally, by the refiner) of domestically produced crude oil. The purpose of this tax is to increase the cost of such oil to the world market price. The definition of crude oil subject to the tax is substantially similar to the definition found in current price control regulations. The tax applies to crude oil produced in the United States, Puerto Rico, and the possessions, and on the related Continental Shelf areas.

The tax is brought into effect in three annual stages. In 1978 and 1979, the tax is imposed on lower tier controlled oil only, and is equal to 50 percent (1978) or 100 percent (1979) of the difference between the ceiling price of upper tier oil and the ceiling price of lower tier oil of the same classification. In 1980 and thereafter, the tax applies to all controlled crude oil, and is equal to the difference between the controlled price and the world market price for crude oil of the same classification. The tax terminates after September 30, 1981. Lower tier oil is the amount of oil produced on a property, up to the lesser of 1972 or 1975 production, and is now controlled at an average price of $5.16 per barrel. Upper tier oil is oil produced on a property in excess of the lower tier production level. Upper tier oil is now controlled at an average price of $10.97 per barrel.

Crude oil used in the production of crude oil, natural gas liquids, or natural gas is not subject to the tax. In addition, the crude oil tax does not apply to the extent crude oil is refined into products that are in turn used in the production of crude oil, natural gas liquids, or natural gas.

A credit or refund of the crude oil tax is also provided for crude oil that is used as a raw material to produce natural gas liquids, but only if the refiner demonstrates that he has not passed on the crude oil tax attributable to his production of natural gas liquids.

2. *Natural gas liquids equalization tax.*—This tax is imposed after December 31, 1977, on sales for end use (as opposed to first purchases), and on certain uses where there is no prior sale, of natural gas liquids. The tax applies to liquids sold or used in the United States, Puerto Rico, and the possessions, and in the related Continental Shelf areas. The purpose of this tax is to bring the price of controlled natural gas liquids up to the price of energy-equivalent No. 2 distillate oil. Accordingly, the tax is based upon the difference between the price for No. 2 distillate in the region in which the taxable sale or use occurred (adjusted for differences in energy content and seasonal variations in price) and the controlled price of the natural gas liquid. The tax is brought into effect in three equal annual stages in 1978, 1979, and 1980. The tax terminates on September 30, 1981.

Exemptions are provided for agricultural uses, uses in a residence, hospital, school, or church, and use as a feedstock in the production of natural gas liquids.

3. *Presidential authority to suspend equalization taxes.*—The President is granted authority to suspend all or any part of an equalization tax increase which would result from an increase in the world price of oil where such tax increase will have a substantial adverse economic effect. A tax increase suspension may not exceed a period of 1 year, and is subject to veto by either House of Congress within 15 legislative days after submission by the President of a plan implementing such suspension.

4. *Crude oil tax credits, special payments, and refunds.—Tax credits.* The net receipts from the crude oil equalization taxes in 1978 will be allocated to each adult. Net receipts are equal to gross revenues derived from these taxes, less: (a) the reduction in Federal income taxes resulting from the imposition of the crude oil taxes, (b) the administrative costs related to the tax credit, special payment, and refund programs, (c) the amount of the heating oil refund, and (d) the amount of the refund to refiners for refining crude oil into natural gas liquids.

Single taxpayers and married persons filing separately will each be entitled to one tax credit. Married persons filing joint returns and heads of households will be entitled to two credits. The tax credits are limited to the taxpayer's tax liability, except for taxpayers entitled to the earned income credit. Withholding tax schedules for 1978 will be adjusted to reflect these tax credits. Estates, trusts, and nonresident alien individuals are not entitled to this credit.

Special payments. Special payments are provided for adults who are not taxpayers. These payments will be made in May or June of 1979 to recipients of benefits under social security, railroad retirement, and supplemental security income programs. To the extent not covered under these programs, individuals may receive payments through State aid to families with dependent children programs. The amount of the special payment is equal to the amount of the tax credit referred to above, reduced by the amount of any crude oil tax credit claimed by the individual. Adults who do not receive a tax credit or a special payment may file an appropriate form with the Secretary of the Treasury in order to receive the payment.

Lump-sum payments are also authorized for the governments of Puerto Rico and the possessions if acceptable plans are submitted to the Secretary of the Treasury for the distribution of amounts under programs similar in effect to the tax credit and special payment programs described above. These lump-sum payments are in lieu of individual tax credits and special payments.

Refunds. An exemption is provided from the crude oil equalization tax for heating oil used in residences, churches, schools, and hospitals. Distributors of heating oil for such uses will receive a refund of the equalization tax for each gallon sold provided that the amount of the refund is passed through completely to the customers in the form of lower prices.

5. *Miscellaneous.—Study of small and independent refiners.* The Secretary of Energy is to conduct a study of the impact of the crude oil tax on the competitive viability of small and independent refiners. The Secretary is to report to the Congress not later than 90 days after the date of enactment of the tax with his findings, together with legislative recommendations.

Natural gas contracts. The crude oil taxes are not to be taken into account for purposes of determining or redetermining natural gas prices under any contract which was entered into before the date of enactment of the act.

D. Tax on business use of oil and gas and related credit

1. *Use tax.—In general.* An excise tax would be imposed on the use after December 31, 1978, of oil or natural gas as fuel in a trade or business. Three different sets of tax rates are provided: The highest rates (referred to as tier 2) apply where conversion to a fuel other than oil or gas is feasible; a lower industrial rate (tier 1) applies where conservation in fuel consumption is feasible; and a third rate (tier 3) applies to electric utility use (including production of steam by an electric utility), certain industrial electric generating use and use in a qualifying cogeneration facility. Tier 2 applies generally to uses in a boiler or in a turbine or other internal combustion engine, except for such uses classified in tier 3. Tiers 1 and 2 apply to uses in 1979 and thereafter; tier 3 applies to uses in 1983 and thereafter.

Tax on oil. The tier 2 tax begins at 30 cents per barrel in 1979, and increases to $3 per barrel in 1985 and later years. The tier 1 rate begins at 30 cents per barrel in 1979, and increases to $1 per barrel in 1981 and later years. Tier 3 uses are taxed at a rate of $1.50 per barrel in 1983 and later years. Inflation adjustments apply to 1981 and later year rates. Oil subject to the tax includes crude oil, refined petroleum products, and natural gas liquids (other than liquids which have an API gravity of 110 or more) but excludes natural gas, gasoline, and substances that are not generally marketable for use as a fuel.

Tax on natural gas. A variable tax is imposed, based upon the difference between a target price and the user's acquisition cost for natural gas. The purpose of this variable tax system is gradually to raise the price of natural gas to slightly less than the price of energy equivalent oil. Accordingly, the target price is based upon the cost of all No. 2 grade distillate oil sold in the relevant region, adjusted by a subtraction factor (which decreases each year, thereby increasing the after-tax price of natural gas) and for inflation. Tier 3 use of natural gas is subject to a tax rate beginning at 55 cents per million Btu in 1983, and reaching 75 cents per million Btu in 1985 and later years. (One thousand cubic feet of natural gas contains approximately 1 million Btu.) These rates would be adjusted for inflation beginning in 1981. The tier 3 tax rate is limited so that the cost of natural gas never exceeds the cost of energy equivalent residual oil in the region where the gas is used. A 10-percent discount is provided for tier 1 and tier 2 uses subject to interruptible contracts.

Natural gas subject to the tax includes natural gas, petroleum, or a product of natural gas or petroleum, having an API gravity of 110 or more. The tax does not apply to substances that are not generally marketable for use as a fuel, such as still gas.

Suspension power. The President may suspend the imposition of part or all of the use tax for a period of up to 1 year if he determines that the imposition of such tax would have an adverse economic effect. A suspension plan must be submitted to Congress, and would be subject to a veto by either House of Congress before the end of 15 legislative days after submission.

Exemptions. Since the tax applies only to use as fuel, uses of oil and natural gas as raw materials such as petrochemical feedstocks are not subject to tax. An industrial process use would be exempt from tax where the use of any fuel other than oil or gas would materially and adversely affect the manufacturing process or the quality of the manufactured product, or the use of such alternative fuel would not be economically and environmentally feasible. Also exempt are uses in: any residential facility; any vehicle, aircraft, vessel, or transportation by pipeline; agriculture; nonmanufacturing commercial buildings; and the exploration, development, and production of oil and gas. An exemption is provided where use of a fuel other than oil or gas is precluded by applicable air pollution control laws.

In addition, each taxpayer is provided an annual exempt amount equal to the energy content of 50,000 barrels of oil. For this purpose, greater-than-50-percent commonly controlled organizations, whether or not incorporated, are considered a single taxpayer. Where a taxpayer suffers a substantial regional competitive disadvantage as a result of the use tax, the Secretary of the Treasury may provide additional exempt amounts for individual plants. The Secretary is required to publish the names of taxpayers and plants receiving such additional exempt amounts.

Reclassifications. The Secretary of the Treasury must establish a procedure for reclassifying taxable uses to lower rates of use tax. Reclassification may include complete exemption from the tax. Reclassifications are to be made only if the Secretary determines that such action is not inconsistent with the goal of encouraging the conversion from, or significant conservation in, the use of oil and gas as a fuel. The Secretary is not authorized to reclassify a use to a higher rate of tax.

2. *Credit against use tax.—In general.* A person subject to the use tax may elect either an additional 10-percent investment tax credit (discussed below), or a dollar-for-dollar credit against the use tax, for qualified expenditures made in alternative energy property. The credit is allowable up to current use tax liability. Excess credits may be carried forward. In addition, 1979 and 1980 taxes (including any tax carried forward from 1979) which are not offset by the credit may be carried over to 1981. Qualified progress expenditures are available under rules similar to the investment tax credit rule. The credit terminates after 1990 except for carryovers and where construction of alternative energy property began, or such property was acquired, before the end of that year.

Alternative energy property. Qualified investments (which generate the use tax credit on a dollar-for-dollar basis) consist of investments in alternative energy property. Generally, this is new tangible property used in the taxpayer's trade or business, which is subject to the allowance for depreciation (or amortization), which has a useful life of at least 3 years and which is not used predominantly outside the United States. The determination of whether property is "new" depends on the extent to which it is constructed, or whether it is acquired, on or after April 20, 1977. The original use of acquired property must begin with the taxpayer.

Alternative energy property consists of: (a) a boiler not fueled by oil or gas; (b) a burner for a combustor (other than a boiler) not fueled by oil or gas; (c) nuclear, hydroelectric, or geothermal energy equipment; (d) equipment for producing synthetic gas; (e) pollution control equipment required in (a), (b), or (d); (f) coal utilization equipment; and (g) the basis for plans and designs for all of the above equipment. Alternative energy property does not include buildings and structural components thereof and property used in the trade or business of leasing.

Election. A taxpayer must specifically elect to treat qualified investments as a credit against the use tax. Otherwise, such investments will be available only for the investment tax credit. This election applies to all the alternative energy property of the taxpayer. For this purpose, greater-than-50-percent commonly controlled organizations, whether or not incorporated, are considered a single taxpayer. Where the qualified investment exceeds the tax liability for a calendar year, the excess may be treated as eligible for the regular (but not the additional 10 percent) investment tax credit. To the extent such election is made, the use tax credit is no longer available. Normally, qualified investments used to offset the use tax would not be eligible for either the regular or the additional investment tax credit, but would otherwise be treated as part of the tax basis for the property.

Special rules. Dispositions of alternative energy property are subject to recapture rules similar in form to the rules for the regular investment credit. In addition, utilities are allowed the credit against the use tax for investment in new boilers only to the extent that old oil or gas boilers are replaced or phased down. For this purpose, phasedown is based upon less than 1,500 hours of use per year. Special penalties and recapture rules apply to phased-down boilers that are subsequently used for more than 1,500 hours per year.

Property which is financed by industrial development bonds is eligible for only a 50-percent use tax credit. No Federal income tax deduction is allowed with respect to any portion of the use tax offset by the use tax credit.

E. Business energy tax credit and special investment credit and depreciation changes

1. *Business energy credit.—In general.* An additional 10-percent investment tax credit is allowed for business investments in qualifying property intended to reduce energy consumption in heating or cooling or in an industrial process. The additional credit is available for qualifying investments made after April 19, 1977, and before January 1, 1983. In the case of alternative energy property, the additional credit may offset up to 100 percent of the taxpayer's income tax liability as opposed to the 50-percent limitation provided under current law. This additional credit may be elected as an alternative to the credit against the use tax.

Qualifying property. Energy property eligible for the additional investment tax credit consists of: (a) alternative energy property (as described above in the use tax credit explanation); (b) the expansion of cogeneration capacity; (c) advanced technology property; (d) specially defined energy property; and (e) certain recycling equipment. Alternative energy property is eligible for a maximum additional investment tax credit of 10 percent, even if described in another category of energy property. Advanced technology property uses solar, geothermal, or wind energy to provide heat, cooling, or electricity in connection with an existing building and (where applicable) an existing industrial or commercial process. Specially defined energy property (such as recuperators, heat wheels, and energy control systems) includes equipment which would recover waste heat in gases or otherwise reduce energy consumption, and equipment to modify existing facilities to allow the use of oil or gas in conjunction with another fuel.

Energy property must be completed or acquired after April 19, 1977, in conjunction with a building or other structure located in the United States. Such property must be subject to the allowance for depreciation (or amortization) and have a useful life of at least 3 years. All business energy property (other than alternative energy property) must meet performance and quality standards which have been prescribed by the Secretary of the Treasury, and which are in effect at the time the property is acquired or construction is begun.

Utilities are subject to a phasedown requirement similar to the requirement incorporated in the use tax credit provision. In the case of property financed by industrial development bonds the additional energy investment tax credit is 5 percent.

Insulation installed in connection with an existing building or industrial facility will be made eligible (to the extent not already eligible) for the regular investment tax credit through 1982. Insulation must be specifically and primarily designed to reduce the heat loss or gain of an existing building or facility. The original use of the property must begin with the taxpayer. In addition, the property must reasonably be expected to remain in operation for at least 3 years, and meet performance and quality standards prescribed by the Secretary of the Treasury.

2. *Denial of investment credit and accelerated depreciation.*—Air-conditioning units and boilers fueled by oil or gas will no longer qualify for any investment tax credit. In addition, such boilers will be limited to straight-line depreciation and denied the 20-percent variance from guideline lives under ADR. If the use of a fuel other than oil or gas is precluded by applicable air pollution laws or qualifies as an exempt use under the oil and natural gas consumption tax, these restrictions on the investment credit and depreciation will not apply.

3. *Accelerated depreciation for phased-down boilers.*—If a taxpayer certifies that he plans to replace or retire a boiler or other combustor which uses oil or gas, he may depreciate the remaining basis of such property over the phasedown period. Under current law, the taxpayer would ordinarily deduct the remaining basis when the old equipment is retired.

F. Miscellaneous provisions

1. *Minimum tax on intangible drilling costs.*—The act makes permanent a provision applicable only for 1977 that applies the minimum tax to intangible drilling costs for oil and gas only to the extent that such costs exceed the sum of the taxpayer's income from oil and gas production plus the result of 10-year amortization of the intangible drilling costs.

2. *Tax treatment of geothermal expenses.*—The expensing of intangible drilling cost treatment now provided for oil and gas will be extended to the exploration and development costs of geothermal resources. Such intangible drilling costs will be subject to the same minimum tax treatment described above for oil and gas, except that oil and gas properties will be treated separately from geothermal properties for purposes of determining income. The recapture rules and at risk rules applicable to oil and gas are extended to geothermal properties.

Percentage depletion is provided at a 10-percent rate for geothermal deposits, subject to the limitation that the total amount of depletion may not exceed the taxpayer's adjusted basis in the property.

3. *Rerefined lubricating oil.*—New lubricating oil would be exempt from the 6 cents per gallon excise tax if such oil is combined with rerefined oil and the new oil makes up not more than 55 percent of the mixture. If the new oil in the mixture exceeds 55 percent, the exemption would apply only to the new oil that would make up 55 percent of the mixture. In any case, the mixture must contain at least 25 percent waste or rerefined lubricating oil in order to qualify for the exemption.

4. *Annual report by the President.*—Beginning in August 1978, the President will report each year to the Congress on the revenue impact, and increased energy conservation and production resulting from the tax provisions of the act.

Trade and Investment Policy

Exhibit 29.—Statement by Secretary Blumenthal, March 16, 1977, before the Senate Committee on Banking, Housing, and Urban Affairs, on legislation regarding bribery of foreign public officials

I would like to say at the outset that the administration supports the aims of S. 305. The Carter administration believes that it is damaging both to our country and to a healthy world economic system for American corporations to bribe foreign officials. The United States should impose specific criminal penalties for such acts. The effective enforcement of U.S. criminal penalties for corrupt payments abroad is a difficult matter, and will require close international cooperation. I will discuss these enforcement aspects later in my testimony.

The problem of corrupt payments is one that is a cause of great concern to this administration. Paying bribes—apart from being morally repugnant and illegal in most countries—is simply not necessary for the successful conduct of business here or overseas. I believe that the responsible elements of the business community agree, and it had been my hope that the business community itself would formulate and implement a code of business ethics that would set high standards. Unfortunately, there has been little movement to date in the private sector. The Carter administration has decided that strong Government action in the form of further legislation is needed.

In its assessment of legislative alternatives, the Carter administration is reviewing carefully the record of recent regulatory action. We are finding this record a very useful guide against which new initiatives can be examined. I believe therefore that it would be worthwhile to review with you the considerable regulatory action that has taken place during the past few years.

1. The Securities and Exchange Commission has been impressively successful in obtaining disclosure from issuers of registered securities who have engaged in these improper practices. It is already clear that these disclosures have compelled many firms to impose strict internal controls against these practices. I need not describe further the SEC's action as I am sure that Chairman Hills will give you a thorough description in his testimony today.

2. In June 1976 the Internal Revenue Service issued 11 questions to which corporate officers and outside auditors are required to respond in affidavit form. These questions are designed to discover whether corporations have been illegally deducting bribes. As of December 31, 1976, the 11 questions had been asked in approximately 800 large case examinations. Indications of slush funds or illegal activity have been found in over 270 such cases. Most of these cases are still under active consideration, and over 50 criminal investigations have been started.

Also in the tax area, the Tax Reform Act of 1976 eliminated the tax benefits (deferrals and deductions) associated with illegal payments made by majority-owned subsidiaries and domestic international sales corporations. This new prohibition parallels longstanding prohibitions against deductions of illegal payments made in the United States.

I believe that this increased audit activity and new legislation will have an increasingly salutary effect.

3. The Arms Export Control Act of 1976 now requires reports of payments (including political contributions and agents' fees) that are made or offered to secure the sale of defense items abroad. The data reported by U.S. firms is made available to Congress and to Federal agencies responsible for enforcing laws on this subject. The Department of State has issued detailed regulations to implement this requirement.

Furthermore, 1976 amendments to the Foreign Military Sales Act require disclosure to purchasing governments and to the Department of Defense of any agents' fees included in contracts covered by the act. Fees determined to be questionable by the Defense Department or unacceptable by foreign governments will not be allowed costs under such contracts.

4. Last year, the International Chamber of Commerce organized an international panel to formulate a code of ethics for businessmen. The panel is scheduled to present a code of ethics to the ICC Executive Board on March 23. Subject to approval by the national chambers of commerce, the code could be adopted by the ICC council at its June 1977 meeting.

5. The United States is actively pursuing in the United Nations a treaty on corrupt payments in international transactions. The United States has formally proposed that the treaty be based on three concepts: (1) Enforcement of host country criminal laws; (2) international cooperation on exchange of information and judicial assistance in enforcement; and (3) uniform provisions for disclosure of payments to foreign officials and agents made to influence official acts.

The U.N. working group for this initiative has met twice and will meet again to begin drafting March 28 to April 8. It has been directed to report by this summer on a possible treaty on illicit payments for consideration by the United Nations Economic and Social Council and possible action by the General Assembly.

A number of other governments have expressed interest in international action, but there is much work still to be done. This treaty may be an essential complement to effective enforcement of domestic legislation, such as S. 305. President Carter is giving this effort his fullest support.

6. The Department of Justice, in cooperation with the Securities and Exchange Commission and the U.S. Customs Service, has reviewed the foreign activities of approximately 50 domestic corporations. This review has resulted in the opening of active criminal investigations of eight multinational corporations. Several of these investigations are now in the grand jury stage.

The United States is also continuing to cooperate through bilateral agreements in the law enforcement efforts of other governments. Thirteen agreements on specific corporate groups have been signed, and discussions are underway with other countries.

The initiatives described above are collectively impressive. They add up to a significant deterrent to corrupt payments by American firms, both in the United States and abroad.

Of equal importance, Mr. Chairman, is the change in the climate of public opinion in the United States. I am certain that any U.S. corporate executive faced with a choice of whether to make a corrupt payment in 1977 will be much more reluctant than he would have been 3 years ago.

However, the administration believes that the recent initiatives must be complemented by new legislation. The administration supports the criminalization of corrupt payments made to foreign officials.

But before turning to the criminalization aspects of S. 305, I would like to assure the committee that the administration agrees with section 102 of title I concerning accounting records and dealings with accountants. We note that the SEC has recently offered for comment proposed regulations which closely parallel section 102. We suggest that the committee consider comments received by the SEC concerning the proposed regulations when it marks up this section.

Now turning to the central aspect of S. 305, the criminalization of corrupt payments made to foreign officials, as I said, we support it. At the same time, the administration recognizes that great care must be taken with an approach which makes certain types of extraterritorial conduct subject to our country's criminal laws. Moreover, a law which provides criminal penalties must describe the persons and acts covered with a high degree of specificity in order to be enforceable, to provide fair warning to American businessmen. Mr. Chairman, I am seriously concerned about the enforcement problems arising from the broad and sometimes vague reach of S. 305 as it is presently drafted. The administration believes that the bill can and must be improved in a number of respects to ensure that it will be fairly and effectively enforced and, in its implementation, will not give undue offense to foreign countries whose officials would be implicated in cases brought under the U.S. criminal law.

Aspects of the bill which we believe require improvement include the following elements:

- The definition of a "domestic concern" should specify the degree of control which will bring a foreign corporation controlled by individuals who are citizens or nationals of the United States within the purview of the law.
- The definition of the term "domestic concern" should also make it clear when a foreign corporation which is owned directly or indirectly by a U.S. corporation is covered.
- Foreign issuers of registered securities should not be subject to the criminalization penalties.
- Requiring the SEC to take primary responsibility for enforcing a criminalization program would be a dubious diversion from its primary mission of securing adequate disclosure to protect investors of registered securities.
- The term "interstate commerce" should be more precisely defined to provide more specifically the certainty and the extent of contacts with the United States constitutionally required in a criminal statute.

I want to emphasize that our reservations do not represent an intent to weaken the thrust of the bill or to delay its passage. Rather, we want to work with your committee to ensure that legislation in this area is workable and fair. We have established an interagency group to recommend language which will satisfy our concerns. We will get that language to you as soon as possible.

Further, the administration believes that prompt disclosure of corrupt foreign payments also may provide a highly effective deterrent. We do not foreclose the possibility that disclosure provisions will be considered in our further review of the enforcement aspects of this subject.

Moreover, once the bill is enacted into law, the administration plans to continue to seek a multilateral treaty and additional bilateral agreements on illicit payments. Such agreements will increase the enforceability of domestic legislation and will help to minimize any adverse effects of this law on our foreign relations. Our intent is to propose that a multilateral treaty include an undertaking by each country to adopt the approach of S. 305—in other words, to apply a criminal prohibition against foreign corporate bribery.

Let me turn now to a brief discussion of title II. First, I support its concept—increased disclosure where it will help investors and serve public policy. In general, I believe that the benefits of increased disclosure outweigh its burdens. The trend in recent years toward both increased corporate disclosure and increased disclosure of shareholders themselves has benefited investors, and I have favored it.

Concerning title II, however, it seems to us that the present reporting requirement, coupled with recent SEC actions, may be already achieving its intended goal. Specifically, we think that these regulations already disclose shareholders in positions of potential control. We particularly think that recent SEC administrative actions have helped improve disclosure of the identity of large shareholders.

Let me provide some specifics concerning our reservations over title II. First, the apparent intention of this legislation is to disclose the ownership interests of persons with potential influence over corporate managements. Presumably, the sponsors believe that shareholders and the general public could be affected by these people and, thus, have a right to know their identity. I agree—disclosure of those who truly could exercise such control makes sense.

The issue, however, is one of whether the present disclosure requirements already accomplish this. It seems to me that the present requirement—that beneficial owners of 5 percent or more disclose their identities—already is effective.

My own experience and observations in business have been that owners of less than 5 percent rarely have potential control of managements. An ownership position of that size rarely threatens a management with being overruled or overthrown. I realize that the 5-percent requirement doesn't reveal a large absolute number of owners in any given corporation, but, nevertheless, it seems to reveal those with potential control.

Indeed, the area of greater abuse has been that of managements abusing shareholder rights—pursuing policies which aren't disclosed to them and which may be contrary to shareholders' best interests. In contrast, there have been almost no examples of less than 5 percent shareholders harmfully dominating managements.

Second, I have some concerns over the effects of this lowered reporting level on foreign portfolio investment in the United States. Our equity market benefits considerably from foreign transactions in U.S. securities. Any actions which might reduce the inflow of foreign capital or divert transactions offshore should be studied carefully. In particular, the amounts of new equity capital available to American business in the past 3 years has been too small, and if this bill would reduce it further, I would be concerned. One reason for this concern is that the 1976 Treasury report to the Congress entitled "Foreign Portfolio Investment in the United States" concluded that disclosure requirements deterred foreign investors from our equity market.

I also question the possible effects of title II on this administration's objective of an open environment for international investment and removing existing obstacles to it. Freer international investment would benefit all nations, and especially the United States with our strengthening economy. Imposing a lower reporting requirement, however, is inconsistent with this goal of facilitating such investment. Our report on foreign portfolio investment noted that many foreign investors often fear filing ownership reports with the U.S. Government, since it might lead to reporting their ownership interests to their home governments. Disclosure of this information to home governments could have, and in some instances has had, serious consequences for foreign investors, including forced repatriation and confiscation of assets.

As you know, portfolio investment ebbs and flows rapidly, and this tightened disclosure requirement might impede these flows. It seems to me that this impact of this legislation on overall portfolio investment should be evaluated more carefully.

My third reservation, Mr. Chairman, reflects this administration's concern with costly reporting requirements imposed on American business by Government. We believe that before new regulations requiring more documentation are imposed, the need should be proven, and the costs of compliance understood. I already have indicated uncertainty over the need; moreover, I don't believe that any estimate has been made of the increased costs which title II would require. Ultimately, these costs probably will be borne by investors, since the financial intermediaries which must report will pass them through. Indeed, they may be borne particularly by individual investors, since securities firms recently have had difficulty in passing through costs to institutional investors.

In summary, we don't think that there is sufficient evidence that the objectives of this legislation aren't already being met. We particularly think that recent SEC initiatives may be making the 5-percent requirement more effective.

Concerning the SEC, its recent broadening of the definition of beneficial ownership will produce more disclosure, and we should assess its effects. Furthermore, recent legislation directed the SEC to require financial institutions to report their equity holdings. This may accomplish much of the purpose of title II. We will consult with the SEC on these developments to assess their effect on overall disclosure. Afterwards, we would be willing to report back to the committee in writing concerning our findings.

Exhibit 30.—Statement by Under Secretary for Monetary Affairs Solomon, March 25, 1977, before the Subcommittee on International Trade, Investment and Monetary Policy of the House Committee on Banking, Finance and Urban Affairs, on proposed legislation extending the expiration date of the Export-Import Bank

I am pleased to support the proposed legislation extending the present expiration date of the Export-Import Bank from June 30, 1978, to September 30, 1978.

This simple 3-month extension will give the administration an opportunity to thoroughly review all aspects of the Eximbank operation and to reach decisions on the future role of the Bank.

Mr. Chairman, in your letter inviting me to testify today, you raised several questions concerning issues on which I might comment. Many of your questions go to the heart of the role of the Export-Import Bank. Specific answers must therefore await the intensive review that the administration will be undertaking over the next several months.

The administration's review will be completed in time for the full and comprehensive hearings which this subcommittee will undertake when it considers the multiyear extension of the Export-Import Bank Act. This review will consider among other issues: Eximbank financing of nuclear power projects; the country, size, and industry composition of Eximbank lending; and the relationship of the administration's human rights policy to Eximbank lending.

Mr. Chairman, I would like to note that last fall the National Advisory Council, after discussing the Eximbank's policy review, welcomed the thrust of the policy changes that had taken place during the year. These policy changes were initiated and implemented with the full cooperation of the Eximbank's senior management. I believe those changes go in the right direction. Further, the useful process of review and discussion of Eximbank policies that was initiated last year should be continued as this administration takes another look at the role of the Eximbank.

In my view, the Eximbank plays an important role in financing and facilitating U.S. exports. However, we must continue to give great weight to changes in the international monetary system, and the progress achieved in limiting counterproductive competition between officially supported export credit institutions, in our assessment of the Eximbank. The general acceptance of flexible exchange rates among industrial countries implies that official export credit institutions should not be used to *promote* exports but rather to *assist* the private sector only in those circumstances when private financing would not otherwise be available. In other words, the role of the Export-Import Bank, and similar institutions abroad, is as lenders of last resort in cases where there are genuine market imperfections, and not as instruments of export competition between the industrial countries.

In recent years, foreign governments have sought, by one means or another, to increase exports in order to deal with the twin problems of recession and the impact of oil price increases on their current accounts. Nevertheless, on the initiative of the United States, it was possible last year for the major trading countries to reach a consensus to reduce international competition among official export credit agencies. The Unilateral Declaration by the United States, which became effective on July 1, 1976, was based on that consensus. The guidelines contained in the consensus have generally been followed by the countries concerned.

There are hopeful indications that not only the seven countries—the United States, the United Kingdom, France, Germany, Italy, Japan, and Canada—but all the industrialized countries of the OECD will join in adopting a more encompassing agreement to limit counterproductive competition in officially supported export credits. Such an international agreement, which deals with the critical issues of downpayments, interest rates, and maturities, will make export competition a matter of price, service, quality, and performance. This is the proper arena for competition among exporters, rather than through officially supported export credits.

Exhibit 31.—Excerpt from Joint Communique on the Third Session of the United States-Saudi Arabian Joint Commission on Economic Cooperation, May 3–4, 1977, Washington, D.C.

The United States-Saudi Arabian Joint Commission on Economic Cooperation concluded its third formal session today with major attention given to new ways in which the Joint Commission can assist in carrying out programs for the economic and social development of Saudi Arabia. The two days of discussion affirmed the special importance each country places on strengthened bilateral economic cooperation.

The Joint Commission evaluated progress on its many program activities with special emphasis on those projects undertaken since the last Commission meeting in the areas of vocational training, electrical services and procurement, and the establishment of a National Park in the Kingdom. At the meeting, new agreements were signed and understandings reached in the areas of desalination technology, consumer protection, executive development, and the establishment of an economic information center.

The United States-Saudi Arabian Joint Commission on Economic Cooperation was established in accordance with the joint statement issued by Crown Prince Fahd and former Secretary of State Kissinger on June 8, 1974. The Joint Commission meeting, held in Washington, May 3–4, 1977, was chaired by Secretary of the Treasury W. Michael Blumenthal. Minister Muhammad Ali Abalkhail, Minister of Finance and National Economy and Chairman for the Saudi side of the Commission, led the Saudi Arabian delegation. Mr. Ali Abdallah Alireza, the Saudi Arabian Ambassador to the United States, also participated in the meetings.

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The American delegation included Richard Cooper, Under Secretary of State for Economic Affairs, C. Fred Bergsten, Assistant Secretary of the Treasury for International Affairs and U.S. coordinator of the Joint Commission, Lewis W. Bowden, Treasury Deputy for Saudi Arabian Affairs, and John P. Hummon, Director of the U.S. Representation to the Joint Commission in Riyadh.

* * * * * * *

The United States and Saudi Arabia agreed that the United States should continue to play a major role in the development of key sectors of the Saudi economy and expressed strong interest in promoting increased mutual trade and private business.

The Commission noted the substantial progress which has taken place since the last meeting in undertaking project activities and in recruitment of technicians for the various programs. At present there are approximately 95 U.S. professionals in the Kingdom working on Joint Commission projects in the four major program areas: agriculture and water, industry and electrification, science and technology, and manpower and education. These projects are financed by the Saudi Arabian Government through the Trust Account in the U.S. Treasury Department.

INDUSTRIALIZATION AND RELATED PROJECTS

Acquisition of electrical power equipment

In November 1975 a $57.6 million project agreement was signed involving the procurement of electrical equipment, together with warehousing and other required supplies and services. Nearly all of that equipment has been received in Saudi Arabia and the three warehouses are essentially complete. In addition, some of the generators are now being installed at three locations in the Kingdom using U.S. contractors for this purpose.

Another Joint Commission program of procurement has been agreed upon for the Saudi Consolidated Electric Company, an entity handling electrification in the Kingdom's Eastern Province, with an initial order of $14 million of equipment. Discussions also were held during the Commission meeting about further purchases of electrical equipment, in the United States, possibly reaching as much as $100 million.

Electrical services project

At the second Joint Commission meeting in 1976 an agreement was reached that the U.S. Treasury would contract with a U.S. firm to prepare a comprehensive 25-year electrification program and to provide advisory assistance on the day-to-day operational problems associated with Saudi Arabia's rapidly expanding demands for power. A contract was signed within a few months after the Joint Commission meeting with a U.S. firm which for several months has had a full team in the field working on this program. A brief report was given on the progress of these activities at the Joint Commission meeting.

Under Joint Commission auspices, an American firm is establishing a training program for mid and senior level managers in electric utilities, for the Saudi Ministry of Industry and Electricity and its General Electricity Organization.

Statistics and data processing

The Commission received a report on the technical cooperation program under which the U.S. Bureau of the Census has been assisting the Saudi Arabian Central Department of Statistics and National Computer Center in achieving an effective statistics and data processing capability. Twenty U.S. project personnel are now permanently stationed in Riyadh. An important supporting element of this project is an ongoing program to provide selected Saudi officials with mid-career professional training.

Highway project

It is expected that a project agreement will be signed shortly between the United States and Saudi Arabia covering U.S. technical cooperation in the area of highway system planning, construction, and maintenance. The 6-year program will be directed toward development of an expanded highway system with emphasis on an expressway network connecting major Saudi cities. The U.S. Federal Highway Administration is initially to place a 12-man team in the Saudi Ministry of Communications for a 2-year period. In addition, extensive training will be provided selected Saudi personnel in the United States.

Industrial inventory

The possibility of an industrial inventory being undertaken for the Kingdom was discussed. It was noted that this proposed project was under review in the Ministry of Industry and Electricity and would be given careful consideration by the Joint Commission.

SCIENCE AND TECHNOLOGY

Science and Technology Center

There were discussions on the Saudi Arabian National Center for Science and Technology. The two countries look toward the implementation of a wide variety of activities intended to develop the Kingdom's scientific resources in a manner responsive to its economic and social goals.

Standards

The Joint Commission is exploring the possibility of a joint U.S. Government-private industry team to assist in developing the Kingdom's industrial and food standards. This follows visits by experts from the U.S. National Bureau of Standards and the Food and Drug Administration to study the needs of the Saudi Arabian Standards Organization.

Telecommunications

It was announced that the U.S. Department of Commerce's Office of Telecommunications has completed a high-frequency computer-modeling study for the Saudi Ministry of Information. This work, which was reviewed and discussed last month during a visit to the United States by Ministry officials, came about as a response to one of a number of recommendations for upgrading the capability of the Ministry in the area of radio and television broadcasting. The two Governments are considering the assignment of one or more U.S. technical advisers to the Ministry of Information.

INFORMATION

Financial Information Center

An agreement was signed at the Joint Commission meeting for the establishment of an Information Center in the Saudi Ministry of Finance and National Economy. This Center is to expand the Ministry's present information-gathering analysis capabilities through provision of U.S. information specialists and economists and the development of a modern Information Center complex. It is planned that an initial staff will be recruited shortly and that architectural and engineering work will begin at an early stage.

MANPOWER AND EDUCATION

Vocational training and construction

The Joint Commission heard a report on the accomplishments of a team of 18 staff members from the U.S. Department of Labor working at the Saudi Ministry of Labor and Social Affairs to improve vocational training programs. Plans are underway for the Joint Commission through the U.S. Department of Labor and the U.S. General Services Administration to provide design and construction for 10 new vocational and prevocational centers and for the expansion of 15 existing centers.

Twenty-three prospective Saudi vocational training instructors arrived in the United States last month to begin instructor training. A group of 20 instructor trainees have been in training in the United States for the past year and will complete their training by September.

Consumer protection

An agreement was signed at the Joint Commission meeting under which the U.S. Departments of Treasury and Health, Education, and Welfare will support the Saudi Ministry of Commerce in equipping and staffing its new Consumer Protection Laboratory in Riyadh and in providing its Consumer Protection Department with other related services.

AGRICULTURE, WATER AND LAND MANAGEMENT

Specialists in agriculture and water

The Joint Commission reported that there are 28 U.S. professionals working in the Saudi Ministry of Agriculture and Water in a variety of fields, including: water resources, Central Research Laboratory, project execution and planning, economic analysis, soils surveys, park development, and agricultural engineering. A very important element in this project is the work at the Central Research Laboratory. U.S.

specialists are working with a number of Saudi Ministry employees to speed the development of this institution which will have primary and overall responsibility for agriculture research within the Kingdom.

Desalination

A project agreement was signed at the Joint Commission meeting for joint efforts between the U.S. Department of the Interior and the Saudi Saline Water Conversion Corporation in establishing a Desalination Research Development and Training Center in Jidda and a related research program. The projects are to lead to the production of a new generation of multistage flash desalting plants using the latest technology.

Kingdom Park

The Joint Commission reported that architectural and engineering work is underway by a private U.S. firm on the development of a Kingdom Park in the Asir region, located in the southwestern part of the Kingdom. It is expected that the design phase will be completed within a year and park construction completed within 3 years. The U.S. National Park Service will monitor the development of the park area.

Agricultural research stations

Fruitful discussions were held on the continuation of a program to establish two agricultural research stations in Saudi Arabia with the assistance of the Montana International Trade Commission. Two Montana specialists would work in the Ministry of Agriculture's Central Research Laboratory to develop future program requirements and carry out research at the two sites.

Development of agricultural areas

Useful discussions were held regarding Saudi plans for developing the agricultural potential of the Wadi Dawasir area in southwest Saudi Arabia. It was announced that a soil survey of the area would soon be underway and that a Ministry of Agriculture and Water task force studying various means of developing the area would be making recommendations in the near future.

Outdoor recreation parks

A discussion of Saudi Arabian Government interest in the creation of municipal parks and outdoor recreation areas resulted in agreement that the Bureau of Outdoor Recreation, U.S. Department of Interior, would furnish a specialist for a short-term assignment.

OTHER POTENTIAL PROJECTS

Archaeology

The two Governments noted that preliminary discussions about cooperative projects in the areas of archaeology, cultural heritage, and historic architectural preservation have taken place between the U.S. Department of Treasury and the Department of Antiquities and Museums in the Saudi Ministry of Education. Both sides indicated their support for the development of projects in these areas, as well as for the channeling of U.S. technical and scientific assistance necessary for the establishment and growth of an effective museum system.

Centralized Procurement Agency

It was agreed that a team of experts from the General Services Administration would go to Saudi Arabia in early May to advise on the feasibility of creating a Saudi General Services Administration which would permit centralized procurement.

Customs assistance

It was agreed by the Saudi Ministry of Finance and National Economy and the U.S. Department of Treasury to cooperate in the area of customs operations and training. An agreement is expected to be signed shortly which will involve the assignment of short- and long-term specialists in the Saudi Department of Customs to assist in upgrading and expanding the Department's capabilities. Also, training programs for Saudi officials will be provided in the United States and in Saudi Arabia.

Sister cities

The two delegations discussed the Joint Commission's participation in the establishment of a sister city program for Saudi Arabia. Activities under such programs traditionally have centered on cultural and educational exchanges as well as mutual visits by city officials.

Executive development program

In order to enhance and deepen mutual understanding between the people of Saudi Arabia and the United States, the two Governments discussed a program for executive development. Under this program, a small number of Saudi Arabian public servants would travel to the United States to meet with a wide variety of American government and industrial leaders and visit a cross section of American government, commercial, and research activities.

OVERALL ASSESSMENT

The Commission considered the results of its third session to have been most useful. It noted that the understandings and project agreements entered into are positive and constructive contributions to the strengthening of United States-Saudi Arabian bilateral economic and commercial relationships.

The Commission commended all participating departments and agencies on both sides for their energetic efforts to date and directed them to continue in their exploration of possible new areas of cooperation.

The cochairmen agreed to hold the next Joint Commission meeting in Riyadh early in 1978.

Exhibit 32.—Statement by Assistant Secretary Bergsten, May 12, 1977, before the Subcommittee on Antitrust and Monopolies of the Senate Judiciary Committee, on the relationship between trade and competition policy

The issue

When President Carter announced his anti-inflation program on April 15, he included a prominent reference to international trade:

> Trade can play an important role in the fight against inflation. *It is an effective means of improving and maintaining competition within American industry.* (emphasis added)

In this statement, the President clearly indicated one aspect of the relationship between trade and antitrust policy. Competition from abroad provides an important spur to competition in our own economy. Such a spur is particularly important in industries dominated by a few large firms, where domestic competition may be inadequate to provide such pressure.

A second facet of the relationship between trade and competition policy relates to the effort of sellers which are heavily concentrated abroad to limit competition in world markets. One effect of such limitation is to raise prices to American and other consumers. OPEC is of course the premier example, but such efforts have been made frequently throughout modern history.

A third relationship between trade policy and antitrust policy relates to U.S. exports. When world markets are relatively open, American firms can maximize their competitive positions by increasing production runs and learning from their counterparts in other countries. Oligopolistic collusion at home is much less likely when American firms can find increasing outlets for their energies in expanding their markets abroad.

Hence there are three major interfaces between trade policy and competition policy. The interrelationship among the three reinforces the implication of each that the most open possible trade policy is most supportive of the basic goals of antitrust policy:

- A relatively open U.S. market for imports maximizes the likelihood that foreign markets will remain open for U.S. exports.
- A relatively open U.S. market for imports reduces the risk that other countries will limit our access to their exports.
- An avoidance of export controls by the United States reduces the likelihood that other countries will deny our access to their supplies by erecting export controls on their own products.

Two policy implications arise from this line of analysis. First, U.S. antitrust policy would be weakened by widespread resort to new barriers to imports or exports. Second, U.S. antitrust policy can be strengthened by achieving, in the multilateral trade negotiations (MTN) in Geneva and elsewhere, (a) further reductions in barriers to international trade flows and (b) new international rules which would limit more effectively the ability of countries to erect barriers to imports (the "safeguard" clause) or to exports ("access to supply" rules).

Many different factors must be considered, of course, in all trade policy decisions. For example, the impact on domestic employment of rapid increases of imports in a particular product can simply be too rapid and too pervasive to be permitted to continue. Hence President Carter has directed the negotiation of "orderly marketing agreements" (OMA's) with the two countries (Taiwan and Korea) whose increased sales equaled almost 100 percent of the increase in U.S. imports of shoes over the past 2 years, and the one country (Japan) which accounts for over 80 percent of all imports of color television sets and whose sales rose by over 150 percent in 1976 alone.

In addition, cutrate selling by foreign companies could in some cases eliminate domestic (and other foreign) firms from a given market, and thus *reduce* competition over the long run. Antidumping duties should be applied vigorously in such cases.

Export subsidies by foreign governments could have similar effects, and should be met promptly by countervailing duties. And, in some cases, imports could cause national security problems.

Hence any given trade policy decision must weigh carefully a variety of competing factors. Nothing which I say today should be construed as depicting, or advocating, a simplistic or single-factor approach to this complex subject. Nevertheless, this administration has repeatedly indicated its strong adherence to an overall trade policy which is as open as possible—as President Carter said in the first sentence of his decision in the escape clause case on shoes, "I am very reluctant to restrict international trade in any way." Just last week, the President led the effort to incorporate a strong commitment to liberal trade into the language of the summit communique. And, from the standpoint of antitrust policy, the subject of these hearings today, an open trading system is highly desirable.

Imports and competition in the U.S. market

Few Americans would quarrel with the need to resist export controls by our foreign suppliers or import controls by our foreign customers, for antitrust as well as much broader economic and political reasons. Hence I will focus my remarks today on the relationship between imports and competition within the U.S. market which—to put it mildly—is a much more controversial subject.

The fundamental point is that import competition stimulates innovation and efficiency. The competitive environment nourished by the relatively open trade posture of the United States over the past 40 years has spurred American industries to make steady improvements in the range and quality of available goods. Import barriers, by contrast, permit protected industries to raise prices and reduce incentives to improve the quality of their output—as has resulted in a number of developing countries which pursued import-substitution strategies of economic development in the 1950's and

1960's. They promote an inefficient allocation of resources and detract from our ability to produce the things we make best.

Through these effects, open international trade serves consumers—the ultimate beneficiary of all antitrust policies. Imports hold down prices and stimulate the discovery of cost-saving technology and other innovations. Trade barriers, by contrast, raise prices to consumers and push up the cost of living. When import penetration raises serious problems for a domestic industry, it is always sensible for the Government to consider helping that industry to improve its competitive ability directly as an alternative to providing insulation from the forces of the marketplace.

The burden of import restrictions falls particularly heavily on low-income consumers, who tend to spend a greater share of their budgets on protected items such as low-cost shoes and meat. In some cases, foreign suppliers respond to trade barriers by discontinuing lower priced items in favor of those with higher unit prices. This tendency also hurts poorer Americans more than others.

The benefits of an open trading system in holding down the rate of inflation extend across our entire economy. But competition from abroad is especially important in industries dominated by a few large firms, since these are the industries which may be least responsive to market pressure. In such industries, imports help to brake price increases and can provide critically important incentives for diversification of production in response to new market trends. I shall illustrate this point by reference to two major American industries, steel and automobiles.

The case of steel

The steel industry illustrates the price-restraining effects of imports under normal circumstances. Steel prices comprise a major component of the overall price level and tend to act as a bellwether for prices throughout the economy. But the steel industry is highly concentrated. The major companies set prices and exercise reasonably effective price leadership. List prices increase but seldom decline.

Imports, which supply about 15 percent of domestic consumption, are of key importance in this setting. A major study of steel prices, undertaken by the Council on Wage and Price Stability in 1975, concluded that:

> The chief limits on administered price increases have been potential loss of steel markets to imports and government opposition * * *. Imports * * * are very important in providing some flexibility or elasticity in steel supply.

The postwar history of steel prices demonstrates the point. From 1946 to 1958, there was virtually no import competition. In those years, steel prices increased by 141 percent as compared to 61 percent for all industrial prices (including steel). Steel prices contributed substantially to the inflation of the period.

In the decade 1959–68, imports grew from 2 million tons a year to 14 million tons and reached about 14 percent of U.S. consumption. During this period, Japan and Europe developed modern and highly efficient steel industries that competed successfully with older U.S. steel plants. Spurred by this competitive pressure, U.S. industry belatedly adopted the most modern production techniques and began to invest huge sums of capital to improve its efficiency. U.S. steel prices remained essentially stable during the entire decade.

In late 1968, the U.S. steel industry and the U.S. Government cooperated in obtaining voluntary restraint agreements (VRA's) from the major exporters. In the 3 years following the initiation of these agreements, the U.S. industry raised its prices five times as much as it had in the previous 8 years. The wholesale price index for finished steel products rose by 23 percent, as opposed to 10 percent for all industrial products (including steel). Other factors than the change in U.S. trade policy were involved, but the correlation between the two is highly suggestive.

According to a detailed study done for the Department of Labor by the Public Research Institute, the VRA added about $1.5 billion (in 1960 dollars) to the cost of steel for U.S. consumers.[1] This translates to about $2.7 billion in 1975 dollars. A more recent analysis estimates that the VRA caused steel prices to increase by $26 to $39

[1] James Jandrow et al., "Removing Restrictions on Imports of Steel," May 1975.

per ton, meaning that the price of steel would have been 13 to 15 percent lower in the absence of the VRA.[2] Interestingly, the data show that U.S. production was only slightly above, and in one year actually below, what it would have been without the VRA.

VRA's have a further adverse effect on the concerns of this committee. In contrast to an import quota administered by the United States, a VRA forces companies in supplying countries—usually aided by their governments—to organize tightly to administer the restraints. In so doing, the firms of course seek to maximize the value of their (restricted) sales, both by raising prices as much as possible and, in the case of volume-based (rather than value-based) quotas, by switching from low-cost to higher cost items. Hence VRA's strengthen anticompetitive tendencies in industries abroad.

Steel, however, also reveals the complexities of international trade—including its impact on pricing and competition policy. When world demand for steel was booming, in 1973 and early 1974, the prices of imported steel came to exceed domestic prices. In a sense, this simply meant that foreign suppliers showed greater flexibility in their pricing on the upside as well as the downside.

However, the episode also raises questions about the reliability and benefits, under contemporary circumstances, of steel imports. To what extent do the practices of governments in other countries promote the ability and willingness of foreign steel suppliers to cut their prices? Do such practices support the usual objectives of international trade? How do they affect the national interests of the United States? These issues require careful consideration by the administration, and we are now proceeding with a review of them.

The case of automobiles

The case of automobiles illustrates two other advantages of imports; The enrichment of choices available to the U.S. consumer, and the promotion of an energy-efficient and environmentally sound technology.

Before the mid-1950's, imports were negligible. Sports cars and luxury items, like Mercedes-Benz and Jaguar, had never been statistically significant. Beginning in 1955, however, Volkswagen led the way into the U.S. market for small imports. By 1958, imports had captured over 10 percent of the market.

Recovery from the 1957–58 recession reduced the demand for small cars somewhat, however, and imports fell to 5 percent of the market by 1962. Throughout the 1960's, in response, U.S.-produced automobiles swelled in size as incomes rose and real gasoline prices fell. There was a clear correlation: As imports fell, the size (and energy consumption) of American-made cars rose.

The 1970's witnessed a new and dynamic upsurge of imports. The recession of 1970–71, the passage of tough antipollution laws, and skyrocketing petroleum prices all pointed to the need for smaller and more fuel-efficient cars. This trend accentuated the shift toward imports.

By 1975, imports had reached an alltime high and accounted for over 20 percent of consumption. Most of this growth stemmed from small and economical cars, such as Datsun and Toyota. But new technology was also a factor: One manufacturer (Volvo) has just marketed a car equipped with a new, three-way catalyst system which many experts believe will be adopted by U.S. automobile producers in order to meet the air quality standards set for the 1980's by the Clean Air Act.

Such import competition again forced the domestic industry to respond. In 1971, the Vega and the Pinto made their appearance. U.S. companies also extended their production abroad, and models produced by U.S. companies in foreign countries (including Opel, Capri, and Dodge Colt) have risen. Imports clearly forced the U.S. industry to develop a capacity to produce smaller and more fuel-efficient cars—a capacity which it lacked almost entirely less than 10 years ago.

It is this previous competition from imports which, paradoxically, places Detroit in a position in 1977 to be able to contribute positively to the energy program proposed by President Carter on April 20. At present, more than 90 percent of imported cars are fuel efficient, whereas less than half of U.S.-made cars are fuel efficient. Average

[2] Wendy Emery Takacs, "Quantitative Restrictions on International Trade," unpublished, Ph. D. dissertation, Johns Hopkins University, 1976, p. 101.

city/highway mileage of imported cars is typically around 25 to 35 miles per gallon, whereas 1977 models of U.S.-produced cars registered an average city/highway mileage of about 16 to 17 1/2 miles per gallon. But less than half is better than nothing, and 16 miles per gallon is better than in the past. Without the previous import competition, Detroit would have confronted the energy crisis in a hopeless position—indeed, its position might have precluded the possibility of adopting a program as essential to our Nation's future as the President's.

Like steel, however, the auto case also illustrates the complexities involved in international trade—and its relationship to domestic competition. On the one hand, still heavier reliance on imports might enable us to meet more quickly the President's goals for saving gasoline. On the other hand, seizure of a much greater share of the U.S. market by imports could well discourage the transition in Detroit which is desperately needed, both for the longrun future of American energy policy and for maintaining the strength, and levels of employment, of a key American industry. We have not yet resolved this dilemma, but plan to work closely with the other major auto-producing nations to find solutions which will provide fair and equitable treatment for them as well as support the longer term goals of our own energy efforts.

Conclusion

In conclusion, it is clear that international trade can support American antitrust policy in several key respects: By providing steady competitive pressure on American industry at home, by limiting the risk that other countries will limit our access to their supplies, and by providing global markets which permit American firms to maximize their productive efficiency. Trade policy should thus be viewed as our important ally of antitrust policy.

At the same time, many factors other than antitrust must of course be considered in formulating U.S. trade policy. No issue which comprises so many domestic and international complexities can be founded solely on a single criterion. Nevertheless, this administration seeks to maintain maximum freedom for international trade—and the factors being considered by this subcommittee are a central element in that approach.

Exhibit 33.—Remarks by Assistant Secretary Bergsten, May 26, 1977, before the American Iron and Steel Institute, New York, N.Y., entitled "The U.S. Trade Balance and American Competitiveness in the World Economy"

In late April, the Commerce Department reported that the U.S. merchandise trade balance for the first quarter of 1977 showed a record deficit of $6.9 billion—an annual rate of almost $28 billion. The deficit for the year as a whole may exceed $20 billion. These are stark numbers. Some commentators have expressed great concern about them. Some have voiced doubts about the competitive strength of the United States in the world economy.

In my view, such doubts are largely unwarranted. But the United States certainly faces some important trade problems. We must reduce our dependence on imported oil. We face a few sectoral problems which require direct attention. And we are experiencing an unprecedented merchandise trade deficit.

Several issues arising from this development must be considered carefully. What does the present deficit suggest about the competitive position of the United States in the world economy? Is the deficit sustainable? How does our position relate to the trade balances of other countries? What should the Government do about it, if anything? In an effort to help answer these questions, my analysis today will focus on four key issues: The share in world trade of U.S. exports of manufactured goods, the effect of changes in oil prices on U.S. imports, the effects on the U.S. trade balance of differences in the economic cycle among the major trading nations, and the important implications for U.S. policy toward its current trade deficit of the continuing large surpluses being run by a few OPEC countries.

The U.S. share of world exports

One of the most widely used indicators of the competitiveness of U.S. products is the market share of world exports held by U.S. manufacturers. The U.S. market share—defined as the exports of the 15 major industrial countries, excluding sales to the United States itself—declined during the latter 1960's, reflecting the declining competitiveness of U.S. products and reaching its historic low in 1972 (table 1). The dollar became substantially overvalued in the late 1960's, sharply reducing the price competitiveness of our exports and some of our import-competing industries. The AFL–CIO and others, including the steel industry, were right to complain in the late 1960's and early 1970's that U.S. international economic policy had permitted the competitive position of the United States to deteriorate badly and intensify domestic unemployment. In retrospect, we can see that the policy errors of that period centered on the exchange rate of the dollar and inflation in the late 1960's—not on policies directly affecting international trade or investment, as many thought at that time.

The effects of the exchange rate changes of the early 1970's began to be realized by U.S. exporters fairly quickly. The devaluations of 1971 and 1973, coupled with a more flexible exchange rate system since early 1973, have clearly benefited U.S. exporters (and import-competing industries). The data on U.S. trade shares in world markets since 1972 confirm the strengthening of U.S. competitiveness:

- The U.S. share of *total manufactured exports* hit its low point of 19.2 percent in 1972, and rose to 21.3 percent in 1975 (before falling back to 20.5 percent in the first three quarters of 1976, the most recent period for which comparable data are available).
- The U.S. share of *chemical exports* rose steadily from 18.7 percent in 1972 to 21.3 percent in 1976.
- Our *nonelectrical machinery* share rose from the 1972 low of 25.1 percent to 27.6 percent in 1975 (before declining to 26.9 percent in 1976).
- *Electrical machinery* climbed steadily from its 1972 low of 20.9 percent to 23.3 percent in 1976.
- *Basic manufactures* rose from a 1972 low of 10.6 percent to 12.6 percent in 1975, and remained at 12.1 percent in 1976.
- Only in *transport equipment* is the U.S. share lower today, down to about 24 percent in 1976 from 26.4 percent in 1972; all of this decline came in 1976, after the U.S. share had risen to 29.2 percent in 1974 and stayed at 28.2 percent in 1975.
- *All other manufactures* rose steadily from 15.9 percent in 1972 to 18 percent in 1976.

Other indicators such as price relationships between the U.S. economy and other major trading countries testify similarly to a sharp improvement in the U.S. competitive position after 1972 and a maintenance of those gains over the past year or so. We will be watching these indicators closely, to see if they continue to improve—or at least maintain the gains of the past 4 years. Any renewed, sustained decline in them would lead us to take a close look at exchange rate relationships and other key factors underlying the economic relationship among nations. On the basis of the evolution of U.S. market shares over the past 4 years, however, we have no reason to doubt the international competitive position of U.S. industry.

Oil and the U.S. trade balance

Exports, however, are only one side of a country's trade. One must look at the entire picture to appraise the overall international position of a country at any point in time. In the case of the United States, recent swings in the trade balance have been dramatic.

In 1972, the U.S. trade balance was in deficit by $6 1/2 billion (on the balance of payments definition). In 1975, only 3 years later, our merchandise trade registered a surplus of $9 billion—an improvement of over $15 billion despite an increase of over $22 billion in the cost of imported oil during those 3 years. But our trade account was in deficit again in 1976, by some $9 billion—an adverse swing of $18 billion in a single year. This year, the deficit may exceed $20 billion—another swing of over $10 billion.

Changes in the price of oil have dominated these changes in the U.S. trade balance. Our current forecast suggests that U.S. imports may reach nearly $150 billion in 1977. Of this total, more than $40 billion will be oil. In fact, it will take roughly one-third of our total exports to pay for oil imports alone.

In volume terms, U.S. oil imports have risen sharply over the last 5 years (table 2). In 1972, the United States imported 5 million barrels a day (mb/d). In 1976, we imported about 7 3/4 mb/d. Our current estimate for 1977 is imports of about 8 1/2 mb/d—an increase of 70 percent in 5 years. But this increase in volume, sizable though it is, would have raised U.S. oil import costs by less than $3 1/2 billion if the price of oil had not risen.

The price of a barrel of crude oil, however, increased from an average of about $2.53 in 1972 to an (estimated) average of about $13.25 this year—a rise of over 500 percent (table 2). Hence the dollar cost of U.S. oil imports has skyrocketed by some 870 percent, from $4.7 billion in 1972 to an estimated $40 billion this year. The increased price of oil accounts for more than $30 billion in increased U.S. import costs from 1972 through 1977.

Excluding these oil imports, our trade balance has shown a very large surplus ever since the exchange rate changes of 1971 and 1973 restored relative price relationships between the U.S. economy and the rest of the world. Nonoil trade was in deficit by $2 billion in 1972, but has been in strong surplus ever since. That surplus peaked at $36 billion in the recession year of 1975. It remains substantial, and is likely to approximate $20 billion this year.

To be sure, the increases in oil prices have had important effects on the price and volume of other traded goods. We have obviously been increasing our exports to OPEC countries at the same time that our oil import costs have been rising. But that export increase falls far short of the rise in the cost of oil imports. Our merchandise trade balance with the OPEC area, including indirect U.S. imports of OPEC crude via third-country refineries, shifted from a deficit of $1 1/2 billion in 1972 to an estimated deficit of about $21 billion in 1976 (table 3). This year the trade deficit with OPEC could exceed $25 billion.

At the same time, our trade balance with the non-OPEC world has shown impressive strength. In 1972, we had a deficit with non-OPEC countries of $5 billion. In 1976, this had shifted to an estimated surplus of about $11 1/2 billion with those countries—an improvement of $16 1/2 billion. This improved trade position has occurred both vis-a-vis other developed countries (about $11 billion) and with the developing countries (roughly $5 billion). In 1977, we expect to remain in surplus with the non-OPEC world by several billion dollars. The strength of our position has in fact led many major countries—including the European Community as a group (with which we ran a surplus of $7.7 billion in 1976), Spain, and Brazil—to complain frequently about the size of our bilateral surpluses with them.

It is thus apparent that the rise in oil prices has been the overwhelming cause of the shift into large deficit of the U.S. trade balance. Even taking into account the "feedback" effects on U.S. exports of higher OPEC earnings, the price rise for oil has dominated the U.S. international accounts. Our position with the rest of the world remains quite positive, just as we saw from my earlier analysis of the U.S. share of world exports of manufactured goods that the overall competitive position of the United States in the world economy appears strong.

Cyclical factors

A second key element in the recent swings in the U.S. trade balance is the differing pace of economic recovery among the major countries. This factor is far less important than the changes in the price of oil, but it is important nevertheless.

It seems reasonable to view 1974 as the most recent year in which cyclical conditions among the major countries were roughly parallel, and the last year in which most economies were operating at relatively full capacity levels. In 1975, the United States plunged more deeply into recession than did most of our major trading partners. Indeed, while the gross national product of the United States (in real terms) declined by 1.8 percent, gross national products rose by 0.6 percent in Canada and 2.1 percent in Japan. Because the U.S. economy has a higher income elasticity of demand for imports than our major trading partners, our imports are more sensitive to changes in income than are the imports of our trading partners and the effects on our trade balance of these differences in growth rates are magnified. U.S. nonfuel imports declined by $6 1/2 billion in 1975, while exports rose by about $9 billion. Our $9 billion trade surplus in 1975 can thus be largely accounted for by cyclical factors.

From 1975 through 1977, U.S. recovery has been fairly rapid. The economies of our major trading partners, notably Canada and Japan—but also other industrial countries and a few major developing countries—have not recovered as strongly. Comparing our expectations for 1977 with the "base year" of 1974, the trade balance may decline by more than $15 billion. Higher fuel costs account for perhaps $14 billion. Agricultural exports may have risen by $1 1/2 billion. The data in table 1 suggest that the U.S. competitive position in trade in manufactured goods has not deteriorated. Thus some $3 billion or so of the 1977 deficit might be attributable to cyclical considerations. Combining this conclusion with our assessment of the effects of higher oil prices suggests an underlying U.S. nonoil trade balance which is in comfortable surplus.

The implications of continuing OPEC surpluses

Finally, we must ask how the current trade position of the United States fits into the world economic picture. The key point here is that large trade deficits in the non-OPEC world are inevitable at the present, and for at least several more years, in view of the large surpluses being run by the OPEC countries themselves. In the interest of international economic and monetary stability, the deficits have to be carried by countries which have the ability to run a surplus on their international transactions in services and other invisibles, and/or attract capital on a continuing basis.

Very few countries can do both. Germany and Japan readily attract capital but, unlike the United States, run sizable deficits on international services—in 1976, about $9 billion for Germany and $6 billion for Japan. They both also ran deficits on net private and government transfer payments of about $3 1/2 and $1/2 billion respectively. Hence their trade balances will always be more "favorable" than their current account balances.

This is a situation precisely opposite to our own. The United States runs a sizable and growing surplus in its international transactions in services—on balance, primarily income on U.S. investments abroad and foreign military sales. Our services surplus reached $13 1/2 billion in 1976. It is growing steadily, and may rise by another $2 billion this year.

This surplus means that the U.S. current account balance is far stronger than the trade balance alone. To be sure, the current account will also be in sizable deficit in 1977—but nowhere near the $20 billion or more deficit on trade alone. In addition, the United States has had no difficulty in attracting capital from abroad. As Secretary Blumenthal pointed out in Tokyo yesterday, the recent shift in the U.S. current account deficit is making a major contribution to the stability of the international monetary system.

Another important indicator of the underlying economic strength of a country is the value of its currency on the exchange markets—which takes all of these factors into account. Exchange rate movements demonstrate the evaluation of the relative strength of national economies by private traders and investors throughout the world. On a trade-weighted basis, the exchange rate of the dollar—relative to the currencies of other OECD countries—has risen about 5 percent during the past 18 months, despite the adverse swing in the trade balance. During the first quarter, when our trade deficit was running at an annual rate of nearly $28 billion, the dollar moved upward against these OECD currencies. Since the oil crisis hit in late 1973, triggering the sharp decline in the U.S. trade balance, the dollar has strengthened by about 11 percent. To be sure, the changes in the average exchange rate of the dollar comprise appreciations against some currencies and depreciations against some others, but such differences are wholly proper in a world of flexible exchange rates in which the relationships between national economies are changing constantly. On the whole this indicator reinforces the picture of underlying strength of the United States in the world economy.

Conclusion

Several conclusions emerge from this analysis. First and foremost, it is time that this country adopted a policy to reduce its dependence on OPEC oil and the costs of that oil to our balance of payments. The President has proposed a wide-ranging program to reduce U.S. oil dependency. That program deserves the support of the Congress and of the American people. It is the answer to the current "problem" of the U.S. trade balance.

Second, there is no need for the U.S. Government to adopt other measures for balance of payments purposes at this time. We must watch closely such indicators as the U.S. share in world exports of manufactured goods, and any evidence that officials of other countries are resisting market forces tending to appreciate their exchange rates against the dollar. New developments in areas such as these could become cause for concern, but present indications suggest no need for policy action by the United States.

Finally, we can all take satisfaction in the continuing competitive strength of the United States in the world economy. To be sure, there are problems in particular sectors: The President has recently ordered that action be taken regarding some imports of shoes and color television sets, and the international problems faced by the steel industry are presently undergoing review both within the U.S. Government and internationally. But these sectoral problems do not indicate any general weakness of the international position of the United States. To the contrary, our overall national economic strength seems secure. It should be a source of confidence both at home and abroad in the months and years to come.

TABLE 1.—*U.S. share of world exports of manufactures*
[Percentage shares][1]

	Chemicals	Nonelectrical machinery	Electrical machinery	Transport equipment	Basic manufactures	Miscellaneous manufactured articles	Total manufactures
1958	29.6	35.0	32.8	35.3			27.7
1959	29.1	33.8	30.6	32.0			25.6
1960	29.6	32.7	28.2	33.2			25.3
1961	28.2	31.1	27.0	30.5			24.1
1962	27.9	30.9	27.3	31.9			24.6
1963	26.9	30.2	26.8	28.2			23.6
1964	27.1	31.4	26.2	28.4			24.0
1965	24.7	30.9	24.0	28.4			22.8
1966	24.6	30.1	25.2	28.7			23.0
1967	23.7	30.2	25.8	31.8			23.3
1968	24.2	29.4	25.1	34.3			23.6
1969	21.9	28.8	24.4	32.4			22.5
1970	21.9	28.1	22.7	29.0			21.3
1971	20.0	25.6	21.0	29.8	10.8	16.3	20.0
1972	18.7	25.1	20.9	26.4	10.6	15.9	19.2
1973	19.0	25.1	21.6	27.0	11.4	16.0	19.5
1974	18.5	26.4	23.1	29.2	12.3	17.3	20.3
1975	20.3	27.6	22.6	28.2	12.6	17.6	21.3
1976[2]	21.3	26.9	23.3	23.9	12.1	18.0	20.5

[1] Shares are calculated from values of exports of the 6 commodity groups from each of the 15 countries. Beginning 1971 when exchange rates began to fluctuate widely, share calculation is based on export-weighted exchange rate indexes for each supplier, using official rates of exchange vis-a-vis 67 principal markets.

[2] Figures for 1976 are averages of first three quarters, the latest date for which these data are available.

Source: Department of Commerce, Commerce America.

NOTE.—Term "manufactures" refers to chemicals, machinery, transport equipment, and other manufactures except mineral fuel products, processed food, fats, oils, firearms of war, and ammunition. World markets are defined as exports, excluding shipments to United States, from 15 major industrial countries which account for approximately 80 percent of world exports of manufactures: United States, Austria, Belgium-Luxembourg, Canada, Denmark, France, Federal Republic of Germany, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom, and Japan.

TABLE 2.—*U.S. imports of petroleum and products*
[Balance of payments basis]

	Average daily volume	Import unit value	Total value
	Mil. b/d	*$/Bbl.*	*$ Bil.*
Annually:			
1970	3.60	2.23	2.9
1971	4.11	2.43	3.6
1972	5.02	2.53	4.7
1973	6.85	3.37	8.4
1974	6.62	11.01	26.6
1975	6.46	11.45	27.0
1976	7.79	12.14	34.6
First quarter 1977 (seasonally adjusted)	9.39 (Est.)	12.93 (Est.)	11.1 (Est.)

Source: Department of Commerce, Bureau of Economic Analysis, Balance of Payments Division.

TABLE 3.—*Estimated area pattern of U.S. trade balances, 1971–76*
[On approximate balance of payments basis; in $ billion]

	Published worldwide balance	Of which, estimated balances with—			
		OPEC countries*	Total other*	Of which—	
				Industrial	LDC's
1971	−2.3	− 1	− 1	− 3	2
1972	−6.4	− 1 1/2	− 5	− 6	1
1973	.9	− 4	5	− 1/2	5 1/2
1974	−5.4	−17 1/2	12	3 1/2	8 1/2
1975	9.0	−14	23	10 1/2	12 1/2
1976	−9.2	−21	11 1/2	5 1/2	6

Source: Treasury estimates, derived from Census data.
*Estimates for OPEC countries include, and total other exclude, estimated U.S. imports of OPEC crude as petroleum products from third-area refineries.

Exhibit 34.—Statement by Secretary Blumenthal, June 10, 1977, to the press following the Joint U.S.-U.S.S.R. Commercial Commission, on the accomplishments of the Commission's sixth session

Before inviting your questions, I would like to make a brief background statement, after which Secretary of Commerce Kreps may wish to make some observations.

The Joint U.S.-U.S.S.R. Commercial Commission was established in 1972 in accordance with an agreement reached at the summit meeting in May of that year. Its purpose is to promote mutually beneficial commercial relations and to work out specific economic and trade arrangements between the United States and the Soviet Union.

Among other things, the Commission studies possible U.S.-U.S.S.R. participation in the development and sale of natural resource materials and the manufacture and sale of other products. It also monitors the spectrum of U.S.-U.S.S.R. commercial and economic relations, identifying and, when possible, resolving issues of interest to both parties.

The first meeting of the Commission was held in Moscow in July 1972. The meeting we have just concluded is the sixth in the series of meetings held alternately in Moscow and in Washington.

In this sixth session, the Commission continued the tradition established in earlier sessions of friendly, frank, and constructive discussion of problems related to expanding U.S.-Soviet trade and intensifying our economic relationships.

Secretary Kreps, who is Vice Chairman of the U.S. delegation, discussed the current status of Soviet-American trade and economic relations.

The activities of the U.S.-U.S.S.R. Trade and Economic Council were reported by its President, Harold Scott.

We received a report from the Working Group of Experts headed by Deputy Minister of Trade Manzhulo and Treasury Under Secretary Solomon on its program of exchange of information related to trade development.

We also received reports from working groups concerned with facilitating the work of U.S. and Soviet businessmen in each other's countries, and with major industrial projects in the Soviet Union involving U.S. firms' participation.

I believe that our talks have been highly useful and constructive. They mark a significant step in our continuing effort to promote trade and to foster the mutual understanding which is so important for good relations not only in the economic field, but for our relations in general.

Exhibit 35.—Summary statement by Deputy Assistant Secretary Hufbauer, July 18, 1977, before the Subcommittee on Trade of the House Committee on Ways and Means, in support of the President's request to extend the Emigration Waiver Authority for Romania under section 402 of the Trade Act of 1974

Mr. Chairman, I am pleased to appear before you today in support of the President's request to extend the Emigration Waiver Authority for Romania under section 402 of the Trade Act of 1974. Such action would further the continued improvement of United States-Romanian political and economic relations witnessed since the signing of the United States-Romanian Trade Agreement in 1975.

Strengthening good United States-Romanian relations—economic and political—serves the interests of both countries. More than any other CMEA country, Romania has aggressively pursued friendly relations with countries of the non-Communist world, and has actively participated in a number of international organizations, including the IMF, World Bank, and GATT.

Romania's economic vitality is the key to its strategy of independence. It is in our own interest to encourage Romania's independent foreign policy orientation through the expansion and improvement of our bilateral relations. To achieve this end, we believe continuation of the Trade Agreement with Romania is in the U.S. national interest.

United States-Romanian trade

With extension of the Trade Agreement, continued expansion of United States-Romanian trade can be expected. Bilateral trade reached a record high in 1976 of $448 million, with U.S. exports making up more than half of this figure. Based on the actual United States-Romanian trade performance for the first 4 months of this year, bilateral trade for 1977 could approach $600 million.

Since 1970, two-way trade with Romania has been characterized by a steady growth pattern and an average U.S. annual trade surplus of $50 million. An exception to this trend occurred in 1974, when U.S. exports soared due to one-time grain and aircraft purchases by Romania.

This mutually beneficial expansion of trade must be seen in connection with the granting of most favored nation (MFN) and generalized system of preferences to Romania. Trade statistics compared before and after the 1975 and early 1976 agreements—excluding the 1974 aberration—indicate an acceleration in our two-way trade. Total trade for 1973 amounted to $172 million while total trade levels in 1975 and 1976 jumped to $322 million and $448 million respectively. In contrast to our

Western competitors, U.S. exports to Romania rose from $190 million in 1975 to $250 million in 1976 while, during the same period, exports from West Germany and Italy actually declined.

Trade financing assistance

Failure to extend the waiver would not only imply loss of MFN tariff status for imports from Romania but also the inability of the U.S. Government to authorize Eximbank facilities and Commodity Credit Corporation (CCC) credits to Romania. Without these credits, U.S. exports to Romania would eventually slacken.

Since the early 1970's, the U.S. Government has encouraged various financing programs designed to expand U.S. exports to Romania. Eximbank and CCC have been the major sources of U.S. financial assistance. Romania has been eligible for trade financing assistance from Eximbank since its lending operations in Romania were resumed in 1971. Except for the suspension of Eximbank's credits to Romania from January to August in 1975, Romania has been actively utilizing Eximbank's facilities.

As of May 1977, Eximbank had outstanding $71.7 million in direct loans—of which $45.1 million has been disbursed—and $3.6 million in long-term financial guarantees to help finance $158 million of Romanian imports from the United States. Other programs—short- and medium-term guarantees, insurance, and the compensatory financing facility credit line—provided an additional $15.9 million of Eximbank financial support outstanding in May 1977. By authorizing a cumulative total of nearly $160 million of financial support since 1971 (not all of which was taken up by Romania), Eximbank has helped U.S. firms in competition with other Western firms for markets in Romania.

The CCC has also played an important role in promoting U.S. exports to Romania. Since 1970, the CCC credit program has financed $158.2 million worth of agricultural commodities, primarily wheat, feed grains, and cotton. The availability of such credits has thus also offered the United States an opportunity to gain a larger share of Romania's agricultural market.

Market disruption

Despite increased United States-Romanian trade, it has not been necessary to employ the safeguard provisions of the Trade Agreement which protect U.S. manufacturers from disruptive imports. Because Romania has exhibited cooperation to resolve potential problems, antidumping issues have been settled without formal action taken by the U.S. Government against Romania.

Three instances illustrate Romania's willingness to prevent market disruptions. When the importation of Romanian welt workshoes was questioned 2 years ago by the International Trade Commission (ITC), Romania agreed to curtail its exports and therefore was found not likely to injure U.S. industry.

In January 1977, Treasury determined that Romanian clear sheet glass was being sold at less than fair market value. After receiving assurances from Romania that it would limit its clear sheet glass exports, the ITC determined that there had not been, nor was there likely to be, injury to U.S. manufacturers.

In the third case, Romania signed a bilateral agreement, effective January 1, 1977, restraining Romanian exports of wool and manmade fiber textiles and apparel to the United States.

Such cooperation has not only prevented potential problems but also demonstrated that should conflicts arise in the future, both countries will be able to work together effectively to resolve them.

Conclusion

Finally, to comment on the subject of emigration—perhaps the most sensitive aspect of these hearings—we believe, that while Romania's emigration policies still need improvement, advancements have been made in recent years. Compared to pre-MFN years, Romania's emigration performance is much better and no doubt will continue to improve as our overall relationship grows.

To conclude, Treasury believes that as a result of the section 402 waiver, overall United States-Romanian relations have improved. Both U.S. and Romanian trade have benefited from the granting of MFN to Romania and availability of U.S. financing programs. Romania has taken advantage of U.S. financial facilities and at the same time exhibited an excellent record in cooperating to avoid market disruption.

In order to encourage Romania to continue its pursuit of a foreign policy independent of Moscow; to foster the expansion of economic cooperation between our two countries; and to provide the climate in which we can expect the Romanian Government to continue to be responsive to our very deep interest in human rights, we believe it is in our national interest to extend this waiver as recommended by the President.

Exhibit 36.—Statement by Assistant Secretary Bergsten, July 27, 1977, before the Subcommittee on Foreign Assistance of the Senate Committee on Foreign Relations, entitled "Administration Policy Toward the Overseas Private Investment Corporation (OPIC)"

The administration has completed a thorough review of OPIC. This review concluded that OPIC can advance several important U.S. foreign economic policy objectives and should be continued. It also was agreed that, with new program directions, OPIC could play an even more important role in the future than it has in the past.

The administration concluded that three changes are needed in the emphasis of OPIC programs to enable it to play such a role. First, OPIC should focus much more heavily on the poorer developing countries (LDC's) which really need its assistance. Second, OPIC should develop innovative, risk-reducing coverage for projects in energy and other raw materials. Third, OPIC cannot successfully pursue its objectives and turn over its entire insurance portfolio to the private sector by the end of 1980; thus, existing legislation should be modified to eliminate the "privatization" objective.

North-South relations and OPIC

U.S. policy toward foreign direct investment in the LDC's, like our policy toward other international economic relationships with these countries, must be seen in the overall context of North-South relations as they stand today. It has become a widespread view that, increasingly, the LDC's have been acting collectively and voting as a bloc in international organizations. The Group of 77, a loose coalition of LDC interests (comprising a voting block now substantially larger than the initial 77 LDC members), has emerged within the U.N. framework. This group is calling for a new international economic order (NIEO) to increase the share of LDC's in world output and economic influence.

Investment aspects of the NIEO would include the following propositions:

- Each state has the right to regulate and exercise authority over foreign investment in its territory in accordance with its laws and national policies.
- Multinational corporations (MNC's) should not intervene in the internal affairs of a host country.
- Each state has the right to nationalize, expropriate, or transfer ownership of foreign property.
- Compensation is to be paid by the expropriating state taking into account its relevant laws and regulations and other circumstances that the state may consider pertinent.

- All investment controversies will be settled under the laws of the host state and in its courts unless there is prior agreement that other peaceful means be sought.

The rhetoric of the NIEO has thus been somewhat hostile to private investment. However, the actual behavior of most individual members of the Group of 77 has been much more moderate. The intense need for capital, technology, and managerial skills has encouraged a pragmatic approach to foreign investment in most countries. The growing ability of the developing countries to harness MNC's to their national development objectives has reduced hostility toward the firms. In multilateral fora, the ideological rhetoric of the U.N. Sixth Special Session has been moderated, and LDC positions in the Conference on International Economic Cooperation and the U.N. Commission on Transnational Corporations reflect a growing awareness that foreign investors are not attracted by excessive verbal abuse.

Thus there is ample scope for the continued operation of foreign direct investment throughout the developing world. Well-conceived OPIC programs can help support such investment, if those programs are tailored to the realities of the latter 1970's and early 1980's. The administration's objective is to recommend changes in OPIC which would further that objective.

Privatization

At present, however, the legislative situation which authorizes OPIC is unstable. Under the 1974 legislation, OPIC must progressively increase private participation in its insurance functions with the aim of withdrawing completely from direct underwriting of inconvertibility and expropriation insurance by the end of 1979, and of war-risk insurance by the end of 1980.

It is now clear that this withdrawal schedule cannot be met. OPIC has made heroic efforts to increase private participation in its portfolio. Some increase in participation has resulted, but success has been strictly limited and at the cost of diverting OPIC from the fundamental objectives of its program. If this requirement is not changed, OPIC will be gutted—and important U.S. policy objectives will lose a helpful policy tool.

OPIC witnesses have detailed their efforts to privatize. Let me simply repeat the results: After 3 years of effort aimed at obtaining private participation, OPIC has succeeded in interesting private insurance in only a very limited part of its portfolio and has not succeeded at all in interesting them in insuring for catastrophic losses. There is virtually no private willingness to insure land-based war risk, and private insurers will accept no more than a 1-year renewable commitment in privatization activities. It is thus unrealistic to expect the private insurers to fully replace OPIC's insurance underwriting by the end of 1980.

Moreover, these efforts to obtain private participation have been costly to OPIC in terms of management time. And, most importantly, efforts to obtain private participation have undoubtedly affected OPIC's portfolio decisions. The portfolio which maximizes OPIC's developmental impact is clearly not identical to the portfolio which maximizes private participation. Private insurers are in business for profit, and their interest in OPIC's portfolio is directly proportional to that portfolio's profitability. Thus the pressure on OPIC to turn over its insurance to the private sector by 1981 has led OPIC toward choosing less risky, more profitable, projects even when these are not the best projects for developmental purposes. It is simply ludicrous that OPIC's past management seriously considered insuring projects in developed countries such as Kuwait, Hong Kong, Ireland, and Spain.

Yet this was the inevitable result of the mandate that OPIC privatize. The administration believes that maximum emphasis should be placed on development, consistent with OPIC's undertaking to be self-sufficient. The issues before the Congress today are whether development in the poorer countries is in the national interest of the United States, whether private direct investment promotes such development, and whether OPIC promotes private direct investment. If the answers to these questions are affirmative, then OPIC should be given new policy direction and a new lease on life.

OPIC development policy

The administration believes that the answers to these questions are affirmative. Private direct investment can play an important role in the economic development process, particularly through—

Transfer of resources, and of managerial and administrative expertise;
The expansion of productive capacity and employment; and
Establishment of new export markets.

A major barrier to private direct investment is political risk. OPIC insurance pools this risk and reduces it for the investor. This lowering of risk is an effective incentive for investment. Thus projects which appear commercially unacceptable because of high political risk may become profitable when the risk is reduced through insurance. Thus OPIC insurance increases the total flow of U.S. private investment to LDC's.

OPIC-insured investment is most likely to be additional for projects in countries where investors consider the political risk to be high. Since investors, whether rightly or wrongly, tend to perceive higher political risk in the poorer LDC's, OPIC is more likely to add additional investment in these countries than in richer LDC's. The administration wants OPIC to assign higher priority in the future to the encouragement of investment in the poorer countries.

Between 1966 and 1975, U.S. foreign direct investment in the developing countries rose from $13.9 billion to $34.9 billion, an increase of 151 percent. This expansion is roughly comparable to the 158-percent rise in U.S. investment in developed countries. The bulk of this increase in U.S. investment, however, was concentrated in a few countries. For example, Brazil ($3.7 billion) and Mexico ($1.8 billion) accounted for $5.5 billion, or about 26 percent, of the total $21 billion increase. U.S. direct investment in Brazil increased more than 400 percent, and in Mexico more than doubled, between 1966 and 1975. Countries such as these have demonstrated an increasing capability to attract foreign investment on their own, and do not need a great deal of help from OPIC or other programs in home countries of potential investors.

Relatively little U.S. investment went into other LDC's during this decade, however. Those nations most in need of external resources received very little private direct investment, measured as a percentage of the U.S. total—though some of them received fairly important amounts relative to their own economies' needs.

In order to further focus OPIC's efforts, the administration has concluded that OPIC programs should, pursuant to guidelines to be established by the OPIC Board, be confined to the less developed countries, excluding the advanced or "upper middle income" countries except for mineral and fuel projects approved by the Board and exceptions recommended by the Secretary of State on national interest grounds. OPIC should concentrate on the poorer countries, which are most in need of external resource transfers and are least likely to receive investment inflows from the private sector on their own. The program should not generally operate in the upper tier LDC's which are quite able to attract private investment without outside assistance.

Energy and raw materials

A second new focus for the OPIC program recommended by the administration relates to investments in energy and nonfuel raw materials, where additional investment as a result of OPIC coverage is also higher since firms are now reluctant to invest in this area without OPIC insurance. OPIC has already introduced a program to develop innovative, risk-reducing coverage for new types of investments—joint ventures, service contracts, and the like—in fuel projects in oil-importing LDC's and in minerals projects. The administration recommends that OPIC continue, and expand, its use of insurance and guarantees to promote U.S. investment in LDC fuel and nonfuel mineral projects. This would enable it to pursue three important U.S. national objectives:

To avoid misallocation of important economic resources,
To diversify supply and contribute to a reduction in U.S. vulnerability to collusive price arrangements and interruptions of supply, and

To help LDC's deal directly with their own energy needs, one of the major current constraints on their development policies.

There is evidence of global misallocation of resources which, if continued, could significantly increase the cost of raw materials over the long run. A recent World Bank survey found that 80 percent of all exploration expenditures in 1970–73 were being made in the industrialized countries—the United States, Canada, Australia, and South Africa. Private firms are reluctant to invest in LDC's, primarily because of political risks. U.S. firms, for example, prefer to develop a copper deposit with less than one-half percent richness in the United States than deposits which are more than twice as rich in an LDC. Yet the rate of return in minerals projects in LDC's is twice as high as in industrial countries (table 1). Indeed, for some Fourth World countries, minerals projects may be the only good projects that external private investment could develop.

Private firms have already begun to demonstrate the feasibility of management contracts, service contracts, and other nonequity arrangements in oil and mineral projects. These approaches offer economic benefits to host countries and profitable opportunities to American companies, and respond to the desire of many developing country governments to maintain sovereign control over their natural resources. OPIC can play an important role in helping U.S. investors and host countries work out such mutually acceptable arrangements. This will help reduce the tensions which have diverted investment from the most economic sites. Also, by reducing the likelihood of expropriation, it will help avoid the inevitable problems for U.S. policy which arise when expropriations occur, including issues posed by the legal requirements of the Hickenlooper and Gonzalez amendments and Section 502 of the Trade Act.

However, the dollar amounts of OPIC activity in this field would be small compared with the capital requirements for most energy and raw materials projects. Thus some means of leveraging OPIC's involvement would need to be developed for it to have a significant impact. In this connection, OPIC would seek to coordinate its efforts with similar institutions in the 16 other countries in which they exist. This coordination would also serve two other U.S. objectives:

To minimize the likelihood that host countries will renege on their end of investment bargains, by maximizing the costs to them of doing so by increasing the number of home countries which would be adversely affected.

To minimize fears of other materials-importing countries, in Western Europe and Japan, that the United States was unilaterally making "special deals" to outbid them for potentially scarce raw materials.

The administration thus supports OPIC's efforts to develop risk-reducing coverage for investments in raw materials in the developing countries, and believes that those efforts should be expanded and intensified.

Conclusion

The administration believes that OPIC can, and should, serve two important policy objectives of the United States: Development of the poorer countries, and increased LDC production of energy and other raw materials. We believe that it can remain self-sustaining financially while doing so.

This approach is clearly not compatible with privatization of OPIC, as mandated under current legislation. As noted at the outset of my testimony, however, privatization proved to be impossible even when the program was aimed wholly at achieving that objective. Hence, for policy as well as for practical reasons, we urge the Congress, in framing new legislation for OPIC, to abandon the existing privatization mandates and reaffirm instead the goal of development. With a clear mandate to this end, OPIC can become a more useful instrument of U.S. policy toward foreign direct investment by American firms.

TABLE 1.—*Rates of return on U.S. foreign direct investment 1967–75* [1]

	1967	1968	1969	1970	1971	1972	1973	1974	1975
					Percent				
All countries	10.3	11.1	11.8	11.4	11.6	12.6	17.5	23.0	14.0
Developed countries	7.7	8.3	9.4	9.3	9.8	11.1	15.0	13.4	11.2
Mining and smelting	10.0	11.2	9.3	7.7	5.5	4.5	8.9	10.6	—
Petroleum	2.4	2.2	2.4	N.A.	4.6	4.6	11.8	11.0	8.6
Manufacturing	8.7	9.9	11.7	10.5	10.9	13.4	16.5	14.0	11.1
Less developed countries	17.3	18.5	17.9	15.9	16.3	17.7	26.2	53.6	23.6
Mining and smelting	24.3	22.1	25.6	16.3	9.5	9.0	13.2	18.9	—
Petroleum	27.3	29.1	26.9	24.6	28.7	29.5	49.9	133.3	40.2
Manufacturing	7.7	10.7	11.1	10.8	9.6	11.3	13.3	13.9	13.4

N.A.—Not available.
[1] Adjusted earnings: Direct investment position (yearly average).

Commodities and Natural Resources Policy

Exhibit 37.—Remarks by Secretary Blumenthal, May 4, 1977, before the Japan Society at the Hotel Waldorf Astoria, New York, N.Y., on the relationship of the United States and Japan to the developing nations of the world

Of the many issues of common interest and concern to the United States and Japan, I have chosen to speak this evening on a single issue which equally affects both countries: our relationship to the developing nations of the world.

This relationship is central to the resolution of one of the most pressing problems of the last quarter of this century—the economic, social, and political needs of the developing nations, and the continuing tensions between "North" and "South" and among the developed countries that flow from these needs and from the demands of the poorer countries.

The United States and Japan share a major responsibility for responding to the developing countries. They represent huge markets for the commodities and manufactured goods sold by the developing countries. Both countries are major sources of external capital, both public and private, for developing nations. And both play major roles in shaping the world economic system within which all nations must operate.

Without constructive policies by the United States and Japan, the needs of the developing nations will not be met, however effective their own economic policies. Their frustrations, and the tensions they engender, will multiply.

Before considering the whys and hows of our development policies, it is essential to note the diversity which distinguishes the developing world of the 1970's. Brazil is not India. Korea is not Bangladesh. Singapore is not Chad.

Indeed, there are at least two distinct sets of developing countries. The more advanced, which have come to be known as the Third World, are rapidly becoming an international middle class. Their per capita incomes are still quite low by our standards, but are generally above $500 and now exceed $1,000 in many cases. They have some modern manufacturing sectors, and indeed are effectively penetrating the markets of the industrial countries in many product lines. Many have attractive deposits of raw materials, and some are agriculturally self-sufficient. They have made the first major leap toward effective development, by rising above grinding poverty and forming the base from which sustained growth can proceed. Much of Latin America and the Middle East, much of the Far East, and some of Southeast Asia falls into this category.

To be sure, these countries continue to face massive problems. But their economic record is impressive—with growth rates that exceeded the targets of the First U.N. Development Decade in the 1960's, strong trade gains including an average growth of 25 percent in their exports of manufactured goods, and a doubled share of world industrial output within the last 10 or so years.

In sharp distinction to this relatively successful Third World is the Fourth World, comprising 40 or so of the poorest nations on Earth. Most of South Asia and sub-Saharan Africa and scattered countries elsewhere belong to this group. These countries with about a billion people have per capita incomes below $500, and frequently below $200. In many of them, per capita incomes have been stagnant throughout this decade. Some face seemingly insurmountable problems—an overwhelming press of population, lack of the most basic economic infrastructure, rudimentary political systems, overwhelming reliance on commodity exports—or even a single product and shortages of indigenous talent.

These enormous problems of the Fourth World are among the most important challenges which face mankind in the coming years.

It is crucial that the responses of the United States, and Japan and the other industrial countries recognize the sharply different characteristics and needs of these two groups of developing countries.

The Third World needs primarily access to our markets. It can afford to borrow on commercial terms—but it needs access to private capital to finance its balance of payments deficits. It can use our technology and management skills—but it needs access to them on terms which are fair and respect its national sovereignties. It can earn much of its way in the world by selling abroad the goods it produces—but it must have the opportunity to do so. It can continue to reap sizable earnings from its commodity exports—but it needs more stable markets to avoid disrupting its development programs.

The Third World needs the market-related lending of the World Bank and the regional development banks. But it does not require concessional lending. It does not need, nor would it even benefit from, other means of direct resource transfer:

- Generalized debt relief would almost certainly impede the access to private capital it needs.
- International compacts which sought to prop commodity prices artificially would erode longrun demand for its output.
- Links between international monetary creation and aid would lessen the stability of the international monetary system.

In short, this new international middle class needs to be brought increasingly into the international economic system which has served the industrial world well for 30 years.

Aid to the Fourth World, on the other hand, must still focus on foreign assistance of all types: Capital, technical assistance, appropriate technology, and food aid. While these countries can benefit from greater access to private capital markets and rich-country markets for manufactured goods, most of them are unable to take major advantage of either.

I believe the United States must respond to these needs rapidly, generously, effectively, and cooperatively. We must do so, first of all, for humanitarian reasons. Our basic feelings as human beings and as Americans must impel us to help and to give new hope to those who face lives of unremitting deprivation and suffering.

Second, our economic interests compel us to help both the Third and Fourth Worlds. Those countries have already become markets for U.S. exports which account for 1 out of every 15 American manufacturing jobs. Those countries supply us with critical imports, including key industrial raw materials. Their sales to us of manufactured goods, while sometimes raising adjustment problems which require direct governmental response, contribute to lower prices for our consumers and help us fight inflation. These countries are home to a quarter of our foreign direct investments and are major clients of our private banks.

Third, our political and even security interests are deeply entwined with the future of the developing world. In part, this is simply because the issues related to their development are central to the developing countries themselves. *They* place these matters at the top of *their* foreign policy agendas. If *we* do not respond, we thwart their fundamental purposes and make any constructive relationship between us virtually impossible.

Development will not necessarily avert tension and international conflict, but we know that an absence of development will trigger frustrations which can only *produce* conflict.

Thus the reasons for cooperation with the Third and Fourth Worlds are compelling. They pose a challenge to the United States and Japan, and indeed all who pride themselves on membership in the "First World." They require both an urgent response and a long-term commitment. They require both money and difficult adjustments and, perhaps hardest of all, understanding and patience. They point to an essential area in which the United States and Japan simply must cooperate to help construct an international society in which we can both live comfortably now and in the years ahead.

But the specific policy responses of our two countries, and indeed of the entire industrial world, must distinguish clearly between rhetoric and reality.

Some of the policy measures which are the focus of rhetoric both in our own countries and in the developing nations themselves do not—to put it bluntly—address the fundamental problems which I have outlined. The agenda for the North-South dialog, as the formal discussions between the developing and industrial countries are called, does not even include the most critical issues in the economic relationship between these two sets of countries.

To be sure, the dialog includes some important matters—the quest for greater stability in commodity prices, and increases in resource transfers through both bilateral aid and the multilateral lending institutions.

But what is much more important to the Third and Fourth Worlds, indeed the single most important step we can take to help them, is the adoption of a policy of strong, stable, noninflationary economic growth for our domestic economies. Every additional percentage point of growth in the American economy generates about half a billion dollars of additional demand for imports from nonoil developing countries. Every additional percentage point of Japanese growth generates about $200 million of such additional demand.

When unemployment is high, it becomes much more difficult to resist the inevitable pressures to raise barriers to imports—especially to imports from "low wage" countries. When budget deficits are high, because revenues are cut by low growth and expenditures must be increased to generate more growth, it is harder to win public support for foreign assistance programs.

A special responsibility for achieving strong growth in the developed countries rests on the United States and Japan. We are not only the two largest economies in the non-Communist world. Along with Germany, we are the strongest and most stable economies with inflation rates that, though still too high, are well under control. And we have external positions which permit us to undertake some degree of internal expansion. The United States expects to meet its growth targets for 1977, and we hope that Japan will meet its announced target of 6.7 percent economic growth and a current account deficit of $700 million. Achievement of these targets is vitally important for both countries.

Second, only to stable economic growth, in terms of its importance to the developing countries, are our trade policies. The developing countries, particularly those of the Third World, must have adequate access to the markets of the industrial nations. Few if any of their economies provide sufficient scope for scales of production adequate to develop truly efficient operations. Even the development of regional markets, which we support, is seldom adequate for this purpose. Hence, they must export to achieve the needed economies. The only alternative is import substitution, whose weaknesses were amply demonstrated in earlier decades. But if developing countries are to adopt the export-oriented strategies which have proven so successful in case after case, the maintenance of open international markets must be assured.

To support this objective, the United States continues to reject restrictive solutions to international trade problems. President Carter refused to adopt widespread controls on the import of shoes, for example, an important part because the foreign exchange earnings from shoe exports are so important to many developing countries. The United States will maintain a trade policy which takes full account of the concerns of such countries.

A third area of great importance to the outlook for development is the health of the international monetary system. That system has been remarkably resilient, and continues to underpin a dramatic growth in international trade and investment—growth which is of great benefit to developing, as well as industrial, nations. In all candor, however, we must recognize that the monetary system now faces important problems: The continued huge deficits forced on the non-OPEC countries, as a group, by the sharp rise in oil prices, and the resultant sharp increase in the role played by private bank lending in financing those deficits.

We are seeking to deal with these problems promptly and decisively. Our own energy program will help reduce the imbalance between OPEC and the rest of the world. Our own more rapid economic growth, and hopefully that of Japan and Germany as well, will share out the OPEC-induced deficits in ways which permit more stable financing patterns to energy. We support the stabilization efforts of deficit countries, both directly and through the IMF, to the same end. And we strongly support the several efforts of the IMF to assure adequate official balance of payments support, particularly through the creation of the supplementary lending facility proposed recently by its Managing Director. Such measures are needed to buttress and stabilize the private lending networks.

But a sizable imbalance between oil exporters and importers will remain for years to come. This imbalance hampers the development of the poorer countries because it is they that have been hit hardest by the actions of OPEC.

Clearly, we must all move together toward resolving the fundamental problem of international payments balance if we are to deal effectively with all of the individual economic problems which I am discussing tonight.

All of these steps relate indirectly, rather than directly, to the needs and desires of the Third and Fourth Worlds. Yet it is our own firm conviction that they can, and must, lie at the heart of North-South relations. For the South can progress only if economic growth in the North is stable and dynamic; only if the North remains devoted to an open world trading system; and only if the international monetary system, for which the North continues to bear a primary responsibility, functions effectively. The United States is committed to all of these objectives itself and will continue to work with Japan and other like-minded industrial countries to fulfill those commitments.

In addition, there are many steps we can take to deal with economic issues that are more specific to the developing countries and are on the North-South agenda in Paris and elsewhere. The administration has indicated that it is openminded about the possibility of negotiating international compacts for the purpose of stabilizing commodity prices around market trends, and has already entered into such negotiations on sugar. We are likewise openminded about agreeing on some kind of "common fund" which will link the buffer stock financing mechanism of individual commodity agreements, once such agreements are in place. We are seeking significant increases in U.S. aid—a 30-percent rise in appropriations for fiscal year 1978. In December 1975, the United States agreed with other IMF members to a sharp expansion of lending through the IMF's compensatory finance facility to stabilize the export earnings of the developing countries. In 1976 the facility extended credits totaling $2.7 billion, more than in its entire 13 years of previous existence.

These measures are important and we are working hard on all of them but they pale in importance compared with the issues of growth, trade, and monetary stability on which I have already focused.

In the effort for development, progress has been made, but much more remains to be done. As we gird for the long haul, we should ask ourselves three questions. First is the traditional question: Are we doing enough? But even more important may be the second question: Are we doing the right things? And, perhaps of greatest importance for the long run: What are we asking in return? I do not pretend to have full answers to these questions tonight, but let me suggest themes which might underlie the response—focusing on the relative roles of the United States and Japan today.

Trade is clearly one of the key areas where we need to do more, both quantitatively and qualitatively. The United States now takes about 23 percent of all its imports from non-OPEC developing countries. Over 20 percent of all its manufactured imports comes from non-OPEC developing countries. And almost half of all U.S. imports from non-OPEC developing countries consist of manufactured goods.

By contrast, Japan imports very little from the nonoil developing countries except raw materials and food. Its imports of manufactured goods from them, which are particularly critical for developing countries' growth, are extremely small. In 1976 they totaled $2 billion, representing 9.2 percent of total Japanese imports from developing countries. This in turn reflects the fact that only 13 percent of Japan's total imports are manufactured goods, compared with 54 percent for the United States. Recognizing the structural difference in the two economies, we believe that Japan can make a greater contribution to helping expand the developing countries' sales of manufactured goods.

The current limits of Japan's demand for manufactured goods imports, coupled with its own traditional strong export orientation, have produced sizable current account surpluses for Japan in 8 of the last 10 years. These surpluses have two adverse effects on the developing countries against the background of the OPEC surpluses: They increase the size of the current account deficits which the developing countries must run as a share of the total non-OPEC current account deficit. And they make it more difficult for the developing countries to penetrate world markets.

Much attention has been paid in recent months to the contribution which elimination of Japan's current account surpluses could make to improving Japan's relations with the United States and other industrial nations. I would submit tonight that such a development in Japan's payments position may be even more important for the future outlook for the developing nations.

Japan needs to demonstrate to the world that it wants to increase imports—that it recognizes the contribution which can be made to its own longrun welfare as well as to the world. Visible steps to create a more hospitable climate for imports would reduce the risk of actions by other nations to limit imports from Japan. Such steps would reduce the risks of worldwide protectionism.

It is clear that Japan shares our concern on this score. So we must move forward together to assure vigorous growth in our economies, to accept our shares of the OPEC-induced current account deficits, to avoid export surges which disrupt others' markets, to provide markets for the products—especially the manufactured products—of the developing countries. In addition, we must work together in the multilateral trade negotiations to reduce trade barriers, especially barriers to sales by the developing countries.

Beyond material help, Japan can provide a source of inspiration for the development process. For postwar Japan is, after all, the most stunning economic development success story of all time. Its per capita income rose from $200 in the early 1950's to $4,900 in 1976, a level well above that of Britain or Italy.

It took masterful advantage of an open world market to develop economies of scale, and to draw in capital and technology to fuel the tremendous talents and hard work of its people. We in the rest of the world can be proud of our contribution to that process, both by keeping our markets open for Japan and by bringing Japan increasingly into the central councils of international economic management.

As we look to the future, similar sharing of rights and responsibilities will be necessary. As countries graduate from the Third World to the First, they too must accept the responsibilities which go with such a transition—opening of their own markets, avoidance of misaligned exchange rates, assurance of foreign access to their supplies of agricultural products and industrial raw materials, and provision of aid to those who lag behind. It is not too soon to begin thinking of how its process should work, as others emulate the brilliant success of Japan over the past quarter century.

By the year 2000, there can be many "new Japans"—if the United States, Japan, and the other industrial countries adopt farsighted policies to permit and support this transition. Today's Fourth World may not progress so far so fast, but it too can make rapid gains if its own policies, and ours in response, are well conceived now.

Exhibit 38.—Statement by Deputy Assistant Secretary Junz, May 20, 1977, before the Subcommittee on Oceanography of the House Committee on Merchant Marine and Fisheries, regarding the Treasury's views on deep seabed mining legislation

I am very pleased to appear before you today to discuss the Treasury Department's views on deep seabed mining legislation. Over the decades to come the wealth of resources at the bottom of the sea will need to be employed productively if our aspirations for increased standards of living worldwide are to be realized. Therefore, it is vitally important that we provide an international and national climate that will ensure that deep-sea resources are indeed developed productively, efficiently, and to the benefit of the world community. The interest the Treasury Department has in the current Law of the Sea negotiations is how they relate to the overall economic objectives of the United States, as is the bill you wish to discuss with us today. I believe, as I know Ambassador Richardson believes, that it is vitally important that the Congress and the executive branch work together as closely as possible on these very difficult and extremely complex issues.

I want, however, to say at the outset that I shall not be able to answer most of the specific questions that you have raised in your invitation with regard to the probable tax treatment of revenues and expenditures associated with deep-sea mining beyond the national economic boundaries. These matters are currently under review, so that more likely I shall take away with me more from our discussion today than I may be able to give you. However, I look forward to future more balanced contacts with you, and I want you to know that I and my staff at Treasury are prepared to provide whatever assistance we can to help you in your deliberations.

As I noted earlier, Treasury's interest in the Law of the Sea Conference is confined to the areas of economic interest and, therefore, our attention has been focused largely on the principles that would govern access to and exploitation of the deep seabed resources. Earlier in these hearings, Ambassador Richardson explained the major objectives the United States has in concluding a successful and equitable treaty on the Law of the Sea. At that time, he expressed to you the whole range of national interests that would be covered by such a treaty. I can, of course, comment only on the economic concerns.

Treasury shares the committee's concern that there is a need to obtain a comprehensive treaty which includes a stable legal framework for deep ocean mining. Such a stable legal framework would create an investment climate that would allow mining consortia to make rational decisions with regard to committing risk capital in seabed mining.

In order to achieve such a stable framework the principle of assured access for seabed mining firms must be a main element in any sound seabed mining regime. Such a regime will encourage state and private firms to undertake the substantial economic risks of exploring the seabed and of developing the new technology needed to eventually exploit these new resources for the world market. The Treasury Department believes that assured access to the seabeds for states and their nationals will lead to the most efficient allocation of resources as well as the most rapid development of the seabed resources to the ultimate benefit of both the United States and the world economy.

The administration believes that a successful seabeds negotiation within a comprehensive Law of the Sea treaty would promote the objectives mentioned above. We must recognize, however, the distinct possibility that despite our best efforts and the efforts of those countries which, like us, are sincerely seeking a reasonable treaty, it may not be possible to conclude the negotiations successfully in a time frame which would allow companies to maintain their current development schedule. And we recognize that the ultimate effect of indefinite delay will likely be a loss in output of a potentially important new industry, a loss of an innovative new technology, inflationary pressures resulting from supply constraints in mineral production, and the loss to the developing countries of the benefits we hope they will obtain from a viable seabed regime.

Despite these very real concerns and the difficulties inherent in the issues and attitudes which confront us in the next session of the New York Conference, it is not appropriate for the administration to support deep seabed mining legislation at the same time that it sends Ambassador Richardson to the Law of the Sea Conference to negotiate a comprehensive treaty. Indeed, support for legislation at this time might well have a negative impact on the Conference.

However, should Ambassador Richardson's efforts meet with no meaningful response, then the administration would have to reconsider its views on legislation regulating the exploitation of the deep seabeds. In that case, we would be prepared to discuss more fully our views on these issues.

Today, I would like to comment briefly on some of the major economic provisions that have been put forward in legislative proposals. Given the uncertainties regarding the negotiations, it is clear that any seabed legislation should be interim in nature and be compatible with likely provisions that would be part of a future internationally ratified ocean mining regime.

Investment protection

A major uncertainty for miners currently prepared to proceed with a seabed mining venture is the risk that a future treaty or an International Seabed Authority might in some way interfere with or change their established mode of operation. Such changes might range from the imposition of onerous conditions to the actual shutdown of operations. Industry sources have stated that the risks involved and the capital to be committed are too great to allow them to go forward with major investments without some kind of insurance or guarantee of their investment in the event a future treaty makes operations uneconomic.

In this context, one could think of two basic types of investment protection: (1) An investment guarantee program, and (2) provision of a basic right to sue the Federal Government in the event adequate grandfather rights are not included in a treaty and a firm's investment is thereby diminished in value.

While it is possible to reduce the U.S. Government liability under any such programs, it could still be very large. For example, if full coverage were to be provided and we assume four operations are in place prior to the conclusion of a treaty, the potential U.S. liability could amount to $2 billion in 1976 dollars. Even if the guarantee were limited to prototype operations the Government's liability could reach approximately $300 to $600 million in 1976 dollars. I do not think there is any point at this time in entering into debates about what the actual costs to the taxpayer might be because these would be purely notional.

In support of the Government's assuming liability, industry spokesmen have argued that the Government incurs a responsibility if U.S. nationals are injured as a result of activities entered into on the basis of official views on international law and/or legislation. In essence, they argue that U.S. agreement to a treaty that impinges on prior rights of U.S. investors should be accompanied by appropriate compensation.

While the Government, of course, will seek to protect the interests of U.S. investors in any treaty, we do not feel that the risk that these investments may be impaired by U.S. accession to a treaty obligates the Government to assume, in effect, part of the overall investment risk by providing investment guarantees. Indeed, Government decisions often dramatically affect an industry's profitability, yet there is no concomitant obligation of the Government to compensate those firms which are adversely affected. The administration has concluded that the situation of the deep-sea mining consortia is not sufficiently unique to justify Government intervention in the investment decision process; nor does it find that an economic case can be made, in terms of our national interest, for providing the international mining consortia with investment guarantees. It is clear the U.S. economy will ultimately benefit from the existence of a viable and productive seabed mineral industry, but we find arguments in favor of preferential treatment of seabed development neither convincing nor equitable. Therefore, we could not support diversion of official financial resources into increased seabed production and away from competing claims for Federal funds.

Because of these considerations, Treasury opposes the Government guarantees provided in section 13 of H.R. 3350. Instead, Treasury proposes negotiation of a grandfather clause in the treaty to ensure that seabed investments made prior to a treaty are not impaired.

Negotiation of these rights would be facilitated if legislation anticipates various aspects of an eventual treaty, such as the treaty provisions for benefits for the international community. Therefore, Treasury recommends that any legislation provide that some benefits for the international community be set aside pending agreement on a treaty. This particular recommendation is based on three factors. First, it allows firms to make investment decisions and operate in an investment climate reasonably similar to that which would obtain after the conclusion of a treaty. Thus, firms would not be faced with a reduction in profitability of their operations by a sudden change in the conditions on which their investment decisions were based as a result of U.S. accession to a treaty.

Second, it would signal to other nations that we fully intend to conclude a treaty which protects the interest of all countries in the deep seabed and that our legislature is aware and supportive of this effort.

Third, providing benefits for the international community has been a constant theme of this Nation's oceans policy. The United States has repeatedly emphasized its commitment to the principle of some type of revenue sharing from deep ocean mining. This commitment to provide benefits for the international community is a recognition of (a) the concept of the common heritage of mankind, and (b) the commitment to help improve the standard of living in the developing world.

The administration is currently conducting an extensive review of how such sharing might actually be realized. Consequently, I will limit my comments to a few general observations. A first principle is that U.S. corporations engaging in seabed mining should receive the same U.S. treatment and operate under the same obligations as do corporations engaged in foreign land-based mining. This principle must govern any revenue sharing arrangements. Second, revenue sharing obligations should, to the maximum extent possible, be compatible with the legislative provisions other states are likely to adopt.

With regard to revenue sharing, the Law of the Sea Conference is considering three possible types of payment seabed miners might be obligated to make to the International Seabed Authority: (1) Front-end fees, (2) fixed royalties, and (3) charges (or taxes) on net income. All of these charges would be linked to activities in the seabed area beyond the limits of national jurisdiction. The front-end fees and fixed royalties place a greater burden than a charge on net income of companies, as they require fixed payments at the outset regardless of actual profitability.

Domestic legislation could provide for similar benefits to the international community to be held in escrow and to be based on payments equivalent to fees, fixed royalties, or taxes such as might eventually be authorized by a treaty. We are currently considering both the best mix of these payments and the mechanics by which they might be collected. We hope to develop a position in this respect in the next several weeks.

After the next session of the Law of the Sea Conference and further consultations with the other prospective ocean mining countries, we will be in a better position to work with Congress in developing an appropriate package of benefits for the international community if we need to enact interim legislation.

Exhibit 39.—Remarks by Assistant Secretary Bergsten, June 27, 1977, Washington, D.C., entitled "Commodity Agreements, Common Funding, Stabilization of Export Earnings, and Investment in Commodity Production: The Policy of the Carter Administration Toward International Commodity Issues"

Introduction

Since the Carter administration came into office 5 months ago, it has launched a number of new initiatives in U.S. international commodity policy:

- We have adopted a positive and open attitude toward the negotiation of individual commodity agreements to stabilize prices around their market trends;
- We have agreed in principle to the establishment of a common funding arrangement to assist in the financing of buffer stocks as part of individual commodity agreements;
- We are seeking to use existing institutions, both national and international, to expand world production of raw materials which may in the future be in short supply;
- We have indicated a willingness to study the options for further reducing the variability of the export earnings of countries which rely heavily on primary products.

All of these issues are of particular importance to relations between the United States and Latin America, as well as to our own domestic economy and to overall U.S. foreign policy. I would like to lay out this morning a few details of that new policy and the rationale behind it.

Both exporting and importing countries face important problems under the current international regime for commodity trade. Excessive price fluctuations can ratchet up inflation in importing countries, and destabilize economic development in exporting countries. Unstable earnings from commodity exports can disrupt such development. Inadequate investment in productive sources of raw materials has an inflationary effect on the world economy over the longer run. The U.S. interest in improved international arrangements for commodity trade is an important component of the overall international economic policy of the United States under this administration.

The problems of commodity price instability

Commodity price instability has adverse effects on consuming countries. Larger manufacturers and food processors, having some measure of control over prices, may justify price hikes on the basis of temporary increases in the prices of raw materials which they use in the production process, pushing up the consumer price index. Increases in consumer costs, in turn, provide justification for increased wage demands which limit the reversal of the earlier price increases for manufactured and processed goods once raw material prices have receded. The effect is a ratcheting-up of the general price level. Temporary price increases for primary commodities can thus fuel inflation in the U.S. economy.

Once inflationary expectations have developed, partly as a result of such events, additional demand for business inventories is generated through hedging and protective stocking. Raw material prices are then forced up even further in a commodity-price spiral.

Paradoxically, excessive price declines in the short run may also contribute to inflation in importing countries in the longer run, by deterring investment in new productive capacity at both the primary and processing stages. This can result in later supply bottlenecks and upward surges in prices in response to increases in industrial production.

From the standpoint of the United States, the primary purpose in pursuing international commodity agreements is thus to reduce the risk of inflationary pressures at home. President Carter referred explicitly to this objective in his anti-inflation message of April 15. If we feel a commodity agreement contributes measurably to this end, we will seriously consider signing it.

Commodity price instability can also adversely affect producing countries. There is little doubt that volatile export earnings, which result from price instability, make it more difficult to manage the economies of developing countries. A 1975 World Bank study showed that 48 developing countries, 13 in Latin America, depend on 3 or fewer commodities for over 50 percent of their total export earnings. The developing countries themselves have argued in international forums, over the past several years, that price instability can have adverse effects on their development.

Thus developing and developed countries alike have an interest in achieving greater price stability in the commodity markets. The problem is to find and implement policies which are effective in reducing price instability in a balanced fashion.

One such policy is international commodity agreements which stabilize price fluctuations through the creation and use of internationally held buffer stocks. Buffer stocks of sufficient size, by buying low and selling high, can work to stabilize prices around market trends to the benefit of both consumers and producers. Both buyers and sellers also gain from the fact that buffer stock arrangements help maintain production at efficient levels when demand slackens sharply; this induces sustained investment in commodity production, which helps insure adequate future supplies.

The developing countries fully recognize the advantages of international buffer stocks, as evidenced by the prominence of such schemes in their proposals in the North-South dialog and the efforts of producing countries for some commodities to organize such schemes on their own. However, the emphasis and balance given to price stabilization in those proposals are considerably less than we would desire. Indeed, they often envisage income redistribution from the developed to the developing countries as well as greater stabilization of markets, prices, and export earnings.

Our policy is to separate out and reject the category of measures designed to effect income transfers through commodity arrangements. We oppose any measures whose effect would be to raise prices, such as indexation. But we look positively, if discriminatingly, at proposals which might achieve greater stability through cooperation between producing and consuming countries alike.

We believe that price stabilization agreements should operate to the maximum extent possible through buffer stocks. Supply controls, by contrast, generally act to reduce supplies and raise prices. Production controls can lock industry into inefficient patterns of production, by forcing low-cost producers to cut back along with high-cost producers. Use of either production controls or export quotas tends to freeze existing production and market patterns, since they are usually allocated on the basis of some past average of market shares and bar entry for efficient new producers.

Most of the buffer stock arrangements proposed by the UNCTAD Secretariat and the producing countries rely heavily on supply controls as "backup measures." It is argued that such measures will help assure that the buffer stock arrangement can defend the floor price and will permit a smaller, less costly buffer stock. However, by limiting the size of the buffer stock, they may also inhibit its ability to protect the ceiling. For this reason, the United States recently submitted proposals for a new international sugar agreement which would contain much more adequate stocking provisions than did previous sugar agreements—which we remain hopeful can be worked out.

Indeed, production controls may actually increase price instability. When production (and/or export) controls are relied upon to stem price declines, the buffer stock is often unable to accumulate sufficient stock at the lower end of the range to defend the ceiling once there is a resurgence of prices. If these measures force producers to cut back output significantly, or drive out marginal producers, they may cause rapid price rebounds and thus destabilize the very markets which they seek to stabilize.

This has in fact occurred occasionally with the Tin Agreement, the only buffer stock arrangement which has functioned over a long period of time. It is also an important reason why the Carter administration has decided to seek congressional approval for a U.S. contribution to the Tin Agreement. We hope that by enlarging the tin buffer stock we can make the Tin Agreement more effective in stabilizing prices and reduce its reliance on export controls to defend floor prices. In short, larger buffer stocks are clearly preferable to smaller buffer stocks from the standpoint of importing countries—and therefore to the United States in many commodity agreements.

We recognize, however, that international buffer stock agreements are not appropriate for every commodity. When international buffer stocks are not feasible, but greater price stabilization appears desirable, the United States will consider export quota arrangements which would promote national stocking to protect against high prices and encourage investment through a flexible reallocation system. We are also willing to consider internationally coordinated national stocks in cases where international buffer stocks are not feasible; we have proposed such a system for sugar, and are preparing a national stocking proposal for wheat.

In summary, U.S. policy with regard to individual commodity agreements is to—

Seek agreements which are effective in reducing inflationary pressures within our own domestic economy and in other consuming countries.

Give priority consideration to buffer stocks as a price-stabilizing technique, where they are technically feasible and where the price of the commodity is determined in an open market.

Seek to provide sufficient financial resources, including through contributions by consuming countries, to accumulate large enough buffer stocks to protect agreed ceiling levels against price surges and floor levels against price declines.

Limit any use of export quotas in support of buffer stocks to extreme situations, in order to allow the buffer stock to operate unencumbered within the price range set by the agreement.

Where necessary, accept agreements implemented through export quotas where production is maintained through holdings of national stocks which are made available for export when prices rise.

Reject the use of production quotas in such agreements.

U.S. policy and the common fund

Commodity agreements of the type which we seek must be adequately financed, to enable them to build buffer stocks of sufficient magnitude. Hence an issue closely related to individual commodity agreements is the proposal to create a "common fund" to provide financial support for such agreements. At last month's North-South Conference in Paris, the United States agreed with other developed and developing countries to the "establishment of a Common Fund with purposes, objectives and other constituent elements to be further negotiated in UNCTAD." We support an arrangement whose purpose would be to facilitate the financing of the buffer stocks by (1) reducing the total cost of financing the several buffer stocks which may be negotiated, and (2) providing some emergency financing in extreme situations when the prices of most commodities are falling.

Financial savings can occur because commodities have differing trade cycles. Prices may be high for some such as tin and coffee at present, while they are low for others such as sugar and copper. As a result, the size, direction, and timing of the cash flows required for the operation of individual buffer stocks would offset one another to some extent, reducing the total funds required through the traditional pooling principle.

This administration, however, does not support the UNCTAD proposal for a $6 billion fund which would (1) be the principal source of financing for individual commodity agreements, (2) finance measures other than buffer stocks, (3) have considerable control over the operations of individual agreements, and (4) be authorized to intervene directly in markets to buy commodities where no agreement exists. We reject the premise on which that proposal is based—that it is necessary to put funding in place to permit the conclusion of international agreements on particular commodities.

We are prepared to negotiate on the creation of a common fund at the same time that individual commodity agreements are being negotiated. But we believe that financial pooling can only be activated after individual agreements have come into effect. In our view, it is the technical and political difficulty of negotiating effective commodity agreements—not inadequate financial support for buffer stocks—which is the primary barrier to progress in this area.

Furthermore, we reject any notion of a common fund which would get into a host of income transfer activities and could be used to raise prices above long-term market trends. Any such scheme would run counter to our own fundamental objectives, be inordinately expensive, require continual replenishment, duplicate a number of the functions of existing international institutions, and disrupt markets. The UNCTAD proposal would clearly not be in the U.S. economic interest, and thus we will not support it.

Within the U.S. Government, and through discussions at the first negotiating session in Geneva, in March, we have begun laying out a set of principles or requirements for the type of common fund which we can support in future negotiations:

- The arrangements must be financially viable.
- Its financial activities must apply only to buffer stocks, not to other commodity-related activities.
- It should facilitate the financing of individual agreements by providing savings over separately financed buffer stocks.
- Each member agreement must retain exclusive authority over all matters relating directly to the commodity it covers, including questions of financing.

Stabilization of export earnings

Price stabilization of individual commodities through international agreements will normally help stabilize the export earnings of producing countries. Yet we know that such agreements will turn out to be feasible for only a handful of commodities, perhaps six or seven. And even the exporting countries which benefit from such stabilization might simultaneously be affected adversely by temporary declines in earnings from their other exports due to factors beyond their control.

Thus there is a need for additional measures to help developing countries, which rely heavily on commodity exports, to avoid the disruption to their development plans which such instability can cause. Just as we will support price-stabilizing commodity agreements primarily because of their contribution to fighting inflation in the United States and other importing countries, we will support effective means of stabilizing the export earnings of producing countries primarily to help stabilize development in those countries.

We believe that the compensatory financing facility (CFF) of the International Monetary Fund is the most effective institutional device for promoting export earnings stabilization. The CFF makes loans to countries in balance of payments need during periods of temporary export earnings shortfalls. By compensating for export earnings shortfalls which occur from factors beyond these countries' control, the activities of the CFF can enhance the possibility of negotiating more economically rational, balanced buffer stock schemes. This is because producing countries will more readily accept price ranges adequate to permit prices to perform their proper allocative function when they can turn to an earnings stabilization fund in addition to the commodity agreement itself. Compensatory financing also reduces reliance on supply controls in buffer stock agreements to maintain floor prices, thus avoiding the economic distortions such controls may bring about.

In an effort to provide additional access to IMF resources for members experiencing balance of payments difficulties related to commodity trade, the CFF was substantially liberalized in late 1975. The technique for calculating compensable export earnings shortfalls was modified to take fuller account of the impact of inflation on export trends. The amount that could be borrowed in a 12-month period was doubled, to 50 percent of the member's quota, and the level of loans which a country could have outstanding from the facility was raised to 75 percent of quota. Procedures were changed to permit more timely financing.

As a result of these changes, and the sharp fall in commodity prices in late 1974–75 from their peaks in 1973 and early 1974, loans from the facility have risen sharply. Last year they amounted to about $2.6 billion. This level of lending was more than double the total financing provided in the previous 13-year history of the CFF, and is more than five times the amount that would have been possible without the liberalization.

In recent international discussions, there have been proposals to further liberalize the CFF through—

Another expansion of the quota limits, or their total elimination.

Basing claims on shortfalls in aggregate commodity export earnings rather than total export earnings.

Basing compensation on the real value of export earnings; i.e., taking account of changes in import prices paid by commodity exporters.

Eliminating the requirement that a country have a balance of payments need to be eligible to borrow.

In its latest review of the CFF, however, the IMF Executive Board decided to make no further structural changes at the present time. This reflected recognition that the current provisions have been in force for less than a full commodity cycle and that it is therefore premature to determine what, if any, changes may be warranted. Furthermore, many of the proposals would be inconsistent with the monetary character of the IMF and could result in an excessive drain on its limited resources. In our view, the current arrangement is functioning well and is capable of meeting export earnings stabilization needs as and when they arise. Should further modifications prove necessary, we would be prepared to consider possible steps to assure that the IMF facility operates effectively to meet such needs.

There are other compensatory financing options which have been proposed to deal with LDC commodity concerns. The most ambitious approach would be a global earnings stabilization scheme modeled after the STABEX scheme of the European Community, which now provides limited stabilization of export earnings for 52 countries of the African, Caribbean, and Pacific regions for 11 agricultural commodities and iron ore. Under the present scheme, the European Community makes loans to these countries—grants in the case of the least developed—when their earnings from any one of the 12 commodities drop below the average of the previous 4 years by more than 7.5 percent (2.5 percent in the case of the least developed, landlocked, or island states).

A number of proposals have been suggested by the European Community itself and by individual European governments to expand STABEX to developing countries in all regions, including Latin America, and to cover a wider list of commodities.

We have agreed to further consider problems of the stabilization of export earnings of developing countries. However, we see no need to take further steps in this area until there is a clear demonstration that the liberalized CFF is inadequate. Indeed, it is our view that an effective earnings stabilization scheme is now in place, and that this particular aspect of the international commodity problem is well in hand.

Investment in commodity production

Any comprehensive commodity policy must include steps to assure the adequacy of long-term supply. We are concerned over possible future shortages and temporary bottlenecks as a result of lagging investment, leading to sharp increases in prices during future periods of industrial country expansion.

In addition, there is a real risk of misallocation of investment in the nonfuel minerals industries due to fears, real or imagined, of political risk in developing countries. The vast bulk of world investment in this sector is now going into a handful of developed countries, even when the quality (and profitability) of their mineral deposits is decidedly inferior to deposits in developing countries. If present investment trends continue, mineral prices by the mid-1980's will be higher than necessary, supply sources in developing countries will become less secure, and developing countries will face lower export volumes and smaller export earnings with which to finance their development plans. We believe that investment policy initiatives are thus required to promote more efficient allocation of investment in mineral production.

The proposal of the previous U.S. administration for an International Resources Bank (IRB) sought to deal with this problem by promoting the negotiation of fair and equitable contract provisions, and by providing insurance against contract default by host countries. The Carter administration, however, is looking to existing institutions, at both the international and national level, to do the job.

One such institution is the World Bank. It is a multipurpose institution and, therefore, has more leverage to reduce the political risks associated with investment in industrial raw materials. In addition, the IBRD is able to weigh a particular resources project in the context of overall development programs. We thus favor World Bank participation in energy and raw material projects with private investors. Indeed, the hope was expressed at the London summit meeting in May that the Bank will give special emphasis to projects which will expand domestic energy production in oil-importing developing countries, and a recommendation to this effect was approved at the recently concluded Conference on International Economic Cooperation in Paris.

The World Bank group already participates in nonfuel raw materials projects. The Bank itself lends funds for infrastructure development related to raw material projects. Its presence during early stages of contract negotiations, and knowledge of its likely participation in the development phase of a project, is already helping in a few cases to reduce uncertainties over whether the contract terms would be fulfilled as agreed by both the host country and the foreign company. Furthermore, the International Finance Corporation (IFC) can take equity participation in projects. Such tripartite approaches on natural resource projects, involving the international development banks, could help to avoid friction between private investors and host governments—and thereby enhance the prospects for increased levels of efficient production of industrial raw materials in the future.

We would also like to see the regional development banks expand their efforts to develop energy and raw materials projects. At the recent annual meeting of the Board of Governors of the Inter-American Development Bank in Guatemala, Secretary Blumenthal proposed that the IDB devote some of its resources to projects in this area which would meet the internal demands of Latin American countries, particularly the poorer nations, and possibly increase exports of those countries as well.

Finally our own Overseas Private Investment Corporation (OPIC), along with its counterpart investment insurance institutions in other industrialized countries, can aid in reducing political risk through greater involvement in raw materials projects. OPIC has already begun a program of innovative, risk-reducing coverage for such projects, and both OPIC management and the administration testified last week in an effort to win congressional support for that objective.

Conclusion

The United States is pursuing a comprehensive program to deal with the international commodity problem, as seen by both industrialized and developing countries. We seek to do so through cooperative means by which both sets of countries will agree upon, and subsequently implement, a series of efforts together.

Our program includes international commodity agreements, preferably operated through international buffer stocks of sufficient magnitude, to stabilize the prices of particular products around their market trends. It includes a common fund to facilitate financing of those agreements. It encompasses the compensatory financing facility at the IMF to help stabilize export earnings of exporting countries, and a willingness to consider additional measures to that end if further steps appear necessary. It envisages new efforts, by both the multilateral development banks and through cooperative efforts of the several national investment insurance agencies, to expand production of industrial raw materials in the developing countries.

We believe that this program will promote the interests of all countries. It should help reduce world inflation, in both the short run and the longer run, and thereby contribute to more stable growth and lower rates of unemployment. It can reduce balance of payments difficulties, particularly for the poorer countries and for industrialized importing nations as well. As a result, it can alleviate the political frictions which otherwise may well arise among three sets of countries—between producers and consumers, among producers, and among consumers—as they scramble to enhance their market positions at the expense of others. We believe our effort can promote joint gains for all the nations of the world, including those in Latin America, and hope that it will do so in the months and years ahead.

Exhibit 40.—Statement by Deputy Assistant Secretary Junz, September 19, 1977, before the Senate Committee on Commerce, Science, and Transportation, and the Subcommittee on Public Lands and Resources of the Senate Committee on Energy and Natural Resources, regarding Treasury's views on deep seabed mining and tax policy

I am very pleased to appear before you today to discuss the Treasury Department's views on deep seabed mining legislation. We feel, however, that the timing of our discussions is somewhat unfortunate. As you know, since the end of the last session of the Law of the Sea (LOS) Conference, the executive branch has undertaken a full review of our posture towards the Law of the Sea Conference, including also the question of legislation. The LOS review will carefully balance advantages against disadvantages over the full range of our interests in this area in order to arrive at decisions that protect them adequately. While this review will still take several weeks to complete, we expect to have a decision on legislation in a matter of days and certainly before this bill goes to markup. Therefore, we may have to defer comments on certain features of this legislation until that time.

You know, from previous testimonies on these matters, that the administration feels that the wealth of resources at the bottom of the sea must not be left to lie idle. Indeed, we feel that if our aspirations for increased standards of living worldwide are to be realized, we will need to employ productively the world's resources wherever they are to be found.

Therefore, it is vitally important that we provide an international and national climate that will ensure that deep-sea resources are developed productively, efficiently, and to the benefit of the world community. The interest of the Treasury Department in the current Law of the Sea negotiations is related to the overall economic goals of the United States, as is the bill you are asking me to comment on.

A legal regime to preserve U.S. economic interests

In the negotiations, Treasury's attention has been focused largely on the principles that would govern access to and exploitation of the deep seabed resources. We share the committee's concern that a stable, legal framework for deep ocean mining is needed. Without such a framework, mining consortia would be unable to make rational decisions with regard to committing risk capital in seabed mining.

A prerequisite for any stable, legal framework is the principle of assured access for seabed mining firms. Uncertainty with regard to the terms of access can—and, indeed, should—discourage state and private entities from assuming the substantial economic risks of exploring the seabed and of developing the new technology needed to eventually exploit these new resources for the world market. The Treasury Department believes that assured access to the seabeds for states and their nationals will lead to the most efficient allocation of resources as well as the most rapid development of the seabed resources to the ultimate benefits of both the United States and the world economy.

The administration has hoped that an appropriate framework for the productive exploitation of deep seabed resources would be provided by a Law of the Sea treaty. As you know, we have not yet been able to achieve acceptable treaty provisions on this point.

In a press conference following the last Law of the Sea session, Ambassador Richardson pointed out the major defects in the text dealing with the economic management of the seabed resources—the so-called Engo Text—and the process used to draft it. In the view of the administration, the Engo Text, produced in private and never discussed with a representative group of participating nations, was fundamentally unacceptable because it not only failed to provide for assured access, but would make deep seabed mining basically uneconomic. But even the Evensen Texts, negotiated during the Conference and set aside by the Chairman in favor of the Engo Text, would have required a considerable amount of further negotiation to assure that national and private enterprises could commit their resources and energies with the prudence dictated by their responsibilities to their taxpayers and stockholders.

While today's technology points only to the existence of nodules, there is no telling what lies ahead in the future. But even with only today's promise, we simply cannot agree to a regime that would unnecessarily inhibit, and perhaps even prevent, deep seabed development. To do so would make a mockery of the principle of the Common Heritage of Mankind and shut off altogether, or reduce to a pitiful trickle, the benefits that could otherwise accrue to mankind as a whole, but in particular to the developing countries.

Mr. Chairman, for some number of months now, we have been engaged in a dialog with the developing countries on their proposals for a new international economic order by which they would achieve participation in world economic affairs on an equal footing with developed countries. And the shaping of an economic regime for the deep seabed forms part of this dialog. It is clear that any new international institution, if it is to work, must reflect the realities of the evolving international system. But one of the realities of our system is that we cannot force the commitment of private capital resources or the transfer of the fruits of private research and patent rights. Governmental actions can facilitate such flows, but finally they must be induced by the economic realities. Therefore, any international institutions we create for the deep seabed must represent a true accommodation of the interests of both developing and developed countries if, indeed, it is to help tap the resources of the deep seabed to the benefit of mankind.

What happened at the Sixth Session is therefore particularly disappointing. We were prepared to agree to a compromise which would produce maximum benefits to be shared with the poorer countries while at the same time opening up the opportunity for the developing world itself to participate in the effort. Such a compromise would have been a major achievement not only for the benefits to be attained from resource exploitation as such, but also as a precedent for future world institutions and the evolution of our international economic relations. Because of both the great importance and the complexity of the whole range of issues pertaining to the establishment of a viable ocean mining regime and a productive seabed mining industry, we believe it is vitally important that the Congress and the executive branch work together as closely as possible on these issues.

U.S. legislation

With respect to the substance of deep seabed mining legislation, Ambassador Richardson and officials of several agencies have on various occasions informed Members of Congress of the administration's views. It is clear from the bills now before the Congress that considerable understanding has been shown for the administration's concerns, and I would like to express my appreciation for this. I am confident it augurs well for continuing cooperative efforts on these matters in the future.

May I briefly review the main elements of administration policy before I turn to a discussion of the bill before us. In our view, legislation—

- Should be interim in nature, and eventually superseded by a treaty;
- Should contain provisions for harmonizing U.S. regulations with those of reciprocating states;
- Should provide for environmental protection, sound resource management, and the safety of life and property at sea;
- Should provide that seabed mining by U.S. companies produces financial benefits for the international community;
- Should not be site specific with regard to licensing;
- Should not require that processing plants be located in the United States;
- Should not offer U.S. mining companies financial protection against adverse effects of a treaty concluded subsequent to the passage of legislation and the

commitment of expenditures by those companies; and

Should assure that all provisions of the legislation leave undisturbed the concept of freedom of the high seas.

As I indicated a moment ago, some of these views coincide with provisions contained in S. 2053. First, this bill clearly is designed to be interim legislation pending the entry into force of an international agreement. Second, it contains provisions designed to prevent conflict with designated reciprocating states engaged in deep seabed mining. Third, it provides for environmental safeguards and the means to assure timely action to avoid and avert damage to the ocean atmosphere, although, in our view, strengthening of enforcement provisions is needed. Finally, there is provision made for sharing the proceeds of deep seabed mining with the international community.

On the other hand, some provisions of S. 2053 are of concern to the administration. Among these, the provisions on tax treatment and investment guarantees are of special concern to Treasury and I would like to comment on these in some detail.

Tax policy

As a general proposition, the administration agrees with the concept that there should be no tax discrimination between U.S. deep seabed mining and U.S. domestic mining. However, while this concept can be stated simply, deep seabed mining does raise a number of complex tax issues, and we believe that the tax provisions in S. 2053 are in need of further refinement in order to take explicit account of these questions.

Among these questions is the treatment of deep seabed mining activities under present tax law, with respect to depletion allowances, asset depreciation range (ADR), the investment tax credit, mining exploration expenses, and payments to special funds for possible transfer to the international community. At this point, I would like to summarize briefly how present tax laws operate with respect to these particular areas.

Under the principle of domestic treatment, deep seabed mining conducted by a U.S. individual or corporation would be subject to U.S. tax. However, this mining activity, under present law, would not be accorded ADR treatment at a class life of 20 percent shorter than the normal guideline life; nor would the investment tax credit be available, because these incentives generally are limited to fixed assets physically located in the United States.

Exploration expenses, which currently may be deducted if incurred with respect to mineral deposits located in the United States, must be capitalized and recovered through depletion when the deposits are located outside the United States. Finally, percentage depletion, if available at all, would be at the rates prescribed for foreign mineral deposits (14 percent for manganese, nickel, copper, and cobalt), rather than at the higher rates for domestic deposits (22 percent for manganese, nickel, and cobalt and 15 percent for copper). In this connection, it should be noted that under present law, depletion is allowed only if the taxpayer has an "economic interest" in the minerals in place. Although the concept of an "economic interest" is not well delineated in the law, it is something akin to an ownership right in the minerals prior to extraction. Because there are no clear ownership rights to deposits in the deep seabed, it is not likely that under present laws deep seabed mining would have the requisite economic interest to qualify for depletion allowances. With this background, it is apparent that nondiscriminatory domestic tax treatment for deep seabed mining cannot be achieved without additional tax legislation.

Further, the definition of U.S. citizenship in this bill can lead, under varying circumstances, to inequities in tax treatment. For example, as we read section 6(15), a "U.S. citizen" is defined to include a foreign corporation or other foreign entity if "controlled" by a single U.S. individual or other U.S. legal entity. Putting aside the troublesome omission of a standard for determining control, this provision can lead to double taxation or tax avoidance. For example, if control were to be defined as a 51-percent interest, a joint venture incorporated in France "controlled" by a U.S. corporation could be a "U.S. citizen" subject to full U.S. tax under this bill. As a French corporation, the joint venture would also be legitimately subject to French taxation. Hence, double taxation could result.

Conversely, if the U.S. corporation did not "control" the joint venture, since it owned, say, only 49 percent, then the United States would have no tax jurisdiction. If a "U.S. citizen" incorporates such a joint venture in a tax haven area, for example in the Bahamas, it would escape all tax. Under the provisions of the bill, which requires control by a single U.S. entity, two U.S. corporations each owning one-third interest in a Bahamian corporation also would escape all U.S. tax liability.

The administration believes that a policy based on the following principles would avoid both double taxation and tax avoidance:

- U.S. entities that engage directly or indirectly in deep seabed mining ventures, on their own or jointly with non-U.S. entities, should be treated for U.S. tax purposes as if they were engaged in land-based ventures in the United States.
- Non-U.S. entities, that either mine on their own or participate with U.S. entities in deep seabed mining, should not be subject to U.S. taxation.
- The tax treatment for payments to an international seabed authority or to an escrow fund held by the U.S. Government should be the same as that accorded domestic land-based mining ventures for payments of royalties. Thus, such payments would either be (1) deductible, or (2) capitalized and recovered through depletion.

Treasury has already furnished the House Merchant Marine and Fisheries Committee with a short paper on "Tax Policy Considerations Affecting Ocean Mining." I have attached a copy of this paper as an Appendix to my testimony.

Remaining issues on which Treasury is continuing to work center on the mechanics for implementing nondiscriminatory domestic tax treatment for deep seabed miners according to the principles set out above. In the coming months, Treasury will be conferring with the committees responsible for ocean mining legislation as well as with the House Ways and Means Committee and the Senate Finance Committee in order to work out the necessary legislation to implement the administration's ocean mining tax policy.

Investment guarantees

Although the administration believes strongly in the desirability of developing the mineral resources of the seabed, an investment guarantee program for such activities is both undesirable and unnecessary in our view.

Investment guarantees are undesirable because they imply an obligation on the part of the Government to indemnify firms for possible adverse consequences of Government policies. But it is a fact of life that Government decisions often affect an industry's profitability dramatically. The claim made for seabed mining in favor of Government guarantees is that it is in a unique situation because the conclusion of a treaty may alter its profit calculations profoundly. However, the administration has concluded that the situation of deep seabed mining consortia is not sufficiently unique to justify institution of a new guarantee program.

Investment guarantee programs currently in place cover certain domestic and foreign land-based mineral operations of U.S. corporations. For example, the Overseas Private Investment Corporation (OPIC) has programs to insure foreign investments in the minerals industries in developing countries. These programs are now being reviewed, and as Assistant Secretary Bergsten stated earlier this year, we are now proposing that OPIC should develop new "risk-reducing coverage for projects in energy and other raw materials." It would be possible to consider whether there is a role for OPIC in seabed mining, but to the extent that we are recommending domestic tax treatment for such operations, it is not clear that OPIC activities indeed could be extended to include seabed mining activities without raising questions about the equity of treatment of domestic versus foreign investment under Federal laws. Certain domestic programs reflect national interests either with respect to the specific industry—for example, energy—or to a class of investors such as small business. In our view, seabed mining consortia do not qualify under these counts.

There is no overall national strategic interest sufficient to justify governmental action to reduce risks that are similar in type to those encountered by both domestic and foreign investors engaged in mineral exploitation. Governmental and nongovernmental groups have conducted several studies of the market for the minerals to be obtained from the seabed and our strategic need for them. These studies have shown that the adequacy of supply is reasonably assured. In the absence of a compelling national interest, the industry ought to compete on equitable terms with land-based producers.

I want to point out that the investment guarantee portion of the proposed legislation is based on two presumptions: (1) That the U.S. Government will negotiate and the Senate will ratify a treaty under which the terms of operation for firms could be arbitrarily and adversely affected; and (2) that if an equitable treaty were accepted, the United States will be unable to prevent later adverse actions through its representation in the seabed authority's governing body.

We think these premises are incorrect. As you know, this administration has consistently opposed treaty texts that would subject miners' operations to capricious or onerous regulation. In fact, the President's Special Representative, Ambassador Richardson, has denounced the current draft text as "fundamentally unacceptable" to the United States for just such reasons. Also, we expect the Congress to look askance at any treaty that significantly diminishes the value of investments of U.S. firms in the deep seabed. Moreover, the United States will continue to oppose provisions of governance which fail to give the United States and other ocean-mining countries a major voice in the decisionmaking councils of an International Seabed Authority.

The second point we want to make with regard to the investment guarantees proposed in this bill is that we consider them to be unnecessary. The lending climate for major investments has changed in recent years. Partly in response to the tumultuous conditions of the early seventies, banks are no longer willing to make loans solely on the merits of specific projects. They now require that specific investments be fully backed by the corporations undertaking them. Hence, the testimony you may be hearing argues correctly that banks will not fund projects without corporate guarantees, but this increasingly applies across the board and not solely to seabed mining.

Consultations with major U.S. banks, and with other financial agencies in Washington, lead the Treasury to conclude that funds are available for deep seabed mining operations without Government guarantees if firms are willing to assume the risk. The decision whether the reportedly rich returns from seabed mining justify investment in this new area—under license by the U.S. Government with assurances that the Government will do all it can to protect mining interests—is a decision which we firmly believe is best left to the companies themselves. If the anticipated returns justify the risk, the investments will take place. If not, the capital will be put to more productive uses elsewhere.

In conclusion, it is clear that the U.S. economy will ultimately benefit from the existence of a viable and productive seabed mining industry. But we find arguments in favor of preferential treatment of seabed development neither convincing nor equitable. Therefore, we could not support diversion of official financial resources into seabed production and away from competing claims for Federal funds.

Other economic policy considerations

Treasury is in complete agreement with legislative provisions that would provide benefits for the international community through the establishment of an escrow account. (S. 2053, section 204 and H.R. 3350, section 203.) Permitting the administration time to submit a specific revenue sharing proposal after the date of enactment is a particularly helpful provision in these bills. This will give the United States time to work out the necessary details and to consult with other prospective ocean-mining countries and reciprocating states. Thus, the administration will be able to develop a revenue sharing system that will assure that U.S. firms are not put at a competitive disadvantage with the miners of other countries.

With regard to provisions in these bills that require license holders to locate processing plants in the United States (S. 2053, section 102 and H.R. 3350, section 103), the administration believes that such a provision should not be a requirement for receiving a U.S. license. By allowing processing plants to be located at the most economical sites, the viability of the ocean mining industry will be increased, and the benefits of ocean mining will be more widespread as will be support for such activities.

For example, countries where processing plants are located would be giving implicit recognition to the fact that U.S. miners are engaged in a legitimate use of the high seas.

Thank you for this opportunity to discuss our views on U.S. ocean mining policy with you. My staff and I will be pleased to make available to you what help we can during the coming months.

APPENDIX

TAX POLICY CONSIDERATIONS AFFECTING DEEP SEABED MINING

Background

Five multinational consortia (four of which are led by U.S. companies) are currently investigating the economic and technological feasibility of mining deep seabed manganese nodules containing approximately 1.5 percent nickel, 1.3 percent copper, .25 percent cobalt, and 24.2 percent manganese. There is thus a need to determine the nature of U.S. tax treatment of deep seabed mining.

Deep seabed mining is juridically unlike most other economic activities. Extraction of nodules will take place in an area which is not subject to the jurisdiction of any nation. On the other hand, all but one of the U.S.-led consortia plan to transport the nodules in chartered vessels to shore for processing. One consortium plans to process at sea beyond national jurisdiction.

While many countries—in particular, developing countries—claim the deep seabed is "common property" and cannot be exploited until an international regime for this purpose is agreed, the United States and other developed countries maintain it belongs to no one and can be exploited under customary international law providing for freedom to use the high seas. The United States is, nevertheless, prepared to agree to the establishment of an international regime and organization (International Seabed Authority) for the administration of deep seabed mining. We are not, however, prepared to agree to Authority ownership of or sovereignty over deep seabed minerals.

The nature of the international regime and organization for the deep seabed is currently under discussion in the third U.N. Conference on Law of the Sea (LOS). It is probable that any agreed regime will provide, inter alia, for (i) contracts between the Authority and private entities sponsored by states to mine specific deep seabed areas, and (ii) certain payments by these entities to the Authority (financial arrangements) in recognition of the economic interest of all countries in deep seabed development.

The current draft treaty texts before the Conference provide potentially for four types of payments from private entities to the Authority:

1. Payments in kind, upon obtaining from the Authority a contract to mine the seabed; i.e., banking by the contractor of mining sites for the Authority's operating arm, the Enterprise.
2. Fee payable on the award of a contract to mine the deep seabed.
3. Royalty based on percentage of value of minerals extracted by the seabed miner.
4. Taxes on the revenues of contractors derived from their activities in the deep seabed.

The U.S. proposal on this subject dated June 3, 1977, provides for (i) banking, (ii) a small fee (not to exceed $500,000), and (iii) profitsharing (15–20 percent of net proceeds depending on return on investment) or royalties (10 percent of the imputed value of the minerals at the mine site; the mine value is calculated as 20 percent of the fair market value of the processed metals).

In addition to the LOS Conference discussions, three House committees (Merchant Marine and Fisheries, Interior and Insular Affairs, and International Relations) are considering three bills (H.R. 3350/4582 [Murphy-Breaux], H.R. 6784 [McCloskey], and H.R. 3652 [Fraser]) which would authorize seabed mining by private entities pending agreement on an international regime. Only H.R. 6784 (McCloskey) provides for international payments and deals as such with U.S. tax treatment. It authorizes a deep seabed resource development revenue sharing fund to which payments would be made in escrow for the international community pending agreement on a treaty, and states such payments shall be considered as payments to a foreign government and credited against U.S. income taxes. For its part, the administration has indicated that any U.S. legislation should provide for some payments into escrow for the benefit of the international community.

Issues

(1) What is the appropriate U.S. tax treatment of deep seabed mining ventures undertaken by a U.S. entity?

(2) What should be the U.S. tax treatment of payments by U.S. entities to an International Seabed Authority and/or to a U.S. Government escrow fund for such an Authority pending its establishment?

Conclusion

U.S. entities that engage in deep seabed mining ventures should be treated for U.S. tax purposes as if they were engaged in land-based mining ventures in the United States. Non-U.S. entities, who mine either on their own or in partnership with U.S. entities, should not be subject to U.S. taxation on this activity to the extent it is undertaken at sea. Payments to an International Seabed Authority or to a United States Government escrow fund will be either (1) deductible from U.S. gross income; or (2) capitalized and recovered through depletion. The tax treatment will be the same as that accorded domestic land-based mining ventures on payments of a similar nature.

Discussion

The policy objective is to assure economic equality of U.S. tax treatment of U.S. entities as between deep seabed and land-based mining of the minerals concerned. Meeting this objective in turn involves consideration of whether the economic equality should be with (i) mining by U.S. entities in the United States, or (ii) mining by U.S. entities in a foreign country. The entire venture might be considered a purely "domestic" investment since none of the investment is located within the jurisdiction of another sovereign nation; or the venture might be considered a "foreign" investment to the extent located outside the geographic area of the United States. (See attachment A for a quantified comparison of these two treatments.)

The tax treatment of an ocean mining venture will vary somewhat depending on its treatment as domestic or foreign. The principal differences currently are the rate of percentage depletion allowed, the availability of ADR (asset depreciation range) depreciation and the investment tax credit, and the deductibility of mine exploration expenditures.

The rate of percentage depletion allowed for foreign mineral deposits of manganese, nickel, copper, and cobalt is 14 percent. The percentage depletion rates in the case of U.S. deposits are 22 percent for manganese, nickel, and cobalt, and 15 percent for copper. ADR depreciation at a class life 20 percent shorter than the guideline life and the investment tax credit are generally limited to fixed assets located in the United States. Finally, mine exploration expenditures may be deducted currently if incurred with respect to deposits located in the United States, but generally must be capitalized and recovered through depletion when incurred with respect to mineral deposits located outside the United States. In all other principal respects the tax treatment of domestic and foreign hard mineral mining operations is the same.

As a matter of tax policy, the choice between "domestic" or "foreign" treatment is relatively simple: Any investment by a U.S. resident should be treated as "domestic" so long as it is not located within the taxing jurisdiction of a foreign government. This classification of investment by a U.S. resident is consistent with national income accounting concepts. Moreover, inasmuch as worldwide income of U.S. residents is subject to U.S. income tax, treating deep seabed mining operations as "foreign" needlessly creates income "source" issues when no other sovereign taxing jurisdiction is involved.

Although treatment of ocean mining ventures undertaken by a U.S. company as purely domestic will require certain amendments to the Code, such treatment is consistent with the tax treatment accorded analogous situations. The investment tax credit is available for communications satellite and transoceanic cable equipment (Code sections 48(a)(2)(B)(viii) and (ix)), and for certain property used in ocean mining ventures located in the international waters of the northern portion of the Western Hemisphere (Code section 48(a)(2)(B)(x)). Income from transoceanic cable or telegraph transmission operations is deemed from U.S. sources to the extent such transmissions originate in the United States, and income from communication satellites would presumably be treated in a similar manner. Finally, tax reform proposals related to international shipping are not inconsistent with domestic tax treatment of ocean mining ventures. Proposals to treat international shipping income as U.S. source to the midpoint of each voyage is roughly the same as treating all outbound traffic as domestic and all inbound as foreign.

On the other hand, from the international point of view, such U.S. tax treatment must make clear that it in no way implies an assertion of U.S. jurisdiction over the deep seabed. Amendments to the Internal Revenue Code providing for such treatment should apply only to U.S. persons and not to non-U.S. persons. In particular, no attempt should be made to tax the deep seabed mining income of non-U.S. persons who are members of U.S.-led consortia engaged in deep seabed mining. Such non-U.S. persons, of course, would continue to be subject to U.S. tax on income arising from their activities in the United States; e.g., income from processing in the United States. Details of this policy, such as the taxation of U.S.-controlled foreign corporations or the leasing of equipment to non-U.S. persons, would need to be worked out in a specific legislative proposal.

The only disadvantage of domestic treatment from the U.S. companies' point of view is the unavailability of potential tax credits against U.S. tax for certain of the payments made to the Authority either directly or in escrow. The fourth category of payments to the Authority (listed above) could be structured so as to be economically similar to income taxes payable to a foreign state with respect to revenues derived from activities within its jurisdiction. Some would argue that such payments should qualify for a foreign tax credit as if these payments were income taxes paid to a foreign government.

The issue of domestic or foreign tax treatment aside, granting a foreign tax credit for payments to the Authority is undesirable. On the one hand, there has been increasing concern about granting credit for payments which are not truly income taxes, especially in the case of payment by oil companies to governments which not only impose the tax but also own the oil. This has been reflected in recent rules and legislation, and the tests for a creditable tax are being more stringently applied than ever. And, on the other hand, to be creditable the income tax must be paid to a foreign government. Payments to the International Seabed Authority would not be creditable because it is not a foreign country endowed with sovereign taxing powers. To endow it with sovereignty would be contrary to both our national security and economic interests. To endow such an international body with sovereign taxing power would be an extraordinary precedent and would encourage the Authority to exercise the monopoly power thus bestowed on it.

While treating deep seabed mining ventures as "foreign" might result in a "revenue gain" from limiting percentage depletion and denying the investment tax credit and the shorter depreciation life, foreign treatment would constitute an unwarranted bias against certain forms of investment of U.S. capital (assuming that access to seabed minerals is assured) and may buttress the arguments of those desiring to invest the International Seabed Authority with "tax sovereignty." Accordingly, deep seabed mining ventures undertaken by U.S. companies should be treated for tax purposes in a manner identical to domestic land-based mining ventures.

Imports of seabed materials

If the seabed mining is defined as a domestic activity, then consistent trade policy would dictate that the products from that activity should be treated as domestic production and exempt from any duties or other import restrictions. Currently the duties applied to imports are relatively low and vary according to the material imported; e.g., specific ore, metal, or mixed ores.

To assure that these seabed materials are defined as domestic, the tariff schedule would have to be amended to specifically define materials from the seabed as exempt from duties. This exemption would be similar to the treatment now extended to fish landed by American fishermen. Under present law, it is not mandatory that materials be transported in U.S. vessels.

Attachment A

Quantification of Differences in Tax Treatment of Ocean Mining Ventures

From the point of view of a U.S. venturer, we may compute the value of "domestic" tax treatment as an amount the venturer would be willing to pay for that treatment rather than "foreign." It is also an amount available to him to pay for a "license" to mine, either as a "bonus" or "royalty" per ton of material removed.

To make such calculations, some specification of expenditures related to the mining, transportation, and processing is required. For this purpose, we rely on a publication of the Ocean Mining Administration of the Department of the Interior which summarizes the fragmentary information on this as yet speculative activity.[1] Based on the published "medium" cost estimates for a venture which would supply 3 million tons of nodules per year to be processed into nickel, copper, and cobalt,[2] and adding the cost of an alternative site to be provided gratis to the DSA as is presently contemplated, we computed the present value of the minimum gross income from the sale of the aforementioned metals which would be required to yield the venturer a 15-percent rate of return after taxes under two regimes: (1) The entire project is regarded as "domestic"; (2) the sea-based mining activity is "foreign." Then, based on these two calculations, we may compute the maximum "additional take" of DSA if that agency is accorded sovereign taxing status.[3]

If the entire project is treated as domestic, the present value of the "required" total sales over the estimated 20-year productive life of the project would be just over $830 million. Of this total value of product, 35 percent would be added by mining, 9 percent by transportation, and 56 percent by onshore processing.[4] If sales values of the minerals finally sold, as projected by the aforementioned publication, are used as a reference point, the venturer would be willing to pay the DSA up to $16 million (in addition to the aforementioned alternative site) for the license to mine. Alternatively, the venturer would be willing to pay $3.85 per ton of nodules removed, when removed.[5]

In contrast, if the sea-mining operation is treated as "foreign," the loss of the investment credit with respect to that investment, along with somewhat slower depreciation and a percentage depletion rate of only 14 percent rather than the weighted average 19 percent for "domestic" mining of the same minerals, increases the "required" total sales to $855 million, which is $25 million more than under "domestic" tax treatment. Given the same projected mineral prices, the venturer could only pay up to $3 million for the license, or a royalty of only about 75 cents per ton of nodules, when removed. While the overall difference between "domestic" and "foreign" treatment is not large—a mere 3-percent increase in "required" gross sales income—it is an 80 percent reduction in the venturer's maximum biddable bonus or royalty, under the assumed conditions of this example. This must always be true, because the

[1] Rebecca L. Wright, "Ocean Mining: An Economic Evaluation"; May 1976.

[2] According to Wright, technology for the extraction of manganese in useful form is still not well-enough defined to permit cost specifications of the onshore processing. Moreover, she considers that manganese processing may usefully be considered as processing "tailings" of the nickel-copper-cobalt process. Ibid, Appendix A.

[3] The published data were organized simply to permit computation of an internal rate of return. For our purposes, and to facilitate reasonably accurate representation of the critical tax terms, it was necessary to reorganize the basic information. Miss Barbara Lloyd, who had performed the original computations, kindly provided us with disaggregation of investment and operating costs, by site. Fortunately, the cost specifications treat transportation as independently provided, not as an integrated operation of the venturer. This is fitting, for ownership and operation of the transport vessels are of no consequence to the economics of the project nor its alternative tax treatments.

[4] Addition of manganese processing would greatly increase the onshore value-added share. Neither the mining nor transport activities depend on the extent of onshore processing of nodules.

[5] The computation of maximum "bonus" takes into account that the payment will become a part of the venturer's "depletion" basis whereas the payments of royalties will simply be reductions of gross income for U.S. tax purposes as production occurs.

rental value of the seabed will always be a tiny fraction of the total value of mineral product.[6]

Finally, if "foreign" tax treatment by the United States is to be accompanied by DSA "taxing power," the U.S. foreign tax wedge may be taken by the DSA without discouraging the venturer. This foreign tax wedge is equal to at least $75 million, in present value terms. If this amount is expressed as additional royalty per ton of nodules, it adds $9.20 to the $0.75 royalty per ton otherwise payable to DSA under "foreign" tax treatment only. Alternatively, it affords the venturer the possibility of paying an additional $39 million bonus.

These calculations may be summarized as follows:

	Maximum DSA "take"* expressed as—	
	Bonus	Royalty
	Million	*Per ton*
Completely "domestic"	$16	$3.85
"Foreign" (at sea)	3	.75
With "creditable" DSA "tax"	42	9.95

*Assumes the Wright projections of nickel, copper, and cobalt prices and projects costs allow a 15-percent after-tax rate of return to the venturer.

International Monetary Affairs

Exhibit 41.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, October 2, 1976, issued after its sixth meeting in Manila, Philippines

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its sixth meeting in Manila, the Philippines, on October 2, 1976 under the chairmanship of Mr. Willy De Clercq, Minister of Finance of Belgium. Mr. H. Johannes Witteveen, Managing Director of the Fund, participated in the meeting. The following observers attended during the Committee's discussions: G. D. Arsenis, New York Office, UNCTAD; Henri Konan Bedie, Chairman, Development Committee; Wilhelm Haferkamp, Vice President in charge of Economic and Financial Affairs, CEC; Rene Larre, General Manager, BIS; E. van Lennep, Secretary-General, OECD; F. Leutwiler, President, National Bank of Switzerland; Olivier Long, Director General, GATT; and Robert S. McNamara, President, IBRD.

2. The Committee discussed the world economic outlook and the functioning of the international adjustment process.

The Committee welcomed the economic recovery that has been under way for the last year. It expressed continued concern, however, about persistently high levels of unemployment and high rates of inflation in many countries. The Committee believes that in present circumstances the restoration of a reasonable degree of price stability will be necessary to establish the basis for sustained economic growth and the reduction of unemployment. Accordingly, the Committee is of the view that policies in the industrial countries at the present time should give priority to the reduction of price and cost inflation. This would require fiscal and monetary policies in these countries that would provide effective control over the expansion of aggregate demand in a manner compatible with this objective, even where price and incomes policies are in effect.

[6] At best, estimates of the mineral content of the nodules are not expected to be much over 3 percent for copper, nickel, and cobalt, all of which are found ashore in ores which are less expensively processed. Clearly, the price of minerals will trace the marginal cost of production, and this will inevitably basically consist in the cost of extraction, transportation, and processing. Only the slight differences in metal content of nodules and ores will give rise to rents for the higher content mineral sources, and these rents will be small relative to total value added.

NOTE.—*The reader is cautioned not to take the numerical values in the text seriously.* Given the insubstantial character of the cost estimates, along with the implicit assumptions about ultimate mineral recovery, the 15 percent discount rate is clearly too low to be applied to an estimated income stream stretching 26 years into the future (6 years' start-up, 20 years' production). Had the high cost estimates been used, the projected income stream would have been insufficient to justify making the commitment, without any lease bonus or royalty, to yield a 15-percent return. The sole purpose of the numerical results is to provide an indication of the relative magnitudes.

The Committee further agreed that, given the constraint under which demand management policies in the industrial countries must operate, special efforts, including the reduction in the barriers to trade in the negotiations now under way, to improve market access to the exports of developing countries, and to increase the flow of development assistance, would be indicated.

With respect to the international adjustment process, the Committee reached the following conclusions:

(a) As a result of the recovery in the world economy, exports are rising in many countries and the international environment has become much more favorable for the adjustment of external payments positions. The Committee believes that such adjustment, which should be symmetrical as between deficit and surplus countries, is now both urgent and opportune.

(b) To this end, deficit countries should arrange their domestic policies so as to restrain domestic demand and to permit the shift of resources to the external sector, to the extent necessary to bring the deficit on current account in line with a sustainable flow of capital imports and aid.

(c) Industrial countries in strong payments positions should ensure continued adequate expansion in domestic demand, within the limits set by effective anti-inflationary policies.

(d) Exchange rates should be allowed to play their proper role in the adjustment process.

(e) In the context of the use of the Fund's resources, adjustment by deficit countries can be promoted by a larger use of the credit tranches and the extended Fund facility.

3. The Committee noted that, in accordance with the agreement incorporated in the provisions of the Proposed Second Amendment, the Fund will have the obligation to exercise firm surveillance over the exchange rate policies of members. The Executive Directors should consider how this function is to be exercised and should report to the Committee on this subject.

4. The Committee noted the section of the Annual Report of the Executive Directors dealing with developments in international liquidity. In accordance with its terms of reference, the Committee requested the Executive Directors to keep all aspects of international liquidity under review and to report to it at a later meeting.

5. The Committee reviewed, on the basis of a report by the Executive Directors, the financial activities of the Fund, including developments in the Fund's policies on the use of its resources and in the liquidity of the Fund. The Committee noted the unprecedented expansion in the use of the Fund's resources by members in order to finance their balance of payments deficits and agreed that, even if all reasonable efforts toward adjustment were made, there might still be a need for large use of the Fund's resources in the near future. The Committee shared the view of the Executive Directors that greater emphasis should be placed on the adjustment by members of imbalances in their payments positions and that the use of the Fund's resources should present the Fund with the opportunity to promote the use by members of the kind of adjustment measures that are most conducive to the interest of all. The Committee noted the actions taken by the Executive Directors with regard to the Trust Fund and welcomed their intention to keep the compensatory financing and buffer stock facilities under review.

6. The Committee endorsed the conclusions of the Executive Directors on the state of the Fund's liquidity. The Committee urged that, pursuant to the resolution on quota increases adopted by the Board of Governors last March, all members that have not yet done so should make the necessary arrangements for the use of their currencies in the operations and transactions of the Fund in accordance with its policies. It was agreed that the Fund's liquidity should be kept under close review. The Committee stressed the fact that prompt adoption of the Proposed Second Amendment of the Articles and the subsequent completion of the steps necessary for quota increases under the Sixth General Review would provide the most effective way of improving the liquidity of the Fund.

7. The Committee noted that the Executive Directors will initiate in the near future the Seventh General Review of Quotas so that it can be concluded, as planned, in February 1978.

8. The Committee noted the report of the Executive Directors regarding the progress made by members in connection with their acceptance of the Proposed Second Amendment of the Fund's Articles. In view of the importance that the entry into force of the amended Articles will have for the functioning of the international monetary system, the Committee urged all members that had not yet notified the Fund of their acceptance of the second amendment to complete as soon as possible the arrangements that would permit them to take this action.

9. The Committee agreed to hold its eighth meeting in Washington, D.C. on April 28 and 29, 1977.

Exhibit 42.—Statement by Secretary Simon as Governor for the United States, October 5, 1976, at the joint annual meetings of the Boards of Governors of the International Monetary Fund and the International Bank for Reconstruction and Development and its affiliates, Manila, Philippines

Once again, it is a distinct honor for me to address this distinguished body. We are fortunate to meet in this beautiful land, a nation known for its traditions of warm hospitality and a nation with which the United States has long maintained the strongest of ties and the warmest of friendships.

There is an old Chinese saying, eloquent in its simplicity, which merely says: "May you live in interesting times." Without a doubt, we who are gathered here today have lived through some very interesting times together. The period since I joined the U.S. Treasury nearly 4 years ago has been one of extreme tension, even danger, in international economic affairs. Repeated shocks threatened the traditions of cooperation that are the foundation of world trade and investment, as well as general stability. Differences among nations over principles and objectives brought our ability to preserve a free and open international trade and investment system.

We have witnessed the development of an inflationary virus stubbornly resistant to our attempted remedies; we have experienced an oil embargo and price increases that disrupted the world economy; and we have lived through the deepest international recession of the postwar era.

We have done much to meet these challenges—but even more remains to be done. Today I would like to discuss both the progress we have made and the challenges we still face.

One of the characteristics that marked this troubled period was a growing recognition of our mutual interdependence. More than ever before, people around the world began to understand that the economy is at the heart of the body politic and that every shock it receives will ultimately be felt in terms of social and political—as well as economic—instability. The result of this new understanding has been that, despite all of the divisive economic pressures unleashed on the international scene in the last 4 years, international cooperation has not broken down and indeed, in one important area, major reform has been achieved—the first comprehensive reform of the international monetary system since Bretton Woods.

The international economic system is now truly universal, involving all countries, large and small. Between 1950 and 1975, the level of trade among market economies increased from $50 billion to $800 billion. This dramatic expansion of the world economy has coincided with the creation of scores of new nations and new centers of economic power. The price and supply of energy, the conditions of trade and investment, the expansion of world food production, the technological base for economic development are today the shared concern of every nation. And it is clear to me that we will either move forward with trust and cooperation or we face the dangers of retreating into economic instability and nationalistic conflict.

So far, we have followed the correct course of cooperation. And much of our progress is the result of the efforts of the men and women gathered here today. Speaking for myself, I am grateful for the chance that has been mine to serve with you—on behalf of my Government but also on behalf of the ideals we all share—during this period of reexamination and searching. I am also grateful for the education afforded me over the past 4 years—for both the many lessons learned willingly and the few learned not so willingly. But, above all, I am thankful for the high rewards of personal contact and friendship with you, my colleagues, and for the sense of genuine accomplishment that has grown out of our work together.

This brings me to the work that remains to be done; the task before us is a fourfold one:

We must restore and maintain economic stability in our domestic economies;
We must make the reformed international monetary system work;
We must tackle with increased courage and understanding the difficult problems of development; and
We must continue to work for a free and open world trade and investment order that is essential to a shared prosperity to all.

As we work together to achieve international economic progress each nation must follow responsible domestic policies to avoid disrupting both its own economy and inevitably those of other countries. Because of its size, this is particularly true of the U.S. economy. Following the most severe economic recession of the postwar era, the United States is now 1 1/2 years into a healthy and balanced economic expansion. If erratic shifts and excesses of government actions are avoided, this expansion will continue well beyond 1976, although the rate of growth will naturally tend to moderate.

The strength of the current expansion that began in the spring of 1975 is indicated by the increase in real output of goods and services which has averaged 7 percent during the last four quarters. The rate of inflation, as measured by the GNP price deflator, has dropped from a peak of over 12 percent in 1974 to the 5- to 6-percent zone throughout 1976. Employment is at a record level of 88 million workers, and 4 million new jobs have been created since the upturn in the economy, although the unemployment rate remains far too high reflecting the lagged effect of the recession and the extraordinary surge of new workers into the labor force. Despite the wide fluctuations in quarterly statistics, it is clear that a healthy expansion can be continued if policies focus on the longer term goals of reducing both inflation and unemployment.

As expected, personal consumption has provided the basic thrust for the growth throughout the current recovery. Business spending did not accelerate as quickly as originally anticipated, but outlays for plant and equipment now appear to be improving and inventory buying is up to expectations. Government spending at all levels seems to be better controlled, and the strength of export sales has continued, although imports are now rising more rapidly. This has resulted in a swing in our balance of trade from a massive surplus in 1975 to a substantial deficit in 1976. The United States views this shift with equanimity because we recognize that it reflects the sharp increase in imports that has occurred as our economy has moved from recession to expansion. This adjustment is a proper reaction to changing economic conditions that the international monetary system can handle well if we do not seek to offset the effect of natural market forces.

The recovery to date has remained well balanced. It was never anticipated that specific sectors of the economy—such as automobiles or housing—would dominate the recovery, although sales of domestic cars have been somewhat stronger than expected, which partly explains the accelerated pace of spending early in the year. Nor have widespread capacity constraints or severe raw material shortages appeared at this stage of the recovery.

Best of all, fiscal and monetary policies have been carefully monitored to prevent the excesses that led to renewed overheating of the economy following the temporary benefits of faster growth.

While many called for more Government spending and significantly faster expansion of the money supply in 1975 and even this year, the President strongly resisted. As a result, the recovery has proceeded to this point without building up excessive demand pressures for increased output or fiscal and monetary policies which would lead inevitably to a repetition of the familiar boom-and-recession sequence. This unfortunate pattern could be repeated, of course, if unwise policy adjustments are made to turn the economy toward excessive near-term growth. But this negative result can be avoided if responsible policies are followed. We fully intend to guard against a return to the stop-and-go policies that have disrupted the U.S. economy in the past.

Looking to the future, we expect the economic expansion in the United States will continue in 1977, but at a somewhat reduced pace. This is a proper pattern because continuation of the rate of output gains in the 6- to 7-percent zone over an extended period of time would inevitably overheat the U.S. economy, once again leading to a new round of inflation, followed soon afterwards by recession and unemployment. Output gains in 1977 should be in the 5- to 6-percent zone as output of the economy gradually returns to its long-term rate of growth.

Personal consumption will continue to be the basic strength of the U.S. economy, since it comprises two-thirds of the total GNP, but the rate of increase in this sector will undoubtedly slow down. Business investment and continued modest gains in housing construction will provide most of next year's thrust for additional growth.

We expect inflation to remain at the 5-percent to 6-percent zone. This is a most unsatisfactory level of price increase and our Nation must not and will not accept it. Employment growth should continue, although not as rapidly as during the last 18 months, and the unemployment rate will continue to decline, particularly as the extraordinary growth in the labor force slows down.

In summary, while there are several worrisome problems to contend with, the likely overall course for the U.S. economy is favorable, assuming fiscal and monetary policies remain responsible. The key to achieving this relatively optimistic goal will be how well inflation is controlled. A resurgence of inflation would quickly erode both consumer confidence and actual purchasing power, which would restrict the personal spending that creates the driving force for the entire economy. In turn, business firms would curtail their spending plans which would erode current economic growth and delay the capital investment necessary for achieving our national goals, particularly the creation of new jobs.

In short, we must guard against a resurgence of inflation if we are to avoid a premature disruption of the economic expansion. This fundamental approach is not based on any obsession with a particular goal but is a realistic recognition that inflation destroys economic stability and leads to recession and unemployment. There never was and is not now a choice between inflation and unemployment. That concept is a fallacy. The real choice is between making steady progress on both inflation and unemployment or returning to the stop-and-go economic policies that have failed to provide the needed stability in the past. Every nation faces this same problem and we must all strive for more responsible solutions.

The new international monetary system

I have said in the past that the most important single price in the United States is the price of our dollar. The same is true of every national currency. The foreign exchange value of a country's currency plays a significant role in determining what is produced—exports and imports, the location of production facilities, and capital flows. All of these vital economic factors are, to varying degrees, a function of the exchange rate—the price of a nation's money. This is why it is important, especially during a period marked by pressures for income redistribution, and a period dominated by industrial, corporate, and national drives for more, that we develop a well-functioning monetary system rather than a series of makeshift, ad hoc arrangements.

A system means an agreed charter—a basic understanding among nations on the principles of behavior—that provides the framework within which we operate. But such a charter is only the beginning. Over time, the development of a system also involves the development of a code of behavior based on generally agreed-upon principles. Such a code must adapt to changing circumstances, but in any case must always adhere to the agreed broad principles.

What are the alternatives to this type of system? One alternative involves specific rules but no agreement on underlying principles. In the absence of any anchor of principles, this would mean a process of continuous negotiations and new rules. Another alternative would be to have no agreement on either principles or codes. In the United States this is referred to as the "law of the jungle."

It is not naive to believe in the need for an operating monetary system. It is not even idealistic. To me, it is the essence of pragmatism. Some of you can recall the disastrous process of competitive devaluation so prevalent in the thirties that became enshrined in the phrase "beggar-thy-neighbor." We have learned and relearned that the law of the jungle means that we all lose, regardless of size, power, or efforts at isolation.

We all recognized this at Jamaica. That was why we agreed on a system. Before describing the results of our efforts and discussing implementation of the system, I think it would be useful to review what we want from a monetary system—what should it provide? There are three overall objectives.

First, the system has to be designed so that it facilitates the international flow of goods, services, and capital. It should be an open, liberal system that enables us to capture the benefits of international trade, the paramount benefit being the higher living standards for all that result. It should facilitate the transfer of capital and ensure its most efficient use, the end result again being higher living standards for all. Most importantly, the system has to operate continuously. Its success must not depend on just the right combination of favorable circumstances. It must be more than a fair weather system. It must be able to function in the economic and financial equivalent of hurricane weather.

Second, the system in both its design and its operation must have a built-in equilibrium. It should engage forces that reduce tendencies toward permanent disequilibrium, in the form of structural surpluses or structural deficits in current accounts. The symmetry of which I speak cannot simply be designed—it must be operational; a system that looks perfect on the drawing board but fails in actual performance is no answer.

Third, the system must help rather than hinder individual efforts toward economic stabilization—it must encourage stability rather than foment instability.

The efforts of this group have, for almost 4 years, been concentrated on designing an international monetary system that will meet these objectives. We have now completed that work. The framework is built. The architecture is complete.

Together we have constructed an international monetary system that is sound in structure, right in approach, and complete in a constitutional sense. That system remains firmly centered on the IMF, and firmly based on the liberal trade and payments philosophy of Bretton Woods. It remains a global system, in which all members subscribe to the same standards of responsible international behavior, and in which all members are treated uniformly. We have a system which has flexibility and resilience and which can function well in the years ahead without further structural amendments.

We have changed, and changed profoundly, both monetary doctrine and the structure of the monetary system, in a way which better conforms to present objectives. Three fundamental alterations can be highlighted—the approaches toward adjustment, exchange stability, and gold.

Influenced heavily by the imperatives of experience, we have come to realize that exchange stability cannot be imposed or forced on nations by the establishment of fixed exchange rates. We have embraced the concept that stability will result only from responsible management of underlying economic and financial policies in our countries. We see more clearly that market forces must not be treated as enemies to be resisted at all costs, but as the necessary and helpful reflections of changing conditions in a highly integrated world economy with wide freedom for international trade and capital flows. We recognize—as proved by events in many countries in recent years—that without stable underlying economic and financial conditions, no amount of exchange market intervention will assure stability, but that with stable conditions, little or no such market intervention would be needed.

The new system thus calls for each of our nations, large and small, developed and developing, to concentrate on achieving sound, noninflationary economic growth. There is no other answer to our desire for stability. Also, we must each permit our performance in domestic policy to show through—to assure that governmental efforts to resist or moderate the operations of market forces do not distort our relative economic positions and become a source of instability once again. This applies of course to avoidance of the use of controls over international trade and payments, long a basic objective of the Bretton Woods system. But it also applies as much or more to governmental action to restrict the operations of market forces through the exchange rate mechanism.

In short, a country with an unsustainable deficit should resort to internal stabilization accompanied by exchange rate change in response to market forces; a country with a tendency toward surplus should not simply accumulate reserves, but should allow its exchange rate to move in order to accommodate these fundamental adjustments of others. Only then can we have effective international adjustment and the built-in equilibrium and stabilization which an international monetary system requires. The inexorable fact is that the implementation of our new system—or any system—will succeed or fail as a consequence of the soundness and prudence of the policies our individual governments pursue. There is no other source of stability, no external entity to which nations can turn as they address the challenges they face today.

Our historic decision to phase out the monetary role of gold and to provide for a greater role for the SDR also is a source of strength in the reformed system. By doing so, we eliminate a major element of instability in the monetary system. Removing gold from the center of the system, eliminating the requirement that gold be used in IMF transactions and agreeing to initiate the process of disposing of IMF gold, the Group of Ten agreement to avoid pegging the price of gold or increasing total holdings are all steps toward realism, and a more rational as well as stable monetary system.

While we have made fundamental changes, the Jamaica agreements constitute a reform and not a revolution. Our changes are less of a grand design than Bretton Woods, and appropriately so. We have not discarded all the concepts or replaced the institutions of the Bretton Woods order.

Most importantly the IMF retains a unique and indispensable role in the provision of conditional credit. It is a different role from that of 30 years ago, reflecting the different world of today, and the growth and development of private international capital markets which now do and should provide the bulk of international lending. The Fund's financing is today more clearly a supplement to other sources. But the conditionality of IMF lending places on that institution a special role and special responsibilities which are critical to international adjustment and a smoothly operating international monetary system.

It is to the operation of our monetary system that we must now shift our attention. The construction of the system, the architecture, has been an essential step. It has been an intellectually stimulating exercise. But we must move ahead to the operational stage. We must, on the basis of the principles of our new constitution, develop workable operating practices. No aspect of the IMF's work is more important.

A central feature in the operation of our new monetary system is the IMF's surveillance of members' exchange rate policies. The new article IV places heavy emphasis on IMF surveillance to assure that members comply with Fund obligations and that they avoid manipulative exchange rate practices. It is essential to the successful functioning of the system that this surveillance be performed in a sensible and effective manner. Working out the techniques of surveillance is the Fund's next major task.

Some have said that precise guidelines for IMF surveillance of members' exchange rate policies should have been delineated in the Articles. I disagree. The Articles, after all, are meant to serve as an international constitution, not a commercial contract. Even if we were agreed on precise guidelines, it would be wrong to incorporate them in the Articles—we learned from Bretton Woods the difficulties of a charter containing detailed rules.

But more importantly, it is neither appropriate nor possible to undertake this important job of Fund surveillance through the application of detailed rules and formulas. Such formulas cannot be equitably applied to economies that differ as profoundly as in the IMF membership. Where the largest member has a gross national product some 60,000 times larger than the smallest, when some have no capital markets while others have highly developed and sophisticated markets, where price elasticities and income elasticities can vary widely, rigid formulas simply won't work.

Similarly, I do not agree with those who would call on the Fund to delineate hard and detailed rules by which each member country's performance with respect to exchange rate policies would be judged. We do not have the capability, the experience, or the knowledge, to develop such a set of rules to be applied across a broad spectrum of individual national situations.

Nor would I agree with those who would call on the Fund to attempt to determine a set of "target" exchange rates toward which each nation's policies should be directed. There are those who believe that a comparison of statistical data on prices or costs in individual countries can reveal appropriate exchange rates. That approach is subject to insurmountable difficulties, both theoretical and practical. While it may indicate that some rates are inappropriate, it cannot be depended on to indicate what rates are proper. It is tantamount to continuous renegotiation of a par value system, based on statistics which are of necessity both partial in coverage and backward looking in approach. In practice, it may prove to be nothing more than a veiled approach to a return to fixed rates.

There are those who are nostalgic for the good old days and may translate this nostalgia into a desire to return to the par value system, thinking that fixed rates would bring stability. I would suggest that such beliefs are an illusion. Think again of 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. Remember, too, the hurried attempts 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. Then think back over the last 4 years of unparalleled flows of money, massive increases in oil prices, inflation, recession, balance of payments problems. Just imagine the old par value system trying to accommodate those strains.

The Fund should, in its surveillance of members' exchange rate policies, proceed by a careful and evolutionary approach. It should cultivate more fully its consultative processes and refine its procedures for monitoring countries' behavior. Rather than adopting a sweeping preconceived, rigid economic code, we need to construct, through a case-by-case approach, a common law based on case history. If we proceed in this manner, we will be able to delineate broad principles of behavior that can be elaborated on the basis of experience. The development—and the acceptance—of these principles cannot be forced. But over time workable codes can be expected to emerge, through consultation with members and through the monitoring of their activities.

I urge the Fund to proceed cautiously in this work. The world faces a new situation, in some ways a dramatically different situation from the past. In this case the lamp of history may not provide the best light to guide us in the future. Our experience is drawn from a past that may not be fully relevant, and our attempts to distill this experience into detailed blueprints for the future may be more harmful than helpful.

The adjustment process is another area in which action is imperative. The international financial system has performed the task of recycling funds from surplus countries to deficit countries with efficiency. The elasticity of our financial system has provided us with the time to correct structural maladjustments. This time must not be wasted. Recycling of funds from surplus countries to deficit countries can continue only to the degree that countries borrowing to finance external deficits can obtain credit. This in turn can only persist so long as lenders remain confident that borrowing countries can repay specific obligations on schedule and service their overall debts.

Frankly, we have not made sufficient progress toward adjustment. Although there have been cases of countries adjusting to higher oil prices and global recession, a substantial number of countries have preferred to delay adjustment and borrow abroad to finance consumption, and have thus continued to run the large external deficits which first appeared 3 years ago.

Unless there is some dramatic change in the outlook, the world payments pattern next year will strikingly resemble that of 1974—the first year of abnormally high oil prices. Indeed, if the oil-producing nations take, as is now rumored, the dangerous step of again raising the price of oil, it would seriously aggravate an already troublesome economic and financial situation. Even without an increase in oil prices, the aggregate OPEC surplus in 1977 will again be $50 billion or more, while deficits in the industrial OECD countries would be on the order of $35 billion, and the oil-importing developing countries in the range of $12 billion to $15 billion.

The 1974 deficits were successfully financed—to the surprise of many doomsday forecasters—as the international financial system displayed unprecedented flexibility and resourcefulness. However, we are approaching 1977's look-alike payments numbers under substantially different circumstances. Aggregate OPEC surpluses of nearly $150 billion from the beginning of 1974 to the present have been reflected in increased external debt by oil importers. The bulk of the heavy international borrowing has been of short- to medium-term maturity, and will in many cases need to be rolled over or refinanced. And as debt grows to finance the continuing deficits, an increasing number of countries which have delayed adjustment will approach limits beyond which they cannot afford to borrow and beyond which prudent creditors will not lend to them. This is a serious matter and it cannot be ignored by lenders or borrowers.

There is still time to act, but we must be cognizant of the choices. One unrealistic possibility that has been mentioned involves widespread debt forgiveness or rescheduling. In reality, this is no choice at all. From time to time circumstances may require a debt rescheduling on the part of an individual country. But a wide-scale approach of this type involving a number of countries or even several in a group can only result in substantial damage to practically all international borrowers. Lenders would regard—I think appropriately—such an approach as ipso facto increasing the risk attached to new lending operations. The result would inevitably be a reduction in the availability of private credit to broad categories of countries, a reduction that would inevitably have a widespread contractionary effect on economic activity.

Another dangerous alternative that has been mentioned by some would be to create large amounts of new official liquidity—a kind of international monetary printing press. Ironically, this would have the same effect—it would ultimately be contractionary, although in the first instance it might have an expansive effect. Eventually, and probably with more speed than many suspect, the creation of excessive international liquidity would destroy the stabilization efforts which many of us have underway. For, in the United States, and I believe in many other countries, we have found that a high rate of inflation and prosperity are mutually exclusive.

The third course—and the only one which I believe holds the promise of success—involves a combination of adjustment by individual countries, some slowing in the rate of private international lending and moderate provision of official financing on a multilateral and conditional basis. Fortunately, a floating-exchange-rate system can respond to changes in underlying economic and financial conditions in a climate devoid of crisis. The resultant flexibility provides a useful tool for adjustment. But it is only effective when linked with meaningful programs of domestic economic and financial stabilization. There is no substitute for such adjustment, and countries that do adjust can look forward to durable, noninflationary growth. The IMF can contribute to this process of adjustment. The Fund has both the expertise and the financial resources to assist in the development of overall stabilization programs and provide conditional credit to bridge the time from the start of an individual country's stabilization effort to its favorable end results.

It seems to me the only way that we can proceed without damaging ourselves and our friends and neighbors is to hold to this third course and immediately introduce where needed appropriate policies for adjustment.

Development

Our approach to the international monetary system has placed responsibility for the achievement of international monetary stability on the domestic policies pursued in each country. Our approach to economic development also places primary emphasis on the policies and efforts of each individual developing country.

At the heart of our policy is the concept of shared prosperity. This concept involves a mutually beneficial approach to development in today's interdependent world. In application, this approach means not only direct aid but, most importantly, a liberal trading and investment system.

We do not regard indirect resource transfer schemes such as generalized debt rescheduling, price indexing, and commodity funds as the best means to provide resources to the developing world. To the contrary, such proposals are likely to lead to inefficiencies and distortions which will make most, if not all, worse off.

I have already commented on the likely adverse impact of broad debt-rescheduling schemes. With respect to commodity policy, we have stated on many occasions that we favor a case-by-case approach to the problems of individual commodities, and in particular a careful examination of the applicability of the buffer stock approach. Specifically we must ascertain whether the operation of a buffer stock is likely to lead to improved market operations or to a structurally higher level of prices for the commodity involved.

If it leads to structurally higher prices it helps a few countries, including those developed countries that are producers, but it hurts the larger numbers of consuming countries, both developed and developing. Even in the case of developing countries that produce the commodity, the "help" provided has a high cost. Funds used to finance the buildup in inventories could have been used for development purposes. To the degree that an artificial price level results, incentives to develop and use substitutes increase. Perhaps most important, the producing country allocates labor and capital to production on the basis of an artificially high and unsustainable price.

In the area of direct resource transfers, the United States has long been in the forefront of those assisting in the economic and social progress of the developing world. Much of what we have done has been governmental—through our bilateral as well as multilateral aid programs such as IDA.

I can assure you that the United States will continue its leadership in this area. Not only will we continue, but we will strengthen our bilateral aid programs, and we will continue our strong support for the international development banks. Our commitment to IDA and to a financially strong IBRD cannot be questioned. With respect to the regional banks, I am pleased that we have just received funds from the Congress to join the African Development Fund. We are now participating in a major new replenishment in the IDB. Here in Manila, the home of the Asian Development Bank, it is particularly gratifying to reiterate U.S. support for that institution. I was pleased to note, in a recent Development Committee report, that loan commitments in all these banks will increase from $8.3 billion to about $12.6 billion from 1975 to 1980, or 50 percent, with the concessional share of the total increasing.

The American partnership with developing countries and development prospects of all countries depends even more importantly on our trade and investment links. The worldwide demands for capital in the period ahead will be massive and the competition fierce. Countries which wish to attract investment capital will find that establishing the proper domestic climate is essential. Countries which raise impediments to capital flows will simply not be able to meet the competition. The experience of many countries illustrates how this can properly be done. Countries and peoples as varied as the Taiwanese, the Brazilians, and the South Koreans have dramatically raised their living standards and expanded their economic base. They have done so not only because of the amount of help they received, but because of the care and self-discipline they used in putting that help to work. Others can do the same, but only with the realization that developmental help involves a partnership and—like all partnerships—requires the best intentions and the best efforts of both partners in order to succeed.

We must all recognize that individual national economies can best achieve the goal of sustained noninflationary growth in a free and open international trading system. We need an open world market to allocate raw material and capital resources efficiently in order to supply abundant goods and services to all of our people at noninflationary prices. All the aid we can give will not help if it does not foster a prosperity shared by all. Achieving such a prosperity will require the close cooperation of both industrial and developing nations. We must, therefore, join together aggressively in the multilateral trade negotiations to take concrete and significant steps to eliminate tariff and nontariff barriers to trade.

As these areas for cooperation between developed and developing countries evolve toward greater mutual advantage, we must preserve the fundamental principles—such as reliance on market forces and the private sector—on which our common prosperity depends. Solutions must be dynamic and have widespread benefits. Thus, we must seek increased production and improved efficiency, not just transfer of wealth. 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.

In a sense this can be thought of as a process by which developed countries devote a portion of their savings to developing countries. The impact of this type of direct transfer depends on the amounts involved, the uses to which these funds are put, and the effectiveness with which the recipient countries implement development efforts. If these funds are devoted to financing a higher level of consumption than a given country can earn, it means only a short-lived improvement in living standards; if these funds are devoted to investment, the result will be a permanent gain in well-being. This is especially the case in a system which allocates financial resources to areas of maximum benefit.

More specifically, in considering how the present system might be improved to the mutual benefit of all nations, we should be guided by the following principles:

- Development by definition is a long-term process; increased productivity, stemming from capital formation and technological advance, is the basis of development, not transfers of wealth which can only be one time in nature. Foreign aid can help, but such aid can only complement and supplement those policies developing countries adopt, which in the end will be decisive.
- The role of the private sector is critical. There is no substitute for a vigorous private sector mobilizing the resources and energies of the people of the developing countries.
- A market-oriented system is not perfect, but it is better than any alternative system. In general, the effort should be to improve conditions for the developing countries—both internally and externally—by removing unnecessary and burdensome government controls, not by imposing additional barriers and impediments to market forces.
- A basic focus must be on increasing savings and making the institutional and policy improvements which will enable the financial markets to channel those savings into activities that enhance the opportunities for people to live better lives.

The World Bank group

With these principles in mind, let me turn now to issues concerning the World Bank group. These institutions play a central role in international cooperative efforts to promote economic progress and development. While their role as suppliers of development capital is a very important one, their contribution to the development process itself is equally important. Economic policies in developing countries—with widely different economic regimes—have greatly benefited not only from the financial support but also from the advice, encouragement, and technical expertise of the World Bank group. To the degree that these institutions are successful in helping to bring about sounder, more consistent, and more effective domestic policies in countries to which they are lending, they multiply their effectiveness as development organizations. Strong and clear U.S. support exists for the institutions which comprise the World Bank group not only because their objectives are laudable, but also because they have proven themselves to be effective agents of policy improvement in the countries in which they work.

In looking at recent developments among the member institutions of the group, I am greatly pleased by the agreement providing for a capital increase for the International Finance Corporation. The key role of the private sector in the developing countries underscores the importance of this proposal. As President McNamara pointed out yesterday, the poorest countries of the world have financed almost 90 percent of their development investments out of their own meager incomes. The capital increase will enable the IFC to expand greatly its ability to encourage private capital flows in these poor countries. As we all know, IFC's participation in projects has a considerable multiplier effect—$4 for every $1 of its own—through the associated private investment. The capital increase implies about $5 billion in cumulative commitments over the next 10 years in the private sectors of the developing world. I hope that the IFC capital increase can be formally ratified by the Board of Governors quickly to permit this expansion to begin.

I am pleased also by the agreement reached on a selective capital increase for the World Bank. The Bank is a unique financial institution—publicly capitalized but privately financed for the major portion of its lending operations. While the paid-in and callable capital from its member governments are important assurances of solvency to its creditors, the Bank is able to operate actively and extensively on its own footing. In our view, the excellent reputation of the Bank and its sound financial condition give it the capacity to raise very substantial sums in private capital markets for relending to its borrowers. We are pleased that, in the course of the negotiations on a selective capital increase, agreements were reached on the lending program and the lending rate which I believe will continue to strengthen the financial position of the Bank.

During those negotiations, it was agreed that Bank commitments would not be increased above the level which could be sustained indefinitely without a further capital increase. I do not believe that this important principle should now be redefined.

With regard to the lending rate formula, I realize the temptation that exists to hold rates and charges on Bank loans to a minimum, but in the long run neither the interests of the Bank nor those of its borrowers would be well served by such a policy. Continued sound financial practices by the Bank are the best guarantee that it will maintain the reputation which gives it the very favorable access to capital markets that it enjoys. Thus, the Bank will remain in a position to be responsive to its clients' needs tomorrow. Also, as Bank reserves continue to grow, the time will certainly come when increased transfers of its earnings can, and should, be made through IDA for the benefit of its poorer member countries.

I should note at this point that we remain very interested in the Bank's continued study of the lending formula. While we believe the current formula is sound, we are prepared to consider an improved version. I might add that the United States supports the use of the lending rate formula, not only in the World Bank, but in the regional banks as well. The Inter-American Development Bank recently approved a similar mechanism, and the Asian Development Bank has taken an interim step leading toward a final decision early next year.

I would like to turn now to the question of the future of the Bank, which I believe quite properly is now on the international agenda. In thinking about the future of the Bank as a development institution, the continued strength of the Bank as a financial institution must be given paramount importance. The Bank is now entering a new financial era as its disbursed loans outstanding have begun to reflect the rapid growth in commitments since 1969. The financial consequences of an expansion of annual loan commitments from less than $1 billion in 1968 to this year's $5.8 billion are substantial. Even holding that commitment level constant indefinitely, loans disbursed and outstanding will grow from $13.6 billion on July 1 of this year to some $26 billion in 1980 and to over $40 billion by 1985. To finance this expanded portfolio, the funded debt of the Bank must grow accordingly. This is the financial challenge the Bank faces. I know how demanding this challenge will prove as the Bank continues its preeminent position in the world's capital markets.

The Bank has in the past made an invaluable contribution to qualitative improvements in the development efforts of its borrowers. Key development problems—restraining population growth, improving the efficiency and equity of domestic tax collections, bringing small farms more fully into the growth process, and others—remain unsolved in many countries. The success of the Bank in encouraging policy improvements in such areas will have a substantial impact on the productivity of Bank lending. The Bank needs to monitor its own policy and practices to make sure that its effectiveness in this objective is maintained.

The current situation also presents an excellent opportunity for the Bank to expand its role in generating complementary financing for its projects. In the future the Bank might well play a role of decisive importance by helping to mobilize substantially increased long-term development credits from the private sector. I see untapped potential for the Bank in this direction, and I would urge that intensified work on this issue be promptly initiated.

The United States in no sense envisages a static role for the Bank, which we believe can and should remain the leading development institution in the world. We are prepared to take an active and constructive part in a frank dialog on the future role of the Bank. I would urge that in considering the Bank's place in a world that is changing rapidly, our intellectual net be cast wide enough to capture significant new directions of Bank activity. In this process, we are committed to doing everything we can to assure that the Bank meets the challenges of today and tomorrow. I am confident that by addressing the important questions forthrightly, the Bank can assure itself for many years to come of a continuation of the leading role in the international cooperative effort to promote growth and progress in developing nations.

Also, the future of the International Development Association is of critical importance. Now that our Congress has acted favorably on our fiscal 1977 appropriation request for IDA, the United States is in a position to participate actively in negotiating an IDA–V agreement. I am confident that with good will and understanding these negotiations can be successfully concluded during this next year, and I am fully confident that my Government will be a generous participant in any arrangements agreed upon.

We recognize the urgency of the IDA problem, and our commitment to IDA can't be called into question. Certainly the replenishment of IDA funds, which support the poorest nations, remains a priority concern of my Government. Of special concern to us is the fact that IDA's commitment authority will end after June 30, 1977.

While progress has been made in international discussions, we have not reached an agreement on an IDA–V package, including magnitude, shares, voting rights, and signup procedures. Reaching such international agreement will take time. Moreover, the United States is not alone in having legislative procedures for subsequently ratifying such international agreements that will also take time.

While it is important to push forward on these negotiations of IDA–V—and we intend to intensify our negotiating efforts—we must recognize that the completion of these negotiations and the necessary legislative action in all our countries by July 1, 1977, cannot be assured. Therefore, in order to avoid a gap in IDA's commitment authority next year, and to inject some momentum into the IDA negotiations, I would propose that not later than January we negotiate a bridge agreement which may be considered a precommitment to IDA–V, and I would hope that prospective new members of IDA will voluntarily make contributions to this bridge agreement. In my view, this should be a primary subject of discussion at the Kyoto meeting of IDA deputies next week so that IDA does not run out of money next June.

Conclusion

In meetings such as this we naturally and inevitably concentrate our attention on international issues of great significance—providing for a reformed international monetary system, or determining future policies of important institutions such as the IMF and the World Bank. In the final analysis, however, what really counts for each of our countries and for the world economy is how efficiently we all manage our own domestic affairs. International cooperation provides a framework of opportunity; individual countries in various ways and to varying degrees seize that opportunity. In all countries—developed and developing, industrial and agricultural, oil rich and resource poor—economic policymakers are confronted with many similar kinds of issues and dilemmas. A country's performance is not predetermined by its level of income or stage of development alone. Just as pertinent is how the tough issues of economic policy that we all face are resolved.

Unfortunately, good economics is not always perceived to be good politics. My experience has been that politics is an art with a high rate of discount. And while the payoff to good economics is real, it takes time. This lag, as the economists call it, is a politician's nightmare. Fortunately, I think that more and more people now understand that this is the case—and I sense growing suspicion of the proposed instant solution, the quick fix. In a world of unlimited demands and limited resources, Finance Ministers not only are inevitably unpopular, but indeed cannot afford to be popular. We are frequently required to be the bearers of bad tidings to our political masters—to reiterate the unpleasant but inescapable fact that resources are scarce while wants are limitless. It is our lot, whatever our country's economic system and whatever its circumstances, to speak out for financial responsibility—to call for prudence in an age of fiscal adventure.

Announcement of dramatic new programs is greeted with great fanfare; the management of sustained, stable growth is a bit like watching the grass grow. Yet, in the end, it is sustained, stable growth that does the most good.

To be sure, for a time an increased inflow of real resources from abroad may enable a country to postpone the hard choices among competing domestic claims, in the process running down assets and/or accumulating debts abroad. But sooner or later, the bills come due—the adjustment I have spoken of earlier has to be made. There simply is no substitute for the hard decisions and the careful husbanding of resources that finance ministries traditionally espouse.

As we meet today we can point to tangible evidence that we have been more than nay-sayers over this past year and more. In the monetary area, through our collective efforts, we have put into place a new structure for the international monetary system, one with the flexibility to accommodate rather than impede the efficient working of the international economy so that trade and capital can serve their full role as engines of economic growth and progress. In trade we have made progress in the multilateral trade negotiations to reduce barriers and ensure fair and orderly rules for the international trading system. In energy, the industrial countries have joined together to coordinate efforts to reduce our dependence on imported oil. We have also established a framework of cooperation with the oil-producing countries. In the relations between developed and developing countries, we are fashioning positive cooperation that will further strengthen the world economy. Finally, we have all avoided restrictions on the free flow of capital at a time when pressures existed to create impediments.

In my stay at Treasury, I have seen the world economy pass through some extremely rough weather. Our management, though imperfect, has enabled us to survive—and a bit more.

We survived in the sense that our economies did not collapse, markets continued to function, and we avoided a wave of restrictions on flows of goods and capital among nations. This achievement in itself was considerable. But beyond that, the foundation we have laid can lead to a great deal more—if we do the right things from here on.

We all know that the present situation has both risk and opportunity. We should not fear the risk and we must not fail to grasp the opportunity. Much has been accomplished—much remains to be accomplished. With determination, we can now strengthen the foundation of individual economic stability. With courage, we can eliminate restrictions on trade and investment, in recognition of our interdependence. With patience, we can work together and find the proper balance of opportunity and responsibility for rich and poor alike that is essential in today's world.

Let us commit ourselves here in Manila to this effort. As we do, I believe we can all look to the future—a future of shared prosperity for all—with confidence.

Exhibit 43.—Statement by Under Secretary for Monetary Affairs Yeo, October 18, 1976, before the Subcommittee on International Economics of the Joint Economic Committee, on international monetary reform—the operational phase

In calling these hearings, you have drawn attention to the need to move to the next phase of international monetary reform—the operational phase. For several years the world was engaged in the complex task of designing a monetary system. Now we must make the system work. As nations move toward ratification of the amended IMF Articles, we must translate the philosophy of that charter into practice, and develop the operating procedures for putting the new system into force. If the job of applying the new system seems intellectually less exhilarating than the job of creating it, certainly the present task is of no less importance for the world economy. Nor do I think it will be less difficult. I am grateful to the subcommittee for an opportunity to comment on this important work though my comments will, at this early stage, of necessity be tentative and general.

The subject of these hearings is "Guidelines for Exchange Market Intervention." But that subject should be seen in a larger context. Under the Jamaica agreements, we and other nations aim at assuring orderly exchange arrangements and promoting a stable system of exchange rates. That objective, of course, cannot be attained solely, or even most importantly, by exchange market intervention. Rather it will be attained by the continuing development of orderly underlying economic and financial conditions in the member countries. The new system recognizes—as events in recent years have proved in many countries—that without such stable underlying conditions, no amount of exchange market intervention will assure stability, but that with stable conditions and limited intervention, orderliness and gradual change will characterize the exchange markets. The focus of the new system is thus much broader than exchange market intervention.

The IMF is specifically charged under the amended Articles with surveillance of members' exchange rate policies. The new article IV, section 3(b), says that the IMF, "shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." This is a central feature of the operation of the new system. The purpose of this surveillance is to enable the IMF to fulfill its functions of overseeing the international monetary system to ensure its effective operation, and of overseeing the compliance of each member with its obligations. Thus IMF surveillance of exchange rate policies—and principles which may be adopted as a framework for that surveillance—should, in my view, not be limited to questions of exchange market intervention but should have a wider focus, if we are to assure that nations do not manipulate exchange rates to the disadvantage of others, and if we are to assure that members' exchange rate policies facilitate rather than counter effective balance of payments adjustment.

How, then, do we work out the techniques of surveillance, and develop the needed principles so essential to the successful functioning of the system? I must tell you that there are differing views on this question.

Some have argued that precise guidelines for IMF surveillance of members' exchange rate policies should have been delineated in the amended Articles. I disagree on two counts—first, that there should be detailed rules, and second, that any such rules should be incorporated in the Articles.

On the second point, the Articles should not, in my view, impose detailed operating rules and procedures on the international monetary system. The Articles, after all, are meant to serve as the Fund's constitution, not a detailed contract. Even if we were all agreed on precise guidelines that should be adopted for assessing members' exchange rate policies, it would be wrong to incorporate them in the Articles. We learned from Bretton Woods the difficulties of having a charter filled with detailed rules which can too soon become obsolete or inapplicable—indeed, a major advantage of the Jamaica agreement is that we are moving to a charter which avoids so many detailed rules and contains appropriate elasticity to allow the system to adapt to changing conditions.

But more importantly, irrespective of where they might be embodied, I do not agree that the IMF should delineate hard and detailed rules by which each member's performance with respect to exchange policies would be judged. It is, in my view, neither appropriate nor possible that this important Fund surveillance work through the application of detailed rules and precise formulas. We do not have the capability, the experience, or the knowledge, to develop such a set of rules to be applied across a broad spectrum of individual national situations. It is particularly difficult to apply rigid formulas equitably to economies that differ as profoundly as in the IMF membership where the gross national product of the largest member is 60,000 times as large as that of the smallest member; where some members have no capital markets while others have highly developed and sophisticated markets; where economic structure and elasticities of price and income can vary widely; and where the relative importance of international transactions to domestic economies differs greatly. Rigid rules and formulas simply won't work in such situations.

Nor would I agree with those who would call on the Fund to attempt to determine a set of "target" exchange rates toward which each nation's policies should be directed. There are those who believe that a comparison of statistical data on prices or costs in individual countries can reveal appropriate exchange rates. That approach is subject to insurmountable difficulties, both theoretical and practical. While it may indicate that some rates are inappropriate, it cannot be depended on to indicate what rates are proper. It is tantamount to continuous renegotiation of a par value system based on statistics which are of necessity both partial in coverage and backward looking in approach. In practice, it may prove to be nothing more than a veiled approach to a return to fixed rates.

How, then, should the Fund proceed in its surveillance of members' exchange rate policies? In my view, we should proceed by a careful and evolutionary approach. We should cultivate more fully the IMF's consultative processes and refine its procedures for monitoring member countries' economic and financial policies. Rather than adopting a sweeping preconceived, rigid economic code, we need to construct, through a case-by-case approach, a common law based on case history. If we proceed in this manner, we will be able to delineate on the basis of experience broad principles of behavior with regard to what constitutes appropriate adjustment policies, and what constitutes manipulation of exchange rates. The development—and the acceptance—of these principles cannot be forced. But over time workable codes can be expected to emerge, through consultation with members and through the monitoring of their activities.

I hope the Fund will proceed cautiously in this work. The world faces a new situation, in some ways a dramatically different situation from the past, and history may not provide the best guide for the future. Our experience is drawn from a past that may not be fully relevant, and our attempts to distill this experience into detailed blueprints for the future may be more harmful than helpful.

Mr. Chairman, in addition to commenting on the general question of developing principles and guidelines for IMF surveillance, you have also asked me to speak to the question of whether, since Rambouillet and Jamaica, other industrial countries have been persistently intervening in exchange markets to maintain their currencies overvalued or undervalued relative to the dollar.

The short answer, in my judgment, is no. I do not think we have a basis for objecting that large or persistent intervention has been conducted to over or under value other currencies at the expense of the dollar. There has been a substantial amount of exchange market intervention in the 11 months since Rambouillet, much of it related to operations within the EC snake, and I would certainly not want to defend each and every action. But I do think I detect some progress over that period. I think there is increased recognition of the doubtful value of efforts to "defend" by exchange market intervention a particular exchange rate which is fundamentally at odds with underlying conditions and market judgments. Also (this is the other side of that same coin) I think there is greater understanding of the need for both surplus and deficit countries to allow exchange rates to play their appropriate role in facilitating balance of payments adjustment. There may in fact be an emerging consensus on future intervention policy. But I would like to comment briefly on other points implicit in your question before outlining that consensus.

My first point relates to the meaning of what was agreed to at Rambouillet and Jamaica. These meetings resulted in understandings in five important areas: (1) Development of a shared analysis of the causes of instability in the international economy; (2) recognition that achievement of monetary stability requires achievement of stability in underlying international economic and financial conditions; (3) recognition that countries should intervene to counter disorderly exchange market conditions, with the judgment about whether to intervene to be left to the individual country concerned; (4) recognition of the need to strengthen consultative procedures among finance ministries and central banks of the major countries; and (5) development of a specific text of amended article IV of the IMF Articles of Agreement to be proposed to other IMF members.

It is important to recognize that neither the Rambouillet understandings, nor the text of new article IV agreed upon at Jamaica, prohibits exchange market intervention per se—even intervention that may persist for a time. Indeed, the text of amended article IV will specifically permit members to maintain pegged rates for their currencies, "common margins" arrangements such as those presently maintained by several European countries, or other arrangements of their choice. The fundamental obligation regarding exchange rates laid out in amended article IV is to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." That obligation does not relate exclusively or even necessarily to exchange market intervention.

My second point is that, while the amended Articles clearly express the will of the IMF membership regarding the framework for future international monetary arrangements, those amended Articles do not yet have legal effect. The first task is to secure ratification of the amended Articles, a process that has received major impetus from passage of our own legislation by the Congress a few weeks ago. But we must be very wary about anticipating obligations that are not yet legally binding and about reaching judgments regarding member countries' current policies based on obligations that will not exist for at least some months to come.

But despite the problems, the uncertainties, my own judgment is that there has been an increasing and healthy coalescence of views on appropriate exchange market behavior and intervention policy since Rambouillet and Jamaica. All agree that exchange market intervention may be useful to counter disorderly market conditions. More importantly, more and more countries appear to be coming to the view—in some cases, after repeated hard and costly lessons—that intervention that attempts to do more may be counterproductive and disruptive. And most recently, the Interim Committee has enunciated several general principles for operation of the system that we think are extremely important in today's circumstances of widespread payments imbalance. These are essentially that—

Countries in structural deficit must stabilize their internal economies;

Industrial countries in stronger positions should pursue expansionary—but not inflationary—domestic policies and maintain unrestricted access to their markets; and

All countries, deficit and surplus, should permit appropriate changes in their exchange rates to facilitate needed balance of payments adjustment.

These principles are indeed broad, but if they are applied—and that is our objective—they are a prescription for needed adjustment and achievement of international monetary stability. This is the main task before us.

Exhibit 44.—Remarks by Deputy Assistant Secretary Widman, December 3, 1976, before the Northwest Mining Association, Spokane, Wash., entitled "Role of Gold in the International Monetary System"

I am pleased to have the opportunity to participate in your examination of the market outlook for precious metals. Yours is a group with a practical, perhaps personal, interest in the prospects for prices and sales of these commodities. I must make clear at the outset, however, that my contribution must be limited basically to an explanation of the role of gold in the international monetary system and the current policies of the U.S. Government with respect to gold, policies which have had broad, bipartisan support.

The governments and international institutions of the world hold stockpiles of gold equivalent to 29 times the annual world gold production. Thus it is clear that governmental views and policies of gold inevitably have a major impact on the gold market. What I would like to do is to review the actions that have been taken in the past year with respect to the role of gold in the international monetary system and the relationship of governmental gold transactions to the gold market.

The judgment that gold does not and cannot serve as a sound or stable basis for a monetary system is almost universally accepted by governments throughout the world. The force of events and practicality have over the years led to a reduction of the role of gold in domestic monetary systems around the world to the point that it no longer serves an important monetary role in virtually any nation.

The amount of gold held does not effectively limit the money supply; it does not serve as a restraint on inflation. Similarly in the international sphere, the size of gold reserves is not a limiting factor on a country's ability to purchase foreign goods or financial assets. In practice, gold's role in the monetary system has been sharply diminished and the recent international negotiations on gold have centered more on how to reflect this reality in the legal framework of the International Monetary Fund Articles of Agreement than on what the role should actually be.

The international monetary system established in 1944 envisaged a central role for gold: As the unit of value for the system and for the International Monetary Fund; as a principal means of payment to be used by governments in transactions with the IMF; as the main element of countries' international reserve holdings; and as the link for holding together the system of fixed exchange rates or par values for national currencies.

But, in fact, gold never fully performed these functions, and over time it became increasingly apparent that it never could. Gold was not used for monetary purposes alone. It was a commodity with many industrial and commercial uses, and industrial demand grew dramatically in the postwar years as the world's economies expanded and personal income grew. But new gold production was strictly limited by natural factors and could not respond readily to the increased demand. Thus the amount of new gold production which became available for monetary uses declined rapidly. Moreover, the amount of new gold becoming available for monetary purposes each year was totally unrelated to the needs of an expanding world economy for liquidity. As a result, price differences inevitably emerged between the controlled official market and the highly volatile private market, leading to official efforts to alleviate or suppress the pressures by sales of gold on private markets—further reducing official monetary stocks—and to widespread pressures and speculation for changes in the official price. But since gold was supposed to be the center of the system—the measuring rod against which the value of national currencies was to be determined—any change in the official price of gold would have had a capricious and destabilizing effect on the entire monetary system.

Actually as the exchange rate system had developed in practice, most countries maintained par values for their currencies by governmental intervention in the exchange markets to maintain exchange rates for their currencies at specified levels vis-a-vis the dollar. Only the United States met its par value obligations by undertaking freely to buy and sell gold at the official price of gold—the dollar's par value. The United States was, in effect, at the center of the system, with an obligation to convert other countries' holdings of dollars into gold at a specified price of U.S. $35 per ounce. But since monetary gold stocks were simply not adequate to permit countries to acquire an adequate amount of reserves in the form of gold, they built up their reserves in the form of U.S. dollars, thus forcing the United States to run balance of payments deficits. The result was that gold convertibility of the dollar became less and less credible and in 1971 was suspended altogether.

- The special drawing right (SDR), the present currency "basket," has replaced gold as the unit of account for IMF operations and transactions.
- Countries have virtually ceased to use gold for payments to the IMF.
- Monetary authorities have stopped using gold in transactions with other monetary authorities, and gold has declined as a proportion of world official reserves—from 70 percent in 1950 to 17 percent today.
- Finally, the system of par values based on the dollar tied to gold convertibility has been replaced de facto by a generalized system of floating exchange rates.

All of these changes have taken place as a matter of practical necessity. They add up to a major reduction of the international monetary role of gold that is widely accepted as inevitable and indeed desirable. The negotiations on gold over the past few years have to a large extent concentrated on how to reflect these changes in new Articles for the IMF—that is, on how to codify and further promote the phasing out of gold's international monetary role. The only problem—and the only real reason for retaining any monetary role for gold—arises out of the fact that a portion of the international financial reserves of most countries—a very high proportion for some—consists of gold and no practical way has been found to dispose of that gold in the short run.

First, gold's legal position is changed. Under the amended IMF Articles of Agreement, gold will no longer have an official price. It will no longer be the legal basis in the Articles for expressing the value of currencies, for determining the value of the SDR, or for calculating nations' rights and obligations in the Fund.

Second, all legal obligations for use of gold in the IMF will be eliminated; for example, in the quota subscriptions and payment of charges. In fact, the IMF will be prohibited from accepting gold except by specific decision, by an 85-percent majority vote.

Third, 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.

Agreement was also reached to dispose of a portion of the gold presently held by the IMF. Some 25 million ounces, or one-sixth of the IMF's holdings, will be sold at public auction over a 4-year period. The profits from this sale—the difference between the original IMF purchase price and the proceeds of the sale—will be used to extend medium-term loans to developing countries. An identical amount, 25 million ounces, will be "restituted" to IMF members—i.e., sold to IMF member countries in proportion to their IMF quotas as the present official price.

The IMF's gold auction program was actually initiated on June 2, and it is expected that restitution of one-quarter (or 6 1/4 million ounces) of the total to be sold to members will take place in the next few weeks. It should be emphasized that the purpose of the IMF's auctions is to mobilize this IMF gold for the benefit of the developing countries. The objective is not to obtain a predetermined sum or to influence the gold price one way or the other. In fact, great care has been taken to sell the gold in an orderly, nondisruptive way that will have the minimal possible impact on the gold market. For the most part, this has involved removing, to the extent possible, all uncertainties regarding the sales, by announcing the time period and schedule over which these sales would be made and sticking to it. The market sales of 25 million ounces are to be made over a 4-year period, on a regularly scheduled pro-rated basis. In many respects, this is similar to a new gold mine coming into production which can be expected to operate for 4 years at a production level of 6 1/4 million ounces a year.

Initial market reaction to the announcement of the IMF sales program was one of concern as to whether demand levels would be sufficient to absorb this amount of gold without seriously depressing the price. Actually, bids at each of the 4 auctions—at each of which 780,000 ounces were sold—totaled between 2.1 and 4.2 million ounces, sufficient to absorb the amount offered at close to the prevailing market price. The market price did decline over the period of the first three auctions—for a variety of reasons including a decline in inflation in some countries, a reduction in commodity prices, and other factors. The market price declined to $111 per ounce at the time of the third auction, and it was suggested by some that the IMF vary its sales program to ease the pressure on the market. The Fund reaffirmed its intent to proceed with the planned sales program. In mid-October the price started an upward climb which actually accelerated following the fourth IMF auction at the end of October. Gold is now trading at around $130 per ounce with another auction scheduled for December 8.

There are undoubtedly many reasons for this turnaround—as there seem inevitably to be for every movement in the gold price. I would only note that the reaffirmation of the IMF's intention to adhere to the agreement on sales of its gold removed one uncertainty. We may confidently expect the IMF to continue with its auction program on a regular basis. Auctions of smaller amounts might be held more frequently, but the principles of the IMF's approach, and the volume to be sold in any 6- or 8-week period, are not at issue, and this fact should be a force for greater stability in the market.

I noted earlier that the official price of gold in the IMF will be eliminated by amendment of the IMF Articles. We have long viewed this as an important symbolic step, a step that is central to demonetization. While elimination of the official gold price will eliminate what has been an effective impediment to official purchases of gold, whether we will actually see a significant volume of transactions in gold between central banks is, in my judgment, extremely doubtful. The system as a whole has evolved too far. The risks of dealing in gold have become too great to make such official transactions likely. A central bank acquiring gold has no assurance that it can be sold at any particular or specified price. This is a risk which central banks may not wish to run with the monetary reserves of their nation.

It is more likely, in my view, that we will see a gradual movement of gold out of official reserves altogether, as countries choose to realize the capital gains on their gold holdings through sales to the market. There will almost surely come a time when governments conclude that it is not fair to their taxpayers to continue to hold gold—an asset which yields no interest—when its sale could reduce the national debt and the continuing interest burden. I would stress, however, that I would expect the disposal of government stockpiles of gold to be a gradual process, in large part because holders realize that large portions of the 1 billion ounces still held in official reserves cannot be sold without significantly affecting the market. Gold sales may take place as individual countries experience an immediate need to sell gold to obtain the foreign exchange with which to pay for essential imports.

Despite the judgment that these agreements are not likely to lead to dramatic changes in official attitudes with respect to gold holdings, important transitional arrangements have been agreed upon by the Group of Ten—the major gold-holding nations—to assure that gold does not reemerge as an important monetary instrument while these changes are taking effect. These arrangements provide that participating nations: (1) will not act to peg the price of gold; (2) will agree not to increase the total stock of monetary gold held by their authorities and the IMF; (3) will respect any further conditions governing gold trading to which their central banks may agree; and (4) will report regularly on their gold sales and purchases. The arrangement took effect February 1, 1976, and will be reviewed after 2 years, and then continued, modified, or terminated. While we need to watch developments carefully, I would hope that such arrangements will not be needed for an extended period.

U.S. gold policy and the market

I would like to turn briefly to the question of how U.S. gold policy relates to the functioning of the gold market.

You will recall that all restrictions on private ownership of gold by U.S. citizens were removed at the end of 1974. Secretary Simon supported the repeal of these restrictions as a "practical step toward our objective of ending the official monetary role of gold so that it may ultimately be treated in all respects like any other commodity." I should stress that moving gold towards a pure commodity status should have advantages for both producers and consumers by allowing the free market to work in the absence of stifling regulations on gold transactions. As the monetary role of gold fades, more countries may follow the U.S. lead in removing restrictions.

The U.S. action has, I submit, contributed to a more efficient and broader world gold commodity market. The U.S. market centered in New York has made possible a world time chain for gold transactions, running from Europe to the United States to the Far East. This has made gold pricing easier and facilitated transactions. The development of an active futures market for gold on the organized commodity exchanges of New York and Chicago has been particularly significant. In an era of fluctuating prices, futures markets serve the valuable function of allowing both producers and users of gold to hedge their operations.

Since the lifting of restrictions on gold holdings by U.S. citizens, the Treasury has auctioned a total of 1.3 million ounces of gold in 2 separate auctions, one on January 6, 1975, and the other on June 30, 1975. These sales were designed to reduce the need for imports. No further auctions have been held and none is currently scheduled.

Thus far this year U.S. demand for gold for industrial and artistic purposes has been running at an annual rate of about 4 1/2 million ounces. Demand, of course, tends to increase as the economy grows. Domestic production is running at approximately 1.1 million ounces a year, and scrap recovery is about 800,000 ounces a year. There is a substantial gap between this supply and industrial consumption. Except to the extent that the Treasury sells from its holdings, this gap, together with any demand for speculative or investment purposes, must be met by imports. In the first 10 months of 1976 we have imported 3.4 million ounces of gold bullion including gold which has been sold out of foreign official accounts at the Federal Reserve Bank of New York.

Treasury policy toward sales is perhaps best expressed in the answer which Secretary Simon gave on February 3, 1976, to a question from Congressman Henry S. Reuss, chairman of the House Subcommittee on International Economics. The Secretary said:

> Sales of U.S. gold by the Treasury to date have been related to helping meet net import demand for gold from abroad, and are consistent with our view that the international monetary role of gold should continue to diminish. We have not attempted to enunciate a long-term sales policy, but would expect to continue to conduct sales from time to time to help meet import demand. We will in no way conduct sales in a manner that would "peg" the market price of gold or that could be construed to have that objective.

In sum, the Treasury favors the increase in gold's status as a commodity, favors the development of a free gold market, and supports official sales of gold in the manner least disruptive to the market. We have no price objective, and we strongly oppose the use of official sales for the purpose of controlling the gold price.

Exhibit 45.—Press release, February 11, 1977, announcing agreement on $300 million credit between the United States and Portugal

The Treasury Department and the Bank of Portugal today formally approved the provisional agreement reached December 31, 1976, for the extension of up to $300 million in short-term credit from the U.S. Treasury Exchange Stabilization Fund to the Bank of Portugal. The ESF arrangement is envisaged as the first phase of a program of assistance—involving this short-term credit, possible drawings from the IMF by Portugal, and a proposed medium-term multilateral credit facility—designed to achieve financial stability and recovery of the Portuguese economy.

Exhibit 46.—Statement by Assistant Secretary Bergsten, April 5, 1977, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, on various issues raised by the foreign lending activities of U.S. commercial banks

The setting

It is a great pleasure to appear before this subcommittee to discuss the various issues raised by the foreign lending activities of U.S. commercial banks. I will first address the dramatic changes in the world economy which have led to the sizable increase in international lending by U.S. banks, and then turn to the role played by the banks and the effects of their activities on the U.S. and world economies.

Since the massive increase in the world price of oil in late 1973, the OPEC countries as a group have been running surpluses in their current account positions—their trade in goods and services—of $40–$65 billion annually. Only two fundamental remedies to this situation are possible: Cutbacks in total energy consumption by importing countries, and increased use of alternative energy sources. President Carter's energy program, to be announced later this month, will pursue both objectives for the United States, and we will be urging other countries to take similar steps. Implementation of such programs will take time, however. Hence the OPEC financial surpluses—which are now concentrated heavily in Saudi Arabia, Kuwait, and the United Arab Emirates, whose own imports will increase only slowly—will probably continue, with a gradual decline for several more years.

The needed response

Two issues are thus raised for the rest of the world: How to share out its OPEC-induced current account deficit, and how to finance that deficit in the most stable possible manner. The recent expansion of international activity by U.S. banks relates directly to both.

Many commentators have focused on the sharing out of the OPEC-induced deficit between (a) industrialized countries and (b) developing countries. I do not believe that this is a useful distinction. A number of industrialized countries have in recent years experienced extremely weak balance of payments positions, exacerbated by—but going well beyond—the problems caused by higher oil prices. At the same time, a number of developing countries have adjusted effectively and rapidly to the new situation and have maintained strong external positions. Attention needs to be focused on the positions of individual countries, whether industrialized or developing, to see whether they are playing their proper role in sharing out the OPEC-induced current account deficit of the rest of the world.

For example, some of the strongest national economies—notably Germany, Switzerland, the Netherlands, and Japan—have continued to run sizable current account surpluses. They thus intensify the pressure on other countries, which is already formidable because of the OPEC surpluses, by perhaps another $12 billion this year. If these stronger countries are unwilling to help share out the OPEC-induced deficits, the problems of adjusting and financing the international payments balance are rendered much more difficult.

It is thus the policy of the United States to urge these countries to take measures which will have the effect of reducing their surpluses and, indeed, to bring them into current account deficit. The United States itself has already taken such measures. We are encouraged that some of these countries have recently taken steps in the proper direction; further action by them will help assure a stable international payment picture.

On the other side of the ledger, countries with excessive current account deficits must also adjust. Some countries, in both the industrialized and developing world, developed sizable deficits because they chose to ride out the world recession of 1974–75—maintaining their planned rates of economic growth, and borrowing abroad to cover the external deficits which resulted from the weakening of the largest industrialized markets for their exports of both commodities and manufactured goods. Hence they have had to adjust in 1976–77, when other countries (such as the United States) were recovering from the recession. To some extent, this pattern has produced an image of economic weakness for some countries which is, rather, a simple matter of the timing of their adjustment to the massive change in world economic conditions since 1973.

Nevertheless, it is essential that such adjustments take place. The United States has urged individual countries to do so. We have strongly supported the efforts of the International Monetary Fund to help both industrialized and developing countries find sustainable adjustment paths, and indeed believe that the Fund should play a central role in supporting the evolution of a sustainable international payments picture. Private bank lending to an individual country is, of course, rendered much more likely, and much more likely to achieve its purposes, when that country has adopted effective adjustment measures—especially when those measures have received the imprimatur of the International Monetary Fund.

Financing the imbalances

A central premise, however, is that the non-OPEC world is going to continue to run a sizable current account deficit for several more years. Hence there will continue to be a need for sizable international financing of surpluses and deficits, in two directions: (a) Between OPEC and the rest of the world and (b) to a lesser extent, among the non-OPEC countries themselves.

We know that the OPEC countries, and other surplus countries, will export sufficient capital to provide the needed financing. There is simply no other way for them to invest the proceeds of their current account surpluses. But two key questions arise: Will this financing be distributed to the specific countries which need it to finance their deficits? What will be the channels through which such financing takes place, and who will thereby take the risks associated with this (as any other) type of lending?

The role of the private banks

Private banks, in the United States and throughout the world, have played a major role in the response to both questions. They have accepted deposits from the OPEC (and other) surplus countries, and then relent to the deficit countries which needed capital inflows to balance their positions; they and others in the private financial markets have provided about 75 percent of the total funds raised from external sources during 1974–76. Financial intermediation between lenders and borrowers, which has become a familiar phenomenon within the United States (and some other countries) and had already reached sizable international dimensions before 1973, has now become a central element in the world economy as well.

Some observers have raised concern over this evolution of events. They have suggested that foreign loans may be inherently riskier than domestic loans, with consequent risk to the stability of our own—or even the world's—banking system. There has been talk of an "overexposure" of U.S. banks in foreign markets.

We believe that these concerns are greatly exaggerated. Alarms have been raised about international banking from the very creation of the Eurocurrency market in the early 1960's. Fears were voiced, primarily by individuals unfamiliar with the operations of the international economy, after the sharp increase in oil prices in late 1973. These fears have proven to be largely unfounded, and we believe that they continue to be greatly exaggerated.

Losses on foreign loans have been small. In fact, loss experience has been better on foreign loans than on domestic loans. Governor Wallich, in his testimony before this subcommittee on March 23, noted that during 1971–75 the loss ratios on international loans of the seven largest U.S. banks were about one-third of their total loss ratios. John Early of the FDIC concluded, in his testimony before this subcommittee, "that recent commitments to LDC's pose no real danger to the overall stability of the U.S. banking system."

In fact, there are only two major differences between domestic and international lending. First, it may be more difficult for American lenders to acquire adequate data and other information on foreign than domestic borrowers. Our own Federal Reserve System is working with the central banks of other countries to improve this situation, as indicated recently by both Chairman Burns and Governor Wallich. In addition, there may be a greater role for the International Monetary Fund to play in reducing any knowledge gap that may exist—a matter which we are now considering with some care.

Second, lending to another country entails judgment about the credit position of the entire country as well as of the specific borrower. An individual borrower, no matter how creditworthy, might be unable to repay as scheduled if its government was forced to adopt restrictions on such payments because of problems in its overall external accounts.

We believe that the remedy to this potential problem is fourfold. First, as just noted, more information is needed. Second, surplus countries—both in OPEC and elsewhere—must reduce their surpluses to reduce the burden on deficit countries. Third, deficit countries, which even begin to approach having a debt service problem, must undertake decisive adjustment programs of their own, with the assistance of the IMF where appropriate. Fourth, there should be adequate official financing available for deficit countries so as to (a) minimize the need for private lenders to assume undue risks and (b) induce deficit countries, as a quid pro quo for obtaining access to such finance, to adopt the needed adjustment measures.

With regard to the latter point, we believe that prudence dictates consideration of a further increase in the financial resources available to the International Monetary Fund, the central official component of the international monetary system. There are a variety of means by which such an increase could be achieved, and several alternatives are now under consideration. At the same time, there has been discussion of augmenting the availability of official funding through other international bodies such as the proposed Financial Support Fund at the Organization for Economic Cooperation and Development (OECD). We are exploring all of these possibilities with other countries, and believe that it will prove possible to move over the next few months toward assuring the continued availability of sufficient official financing to meet the needs of the system.

Some specific issues

Individual countries can, of course, find themselves at times in situations where their external debt burden is too great to be met without policies which are unduly restrictive, from a domestic or international point of view. Such situations have occurred occasionally, and there have been about 30 instances in the postwar years in which multilateral negotiations with creditor countries were needed to reschedule existing debts to official lenders. Remarkably, the pace of such reschedulings has actually declined in recent years despite the massive shocks to the world economy from higher oil prices and world recession.

When such cases do arise, there are well-developed international mechanisms for arranging the needed reschedulings. Any such steps are of course linked to adjustment measures which will ensure that the fundamental problem of the countries involved will be resolved in an orderly fashion. Hence no systematic problem would result even if individual country problems were to emerge occasionally, as they have in fact already done throughout the postwar period.

Concern has also been expressed in some quarters that domestic demand for bank credit will at some point dangerously reduce the amount of credit available to other countries—or, conversely, that "excessive" loans to foreigners will drain needed funds away from our own economy. Neither outcome is at all likely.

The danger that our domestic economy would suffer from inadequate funds as a result of excessive capital exports is minimal. If capital in the United States becomes scarce, interest rates will tend to rise; U.S. funds will be employed at home, and indeed funds will flow in from abroad.

If our economy is expanding more rapidly than that of other countries, or if we are approaching capacity utilization of our resources, our current account deficit is likely to grow and the net inflow of funds to the United States will increase. At the same time, such an increase in the current account deficit will mean that there is a strong U.S. market for the exports of other countries—strengthening their current account position and reducing the need for them to borrow in the first place. There might be less borrowing, but there would be less need for such borrowing.

At this time, in fact, there is a net inflow of foreign capital to the United States. Except for 1975, when special circumstances dictated, the U.S. current account has been in deficit since the increase in oil prices. Hence we have imported capital to balance our international accounts. The risk to our domestic economy of inadequate funds is minimal.

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Exhibit 47.—Remarks by Assistant Secretary Bergsten, April 22, 1977, before the Chicago Council on Foreign Relations, Chicago, Ill., entitled "The International Economic Policy of the Carter Administration"

The setting

When the Carter administration came into office 3 months ago, it faced a difficult and complex set of economic problems both at home and abroad.

Unemployment was far too high. Over 7 million Americans were out of work. Another 7 or 8 million workers were unemployed in the other industrialized countries. Countless millions more were unemployed and underemployed in the developing world.

At the same time, inflation remained a major threat. The rate of price increase in the United States had dropped sharply, to 5 or 6 percent, but was still far too high. A few countries, including Switzerland, Germany, India, and Taiwan, had done better than we. But many others had not, and some still faced price rises in the double-digit range. In some, inflation was still rising or had begun to rise once more.

The energy problem remained unresolved. High and still rising oil prices intensified both inflation and unemployment. We in the United States had not made sufficient efforts to cut back on our own profligate consumption of energy. The continuing current account surplus of several OPEC countries forced a sizable deficit upon the rest of the world, which had to be distributed and financed in ways which would support international economic and financial stability. The sharp increase in international lending activities of private banks in both the United States and Europe, which was occasioned by the necessity of financing these large imbalances, raised questions in the minds of some observers.

Threats to an open international trading system were widespread. Several important industries here in the United States sought the imposition of significant impediments to imports. Pressures to adopt such impediments were widespread in other countries, in both the industrialized and developing world, and some had already taken steps in response to those pressures.

The overall relationship between industrialized and developing countries was at an impasse. There was major discord on commodity issues. The ministerial meeting which was to have concluded the North-South dialog—the Conference on International Economic Cooperation (CIEC)—had been postponed due to its lack of progress. Both developing and industrialized countries awaited the arrival of the new administration with keen interest.

Finally, and encompassing all of these issues, was the widespread expectation that a new summit meeting was needed to discuss the whole range of international economic issues of concern to the major countries. The advent of a new administration in the United States added to the interest of other countries in holding such a session at the level of heads of governments.

A full menu of issues thus confronted President Carter and all of his economic officials. We have begun to respond to each of them in these first 3 months. Before turning to the specific topics, however, I would like to first discuss a much more fundamental issue—the basic attitude and approach of this administration toward the world economy.

The fundamental philosophy

The basic philosophy of the administration is that domestic and international economic issues are inextricably linked. Our own high energy consumption strengthens the ability of OPEC countries to raise world oil prices, which in turn creates balance of payments difficulties for other countries. Our maintenance of an open trading market provides essential support for jobs abroad and jobs here, both directly and through its resultant effects on the trade policies of others. A well-functioning monetary system, reasonably stable commodity prices, and healthy international competition are essential components of our fight against inflation and unemployment. Indeed, each issue to which I have referred has critical dimensions both here and abroad.

There is a similarly intense relationship between internal and external economic concerns in other countries as well. Moreover, the actions of many of these countries, like the actions of the United States, can have major effects on their trading partners, including the United States—and, indeed, on the entire world economy. Hence, it is essential that we and they work ever more closely together. At a minimum, this requires that each of our countries resist the perennial temptation to export its internal problems—the result of which can only be emulation and retaliation by others, with consequent costs for all. This is a second fundamental principle underlying the approach of the Carter administration to international economic policy.

But such collaboration must go beyond the avoidance of beggar-thy-neighbor measures. The world's major economic powers must, in a positive sense, exercise collective responsibility for the stability and progress of the world economy. They must consult constantly on their individual goals, and on the means to carry out those goals. They must monitor each other's performances in achieving agreed goals. They must take explicit account of conditions and policies elsewhere in formulating their own national policies. The search for effective exercise of collective international economic responsibility is a third fundamental element of the philosophy of the Carter administration.

The United States is fully prepared to participate in such an exercise of collective economic responsibility because the economy of the United States has become inextricably intertwined with the world economy of which it is a part:

- One out of every six manufacturing jobs in this country produces for the export market.
- One out of every three acres of American farmland produces for the export market.
- Almost one out of every three dollars of U.S. corporate profits now derives from the international activities of the firms, including their foreign investments as well as their exports.
- It was external forces (oil price rises, crop failures, and the exchange rate adjustment to previous levels of domestic inflation) which propelled our rate of inflation into double digits in 1973–74.
- We depend on imports for more than one-fourth of our consumption of 12 of the 15 key industrial raw materials.
- The share of trade in our gross national product has doubled over the last decade or so; when investment is included, our engagement in the world economy is probably at least as great as that of Japan or of the European Common Market, taken as a group.

It is thus immediately clear that the economic interests of the United States can be served only through effective integration of our domestic and international economic policies. Our foreign policy also requires such integration because of the central importance of economic issues to overall relations between the United States and other countries.

The first basic steps

International economic policy, like all foreign policy, begins at home. Hence our first steps were to create the domestic base for an effective international economic policy.

Even before the administration took office, President Carter was hard at work developing what became his economic stimulus program to accelerate the reduction of unemployment—a program which, even without the tax rebate, exceeds $20 billion in 1977–78. As that program developed, during the month of December, international considerations came to loom large in the final decision.

High unemployment in Europe and Canada threatened the political stability which was a crucial underpinning of NATO and the entire Atlantic alliance. Yet some key countries in Europe needed to restrain domestic consumption because of continuing high inflation and large balance of payments deficits. They clearly needed an opportunity for export-led growth—which could only be provided by the stronger economies. Such an expansion of trade would also reduce the payments imbalances between the stronger and weaker countries, thereby enhancing international monetary stability. Hence more vigorous expansion was needed in the United States, both for its direct effects on other countries and because leadership by the United States could help bring about a commitment by other strong countries to pursue similar policies strengthening the prospects for a sustained worldwide recovery.

More rapidly growing markets in the industrial countries were also a matter of central importance to the developing countries. Many of these countries, particularly our neighbors in Latin America, rely heavily on our market and had experienced large external deficits due to higher oil prices and the world recession of 1974–75. Successful pursuit of their longrun development strategies depended in large part on their being able to maintain a rapid growth of their exports. Indeed, there was no policy step which the United States could take which was of greater importance to the developing countries than achieving more vigorous and sustained expansion of our own economy.

In addition, the threats to an open world trading system were magnified by continuing high rates of unemployment. More rapid progress in expanding job opportunities in both America and in other major trading countries was necessary to enable governments everywhere to maintain policies which would continue to bring the advantages of freer international trade to their societies.

At the same time, reasonable price stability in the United States remained of central importance to the world economy. The onset of rapid inflation in the United States in the late 1960's was a major cause of the breakdown of the old international economic order in the early 1970's. In an interdependent world in which the United States remains the largest single economy and trading nation, and whose monetary system still relies heavily on the dollar, price stability in America promotes price stability in the rest of the world as well.

Hence U.S. economic policy had to achieve more vigorous growth, while retaining reasonably stable prices, for a series of key international reasons as well as for domestic reasons. These considerations played a central role in the development of what emerged as the administration's first approach to economic policy. They reveal both the importance of international considerations to U.S. economic policy, and the recognition of that importance by the Carter administration.

A second step followed logically. When President Carter asked Vice President Mondale to visit Europe and Japan within the first hours of his administration, he instructed the Vice President to place economic issues at the very top of the agenda. There was no crisis which compelled such action. We were not forced to accord such priority to these issues. We chose to do so because of their importance—to the U.S. economy, and to the overall international relations of the United States. Building on the measures already proposed by the administration at home, the Vice President thus urged the economically stronger countries which we visited to expand more rapidly; the weaker countries to maintain their stabilization efforts; and all countries to avoid steps which would impair our mutual gains from an open international trading system.

Beyond these substantive policies, President Carter took a series of institutional steps in an effort to implement effectively the heavy emphasis which his administration would place on international economic issues. In recent years, international economic policy had been hampered by major institutional problems: Rancor, and often open hostility, between the key departments of Government with responsibilities in this area (notably, State and Treasury); mistrust and noncooperation between the administration and Congress; a general failure to effectively integrate domestic and international economic policy.

The administration took three immediate steps to avoid such difficulties. In choosing his top officials, at both the Cabinet and sub-Cabinet levels, President Carter did not follow the traditional approach of staffing each agency vertically. Instead he chose "clusters" of officials in the several related agencies who would be working closely together on particular issues such as defense or international economics. As a result, when asked by a member of the Commission of the European Community during the Mondale trip what we had accomplished in our first 2 days in office, I was able to reply: "Total detente between the State and Treasury Departments." That detente, and indeed the closest possible working relationship among the many agencies involved in these issues, has held up for 3 months. We believe that it will continue to produce a cohesive and effective approach to international economic policy throughout the administration.

In addition, we went to work immediately to repair relations with Congress. The President has personally led the way, and insisted that all of us consult actively and consistently with the committees and Members who bear responsibility for issues in our respective areas of responsibility.

Because of the budget and general legislative cycle, foreign assistance was the first international economic issue to require congressional action. Hence an immediate and intensive round of formal hearings, and informal discussions, was begun in that area. These consultations have been exceptionally productive. For example, we have adopted a number of new policies toward the international development lending institutions (the World Bank, International Development Association, Inter-American Development Bank, Asian Development Bank, African Development Fund) which were originally proposed by the Congress.

When I led the U.S. delegation to conclude the negotiations for a fifth replenishment of the International Development Association in Vienna in mid-March, I was accompanied by two key Members of the House of Representatives. We have indicated that we will invite Members to join us at all such sessions in the future, to emulate a practice which has been carried out in the trade field for many years. We hope through such steps to forge a strong working partnership between the administration and the Congress, so that our policy efforts abroad will be fully sustainable at home.

Finally on the institutional front, the President created a single decisionmaking body for all economic issues, domestic and international—the Economic Policy Group (EPG). He decided to abolish the old Council on International Economic Policy, on the grounds that international economic policy was too important to be fashioned separately. Rather, it must be integrally related to all economic policy—just as all domestic economic policy steps must take into account their international ramifications. Hence the Department of State sits as a full member of the EPG in its consideration of all issues, and the domestic agencies are engaged in the discussion of all international economic issues. The results to date, in terms of assuring a unified administration position that takes the whole range of domestic and international factors into account, have been heartening.

Specific policies

Principles, priorities, and institutional arrangements are of great importance. They are particularly important during the early days of an administration, when basic attitudes and perceptions—both inside and outside the administration—are being shaped. Ultimately, however, they are only as important as the policies which they produce.

Some of these policies are still in the process of formulation. Yet some have already emerged clearly, in response to the series of issues which I have outlined. I would like to close by summarizing briefly the steps we have already taken, and the results as we see them to date.

To promote more rapid expansion of the world economy, we have proposed a stimulus program and our economy is moving briskly ahead. The underlying growth rate is at least 6 percent, our target for the year. Indeed, the economy is moving so briskly that the President felt that the income tax rebate was no longer needed. This expansion, by enhancing the opportunity for other countries to expand their exports, has contributed to a sizable shift in the U.S. current account position—which, in turn, makes for a better balance in the world payments pattern and reduces strains on the international monetary system. President Carter has also adopted a multipronged anti-inflation program for this country, which includes a number of specific international measures as well as aggregate fiscal restraint and rationalization of numerous Government programs.

The other strongest economies, notably Japan and Germany, have strengthened their economic programs in the past few months. Perhaps, more importantly, they have committed themselves to assure that their growth projections actually materialize. Japan has also recently contributed greatly toward improved balance in the world economy by permitting, and indeed welcoming, a sizable appreciation of the yen.

These steps help the weaker countries to reap the benefits of the stabilization programs which they have now implemented. Britain, Italy, and Mexico have reached standby agreements with the International Monetary Fund on the basis of such programs. The Barre plan in France is achieving marked success. These steps, by both stronger and currently weaker countries, represent essential contributions to an effective exercise of the collective responsibility for a healthy world economy which rests on the shoulders of the major countries, without which a resumption of sustained worldwide economic growth will not be possible.

Several steps are underway to reinforce international monetary stability. In reducing U.S. (and world) dependence on imported oil, the President's energy program will, over time, cut the OPEC surpluses which lie at the heart of the present monetary imbalance. The macroeconomic and exchange-rate policies of other key countries, already mentioned, should provide a better balance outside OPEC by trimming both excessive surpluses and excessive deficits. To assure that there are adequate official funds to finance the imbalances which will unavoidably remain, in a way that will promote needed adjustment, we support the initiative of the International Monetary Fund in seeking to borrow directly from surplus OPEC countries and from the stronger industrial countries to augment the resources available to the Fund over the next few years.

In the trade area, President Carter has taken actions which will avoid disruption of the international trading system and preserve the benefits of trade to American consumers, while providing effective help to those at home who have been hard hit in particular industries:

- In the shoe case, he has directed the development of a major new program of direct assistance to the industry and, to provide a bridge until that program can take effect, the negotiation of "orderly marketing agreements" with the two countries whose increased exports equaled the entire increase in U.S. imports from 1974 through 1976.
- In color television, we are negotiating an orderly marketing agreement with the country which accounts for 80 percent of U.S. imports and whose sales grew by 150 percent in 1976 alone; at the same time, the administration is appealing the Customs Court ruling in the Zenith case which, if sustained, would disrupt billions of dollars of international trade.
- In sugar, negotiations have begun on an international agreement whose objective is to avoid the massive price fluctuations of recent years, which have brought heavy costs to producers and consumers alike.
- On automobiles, the President's energy proposals seek to reduce the U.S. addiction to "gas guzzlers," and hence serve the objective of all oil-importing countries, with minimum disruption to international trade.
- And we have indicated our intentions, now that Ambassador Robert Strauss has been confirmed as the President's Special Representative for Trade Negotiations, to push hard for a major substantive outcome to the multilateral trade negotiations with as much progress as possible in 1977, to enhance further to all countries the benefits of an open trading system.

In North-South affairs, we have taken several major steps. As already noted, the brisk expansion of our own economy is expanding the world's biggest market for the commodities and manufactured exports of the developing countries. The accelerated expansion of other countries reinforces that effort. Our determination to avoid widespread import restrictions has been of great value to the poorer countries. Our support for an expansion of the lending facilities of the International Monetary Fund helps the prospects of making more balance of payments finance available to these countries, under proper conditions.

We have also undertaken a number of steps which relate more directly to the developing countries. As President Carter indicated in his anti-inflation message of April 15, international commodity agreements undertaken for purposes of price stabilization around market trends can promote U.S. economic objectives. This can occur for two reasons: The price ceilings of effective commodity agreements will restrain sharp runups in commodity prices, as occurred particularly in 1973–74, and their price floors will encourage continued flows of new investment so that temporary declines in returns will not deter the creation of capacity needed to meet demand when stronger markets return.

Such agreements have long been sought by the developing countries. There remain some differences in our specific approaches, but we foresee a series of cooperative endeavors in that area. As far as funding goes, we are openminded concerning U.S. contributions to the buffer stocks of such agreements, and to the possibility of pooling the financial resources of each in some sort of common funding mechanism for those commodity agreements that can be negotiated.

Another primary area of the North-South relationship is foreign assistance. We believe that direct assistance is far superior to indirect types of resource transfer which are often proposed such as generalized debt relief or efforts to prop commodity prices beyond levels which reflect market forces because it can focus directly on those countries which most need help and can best assure effective use of the resources transferred. Indeed, our support of economically sensible policies such as adequate levels of foreign assistance and price-stabilizing commodity agreements is necessary in enabling us to resist proposals for such less desirable approaches.

A particular focus of the new administration is on contributions to the international development lending institutions, where the need to fulfill a backlog of past pledges leads us to seek over $5 billion of congressional authorizations and $2.6 billion in appropriations in fiscal year 1978. In this area, every $1 contributed by the United States is matched by $3 from other donor countries. Our average share in the current replenishment of these institutions is only 25 percent, although our share of the total gross national product of all donor countries is about 38 percent. The House of Representatives and the Senate Foreign Relations Committee have already voted to support the full authorization request, and both Budget Committees have supported virtually our full request for appropriations. In addition, in the supplemental appropriations for fiscal year 1977, both Houses voted to make good in full on past U.S. pledges to the International Development Association and the Asian Development Fund, as well as the bulk of our past pledges in the Inter-American Development Bank.

It is our hope, and belief, that these steps by the United States—in partnership with the other industrialized countries—will promote greater progress in the developing world and an era of close cooperation between North and South. In that relationship, we would look to the developing countries to exercise economic responsibilities as well as to enjoy economic rights. We will seek to help develop a framework in which they all find it in their interests to do so.

All of these issues will be discussed in the forthcoming seven-nation summit. President Carter is eager to attend that meeting, so that the heads of government can provide a powerful political impulse to actions that can then be taken in other forums—to concert domestic policies, expand international financing, move ahead with the multilateral trade negotiations, reduce energy consumption, and help meet the needs of the developing countries.

The objective in all these areas is to strengthen the international procedures and institutions through which the problems of the industrialized and developing countries, alike, must be addressed. We are confident that the summit will represent a further, important step toward forging the sense of collective responsibility for the world economy which must lie at the heart of our own policies, and those of all other countries, in the months and years ahead.

Exhibit 48.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, April 28–29, 1977, issued after its eighth meeting in Washington, D.C.

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its eighth meeting in Washington, D.C. on April 28–29, 1977 under the chairmanship of Mr. Willy De Clercq, Minister of Finance of Belgium. Mr. H. Johannes Witteveen, Managing Director of the Fund, participated in the meeting. The following observers attended during the Committee's discussions: Mr. G. D. Arsenis, Director, New York Office, UNCTAD; Mr. Mahjoob A. Hassanain, Chief, Economics Department, OPEC; Mr. Pierre Languetin, General Manager, National Bank of Switzerland; Mr. Rene Larre, General Manager, BIS; Mr. Emile van Lennep, Secretary-General, OECD; Mr. Olivier Long, Director General, GATT; Mr. Robert S. McNamara, President, IBRD; Mr. Francois-Xavier Ortoli, Vice-President, CEC; and Mr. Cesar E. A. Virata, Chairman, Development Committee.

2. The Committee discussed the world economic outlook and the functioning of the international adjustment process.

The Committee noted the expansion of activity that has taken place in the world economy over the past year and welcomed the improvement in economic outlook during recent months following cessation of the "pause" in the industrial countries. The Committee expressed concern, however, about the persistence of high levels of unemployment, especially among young people, and high levels of inflation in many countries.

I. On the broad question of the economic policy options and priorities of member countries, the Committee agreed on the following conclusions:

(a) Policies of demand management in most countries must emphasize the need to deal with problems of inflation and the balance of payments. These policies are being guided by the conviction that measures to combat inflation and, where necessary, to strengthen the external position are not only necessary in present circumstances but also will make for a better record over time in terms of economic growth and employment.

(b) At the same time, special efforts should be made to improve market access for the exports of the developing countries and to increase the flow of official development assistance. Any tendencies toward protectionist trade policies cannot be considered acceptable from an international point of view and should be strongly resisted; indeed, increased attention should be paid to the need to reduce the existing restrictions on trade. Success in the current negotiations in Geneva would make an important contribution to this end.

II. The Committee drew the following conclusions from its review of the international adjustment process:

(a) The needs for adjustment remain large and, as experience shows, delays in dealing with them can be very costly. It will take international cooperation, and determined action by surplus as well as deficit countries, to make continuing progress with respect to adjustment. An encouraging development is that a number of countries, both large and small, developed and developing, have adopted programs to strengthen their external positions, often in the context of stand-by arrangements approved by the Fund.

(b) Strategies of adjustment must include emphasis on conservation of energy, on elimination of domestic sources of inflation particularly in the deficit countries, and on improvement in cost-price relationships among countries. It is important that industrial countries in relatively strong payments positions should ensure continued adequate expansion of domestic demand, within prudent limits. Moreover, these countries, as well as other countries in strong payments positions, should promote increased flows of long-term capital exports.

(c) Given the persistence of large payments imbalances, important demands for the Fund's resources can be expected to materialize. The Committee found good grounds for believing that expansion of the Fund's role as a financial intermediary could contribute significantly to promotion of international adjustment and to maintenance of confidence in the continued expansion of the world economy and in the effective functioning of the international financial system.

3. The Committee reviewed the developments in international liquidity and in the financial activities and resources of the Fund. In this connection, it had the benefit of a report of the Managing Director summarizing the discussions that the Executive Directors have had to date on these subjects.

As a result of this review, the Committee reached the following conclusions:

The Committee recognized that there was an urgent need for a supplementary arrangement of a temporary nature that would enable the Fund to expand its financial assistance to those of its members that in the next several years will face payments imbalances that are large in relation to their economies.

The Committee agreed that some of the main features of this supplementary arrangement would be as follows:

(i) The Fund would establish substantial lines of credit in order to be able to assist members to meet their needs for supplementary assistance.

(ii) Access to assistance under the supplementary arrangement should be available to all members and should be subject to adequate conditionality, and such assistance should normally be provided on the basis of a stand-by arrangement covering a period longer than one year.

(iii) The Fund should pay interest on amounts borrowed under the lines of credit at market-related interest rates, and charges by the Fund for the use by members of resources borrowed by it under these lines of credit should be based on these rates. The possibility of a subsidy related to the rates of charge that would be payable by low-income countries should be explored.

(iv) The claims of lenders under the supplementary arrangement should be appropriately liquid.

The Committee welcomed the willingness of a number of countries in a position to lend to the Fund to collaborate with it on arrangements for supplementary credit and urged the Managing Director to complete, as soon as possible, his discussions with potential lenders on terms and conditions and amounts. It further requested the Executive Directors to take the necessary steps for making such an arrangement operative as soon as possible.

4. The Committee considered the main issues relating to the Seventh General Review of Quotas. It was agreed that, in view of the expansion of members' international transactions and the need for the Fund to be able to give balance of payments assistance to members on a larger scale than would be available on the basis of quotas under the Sixth General Review, there should be an adequate increase in the total of quotas pursuant to the Seventh General Review. On the question of distribution of quotas, one view was that in order to conclude the Seventh Review at an early date, increases should be equiproportional to the quotas that will result from the Sixth General Review. Another view, however, was that a few special adjustments should be made for those members whose quotas are seriously out of line with their relative positions in the world economy, and in this connection some emphasis should be placed on increases that would strengthen the Fund's liquidity. The Committee urged the Executive Directors to pursue their work and to prepare a report, together with draft recommendations to the Board of Governors, on increases in the quotas of members under the Seventh General Review for consideration by the Committee at its next meeting.

5. The Committee also considered the question whether a further allocation of SDRs would be advisable at the present time. The Committee noted that the Executive Directors have been discussing this question and agreed to request them to give further consideration to all aspects of this matter and to report to the Committee at its first meeting in 1978.

The Committee also agreed to request the Executive Directors to review the characteristics and uses of the SDR so as to promote the purposes of the Fund, including the objective of making the SDR the principal reserve asset in the international monetary system.

6. Although the Committee discussed the proposals for supplementary credit, the Seventh Quota Review and any allocation of SDRs separately as indicated above, members of the Committee attached importance to the interrelationships among them and particularly to the overall effect of the decisions as a whole.

7. The Committee noted with satisfaction the work of the Executive Directors on the implementation of Article IV of the Proposed Amendment of the Articles of Agreement, and welcomed the consensus reached by them on the principles and procedures for the guidance of members and for the exercise of surveillance by the Fund over the exchange rate policies of members in the period after the Second Amendment has become effective. The Committee endorsed these principles and procedures, and agreed that they will make an important contribution to the effective functioning of the international monetary system in the future.

8. The Committee noted that so far no more than twenty-four members of the Fund having about 32 percent of the total voting power have notified the Fund of their acceptances of the proposed Second Amendment of the Fund's Articles and that very few members have given their formal consents to increases in their quotas under the Sixth General Review of Quotas. The Committee expressed its concern at this delay and urged all members that have not yet accepted the proposed Second Amendment to complete as soon as possible the arrangements that would enable them to take this action and to increase their quotas under the Sixth General Review.

9. The Committee agreed to hold its ninth meeting in Washington on September 24, 1977.

Exhibit 49.—Text of communique and appendix, issued following the meeting of the heads of state or government of Canada, France, Federal Republic of Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States of America, May 7–8, 1977, in London, England

In two days of intensive discussions at Downing Street we have agreed on how we can best help to promote the well-being both of our own countries and of others.

The world economy has to be seen as a whole: it involves not only cooperation among national governments but also strengthening appropriate international organizations.

We were reinforced in our awareness of the interrelationship of all the issues before us as well as our own interdependence. We are determined to respond collectively to take the challenges of the future.

Our most urgent task is to create more jobs while continuing to reduce inflation. Inflation does not reduce unemployment. On the contrary, it is one of its major causes.

Problem of unemployment

We are particularly concerned about the problem of unemployment among young people. We have agreed that there will be an exchange of experience and ideas on providing the young with job opportunities.

We commit our governments to stated economic growth targets or to stabilization policies which, taken as a whole, should provide a basis for sustained noninflationary growth in our own countries and worldwide and for reduction of imbalances in international payments.

Improved financing facilities are needed. The International Monetary Fund must play a prominent role.

We commit ourselves to seek additional resources for the IMF and support the linkage of its lending practices to the adoption of appropriate stabilization policies.

We will provide strong political leadership to expand opportunities for trade to strengthen the open international trading system, which will increase job opportunities.

We reject protectionism—it would foster unemployment, increase inflation and undermine the welfare of our peoples.

Impetus for trade talks

We will give a new impetus to the Tokyo round of multilateral trade negotiations. Our objective is to make substantive progress in key areas in 1977. In this field, structural changes in the world economy must be taken into consideration.

We will further conserve energy and increase and diversify energy production so that we reduce our dependence on oil.

We agree on the need to increase nuclear energy to help meet the world's energy requirements.

We commit ourselves to do this while reducing the risks of nuclear proliferation. We are launching an urgent study to determine how best to fulfill these purposes.

The world economy can only grow on a sustained and equitable basis if developing countries share in that growth.

We are agreed to do all in our power to achieve a successful conclusion of the CIEC (Conference on International Economic Cooperation) and we commit ourselves to a continued constructive dialogue with developing countries.

We aim to increase the flow of aid and other real resources to those countries. We invite the COMECON countries to do the same.

Support for institutions

We support multilateral institutions such as the World Bank, whose general resources should be increased sufficiently to permit its lending to rise in real terms.

We stress the importance of secure private investments to foster world economic progress.

To carry out these tasks we need the assistance and cooperation of others. We will seek that cooperation in appropriate international institutions, such as the United Nations, the World Bank, the IMF, the GATT and OECD.

Those among us whose countries are members of the European Economic Community intend to make their efforts within its framework.

In our discussions we have reached substantial agreements.

Our firm purpose is now to put that agreement into action.

We shall review progress on all the measures we have discussed here at Downing Street in order to maintain the momentum of recovery.

The message of the Downing Street summit is thus one of confidence: in the continuing strength of our societies and the proven democratic principles that give them vitality: that we are undertaking the measures needed to overcome problems and achieve a more prosperous future.

APPENDIX TO COMMUNIQUE

World economic prospects

Since 1975 the world economic situation has been improving gradually. Serious problems, however, still persist in all of our countries. Our most urgent task is to create jobs while continuing to reduce inflation. Inflation is not a remedy to unemployment but one of its major causes. Progress in the fight against inflation has been uneven. The needs for adjustment between surplus and deficit countries remain large. The world has not yet fully adjusted to the depressive effects of the 1974 oil price rise.

We commit our governments to targets for growth and stabilization which vary from country to country but which, taken as a whole, should provide a basis for sustained noninflationary growth worldwide.

Some of our countries have adopted reasonably expansionist growth targets for 1977. The governments of these countries will keep their policies under review, and commit themselves to adopt further policies, if needed to achieve their stated target rates and to contribute to the adjustment of payments imbalances. Others are pursuing stabilization policies designed to provide a basis for sustained growth without increasing inflationary expectations. The governments of these countries will continue to pursue those goals.

These two sets of policies are interrelated. Those of the first group of countries should help to create an environment conducive to expansion in the others without adding to inflation. Only if growth rates can be maintained in the first group and increased in the second, and inflation tackled successfully in both, can unemployment be reduced.

We are particularly concerned about the problem of unemployment among young people. Therefore we shall promote the training of young people in order to build a skilled and flexible labor force so that they can be ready to take advantage of the upturn in economic activity as it develops. All of our governments, individually or collectively, are taking appropriate measures to this end. We must learn as much as possible from each other and agree to exchange experiences and ideas.

Success in managing our domestic economies will not only strengthen world economic growth but also contribute to success in four other main economic fields to which we now turn—balance of payments financing, trade, energy and North-South relations. Progress in these fields will in turn contribute to world economic recovery.

Balance of payments financing

For some years to come oil-importing nations, as a group, will be facing substantial payments deficits and importing capital from OPEC nations to finance them. The deficit for the current year could run as high as $45 billion. Only through a reduction in our dependence on imported oil and a rise in the capacity of oil-producing nations to import can that deficit be reduced.

This deficit needs to be distributed among the oil-consuming nations in a pattern compatible with their ability to attract capital on a continuing basis. The need for adjustment to this pattern remains large, and it will take much international cooperation, and determined action by surplus as well as deficit countries, if continuing progress is to be made. Strategies of adjustment in the deficit countries must include emphasis on elimination of domestic sources of inflation and improvement in international cost-price relationships. It is important that industrial countries in relatively strong payments positions should ensure continued adequate expansion of domestic demand, within prudent limits. Moreover, these countries, as well as other countries in strong payments positions, should promote increased flows of long-term capital exports.

The International Monetary Fund must play a prominent role in balance of payments financing and adjustment. We therefore strongly endorse the recent agreement of the Interim Committee of the IMF to seek additional resources for that organization and to link IMF lending to the adoption of appropriate stabilization policies. These added resources will strengthen the ability of the IMF to encourage and assist member countries in adopting policies which will limit payments deficits and warrant their financing through the private markets. These resources should be used with the conditionality and flexibility required to encourage an appropriate pace of adjustment.

This IMF proposal should facilitate the maintenance of reasonable levels of economic activity and reduce the danger of resort to trade and payments restrictions. It demonstrates cooperation between oil-exporting nations, industrial nations in stronger financial positions, and the IMF. It will contribute materially to the health and progress of the world economy. In pursuit of this objective, we also reaffirm our intention to strive to increase monetary stability.

We agree that the international monetary and financial system, in its new and agreed legal framework, should be strengthened by the early implementation of the increase in quotas. We will work toward an early agreement within the IMF on another increase in the quotas of that organization.

Trade

We are committed to providing strong political leadership for the global effort to expand opportunities for trade and to strengthen the open international trading system. Achievement of these goals is central to world economic prosperity and the effective resolution of economic problems faced by both developed and developing countries throughout the world.

Policies on protectionism foster unemployment, increase inflation and undermine the welfare of our peoples. We are therefore agreed on the need to maintain our political commitment to an open and nondiscriminatory world trading system. We will seek both nationally and through the appropriate international institutions to promote solutions that create new jobs and consumer benefits through expanded trade and to avoid approaches which restrict trade.

The Tokyo round of multilateral trade negotiations must be pursued vigorously. The continued economic difficulties make it even more essential to achieve the objectives of the Tokyo declaration and to negotiate a comprehensive set of agreements to the maximum benefit of all. Toward this end, we will seek this year to achieve substantive progress in such key areas as—

(1) A tariff reduction plan of broadest possible application designed to achieve a substantial cut and harmonization and in certain cases the elimination of tariffs;

(2) Codes, agreements and other measures that will facilitate a significant reduction of nontariff barriers to trade and the avoidance of new barriers in the future and that will take into account the structural changes which have taken place in the world economy;

(3) A mutually acceptable approach to agriculture that will achieve increased expansion and stabilization of trade, and greater assurance of world food supplies.

Such progress should not remove the right of individual countries under existing international agreements to avoid significant market disruption. While seeking to conclude comprehensive and balanced agreements on the basis of reciprocity among all industrial countries we are determined, in accordance with the aims of the Tokyo declaration, to insure that the agreements provide special benefits to developing countries.

We welcome the action taken by governments to reduce counterproductive competition in officially supported export credits and propose that substantial further efforts be made this year to improve and extend the present consensus in this area.

We consider that irregular practices and improper conduct should be eliminated from international trade, banking and commerce, and we welcome the work being done toward international agreements prohibiting illicit payments.

Energy

We welcome the measures taken by a number of governments to increase energy conservation. The increase in demand for energy and oil imports continues at a rate which places excessive pressure on the world's depleting hydrocarbon resources. We agree therefore on the need to do everything possible to strengthen our efforts still further.

We are committed to national and joint efforts to limit energy demand and to increase and diversify supplies. There will need to be greater exchanges of technology and joint research and development aimed at more efficient energy use, improved recovery and use of coal and other conventional resources, and the development of new energy sources.

Increasing reliance will have to be placed on nuclear energy to satisfy growing energy requirements and to help diversify sources of energy. This should be done with the utmost precaution with respect to the generation and dissemination of material that can be used for nuclear weapons. Our objective is to meet the world's energy needs and to make peaceful use of nuclear energy widely available while avoiding the danger of the spread of nuclear weapons.

We are also agreed that, in order to be effective, nonproliferation policies should as far as possible be acceptable to both industrialized and developing countries alike. To this end, we are undertaking a preliminary analysis to be completed within two months of the best means of advancing these objectives, including the study of terms of reference for international fuel cycle evaluation.

The oil-importing developing countries have special problems both in securing and in paying for the energy supplies needed to sustain their economic development programs. They require additional help in expanding their domestic energy production and to this end we hope the World Bank, as its resources grow, will give special emphasis to projects that serve this purpose.

We intend to do our utmost to ensure, during this transitional period, that the energy market functions harmoniously, in particular through strict conservation measures and the development of all our energy resources. We hope very much that the oil-producing countries will take these efforts into account and will make their contribution as well.

We believe that these activities are essential to enable all countries to have continuing energy supplies now and for the future at reasonable prices consistent with sustained noninflationary economic growth, and we intend through all useful channels to concert our policies in continued consultation and cooperation with each other and with other countries.

The world economy can only grow on a sustained and equitable basis if developing countries share in that growth. Progress has been made. The industrial countries have maintained an open market system despite a deep recession. They have increased aid flows, especially to poorer nations. Some $8 billion will be available from the IDA for these nations over the next three years as we join others in fulfilling pledges to its fifth replenishment. The IMF has made available to developing countries, under its compensatory financing facility, nearly an additional $2 billion last year. An international fund for agricultural development has been created, based on common efforts by the developed OPEC, and other developing nations.

The progress and the spirit of cooperation that have emerged can serve as an excellent base for further steps. The next step will be the successful conclusion of the Conference on International Economic Cooperation and we agreed to do all in our power to achieve this.

We shall work—

(1) To increase the flow of aid and other real resources from the industrial to developing countries, particularly to the 800 million people who now live in absolute poverty; and to improve the effectiveness of aid;

(2) To facilitate developing countries' access to sources of international finance;

(3) To support such multilateral lending institutions as the World Bank, whose lending capacity we believe will have to be increased in the years ahead to permit its lending to increase in real terms and widen in scope;

(4) To promote the secure investment needed to foster world economic development;

(5) To secure productive results from negotiations about the stabilization of commodity prices and the creation of a common fund for individual buffer stock agreements and to consider problems of the stabilization of export earnings and developing countries; and

(6) To continue to improve access in a nondisruptive way to the markets of industrial countries for the products of developing nations.

It is desirable that these actions by developed and developing countries be assessed and concerted in relation to each other and to the larger goals that our countries share. We hope that the World Bank, together with the IMF, will consult with other developed and developing countries in exploring how this could best be done.

The well-being of the developed and developing nations are bound up together. The developing countries' growing prosperity benefits industrial countries, as the latter's growth benefits developing nations. Both developed and developing nations have a mutual interest in maintaining a climate conducive to stable growth worldwide.

Exhibit 50.—Remarks by Secretary Blumenthal, May 25, 1977, at the International Monetary Conference, Tokyo, Japan, entitled "Toward International Equilibrium: A Strategy for the Longer Pull"

As we come to the closing session of this International Monetary Conference, I can well understand how your meetings have become an annual highlight for the world financial community. For me it has been a valuable opportunity to share thoughts on current international problems with this informed assembly. I am particularly honored that you have invited me to offer some ideas on how I think we should deal with these issues.

One encounters, these days, a good many uncertainties, doubts, even fears about our international financial prospects, and about our collective ability to resolve successfully the formidable difficulties that appear to lie ahead.

Central to these doubts is an apprehension over the capacity of our monetary system to finance—for an extended period—the world's future oil requirements. Can our system continue to handle successfully the financial consequences of massive OPEC surpluses, surpluses which cumulated to about $150 billion during 1974 through 1976, which may amount to $45 billion this year and continue to be substantial for a good many years?

Is the international commercial banking system becoming dangerously exposed as a result of the recent sharp expansion in balance of payments lending? Are debt burdens becoming unbearable? Can we be sure that official lending resources will be adequate to the need? Are nations in danger of drifting into protectionism, losing confidence in their ability to correct maladjustments promptly by more acceptable means?

We are right to acknowledge these doubts and to face them squarely. Nevertheless, the U.S. administration has full confidence that the international community, working together, can and will assure a stable financial environment and a smoothly functioning international payments system. I can assure you that the United States will do its part.

To begin with, we must acknowledge that large OPEC surpluses are not, as some thought, a short-term problem. They will exist for an extended period, and we must develop a strategy for the longer pull.

Such a strategy must have three facets. First, we must assure that our national governments follow the right policies. Second, we must assure that our international institutions have both the resources and the authority to fulfill their important responsibilities. Third, we must assure that our private financial markets are in a position to carry out their essential intermediary role safely and effectively. I would like today to examine with you what must and can be done in terms of each of these three groups: *governments*, *international organizations*, and *private financial markets*.

Responsibilities of governments

Governments' policies are of key importance. There are several imperatives. For one thing, each nation must pursue a sound energy policy. There can be no permanent solution to the problem of OPEC financial surpluses until oil-importing nations adopt more effective programs for conserving the use of oil and developing alternative supplies. The United States has had no comprehensive energy policy. Our fuel import bill has grown explosively—from $5 billion in 1972 to $37 billion last year. This year it may reach $43 billion. Without corrective action, our oil imports would rise from less than 8 million barrels per day last year to 12 to 16 million barrels per day in 1985. The President has now put forth a national energy plan designed to reduce those imports to 6 million barrels per day by 1985. This reduction, supplemented by appropriate policies in other major nations, will materially assist in achieving a desirable world energy balance. OPEC, meanwhile, must recognize that a healthy world economy is in its own longrun interest and must display responsible restraint on its pricing policy.

Sound energy policies will reduce the collective current account deficit of the non-OPEC states. A second imperative, however, is that governments collaborate to assure that the deficits which remain are distributed among countries in a pattern compatible with their ability to attract capital on a continuing basis. The present pattern does not achieve that balance. Substantial redistribution is required. That requires basic macroeconomic policies and exchange rates for each nation appropriate to its own situation.

Countries in a weaker position, with major deficits, must pursue stabilization policies which will provide a basis for sustained domestic growth while reducing inflationary pressures and expectations. A number of countries have adopted such policies. Several others should.

Countries that are in current account surplus or that can readily attract capital must follow policies designed to insure maximum sustainable domestic growth consistent with a gradual reduction of inflation.

These policies, of course, must focus on domestic market demand rather than on exported growth which further adds to current account surpluses. The United States is following such a policy. Similarly, Germany and Japan have adopted expansionary growth targets for 1977, and we are all committed to adopt further policies if needed to achieve stated targets and to contribute to the adjustment of payments imbalances.

Flexibility in exchange rates is essential for both surplus and deficit countries. The

United States, Germany, and Japan have made clear that they will not resist market pressures for appreciation. Countries which need to strengthen their competitive positions to reduce their deficits must be equally ready to accept depreciation.

Most importantly, all major countries are committed to reject protectionism and to pursue opportunities for expanding trade. Stronger countries should also increase their development aid. Finally, each nation—industrial as well as developing—should adopt policies to expand domestic investment. If borrowed funds are used for investment that expands productive capacity, the ability to service debt will grow as the debt increases.

The steps that have been taken are, in general, correct steps. Whether they are sufficient in all cases remains to be seen.

The current account position of the United States has already shifted dramatically, from a surplus of $11 billion in the recession year 1975 to a deficit this year of perhaps $10 to $12 billion. That shift is making a major contribution to the stability of the international monetary system.

We accept that shift. We can sustain it—although we would not expect the deficit to continue at this level indefinitely. We receive substantial inflows of capital from OPEC and elsewhere and our overall position remains satisfyingly strong. The dollar exchange rate has not declined despite the very large current account deficit.

What is now required is a similar shift in the position of surplus countries such as Japan, Germany, Switzerland, and the Netherlands.

The contribution of international institutions

An important part of our strategy depends on the activities of international institutions—most importantly the International Monetary Fund. The United States supports the view that the IMF's financing capability and its responsibilities for overseeing the monetary system must be strengthened. We believe that the Fund's role in preserving a sound international environment will be of great importance in the years ahead.

As a temporary arrangement, the Managing Director has proposed that lines of credit be negotiated. These would be available as needed to provide additional conditional financing for particular countries whose needs are very large relative to quotas. The IMF's Interim Committee recently recognized the need for such a supplementary credit arrangement, and the seven nations at the summit have endorsed that concept. Exploratory talks are in progress. For the United States, I have told Mr. Witteveen that I would strongly favor U.S. participation, provided a well-designed plan can be agreed, with an appropriate balance between credits from OPEC countries and the industrial world. I am confident that Congress would also support such a plan.

After work is completed on the establishment of this supplementary credit, we must turn our full attention to a more permanent reinforcement of the IMF's conditional lending resources through another increase in IMF quotas.

An equally important task for the IMF is to determine in individual cases the form and degree of policy conditionality to go along with the financing. The IMF must work out specific adjustment programs and corrective measures to be adopted by particular borrowing countries. Conditionality must be applied in an appropriate manner—neither too harsh nor too soft, enough to assure adequate adjustment but no more.

Mr. Witteveen's proposal explicitly recognizes the implications of the present situation for the pace of adjustment in calling for programs spanning a period longer than the 1 year involved in traditional standby arrangements. The IMF's past record in negotiating programs of adjustment is an excellent one, and I am confident that the organization will continue to perform this duty with equity, objectivity, and good sense.

Quite apart from its financing activities, the IMF will take up, under the amended IMF Articles, a major responsibility for surveillance of member countries' exchange rate policies. The Fund is approaching this task, wisely in my view, in a careful and cautious way, avoiding grandiose theoretical concepts. It is not trying to delineate detailed or rigid principles, but rather seeking to develop, on a case-by-case basis, a body of common law based on experience. We must all support and encourage the Fund in the development of this important tool for assuring that no nation will manipulate its exchange rate to prevent payments adjustment or to gain unfair competitive advantage over its partners.

Responsibilities of the private markets

The role of private capital has been enormously increased by the OPEC surpluses. Since OPEC's geographic placement of its surplus funds does not correspond to the distribution of current account deficits, intermediation is required. Over the past 3 years, about three-quarters of the deficits have been financed through the world's money and capital markets.

Concern has been expressed that the private market will not be able to continue this intermediation because of decline in the creditworthiness of borrowers and in some cases limits imposed by the banks' own capital. Although some banks are in fact approaching their legal limits on loans to a few governments, it does not appear likely that this limitation will present a major problem in the continued growth of aggregate bank loans either to foreign corporate customers or to foreign governments.

This issue is frequently posed as an "LDC debt problem." This is a misconception. The pressures on the private markets arise from the difficulties of a very few countries—many of which are not normally regarded as LDC's. For some developing countries, financing continues to be largely a question of the level of available funds from foreign assistance sources. For the rest of the world—developing, developed, and middle-income countries—there is no alternative to a continued central and predominant role for the private capital markets.

Only the private markets have the resources, expertise, and institutions in place to handle the large-scale, highly complex intermediation function smoothly and efficiently; legislatures are not prepared to vote the massive amounts of official funds, or guarantees, required for a basic shift from reliance on private financing to reliance on official financing.

Clearly it is in the interests of all concerned—the oil-exporting countries which are the ultimate creditors, the money and capital markets which are intermediaries, and the borrowing countries—that the flow of private capital continue. Countries which expect to borrow must therefore make sure that they retain their creditworthiness.

Some have asked whether proposals for increasing IMF lending resources were not mechanisms for bailing out the commercial banks, or taking over risky loans injudiciously contracted by the banks. But this is neither the intent nor the likely result. Uniquely, IMF lending is associated with policy conditions and adjustment programs tailored in each case to correct the problems which caused the need for financing. Thus IMF lending can, in a very meaningful way, enhance the creditworthiness of the borrower as viewed by commercial lenders. Bankers have long recognized this fact in their operations—sometimes by directly requiring a nation to enter into an IMF program as a prior condition to further bank credit.

The amount of credit provided through the IMF is small relative to private credit and will remain so. In the 3 years since oil prices increased, the IMF has financed only about 6 percent of the aggregate payments deficits, even though Fund lending has been at historic peaks. While the balance may shift toward a somewhat higher ratio of IMF to private financing, there will be no "takeover" of international lending by the IMF. The significance of IMF credit, and the value of expanding the IMF's lending capacity, is largely that it strengthens creditworthiness and reinforces the system.

I see no evidence that the system as a whole is overloaded. The problems—and there are problems—are found in a few individual nations which are approaching or have reached the boundaries of prudence.

The concern of private markets about increasing their exposure in particular countries is a matter of perceived risk—of the degree to which particular borrowers, and their particular economies, appear to have the capacity to service debt. It is on this risk that private lenders—and the bank regulators looking over their shoulders—are quite properly focusing.

Basic to risk evaluation is information, and borrowers will find they are facing increasing demands for information about the "vital signs" of their economies. Lenders should be in a position to weigh on a reasonably current basis a country's relative performance in such areas as inflation rates, wage rates, and productivity measures, the shares of investment and consumption in GDP trends, public sector deficits, and trends of monetary aggregates. Chairman Burns has made the very sensible suggestion that the central banks agree on the kind of information which a borrowing country would normally be expected to supply.

For some borrowers, meeting these requirements will simply mean revealing information now held confidential. For others, it will require expansion and upgrading of their collection and processing effort so as to obtain more comprehensive, accurate, and timely data. In some cases, this effort will require fundamental changes in the way governments view this aspect of their economic management. But the ability and willingness of countries to provide such data and analyses will increasingly constitute the price of admission to private capital markets—because of the lenders' insistence in their own prudent self-interest, quite apart from any suggestions of the regulatory agencies.

Lenders, by the same token, will need to develop the capability of extracting the maximum benefit from this additional information. This will require that they refine their capability for country analyses. There is in process a change in the type of borrowers coming to market. Formerly, the bulk of international lending was to private, largely corporate borrowers. In many cases, such lending was for short-term trade financing or related to a specific project; and there was a balance sheet, a management with a known track record, a product and a market whose prospects could be analyzed according to reasonably well developed criteria.

Increasingly, however, the prospective borrowers are governments or quasi-public entities. Their purpose in entering the market is likely to be much less clearly commercial than, for example, when a firm borrows to expand to service a new market. In some cases, loans are for general balance of payments support, and it is not immediately evident whether they will finance consumption or increase productive capacity.

In such situations, we enter the realm of what used to be called political economy, a term that could well bear revival. In assessing the riskiness of a balance of payments loan—or assessing the creditworthiness of a country—a major question becomes the willingness and the ability of the government of the prospective borrower to implement the policies which will permit the service of the debt. A lender's assessment of the prospects may require an assessment of the possible changes in the political climate, as well as in the underlying economic situation.

It seems to me important, therefore, to give careful study to the possibilities of developing a closer interaction, a smoother transition, between financing through the private market and official financing through the IMF. There is a view that the private markets and the IMF may in some cases be working at cross-purposes—with private lenders increasing their exposure with growing unease and reluctance, while the IMF watches from the sidelines with increasing frustration while the underlying situation deteriorates. Countries in such cases may avoid recourse to the IMF and adoption of needed adjustment policies as long as access to private financing is more or less readily available. When the situation deteriorates to a critical point, it becomes evident to all, and there is sudden, discontinuous change. The question is whether there is legal and practical scope for earlier involvement by the IMF.

The resolution of this question may be the next needed step in the evolution of the framework of international monetary cooperation. We do not know, at this stage, whether there is a need for formal mechanisms, informal arrangements, or neither. Certainly we must recognize the limitations on the IMF's freedom of action. There would be great reluctance, for example, to have the IMF enter the field of credit rating, not least because such action could undermine the confidential basis on which information is given to the Fund. Nevertheless, there may be ways in which closer private-official cooperation could be fashioned without putting the IMF in the credit-rating business. To invite discussion, I will list several theoretical possibilities without endorsing any; and I want to stress again that I do not feel we are yet in a position to make decisions in this area.

Perhaps the least dramatic step could involve IMF willingness to provide staff reports and country assessments to prospective lenders, on the basis of formal requests by the countries in question.

The IMF might publish reports based on its annual consultations with countries, again subject to the approval of the countries in question. There is precedent for this in the OECD's publication of annual reviews of member countries' economic situations.

A more overt IMF role might involve IMF staff participation in the development of policy conditions to be associated with private or largely private lending. Thus the Fund might make available its services to help design stabilization programs, if requested by both prospective borrowers and lenders. As a variant on this approach, the banks might insist, as part of a negotiated loan package, that a country establish eligibility for borrowing from the Fund.

Among other suggestions, it has been proposed that the IMF might participate in the development of mixed financing packages, featuring a blend of official and private funds. Depending on the circumstances, the initiative might come from private lenders, the borrowers, or even the Fund itself. Arrangements in some cases might involve a "stretchout" of debts to correct excessive "lumpiness" in the earlier maturities.

All of these proposals raise basic questions of how the IMF should operate and how it should relate both to its sovereign members and to the private sector. I do not suggest that the international community will in the end necessarily decide that it is wise to make such changes. But I do think that we should be willing to reexamine old premises, review old practices, and consider innovations. Only in that way can we assure that our institutions grow and adapt to current conditions, and are used with the maximum effectiveness that the future will require.

Conclusion

To conclude, I am confident that the strategy I have outlined—a strategy based on application of sensible government policies, reinforcement of our international institutions, and strengthening of private market mechanisms—will be adequate to the test for the longer pull. My confidence is fortified by two facts:

First, the record of the past 32 years is, on the whole, an excellent one. In the international monetary sphere, the world community has, time and again, faced new problems, new strains. On each occasion, it has found a cooperative and responsible solution. I am sure we can do so again.

Second, we have the advantage of a new, realistic, and flexible monetary system as a framework for our policies. That system is itself a product of international cooperation and will facilitate our progress.

This effort will require the best from all of us. The skill and determination which you in the international banking community, as well as we in national governments, apply in adapting to the situation we confront will largely determine our success.

Exhibit 51.—Remarks by Secretary Blumenthal, June 24, 1977, at the OECD ministerial meeting in Paris, entitled "Prospects and Policies for Sustaining Expansion in the OECD Area"

Last month the heads of government of seven of the countries here agreed on several basic objectives:

To create more jobs while continuing to reduce inflation;
To achieve stated growth targets or to pursue appropriate stabilization policies;
To support IMF efforts to obtain additional resources and to link IMF lending to the adoption of appropriate stabilization policies;
To pursue both national and joint efforts to limit energy demand and to increase and diversify energy supply;
To reject protectionism and give a new impetus to the Tokyo Round of multilateral trade negotiations; and
To provide the developing countries with greater opportunities to share in the growth of the world economy.

This meeting provides an opportunity for other nations to join in those commitments. I urge each one to do so.

It provides an opportunity to establish procedures which will improve our understanding of the implications of each nation's policies and enable us to monitor our progress. I propose that we do so.

And it is an occasion of a considering together of our prospects for sustained economic growth in the OECD area.

In virtually every country represented here unemployment is at a totally unacceptable level. In most of our countries inflation is too high. Many of our nations are experiencing external payments deficits which cannot be long sustained.

We face interrelated problems in an interdependent world. We cannot solve one problem at the expense of the others. Nor can any nation expect to be an island of prosperity in a sea of economic troubles. Our problems must be solved together and cooperatively. The survival of our political institutions and our open trade and financial system depends on our success.

We can meet this challenge; we can succeed in achieving sustained noninflationary growth—

If every member country in a position to do so pursues the domestic macroeconomic policies which will induce the maximum rate of domestic growth consistent with avoiding a resurgence of inflation;
If every country which does not yet have inflationary pressures under control pursues forceful and effective stabilization policies;
If we go beyond traditional demand management measures to attack the underlying structural causes of unemployment and inflation;
If both surplus and deficit countries allow exchange rates to play their appropriate role in the adjustment process.

Because some countries have made more progress than others in controlling inflation and some are under external financial strains while others are not, the policies required will differ from country to country.

In the financially strong countries this situation calls for economic expansion at the maximum rate consistent with control and reduction of inflationary pressures. In the United States, we are already well on our way toward achievement this year of roughly 6 percent growth, yearend to yearend. First-quarter economic activity grew at an annual rate of 6.9 percent. We expect a similar performance in the current quarter, followed by a 5- to 5 1/2-percent growth rate in the second half of the year. Unemployment has been pushed below 7 percent for the first time in almost 3 years while employment has risen by over 2 million in 6 months.

At the same time, despite temporary setbacks because of bad weather, the U.S. underlying inflation rate has remained stable, although still too high.

We are naturally concerned by the Secretariat's forecasts which suggest that current policies may not enable either Germany or Japan to reach its stated growth target and that too much of the growth of output, in Japan particularly, is going into exports. But we have faith in the assurances of Chancellor Schmidt and Prime Minister Fukuda that they will take further measures, as needed, to achieve their growth goals and to reduce their current account surpluses.

Reduction of the current account surpluses is essential because some of the weaker countries are approaching prudent limits to the accumulation of debt—whether to private lenders or official institutions. In these circumstances the availability of ample lendable funds from persistent surplus countries is not a complete answer.

Stronger domestic growth and exchange rate appreciations in the stronger countries will tend to eliminate their surpluses. But supplementary steps are also in order. This is the time for surplus countries to eliminate practices which favor exports over output for domestic consumption or impede imports or interfere with exchange markets. It is a time for strong countries to dismantle monetary and capital controls that might depress exchange rates and for seeing that foreign exchange acquired outside the market, such as interest accruals on existing reserves, is resold on the market.

Among the responsibilities of the stronger countries, I count the obligation of the United States to reduce its excessive imports of oil. The flow of oil from Alaska will provide an immediate reduction of our import demand. But for the longer run, we must achieve a strong energy program based on conservation and the substitution of domestic for imported fuels. President Carter has made that goal his top priority despite the difficulty of achieving the economic and social changes it entails.

Countries in weak external financial positions have an equal responsibility to put their own houses in order, to stabilize their economies and improve their international competitiveness. They have a right to the cooperation of the stronger countries, but they cannot expect others to solve their problems for them. They should not overborrow. They should permit sufficient depreciation of their currencies to improve their competitive positions. And they should back up their declining exchange rates with domestic policies that retain their competitive gain. The benefits of depreciation may not come quickly but if exchange rates are not allowed to respond to differences in inflation rates, payments imbalance can only grow worse. It is hard to see how any country can improve its international position unless its policies allow its producers export profit margins that are essential to an adequate export performance as well as to improved import competitiveness. Manufacturers must have the proper incentives to invest in facilities for both the export and home markets.

Obviously the domestic economic policies needed to restore domestic price stability and external creditworthiness are not easy for governments. They involve national belt-tightening. Yet delay will only lead to the necessity for more severe and more painful action. At the first sign of difficulty in attracting capital on normal terms, stabilization programs should be developed, with the cooperation of the IMF if necessary. Such cooperation will not only bring official financing but will also help to sustain financing from private sources.

Many countries have, of course, been following this growth or stabilization strategy for some time. We are now beginning to see results. The world payments pattern is shifting significantly in the right direction.

Economic expansion is beginning to exert its impact, notably in the United States. We expect a current account deficit of $10 to $12 billion this year compared to a deficit of $600 million in 1976 and a surplus of $11 1/2 billion in 1975. As the strength of the dollar indicates, the United States can sustain this deficit for a time because we attract the capital required to finance it.

General economic recovery is clearly improving the earnings of many developing countries. Exports of the nonoil developing countries were one-third higher in the fourth quarter of 1976 than a year earlier. And while some individual developing countries face difficulties, there is no general LDC debt problem. In fact, reserves of nonoil developing countries rose by $11 billion last year.

Stabilization programs are beginning to show results. The United Kingdom's balance of payments appears to be edging into surplus while Italy, Mexico, and Brazil have sharply reduced their deficits.

But despite these signs of progress, we have a considerable distance to go toward appropriate payments balance.

We need significant shifts—into deficit—in the current account positions of such surplus countries as Japan, Germany, Switzerland, and the Netherlands.

We need to see stabilization policies adopted in a number of smaller countries represented at this table.

And in the countries which have already adopted stabilization measures we need perseverance until inflation is brought down and the fears of its resurgence allayed.

I recognize that such changes cannot occur overnight. They require time and careful, gradual policies. Countries in a weak external position will need adequate official financing, conditioned on the adoption of suitable stabilization policies. I am confident that the current efforts to expand the IMF's resources will ensure the adequacy of official financing to meet this need for the near term, apart from the unique case of Portugal. For the longer term, I trust that all OECD members will also be prepared to support an adequate increase in the quotas of the IMF.

But while adjustments and structural changes in our economies take time, the longer the initiation of this process is delayed, the greater the danger of domestic turmoil or of trade restrictions and debt defaults. We have been preoccupied with concerns about the sustainability of the financial system. But the penalty for failure to solve our financial problems may not be financial collapse. Instead, the result may be trade restrictions and a slide back into the inefficiencies of economic nationalism.

Unilateral trade restraints must be rejected as an unacceptable response to payments deficits or to problems of domestic economic adjustment. Such measures clearly risk fostering further unemployment and increasing inflation, both at home and abroad.

While we cannot ignore the reality of trade-related difficulties in certain sectors which cannot be fully resolved overnight, our objective should remain meaningful adjustment to structural change within our own economies without shifting those problems to our trading partners. Our record has not been perfect on this score, but overall the OECD members have resisted the pressures of protectionism.

Renewal of the trade pledge of 1974 provides us the opportunity jointly to reaffirm our determination to avoid trade restrictions or other restrictive current account measures and the artificial stimulation of exports. The United States strongly supports its renewal and urges your support as well.

We must also seek to liberalize trade by granting new impetus to the multilateral trade negotiations in Geneva by seeking substantial progress in key areas this year.

This means that we must agree on what the critical issues are, on what rules we will adopt to deal with them, and within what time period each of these steps is to be taken.

We urgently need agreement on—

A formula for tariff reductions and rules for negotiating the lowering of nontariff barriers;

A practical and effective means of breaking the deadlock on agricultural trade;

Steps to help the developing countries benefit from expanding world trade; and

A new international code on subsidies and countervailing duties.

We need better mutual understanding of what constitutes fair and unfair trade and host governments may justly respond to unfair trade practices to counter a major irritant in our trading relations.

We need, in short, not rhetoric, but real progress in addressing the difficult problem of trade liberalization.

I would like to stress the importance of further progress toward an arrangement which broadens and strengthens the present international consensus on export credits.

Achieving the domestic and international adjustments I have outlined will require skilled and responsible economic management and a willingness to plan ahead. As the Secretariat points out, our countries must give more attention to the medium term. In the United States, President Carter has set a goal of reducing both the rate of inflation and the rate of unemployment and balancing the Federal budget in a high-employment economy by 1981. We are viewing economic and budgetary decisions and developing economic goals in that context.

Growth targets and stabilization policies must, of course, remain the ultimate responsibility of sovereign nations. Each country will be assisted in arriving at its growth goals and stabilization policies, however, if it has a clear understanding of the plans of other nations and of the global implications of its own objectives.

I believe it would be useful, therefore, to strengthen the procedure for multilateral examination and subsequent monitoring of the economic policies of member countries. We need to be realistic, however. The members as a whole—although not all member countries—probably should be aiming at a somewhat faster rate of expansion in 1977. Nevertheless, we are not in a position at this meeting to set a quantitative target for the growth rate for the area as a whole in 1978. Any such target must be the outgrowth of national decisions not yet made.

I support the suggestion that each country be asked to submit preliminary objectives for the growth of domestic demand and for stabilization policies for 1978 to the Organization early in the fall. We should also expect countries to indicate the desired direction of change in prices and current account positions, although specific targets for these indicators would be impractical. These submissions would form the basis for study and comment by the Economic Policy Committee. Because this proposal blends directly into the ongoing work of the Organization, I would not expect it to require the impetus of a special meeting of the Ministerial Council.

Finally, let me say that we must conduct our economic policies with the recognition that some of our tools of economic management no longer work as they once did. In the United States and other countries, the tradeoff between economic activity and inflation has changed. We see that neither high unemployment nor low utilization of capacity leads automatically to a rapid drop in inflation. Factors other than excess demand are increasingly important determinants of inflation.

So we must seek new programs and policies to supplement demand management in our efforts to reduce unemployment and inflation. Many of the measures we must adopt should focus on specific structural problems in our economies—the need to change employment patterns and develop new labor skills, the need for new measures to provide employment for our youth, the need to foster competition and to remove regulations that are outdated or fail to meet a cost-benefit test.

I support the proposal for a high-level conference to exchange experience and develop policy directions on measures for alleviating youth unemployment. This problem is universal among our countries. Because many of us are embarked on specific programs to combat it, we can benefit from sharing our ideas and our experiences. I also welcome the useful and timely discussion in the report of the McCracken group on techniques for combating inflation. As part of President Carter's comprehensive anti-inflation program, the United States is already reviewing Government regulations with the intent of reducing unnecessary costs imposed on the private sector and enlarging the scope for the free market. At the same time, we are working with labor and management to develop voluntary, cooperative measures to avoid wage-price spirals.

When all is said and done, the success of our economic policy depends fundamentally on our ability to engender confidence that we will achieve sustained growth with lower unemployment and price stability and that we will maintain a strong and open monetary and trading system. In a cost-benefit calculus, the dangers of pushing ahead too far and too fast have increased because our economies seem less responsive to attempts to correct overstimulation. We should recognize this reality, as the United States did in withdrawing the proposed tax rebate. Our policy should be cautious yet committed, providing a firm basis for rebuilding the confidence that we need to call forth increased investment in productive capacity. After their experiences of the recent past, businessmen in all countries are wary—and understandably so. But investment is vitally needed to create jobs, avoid supply problems, and speed up productivity growth.

Our words alone will not win this confidence. But if we take actions which demonstrate the determination and ability to adhere to the approach being proposed here today, we will gain the confidence that will undam the vital flow of investment. Unemployment will be brought down; inflation will be reduced; and a sustainable pattern of external payments will evolve.

Exhibit 52.—Statement by Under Secretary for Monetary Affairs Solomon, July 13, 1977, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, on the International Banking Act of 1977 (H.R. 7325)

It is a pleasure to appear before this subcommittee to present the position of the administration on this proposed legislation. We generally support this legislation with certain modifications that I would suggest.

Growth of international banking

International banking operations have been growing in recent years, although they are still small in relation to our domestic banking industry. Specifically, while total assets of foreign banks held in the United States have tripled during the past 4 years, rising to $76 billion at the end of 1976, this amount still represented only about 7 percent of the total assets of all domestic banks. In comparison, the total assets held abroad in foreign branches of U.S. banks were almost three times that amount, $220 billion.

Growth in international banking is the financial counterpart of healthy increases in international trade and also reflects desirable reductions in international obstacles to investment. The United States, like our major trading partners, recognizes the importance of this growth to an efficient world economy. In particular, foreign banking operations in the United States have increased competition in the financial services industry here.

We expect international banking operations to expand further in the future. Accordingly, this is an appropriate time for the United States to consider a national policy toward foreign bank operations here.

In determining a national policy, we must keep in mind that our regulation of foreign banks may affect foreign government treatment of U.S. banks and other financial institutions operating overseas.

Competitive equality

U.S. policy toward foreign direct investment in America reflects the principle that foreign companies, in general, should be accorded the same opportunities and be subject to the same restrictions as domestic businesses. This policy, known as national treatment, seeks neither to promote nor to discourage foreign investment, but to insure regulatory equality. Moreover, it is consistent with U.S. treaty obligations governing foreign trade and investment. Accordingly, the basic objective of H.R. 7325, which we support, is to treat foreign banks operating here equally vis-a-vis domestic banks.

Some argue that our policy should reflect reciprocity rather than competitive equality. In this case, reciprocity would permit foreign banks operating here to engage in whatever activities U.S. banks are permitted in selected countries abroad. While reciprocity has a superficial appeal, it would not be desirable for us to adopt it. Such a policy could reduce permissible international banking activities to the lowest common denominator, as countries tighten regulations to achieve strict reciprocity. Furthermore, it could be an administrative nightmare to enforce different sets of rules for different foreign banks operating in this country.

It should be made clear, Mr. Chairman, that the application to foreign banks of restrictions governing domestic banks does not mean that the administration is reaffirming the desirability of any or all of these restrictions. As I am sure this subcommittee is aware, many issues addressed in the foreign bank bill are currently being reviewed by the Congress, the administration, and independent regulators. Indeed, in the areas of this bill dealing with the securities activities of commercial banks, we would prefer that decisions await these reviews. At the very least, my testimony is not meant to prejudge any of this work. In supporting H.R. 7325, we have simply sought to extend the existing regulatory framework, as we find it, to foreign banking.

Existing law and elimination of disparities therein

Our existing laws and regulations covering foreign banks are not balanced. On the one hand, they deny foreign banks certain banking opportunities here. For example, foreign banks are deterred from establishing national banks. In addition, our laws encourage foreign banks to operate branches or agencies, but these operations are unable to obtain Federal deposit insurance.

On the other hand, there is no Federal regulation or supervision of foreign bank branches and agencies, even though almost all domestic banks come under the regulation of either the Federal Reserve, the Comptroller of the Currency, or the Federal Deposit Insurance Corporation.

Mr. Chairman, we support the objective of reducing these disparities of treatment between foreign and domestic banking operations in the United States. We are pleased that the bill will provide foreign banks with new Federal chartering opportunities to establish national banks, and Federal branches and agencies.

At the same time, it also is sensible that H.R. 7325 would subject branches and agencies of foreign banks to Federal regulation comparable to that of domestic banks. In certain respects, the bill recognizes that branches of foreign banks require treatment as a special category of banking institution. For example, since State branching laws are not applicable to interstate branching by foreign banks, the bill employs Federal law to fill the gap.

Proposed changes in the bill

While offering our general support for H.R. 7325, Mr. Chairman, we recommend several modifications to achieve a greater degree of regulatory equality.

1. *Nonbank affiliates of foreign banks.*—Section 8(a) of the bill applies the Bank Holding Company Act to foreign banks which maintain U.S. branches and agencies.

Section 8 also grandfathers nonbanking activities in existence as of December 3, 1974. We recommend moving forward the cutoff date to July 1, 1977. Also, we recommend exempting from the prohibitions of the Bank Holding Company Act those nonbank acquisitions by foreign banks which do not significantly affect the United States. As suggested in Federal Reserve testimony last August, the proposed amendment would—

> * * * make clear that the nonbanking prohibitions of the Bank Holding Company Act are not meant to prevent foreign banks principally engaged in banking abroad from retaining or acquiring interests in foreign-chartered nonbanking companies that are also principally engaged in business outside the United States. * * * However, * * * as a corollary * * *, a domestic office of a foreign bank should be required to deal with the domestic operations of a foreign company in which it may have an equity interest on a strictly arm's-length basis so as not to give the firm or bank involved an advantage over their respective U.S. competitors.

Generally, the administration believes that the Federal Reserve's proposed amendment would provide greater certainty to foreign banks concerning their nonbank affiliates and is desirable in light of the different regulatory frameworks abroad which permit closer ties between banking and industry.

This amendment is not designed to change the Bank Holding Company Act as currently implemented by regulations of the Federal Reserve Board. It simply gives foreign banks greater certainty about the act's application.

It is desirable to amend the Bank Holding Company Act in this way for two specific reasons. *First*, the existing administrative process for exemptions under the act would create considerable uncertainty for foreign banks concerning which foreign nonbanking activities or acquisitions are permissible when they also affect U.S. commerce. *Second*, the present version of section 8(a) could be seen as applying the Bank Holding Company Act extraterritorially to prohibit foreign banks located abroad from acquiring or providing assistance to nonbank enterprises abroad.

2. *Grandfathering of securities operations.*—A second provision of section 8—the proposed treatment of the U.S. securities operations of foreign banks—also concerns us, Mr. Chairman. Specifically, H.R. 7325 proposes that foreign banks now lawfully engaged in securities activities here must terminate these activities by December 31, 1985. However, foreign banks would be permitted beyond 1985 to engage in underwriting securities so long as the securities are sold outside the United States. We recommend that this provision be amended to provide permanent grandfathering for the existing securities operations of foreign banks.

This issue of grandfathering existing securities operations is a difficult one. A responsible argument certainly can be made that, when applying to foreign banks here the principle of separating commercial from investment banking, it produces more uniform treatment to apply the principle both to prospective entrants and to existing firms. However, we believe other considerations outweigh the advantage of such proposed uniformity.

First, divestiture would obviously cause a hardship to the foreign banks involved, and would eliminate a small foreign presence which now may have a procompetitive effect on our large domestic securities industry.

Second, we believe that divestiture would be inequitable to the foreign banks who established themselves here under the rules of the game prevailing at the time. We should also take account of the history of permanent grandfathering that has been applied for domestic banks under the Bank Holding Company Act and also under the McFadden Act. It might be argued that securities activities of domestic banks were not grandfathered in 1933. However, a lack of grandfathering in that case is not a good precedent for the treatment of foreign banks today, because divestiture then was based upon widespread abuses whereas we have no evidence of foreign banks abusing their position now.

Third, we feel that our relations with other countries might be damaged as a result of forced divestiture of existing operations of their banks.

These are the disadvantages involved in divestiture. In our judgment, they outweigh the advantages gained from uniformity.

In any case, as you know, Mr. Chairman, the Congress and a number of agencies are in the process of an intensive study of the participation of banks in various aspects in the securities industry. If, as a result of its review of this area, Congress determines that bank securities activities are not in the national interest, Congress of course would not be precluded if it so wished from extending those prohibitions to presently existing securities activities at that time.

3. *Special Federal review of foreign bank applications.*—I would now like to address, Mr. Chairman, a third basic area in which we favor modification of this bill. Section 9 would introduce special Federal screening of applications by foreign banks desiring to establish operations within the United States. Specifically, this section would require: (1) the Secretary of the Treasury to issue guidelines containing general criteria for the admission of foreign banks; (2) Federal and State bank supervisory authorities to solicit the views of the Secretary of State, the Secretary of the Treasury, and the Federal Reserve Board before acting on the applications; and (3) Federal and State banking authorities to disapprove applications unless foreign banks specifically state that they will comply with U.S. antidiscrimination laws which apply to domestically chartered banks.

We strongly recommend the elimination of section 9 because it would deviate unnecessarily from our overall Federal policy of national treatment. Section 9 would apply to foreign-owned banks only and would establish for these banks new criteria beyond that normally applied to both foreign and domestic banks. In this sense, establishing special guidelines and review procedures for foreign banks operating here would conflict with our traditional policy of neither promoting nor discouraging foreign investment and could set an unfortunate precedent for the establishment of similar procedures for foreign investment in other sectors of our economy. It also could induce other countries to introduce or expand restrictions on American financial activities and investments abroad.

This provision also appears to contradict certain national treatment provisions of treaties of friendship, commerce, and navigation which we have with most of the major banking nations because it would apply to establishing international banking operations which do not involve depository or fiduciary functions. With regard to the antidiscrimination provision, we understand that foreign bank operations in the United States already are covered by existing antidiscrimination laws applicable to domestic banks. Thus, it would be inappropriate to incorporate this provision into a new banking law since such action could imply that foreign bank operations were not subject to the law in the past. Moreover, we have no evidence of nonadherence to U.S. antidiscrimination laws.

Furthermore, we also advise against the second part of the antidiscrimination provision that would require only foreign banks to take an antidiscrimination oath as a condition of obtaining charters. This proposal singling out foreign banks is discriminatory. As a final point, section 9 as a whole simply seems unnecessary because it would provide no additional protection to U.S. depositors or to national interests. There already are adequate safeguards in existing law, administrative procedures, and in the proposed legislation.

4. *Special deposit insurance.*—Another important provision of H.R. 7325, Mr. Chairman, is section 6, which would require U.S. branches of foreign banks to maintain with the FDIC a surety bond or pledge of assets. We recommend that this section be amended to provide more equal treatment vis-a-vis domestic banks. Specifically, we believe the section should be changed (1) to make insurance optional for those State-licensed branches which operate in those very few States that do not require FDIC insurance for State nonmember banks and (2) to offer U.S. branches of foreign banks regular FDIC deposit insurance.

These changes are designed to take care of two concerns. *First*, while we firmly believe that deposit insurance is highly desirable, we again feel that it should be provided while avoiding unequal treatment between foreign and domestic banks in this area. In particular, we want to avoid departing from the national treatment policy and raising questions about U.S. obligations under our treaties of friendship, commerce, and navigation.

Second, we are concerned that the special insurance program currently contained in the bill would be unduly burdensome. It would not offer foreign-owned branches access to the Federal deposit insurance fund but instead would require branches to pledge assets or a surety bond against their deposits, with the FDIC as custodian of the assets. In the absence of an insurance fund to pool risks, the pledge of assets might prove inadequate to protect depositors.

Last year, the FDIC worked with Treasury to develop a proposed modification of section 6 to increase the attractiveness of the deposit insurance program for foreign banks. Under this proposal, foreign-owned branches in the United States would apply for regular FDIC insurance coverage and would pay the standard insurance premium of domestic member institutions. In addition, the branch would pledge some assets or a surety bond to the FDIC to cover any additional risk.

The administration supports the FDIC's proposed modification. However, we believe that deposit insurance should be mandatory for U.S. branches of foreign banks, except, as noted above, in those States where State-chartered, nonmember domestic banks are not required to obtain it. With these changes, deposit insurance should be viable for U.S. branches of foreign banks.

5. *Interstate branching.*—Let me turn finally, Mr. Chairman, to the issue of interstate branching by foreign banks. In section 5 of the bill, interstate branching by foreign banks would be prohibited unless national banks are accorded the same privilege. However, foreign bank branch, agency, and commercial lending operations underway prior to May 1, 1976, would be permanently grandfathered. We support the grandfathering of these operations so as to minimize the disruption of ongoing banking services, and we also favor changing the effective grandfather date to exempt operations underway on July 1, 1977. Currently, foreign banks may establish branches in more than one State where the law of each State permits, although domestic banks have no ability to branch outside their home State. This occurs because foreign bank branches are not chartered by States and, therefore, State laws restricting branches chartered by other States are not applicable. Since we favor equal regulatory treatment of foreign and domestic banks, we support a prohibition on interstate branching by foreign banks unless and until U.S. banks are accorded the same privilege. However, we do not favor the language of section 5, for it would subject both State and nationally licensed foreign branches to the restrictions applying only to domestic national banks. While the basic prohibitions on branching imposed by State law are adopted by Federal law, the latter contains additional, somewhat more onerous requirements (e.g., higher capital requirements). We suggest that the subcommittee could attain its intent by having section 5 phrased to apply the branching law for domestic national banks to nationally licensed foreign branches, and for domestic State banks to State-licensed foreign branches.

Exhibit 53.—Statement by Under Secretary for Monetary Affairs Solomon, September 20, 1977, before the Subcommittee on International Trade, Investment, and Monetary Policy of the House Committee on Banking, Finance and Urban Affairs, on legislation to authorize U.S. participation in the IMF Supplementary Financing Facility

I welcome these hearings, and this opportunity to testify for the administration in support of legislation to authorize U.S. participation in the Supplementary Financing Facility of the International Monetary Fund.

This new facility is needed, and needed urgently, to strengthen the International Monetary Fund, and to enable us through the Fund to deal with certain potentially serious problems in the international monetary system today. The establishment of the facility will help to make sure that our international monetary system continues to function smoothly, and will foster our objectives of an open and liberal system of international trade and payments. U.S. participation is a prerequisite to the facility's establishment. I urge, on behalf of the administration, that the Congress act promptly to authorize that participation. I cannot exaggerate the importance, for international financial stability, of this facility, and this legislation.

The need for the Supplementary Financing Facility arises from the drastic changes that have occurred in the pattern of international payments since 1973. As this subcommittee knows, the quintupling of oil prices, the most severe world recession since the 1930's, and world inflation, unprecedented in pervasiveness and obstinacy, have all combined to bring radical changes to many aspects of the international payments situation. Thus, in recent years, the *pattern* of international payments has dramatically changed, with certain oil-exporting countries accumulating immense current account surpluses, while the rest of the world accustomed itself to very large deficits; the *attitude* toward imbalances has changed, with recognition that the aggregate oil deficit cannot be eliminated in the short run; and the *magnitude* of worldwide financing requirements has thus increased by a quantum step to multiples of the levels of earlier years.

The increase in balance of payments financing has indeed been striking. In the 3 years 1971 through 1973, the aggregate deficit of all nations running current account deficits averaged about $15 billion per year. In the 3 years 1974 through 1976, the aggregate deficit averaged about $75 billion per year, or five times as much. Understandably, an increase of this magnitude in financing requirements has caused strains in the international monetary system.

This large amount of balance of payments financing, about $225 billion over the last 3 years, was largely matched by an increase in debt. The rapid growth in financing and debt came as no surprise. Soon after the shock of the increase in oil prices, it was recognized that with such price levels and the absorptive capacity constraints of oil producers, the resulting OPEC payments surpluses—and counterpart deficits of the oil-importing countries—could not be eliminated in the short run. The oil-importing nations acknowledged that they could all harm each other if each tried to shift its oil deficit to other countries by external restrictions and excessive domestic retrenchment. The IMF membership agreed formally in January 1974 in the Rome Communique to avoid such self-defeating actions. In the circumstances, it was appropriate that nations were urged to "accept" the oil deficit, at least temporarily, and finance it. Efforts were concentrated on assuring that recycling of OPEC surpluses occurred smoothly and that adequate financing would be available to all countries to meet the higher costs of oil imports. As part of this stress on financing rather than adjustment, the IMF established a temporary oil facility, which channeled $8 billion to member nations, allocated largely in relation to the increase in oil import costs, and with much less than the usual emphasis on the IMF's usual requirement that its financing be linked to carefully negotiated adjustment programs or corrective measures on the part of the borrowers.

Nations thus borrowed very heavily in the years 1974 through 1976 to finance their large balance of payments deficits. The borrowing took many forms. While official financing through the IMF during this period was far above historic levels, it was the private markets that handled the bulk of the financing, accounting for about three-quarters of the total.

Such data as are available—admittedly incomplete—show a pattern of world payments in the period 1974 through 1976 roughly as follows:

- The cumulative current account deficits financed equaled about $225 billion or so (after the receipt of grand aid), representing the counterpart of the lendable surpluses of OPEC plus those of certain industrial countries registering surpluses during the period.
- About $15 billion of these deficits, or 7 percent of the total, was financed through the IMF, the bulk of it through the temporary oil facility and the compensatory financing facility, both of which provided financing largely on the basis of "need" with relatively little emphasis on "conditionality" or the adoption of corrective adjustment measures by the borrower.
- About $40 billion of the deficits, or 18 percent of the total, was financed through a variety of other official sources—development lending by industrial countries and OPEC, by the IBRD and regional development banks, and other sources.
- The remaining current account deficits, some $170 billion, plus about $40 billion of debt repayments, were financed largely through market-oriented borrowing. Most of these funds were obtained through banks and securities

markets. Some came from governments seeking investment outlets for their surpluses or as export financing.

Given the private market orientation of the world economy, it was natural that the bulk of this financing be handled by private rather than official channels. The private institutions were in a position to expand the level of their activity. Huge surpluses, by OPEC and other countries, of course, brought large deposits and placements to the banks and other financial intermediaries, and greatly expanded the loanable funds of those institutions. In addition, the period was one of rapid institutional expansion in the international banking system. Many institutions were competing eagerly for new customers, as they sought to establish themselves in new activities and new geographic areas, and endeavored to broaden their scope of operations so as to spread risks and diversify portfolios at a time when domestic loan demand was less buoyant than in immediately preceding years.

The question has been raised as to whether this rapid and unprecedented enlargement of lending activity and debt has reached a danger point for the monetary system—either in the sense that large numbers of countries have borrowed beyond their capacity to service debt, or in the sense that our banks and other institutions are overextended.

It is our considered judgment that the system as a whole is *not* in any such position of imminent danger, either as a result of excessive borrowing by large numbers of debtor nations or as a result of our financial institutions being overstretched.

But the fact that the system as a whole has performed well thus far is no cause for comfort or complacency. Success in the past is no guarantee that we are adequately armed for the future. Much remains to be done. Structural changes, domestic and external, must take place in many countries, often involving major alterations of traditional patterns of production and consumption. Such changes will not come easily and must take place over a number of years if satisfactory levels of growth and employment—and an open system of trade and payments—are to be maintained. Substantial financing will continue to be needed by countries in deficit. And, in some countries, adjustment measures need to be introduced. The Supplementary Financing Facility will help to assure that the financing is available and that the adjustment measures are adopted.

Clearly there are countries—certainly not a large number but a significant number—that have already reached or are approaching the limits of their ability to borrow or their prudence in doing so. These are countries that are beset by internal economic imbalances, that still face large payments deficits, where the need for corrective measures and internal and external adjustment is compelling.

Such countries, and others which may in the future face similar difficulties, must be encouraged, and permitted, to adjust their economies in ways that are compatible with our liberal trade and payments objectives, in ways that avoid discrimination against others and disruption of the world economy. Our monetary system must foster sound adjustment, internationally responsible adjustment, with programs that develop underlying economic and financial stability in the countries undertaking adjustment measures, while avoiding recourse to trade and payments restrictions that are destructive of international prosperity. This economic and financial stability is a prerequisite to sustainable expansion and high employment. A major function of the IMF is to induce such adjustment.

Our international monetary system is at present strong and functioning effectively. But we must eliminate its vulnerabilities and put in place the machinery needed to insure that it will continue to operate effectively in the future. Looking ahead, we can make two fairly safe predictions:

First, that large payments imbalances will continue for the next several years. The OPEC surplus, the largest part of the imbalance, will diminish only gradually, as OPEC spending grows and as effective energy conservation and production programs are implemented in the United States and elsewhere.

Second, that there will be a need for greater emphasis on adjustment of imbalances, rather than simply financing the imbalances, especially by those countries facing relatively large payments deficits. With the passage of time, the need for countries to adapt to higher energy costs and other economic developments has become stronger and is increasingly recognized. Indeed, at the Manila IMF meeting last fall, a basic strategy of adjustment was agreed, which, among other things, called upon deficit countries to shift resources to the external sector and bring current account positions into line with sustainable capital inflows.

Given these expectations, it is essential that the resources of the IMF be adequate both to enable it to foster responsible adjustment policies by members facing severe payments difficulties, and also to provide confidence to the world community that it can cope with any potential problems that may arise. That, fundamentally, is why the Supplementary Financing Facility is needed.

Without the additional funds of the new facility, the IMF's resources may not be adequate to meet demands placed on it over the next several years. With relatively large use in the past 3 years, the IMF's usable resources are at present extremely low at about $5 billion. These usable resources will be increased by about $6 or $7 billion with the coming into effect of the sixth quota review approved in 1976 and now being ratified, and about $3 billion remains available under certain conditions through the General Arrangements to Borrow. Even with those additions, and the repayments which may be expected, the IMF's resources look sparse in a world in which total imports are running at an annual level of nearly a trillion dollars, and in which OPEC surpluses are likely to decline only gradually from the current $40 billion annual level.

Against this background, the decision was taken to seek to establish the Supplementary Financing Facility, with financing of about $10 billion to be provided initially by seven industrial nations and seven OPEC countries. The industrial countries would provide $5.2 billion, of which the U.S. share—subject to congressional authorization—would be SDR 1.45 billion (about $1.7 billion) approximately 17 percent of the total. The OPEC members would provide about $4.8 billion, or nearly half the total, with Saudi Arabia the largest single participant of either group at $2.5 billion.

The terms relating to the provision of this financing to the IMF by the participants are presented in detail in the National Advisory Council "Special Report on the Supplementary Financing Facility," presented to the Congress with the legislation. Under the agreed terms, participation in the facility is advantageous to the United States and others providing the financing. In addition to furthering our interest in assuring a strong and smoothly functioning international monetary system, U.S. participation in the facility provides us with a strong, liquid, and interest-earning monetary asset. Under the facility, the United States and other participants agree to provide currency to the IMF in exchange for a liquid claim on the IMF of equivalent value. These claims on the IMF, which can be drawn down any time there is a balance of payments need to do so, form part of our international reserve assets. The United States also can sell or transfer these assets to others by mutual agreement. Since, in exchange for any dollars we provide, we receive a fully liquid claim which can be drawn down any time we have a need to do so, there is no U.S. budget expenditure involved, but rather an exchange of one asset for another. This treatment is in keeping with the budget and accounting practices followed with respect to all U.S. transactions with the IMF.

The interest rate we receive from the IMF is linked to U.S. Treasury issues of comparable maturity, so that there is no net cost to the Treasury from our participation in the facility. As the drawings are repaid by the borrower, the IMF returns the dollars to the United States, U.S. drawing rights on the IMF correspondingly are reduced, and the transaction is reversed.

This $10 billion facility would be available to the IMF for a temporary period. Countries could apply within the next 2 to 3 years, and could draw down funds over a period of 2 to 3 years, though the total period of disbursements could not exceed 5 years. It would be available for use by IMF members only under clearly defined criteria. Specifically, a member drawing under the facility—

- Must have a balance of payments financing need that is large in relation to its IMF quota and exceeds the amount available to it under the IMF's regular policies.
- Requires a period of adjustment that is longer than that provided for under regular IMF policies.
- Must enter into a standby agreement with the IMF in which it undertakes to adopt corrective economic policy measures adequate to deal with its balance of payments problem.

The facility, in short, is designed to encourage those countries with particularly severe payments problems to adopt internationally responsible adjustment programs—

and to avoid the unwelcome alternatives of resort to the controls, trade restrictions, and beggar-thy-neighbor policies which can be so harmful to world prosperity and so disruptive to our liberal trade and payments order. It will, in addition, by fostering a smoother, more effective process of international balance of payments adjustment, reinforce confidence in the international monetary system, and thus facilitate the flow of financing throughout the system. It is not a device for augmenting development assistance—the IMF provides only short- to medium-term balance of payments support. The member drawing on the facility receives more financing than is otherwise available from the IMF; a longer period of adjustment (a 2- to 3-year program, as compared with the 1 year normally applicable in the IMF); and a longer period of repayment (3- to 7-year maturity, as compared with the IMF's normal 3- to 5-year maturity). Since interest on the financing provided to the Fund is market related, the borrowing country would also pay a somewhat higher charge than for normal IMF drawings.

The facility is a cooperative venture, with the surplus countries of OPEC and the stronger industrial countries joining together to assure that the needed financing will be available. The agreement requires that before the facility can begin operations participants must formally commit $9 billion of the full $10 billion, and the six largest participants must all formally commit themselves to participate. Thus action by the United States, and the Congress, is necessary before the facility can become a reality.

Let me assure you that the Supplementary Financing Facility is not proposed or represented as a solution to all the world international financial problems. For one thing, it will not meet the problems of nations whose real need is for permanent transfers of resources or long-term development aid. Most importantly, it cannot eliminate the large imbalance between the OPEC surplus countries and the oil-importing world. We must work toward the elimination of that imbalance. But that will come about only through, on the one hand, effective programs by the United States and others to conserve energy and develop alternative energy supplies and, on the other, continued growth in the capacity of oil-exporting nations to absorb goods and services produced in the oil-importing world.

What the Supplementary Financing Facility will do is help redistribute, as well as reduce, the collective current account deficits so that the necessary borrowing is undertaken by those countries whose creditworthiness and economic strength are adequate to sustain the additional debt. By encouraging responsible adjustment measures in those countries experiencing severe domestic economic distortion, large payments deficits and serious financing problems, such deficits are reduced and shifted to a more sustainable worldwide pattern.

With the establishment of the Supplementary Financing Facility there will continue to be a large amount of borrowing—private as well as public. Concern has been expressed that continued borrowing in such large amounts, irrespective of who is borrowing or how the credit is used, constitutes a serious danger for the monetary system. I do not share that view. *If* the borrowed funds are properly used to support productive investment, and strengthen the borrower's current account position, the debt need not constitute a serious future burden, as shown by the experience of the United States in the last century and other countries at present. Excess savings in surplus OPEC countries can, in effect, finance investment in the oil-importing countries by supplementing domestic savings. But the borrowed funds should be productively invested in order to avoid servicing problems in the future.

This, then, is the broad strategy within which the Supplementary Financing Facility fits: We aim for a sustainable pattern of payments in which the borrowing is undertaken by countries commensurate with their creditworthiness; we seek to assure that the borrowed funds are used to support sound and effective programs of stabilization and adjustment; and, meanwhile, we work toward elimination of the oil imbalance through energy programs and OPEC development.

Let me address three questions which have been asked with respect to this new facility.

First, how can we be sure that the $10 billion contemplated for the facility is adequate to do the job but not more than is needed?

Obviously it is a matter of judgment and no one can be absolutely sure. We cannot predict with certainty just which countries will have the particularly large needs for credit that make them eligible for this facility, along with the willingness to adopt the kind of adjustment programs associated with it. It is our judgment that this facility plus the amounts available to the IMF from other sources will enable it to provide financing over the next 2 or 3 years up to, say, a total of $25 billion. This is above the levels of IMF financing of recent years which were already relatively high. To assure confidence in the monetary system, it is vital that the IMF always be known to have adequate resources in reserve to meet whatever urgent problems may arise, even if it turns out that less than the full amount is actually drawn. Since no cash transaction occurs until a member country actually draws from the IMF, there is no interest or other cost whatever—to the IMF, or to the United States and other participants—for any portion of the facility not actually utilized for drawings.

A *second* question is, will the facility serve to "bail out" private banks which have lent unwisely or excessively?

The answer is "no." The facility is not so designed and will not be so used. It will not bail out either countries or banks. It will encourage countries to initiate needed adjustment measures before their debts become too large to handle or credit is no longer available, and it will provide transitional financing while the measures take effect. It will help redistribute deficits to a more sustainable pattern, and improve nations' creditworthiness and confidence in the monetary system.

It is not a substitute for bank credit and will not take over the banks' regular lending activities. While IMF financing may in the period ahead account for a share of total balance of payments financing larger than the 7 percent it provided in 1974–76, it will remain small in comparison with the share channeled through private markets. In fact, the facility is expected to encourage banks to continue to expand their foreign lending rather than cut back, by promoting sound economic policies on the part of borrowers—and experience indicates that in fact the banks normally lend *more* to a country after it has entered into a standby agreement with the IMF. The banks will benefit from the new facility, but only indirectly—through the improved international environment, stronger monetary system, and high levels of trade that will benefit all elements of the American economy.

A *third* question is, why was the Supplementary Financing Facility established rather than the alternative of a permanent change in IMF quotas?

The answer is that this method was chosen for reasons of timing and practicality. A review of IMF quotas is underway, but with the complications of negotiation and ratification, it may not lead to actual quota increase for, say, 2 years or more. Hopefully the new facility can be put into operation at an early date, and cover the particular needs until a quota revision occurs. The facility is also more flexible than a quota increase, since it is not subject to the same quota constraints and can be used more selectively to meet the problems of countries with particularly large needs.

Mr. Chairman, the IMF is a valuable institution, in which all members contribute, financially and otherwise, to an effective international monetary system. It has a good record. The proposal for a Supplementary Financing Facility is a sensible and realistic way to strengthen it to meet present problems. The facility is equitable to all parties. It is needed, and needed soon. The administration urges that the committee report the proposed legislation favorably, and that the Congress enact it promptly.

Exhibit 54.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, September 24, 1977, issued after its ninth meeting in Washington, D.C.

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its ninth meeting in Washington, D.C., on September 24, 1977, under the chairmanship of Mr. Denis Healey, Chancellor of the Exchequer of the United Kingdom, who was selected by the Committee to succeed Mr. Willy De Clercq of Belgium as Chairman. 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. G. D. Arsenis, Director, Division for Money, Finance and Development, UNCTAD; 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; Mr. Robert S. McNamara, President, IBRD; Mr. Francois-Xavier Ortoli, Vice-President, CEC; Mr. Cyrus Sassanpour, Market Research Analyst, OPEC; and Mr. Cesar E. A. Virata, Chairman, Development Committee.

2. The Committee discussed the world economic outlook and the policies appropriate in the current situation.

While welcoming progress made in many countries in achieving stabilization and growth objectives, the Committee expressed concern about the faltering of economic activity during recent months in a number of industrial countries. Sluggishness in private investment demand, the Committee stated, continued to be a major feature of the current economic situation.

The Committee noted that the slower expansion of the economic activity had been accompanied by a deceleration in the growth of world trade. The impact of this on the export earnings of developing countries was a matter of concern to the Committee, which noted that these earnings had also been adversely affected by the marked declines in primary commodity prices during recent months.

The Committee paid considerable attention to the special problems that affect the economies of the developing countries. It was particularly concerned to ensure that adjustment measures by developed countries should not reduce the transfer of real resources to the developing world.

The Committee expressed concern about the persistence of high unemployment, noting that the overall rate of unemployment for the industrial countries as a group remained close to the recession peak reached in the latter part of 1975.

Although progress has been made in many countries in countering inflation, the Committee remained concerned about current rates of inflation, noting that in almost all countries these were still much too high to be considered acceptable.

The Committee reaffirmed its view that tendencies toward protectionist trade policies are unacceptable from an international point of view and should be strongly resisted. In this connection, it stressed the importance it attached to the successful outcome of the current Multilateral Trade Negotiations in Geneva, and to the early conclusion of agreements that would benefit all countries, in particular developing countries.

With respect to national economic policies, the Committee agreed on the following conclusions:

(a) All countries in relatively strong external positions should make every effort to ensure adequate growth of domestic demand compatible with containing inflation; this would not only be in the interest of those countries themselves, but also would help to ensure achievement of a satisfactory rate of growth in world trade, supporting and facilitating external adjustment efforts by deficit countries. The Committee expressed regret that growth of domestic demand in some of the larger industrial countries had lagged behind the targets and expectations of their authorities, and it welcomed the expansionary measures recently announced by several governments. Also, the Committee expressed the belief that, as the results of adjustment action become progressively more evident, an increasing number of countries will be able to bring their inflation and balance of payments problems under control and thus will be strong enough to make their contribution to growth of the world economy.

(b) Demand policies in countries with relatively high inflation or seriously weak external positions should place primary emphasis on combating inflation and improving the balance of payments. The Committee reaffirmed its belief that for these countries this was not only necessary in present circumstances but over time would yield the best results for growth and employment.

(c) The Committee noted the importance of structural problems in the economic situation of many countries and the need to develop appropriate energy policies.

(d) Policies in all countries should be directed as a minimum to avoiding a resurgence of inflation and in many countries to reducing inflation rates which are clearly excessive.

3. An important requirement of the international adjustment process relates to the provision of official financing to deficit countries. Such finance should be provided in

sufficiently large amounts, and under appropriate conditions which take account of the specific problems of the borrowing countries, and permits adequate time for necessary adjustment.

The Committee welcomed the completion by the Executive Directors of their work on the establishment of a supplementary financing facility that will enable the Fund to expand substantially the resources it can make available to members facing payments difficulties that are large in relation to their quotas, and the adoption of the decisions of August 29, 1977 on the facility and related arrangements. The Committee noted that a number of members and official institutions have expressed their willingness to make available to the Fund resources for the financing of the facility of about SDR 8.6 billion, equivalent to approximately $10 billion, but that the facility will not become operative until agreements have been entered into for a total amount of financing of not less than SDR 7.75 billion, including at least six agreements each of which provides for an amount not less than SDR 500 million. The Committee welcomed the prospect that some of the initial amounts made available might be increased and noted that it would be possible for other members in strong positions to make resources available to the facility. In view of the need of some members for prompt financial assistance on the scale envisaged under the new facility, the Committee urged all potential participants in the financing of the facility to complete as soon as possible the necessary action that will bring the facility into operation at the earliest date possible. At the same time, the Committee agreed to request the Executive Directors to pursue their consideration of the possibility of a subsidy, perhaps through voluntary contributions, that would be related to the charges payable by members determined by the Fund to be in difficult circumstances.

4. The Committee noted the report of the Executive Directors on the Seventh General Review of Quotas and their intention to give priority to this matter in their work after the Annual Meeting. It asked the Executive Directors to submit appropriate proposals to the Committee for its consideration, at its next meeting, together with draft recommendations to the Board of Governors.

5. The Committee reaffirmed its request to the Executive Directors to report on the question whether a further allocation of SDRs would be advisable at the present time and to report to the Committee at its first meeting in 1978.

The Committee also reaffirmed its request to the Executive Directors to review the characteristics and uses of the SDR so as to promote the purposes of the Fund, including the objective of making the SDR the principal reserve asset in the international monetary system.

6. The Committee expressed concern at the delay in the entry into force of the Proposed Second Amendment of the Fund's Articles of Agreement and in the increases in quotas under the Sixth General Review of Quotas. In this connection the Committee noted that it has been eighteen months since the Board of Governors completed its action on both these matters and that, although progress had been made in recent months, acceptances and consents from many more members will be needed to attain the required majorities. In view of the importance for members and the international monetary system of the entry into force of the Amendment and the increases in quotas, the Committee once again urged all members that have not yet accepted the Amendment or consented to the increases in their quotas, to do so at the earliest possible date.

7. The Committee agreed to hold its next meeting in Mexico on March 21, 1978.

Exhibit 55.—Statement by Secretary Blumenthal as Governor for the United States, September 27, 1977, 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.

We meet at a time of doubt about the world's economic future. The legacy of the oil shocks of 1974, inflation, and the deep recession of 1974 and 1975 poses questions of whether our system of international economic cooperation can endure.

The main points I want to make are these:

The world economy has begun to recover from staggering blows;
We have in place a strategy for sustained recovery, and that strategy is working; and
We will succeed—though success takes time—if we continue to act together and do not lose our nerve.

The effective functioning of the institutions that bring us together today—the Bank and the Fund—is a critical part of that cooperative effort.

The U.S. economy

I will first report to you on the condition of the U.S. economy.

I am pleased that we are continuing to make solid progress. We have recorded economic growth of 7.5 percent for the first quarter and 6.2 percent for the second.

We expect to meet our target for real growth during 1977 of over 5 1/2 percent, and we expect continued strong growth in 1978.

We have reduced our unemployment rate by about 1 percentage point and so far this year have created more than 2 million new jobs.

Inflationary pressures are diminishing, despite the adverse effects of an unusually harsh winter. Consumer prices rose at the rate of more than 8 percent in the first half of the year. We expect the rate to decline to less than 5 percent in the second half.

We also have problems—serious ones.

- Unemployment is much too high. Creating new jobs to bring it down is a top priority.
- Despite our progress, inflation also remains too high. We know well how difficult it is to break the inflationary cycle.
- Business investment, though increasing, is weaker than it should be.
- Energy consumption and oil imports are excessive.
- Our current account deficit is likely to be in the range of U.S.$16–$20 billion.

In part, the shift in our current account position since 1975 has been caused by our heavy consumption of oil. But it is also a consequence of the comparatively high rate of economic growth in the United States and more restrained expansion in many other countries.

We are determined to correct our problems.

- The expansionary effects of new programs for public works and public service jobs will show up strongly in coming months.
- We have undertaken a series of measures to keep inflation under control and to bring it down.
- President Carter will soon present tax proposals that will include important new incentives to stimulate business and encourage higher productivity.
- We are urging Congress to complete action on legislation which will encourage energy conservation and increase domestic energy production. That program will be an important first step. But more will have to be done to limit demand and, especially, to develop new domestic energy supplies.
- We look to countries with payments surpluses to expand their economies to the maximum extent consistent with the need to combat inflation. Such moves are essential to a smoothly functioning international economic system. We are encouraged by expansionary measures decided on or implemented in recent weeks.

The strategy of cooperation

The international economic system is under stress because of the need to adjust to wide variations in national economic performance, high energy costs, and large imbalances in international payments positions.

A broad strategy to facilitate these adjustments has been agreed in international discussions. The guiding principle of that strategy is cooperation.

It calls for symmetrical action by both surplus and deficit countries to eliminate payments imbalances.
It calls on countries in strong payments positions to achieve adequate demand consistent with the control of inflation.

It calls on countries in payments difficulties to deploy resources more effectively so as to bring current accounts into line with sustainable financing.

One point is clear. If this strategy is to succeed, the oil-exporting countries will have to show restraint in their pricing. This is an essential element of international cooperation and is in the interest of the oil-exporting and oil-importing nations alike.

We also need to resist protectionist pressures. Most importantly, we must work for the successful completion of the Tokyo Round of the General Agreement on Tariffs and Trade negotiations.

The IMF, with its key role at the center of the international economic system, must be in a position to help countries carry out the agreed strategy.

This requires *first* of all that the Fund have adequate resources.

The United States has formally consented to the increase in its quota agreed to in the sixth quota review. We urge others to act promptly so that the increased quotas can be put into effect without further delay.

We welcome the new Supplementary Financing Facility to provide an additional U.S.$10 billion for nations whose financing needs are especially large. We intend to press for prompt legislative authorization of U.S. participation.

A permanent expansion of IMF resources for the longer term is also needed. We will work for agreement on an adequate increase in Fund quotas during the seventh quota review.

The *second* requirement is that the Fund use these resources to foster necessary adjustment. As the Supplementary Financing Facility recognizes, serious imbalances cannot be financed indefinitely. Current account positions must be brought into line with sustainable capital flows. The facility retains the central principle that IMF financing should support programs that will correct the payments problems of borrowers, not postpone their resolution.

In today's circumstances, that process will in some cases require a longer period of time. Consequently, the United States supports the provisions in the new facility that introduce flexibility in determining the pace of adjustment.

In large measure, this comes down to a question of balance and judgment in the Fund's operations. The Fund cannot avoid its responsibilities to press for needed changes, nor, on the other hand, can it be rigid and inflexible in requiring adjustments. The course it must steer is often narrow and difficult.

I believe that, on the whole, the Fund has carried out this responsibility with skill and sensitivity. I am confident it will continue to condition the use of its resources in a reasonable and equitable manner, taking into account the needs and circumstances of individual countries as well as the particular conditions in the world economy today. It is not a matter of whether the Fund attaches conditions, but what kind. In individual cases, there will be a need to adjust the emphasis between deflationary measures and policies for the redirection of resources to productive investment and improvement of external accounts.

Third, we must bear in mind the influence of the actions of the Fund on the flow of private capital. It is inevitable and right that the private capital market will continue to play the dominant role in financing imbalances.

At the same time, banks, in their lending policies, are increasingly looking to the existence of standby arrangements with the Fund. These arrangements, with their stipulations about domestic economic and external adjustment policies, can considerably strengthen nations' creditworthiness.

A greater availability of information may also prove useful and feasible. The Executive Board is currently examining the question of how the system might be strengthened by greater private access to factual information produced by the Fund, on a basis that respects the confidential relationships between the Fund and its members.

I believe that in general it is important to explore possible methods to make sure that private and public flows of capital are compatible with each other. This, too, is a way of strengthening the international financial system.

The responsibility of the Fund goes beyond its operations in support of countries in payments difficulty.

The amended Articles give the Fund an important, explicit role in overseeing the operations of the system as a whole and in exercising surveillance over the exchange rate policies of its member governments.

The principles to guide the Fund in carrying out these responsibilities reflect widely held views, and a consensus has also been reached on the procedures to be used. It is underlying economic and financial factors that should determine exchange rates. That is recognized.

I believe we all acknowledge that in carrying out these new provisions the Fund will have to approach its task cautiously. These are uncharted waters. History is by no means an adequate guide to the future. Only by experience will it be possible to test the principles we have established and to modify them where it is proven necessary. It is evident that the Fund's effectiveness in this area will depend on the genuine support of its members for the principles it develops.

I believe the Fund is in an excellent position to undertake this new role. It is now time for the member countries of the IMF to act by approving the amended Articles and bringing these provisions into effect.

Problems of development

Establishing conditions for sustained growth and strengthening the financial adjustment processes are the most pressing intermediate-term issues facing the world economy. The critical long-term problem, however, is to assure economic growth with equity in the developing world.

President Carter spoke yesterday of the strong commitment of the United States to help in the effort to meet the basic human needs of the world's poor. President McNamara gave us a picture of the magnitude of the task.

Action is required by both industrial and developing countries.

The most important contribution the industrial countries can make is to achieve adequate, sustained economic growth in the context of an open international economic system. In the past year the oil-importing developing countries have improved their trade position by U.S.$8 billion as a result of the export opportunities arising from the growth in the U.S. economy. An acceleration in the economic expansion of other industrial countries would provide comparable benefits. For such benefits to be realized in the future, markets must be open and protectionism resisted.

Healthy economic conditions in the industrial world will also facilitate the flow of capital to meet productive needs in the developing countries. In this connection, we must review our efforts to assure adequate access to private capital markets.

In addition, specific actions must be taken to facilitate the growth of developing countries.

A substantial increase in the transfer of official capital to developing countries is necessary. The United States will do its share. The Congress has authorized over U.S.$5 billion in contributions to the international development banks and has supported a sizable increase in bilateral assistance. We are prepared to begin formal negotiations in the Board of Directors of the World Bank leading to a general increase in its capital.

We must work together to strengthen arrangements for stabilizing earnings from raw material exports.

We must also approach the management of international indebtedness, not as a crisis, but as a short- and medium-term balance of payments problem. We can draw encouragement from the fact that the aggregate current account deficit of the oil-importing developing countries declined in 1976 as the world economy began to recover. Where individual countries face severe balance of payments problems, the new Supplementary Financing Facility will help to facilitate adjustment.

Actions by the industrial countries are only part of the story. The real payoff lies in the policies adopted by the developing countries. This is not surprising. Four-fifths of the investment capital of developing countries is mobilized from domestic savings. Domestic policies will determine not only how much savings can be mobilized in the future but also how efficiently resources are used and how effectively the developing countries can take advantage of an expanding international economic environment.

The development partnership requires not only healthy global economic conditions that will enable the developing economies to grow, but also efforts by the developing countries to assure that the benefits of growth are enjoyed by their poorest citizens.

In this connection, my Government strongly supports the new directions charted by the World Bank in financing social and economic development. The Bank has pioneered in designing new approaches to alleviate urban poverty and stimulate rural development. I believe the continued expansion of the activities of the World Bank group, more than any other single action, will contribute to constructive relations between industrial and developing countries.

In supporting this expansion, the United States will urge—

- More emphasis on food production, expanding employment opportunities, and other measures to improve the lot of the world's poorest people;
- Increased lending to expand energy resources in developing countries;
- Using the Bank's resources to facilitate the adoption of sound economic policies in the developing countries.

I am convinced that foreign assistance will not have the support of the American people unless they perceive that it is making a real contribution to improving the lives of the poor.

My Government also believes that the goals and purposes of development encompass human rights as well as freedom from economic privation and want. The U.S. Congress has instructed the administration to seek international agreement on standards for human rights. We will pursue this mandate.

Looking ahead, the Bank and the Fund have a vital and expanding role to play in the international economic system. Their record entitles them to strong support and they shall have it from the United States.

I must point to a problem, however, that concerns both the Bank and the Fund. My Government's continued ability to support these two institutions will depend on their efficient administration. Most importantly, we must resolve the issue of proper compensation policies for their staffs and Executive Directors.

On salaries there is need for restraint. More generally, it is essential to overhaul the entire compensation system of these institutions—as well as the systems of other international organizations—to meet today's realities. We hope that the Joint Committee set up to review the situation will enable us to move to such a new system. We must not permit this issue to threaten these great institutions.

As I conclude my comments, it is a matter of deep regret to the United States and to me personally that as the Fund crosses a threshold into a new era of operations, it will lose the valued services of its Managing Director, our trusted friend, Johannes Witteveen. He has guided the Fund with firmness, fairness, imagination, and good sense.

He deserves a large portion of the credit for the great progress the Fund has recorded in recent years, and he leaves the institution strong and fully capable of meeting its new and challenging responsibilities. I join other Governors in expressing our thanks.

We have a formidable agenda before us and one that we should approach with a sense of hope and resolve. The necessary actions are difficult but the potential gains are immense. Pursuit of sound economic policies domestically and adherence to open and cooperative policies internationally will see us into a new period of economic progress and equity worldwide.

Developing Nations

Exhibit 56.—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), October 3, 1976, issued at the close of its sixth meeting in Manila, Philippines

1. The Development Committee (the Joint Ministerial Committee of the Boards of Governors of the Fund and the Bank on the Transfer of Real Resources to Developing Countries) held its sixth meeting in Manila on October 3, 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. M. M. Ahmad, Acting 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 approved for presentation to the Boards of Governors of the Fund and the World Bank its second annual report covering the period July 1975 to June 1976.

3. The Committee considered the program of its future work in the light of the situation and prospects of developing countries. The analyses presented to it by the staffs of the IMF and the World Bank showed that the current account deficit of non-oil developing countries had declined somewhat but was still expected to be running at a high annual rate of about US $32–33 billion in 1976 and the first half of 1977. These estimates did not suggest that a significant relief from current difficulties would be forthcoming in the early part of 1977. Many developing countries, especially the middle-income countries, borrowed heavily to maintain the flow of imports and to avoid undue interruption of their development programs, leading to an increase in their external debt and debt service payments. The low-income countries have had little or no growth in per capita income since 1970 and their level of imports fell by some 20 percent below those of the late 1960's. Official aid to them has been inadequate. To assist the developing countries in their adjustment process and to help them achieve a higher rate of growth, the low-income countries would require additional concessional assistance and the middle-income countries would need increased flows from both official and private sources. To be effective, these in turn would require a greater emphasis upon domestic policies attuned toward the necessary internal adjustment processes and toward employment creation.

4. The Committee reaffirmed its strong support for the timely and satisfactory completion of the Fifth Replenishment of IDA so as to permit a substantial increase in IDA resources which, in the opinion of many members, should be in real terms, and to maintain continuity of its operations beyond June 1977. The Committee also agreed that it was important that the lending programs of the international lending institutions remain adequate to help meet the capital requirements of the developing countries. They asked the Boards of these institutions to review the adequacy of their capital resources for this purpose and, where such capital is inadequate, to review the issues prerequisite to consideration of augmenting such capital.

5. The Committee, with due regard to the functions of the Boards of the IMF, the World Bank, and other international institutions, desired to focus attention on the resources situation of the international development finance institutions, on the volume, terms and distribution of official flows, and on the role of adjustment in the development process. The Committee agreed to establish a Working Group which would, initially, consider the study of the International Resources Bank requested of the World Bank. In addition, the group could be assigned other specific matters, including the volume, terms and distribution of official flows. The Working Group will present its conclusions and recommendations for the consideration of the Committee.

6. The Committee received a further interim report from the Working Group on Access to Capital Markets. It was agreed that capital market countries would endeavor, as far as their balance of payments situation permitted, to move progressively toward greater liberalization of capital movements, in particular capital outflows. In the meanwhile, when regulations governing capital outflows are maintained for unavoidable reasons,

- governments of capital market countries would afford favorable treatment, as among foreign borrowers, to developing country borrowers with regard to permissions to make an issue or place in the issue calendar;
- those capital market countries which currently maintain quantititive limits on the amount of foreign issues in their markets would endeavor to keep developing country borrowers outside these limits, at least up to specified amounts;
- since the Eurobond market presents potential opportunities for developing countries to raise finance, countries whose currencies are in strong demand, and which maintain restrictions on international issues denominated in their

currencies, would endeavor to give favorable treatment, as among foreign borrowers, to developing country borrowers.

The Committee noted a number of recommendations in the report that consideration be given to the removal of legal and administrative barriers so far as is consistent with investors' protection and urged capital market countries to give them earnest consideration.

7. The Committee recognized the need to reinforce and expand technical assistance activities in the field of access to capital markets, noted the bilateral programs already in the field, recognized the need to coordinate the implementation of present and future available services, and recommended that attention be given by the Board of IFC to the possibility of IFC expanding its activities.

8. The Committee stressed the importance of co-financing by international and regional development banks as a means of augmenting private capital flows to some developing countries, noted the progress being made in this regard and urged that these arrangements be further expanded.

9. The Committee noted with satisfaction that the Working Group had considered the subject of multilateral guarantees and the proposal for an international investment trust and asked that it continue its studies on these subjects. The Committee also agreed that the Working Group should present to the Committee at its next meeting concrete recommendations for improving the various reporting systems on international financial stocks and flows.

10. The Committee agreed to meet again on October 6 in Manila and also tentatively to meet on April 17, 1977, in Washington, D.C., the time of the next meeting of the Interim Committee.

11. The Committee expressed its deep appreciation to the Government of the Republic of the Philippines for its warm hospitality and for the excellent facilities provided to the Committee for the conduct of its meetings.

Exhibit 57.—Excerpt from statement by Assistant Secretary Bergsten, February 16, 1977, before the Subcommittee on Foreign Operations of the House Appropriations Committee, on the U.S. foreign assistance program for 1977 and 1978

It is an honor to appear before you today to begin the testimony of the Carter administration on the U.S. foreign assistance program for 1977 and 1978. Because these are the initial hearings on our overall proposals for the international development lending institutions, which this administration strongly supports, and because we are seeking substantial sums for the current and coming fiscal years, I believe that—before turning to the specifics of our appropriation requests—it would be desirable to spell out in some detail the basic philosophy and policy approach of the administration.

Before doing so, however, I wish to stress, as I did before the Senate Subcommittee on Foreign Operations last week, the total commitment of this administration to the closest possible cooperation with the Congress in this policy area. The President has already been actively fulfilling that commitment across a wide range of issues, both domestic and international. It is an honor for me to be able to intensify it today, concerning U.S. policy toward the international development lending institutions.

In preliminary conversations with yourself and others in the Congress, and with committee staffs from both House and Senate, I believe that progress has already been made toward resolving some of the major issues which have been outstanding in the recent past.

First, we fully accept your view that U.S. contributions to the international development lending institutions be pledged "subject to appropriations." I have so informed the management of the World Bank, which is already at work on the adjustments that may therefore be required in its previous operating procedures. I will convey this position clearly to all other donor countries, at a special meeting to be held shortly for that purpose.

Second, we will initiate a full review of the lending policies and practices, and the internal administration, of all international development lending institutions of which the United States is a member. As President Carter has indicated on several occasions, and as Secretary Blumenthal affirmed in his confirmation hearings before the Senate Finance Committee, this administration strongly supports the extension of foreign assistance through international development lending institutions. But, in keeping with the priority which the administration attaches to efficiency in management and minimization of administrative costs, we will look carefully at all aspects of the banks' operations and report our findings to you as soon as our analyses can be completed. The Treasury Department will attach very high priority to this review. And we will appoint U.S. Executive Directors to each of these institutions who will forcefully convey U.S. policy to them.

Third, we accept the proposal in your letter of February 2 to Secretary Blumenthal, cosigned by Chairman Daniel Inouye of the Senate Subcommittee, that the fiscal year 1978 budget submission should seek appropriation of all callable capital for the international financial institutions. We have informed the Office of Management and Budget of our desire to thereby revert to the traditional approach to this issue.

Fourth, we particularly welcome the opportunity to discuss in these hearings a pending U.S. international financial contribution. Mr. Chairman, we recognize the problems created in the past by international pledges made by administration officials prior to the conclusion of adequate consultations with the Congress. As a result, relationships between the administration and Congress have been uneasy, and there has been a growing uncertainty on the part of other governments—both donors to the international development lending institutions, and recipients of the funds in planning their development program—about the followthrough of the United States in fulfilling its pledges. This administration is committed to eradicating those problems, by ensuring that full consultation with the Congress precedes every pledge of U.S. funds to an international development lending institution.

It would probably be impractical to hold formal hearings, in all cases, to achieve this purpose. In some instances, it would seem that extensive informal consultations could do so. In launching this new spirit of consultation, however, we are delighted that the opportunity has arisen for formal discussion—both in these hearings before your committee, and before the Senate Committee in early March—of the U.S. contribution to the fifth replenishment of the International Development Association (IDA V) before we meet with the other donor countries, in Vienna on March 14–15, to try to complete that arrangement.

The objective of this administration, across the entire range of international economic issues, is to develop sustainable policies. We will avoid making pledges, or proposals, in international forums which are unlikely to command support with our own Congress and our public. We believe that such an approach will strengthen the credibility, and hence the capacity for influence and leadership, of the United States in international affairs.

With the several steps which have already been taken, we believe that we are moving toward a firm partnership with the Congress in this important policy area. In that vein, we note with pleasure the comment in your letter of February 2 to Secretary Blumenthal, Mr. Chairman, that "congressional support for the development finance proposals of the executive branch will be enhanced" by commitments such as we have just made.

We are also heartened that the Budget Committees of both the House and Senate, after contemplating cuts in the supplemental appropriations for fiscal year 1977 under consideration today, have decided to include the full amounts in their Third Concurrent Resolution. We sincerely hope that these several expressions of support for the program do indeed presage a new period of the closest cooperation between us, beginning with the supplementary appropriations for fiscal 1977 and the regular appropriations for fiscal 1978.

President Carter has personally and publicly indicated his strong support for the legislation before you today. Speaking to a news conference in Plains, after a half-day session on the whole range of international economic issues last August 18, he stressed his firm belief that the United States should make its full contribution to the ongoing activities of the Inter-American Development Bank, the Asian Development Bank, and the World Bank family—the appropriations which we seek today. President Ford also indicated his full support for these appropriations by including all of them, except those reflecting our decision to seek appropriation of the callable capital needed in fiscal 1978, in his final budget proposals.

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The 1977 supplemental

The most urgent business before us is the supplemental appropriation for fiscal 1977. It is urgent because, without these appropriations, the Inter-American Development Bank and the Asian Development Fund would shortly have to suspend making commitments to the neediest borrowers, and because U.S. support for IDA—and hence our position in the upcoming IDA V negotiation—would be thrown into serious doubt.

There are three avenues through which the IDB obtains capital to finance borrowing countries in Latin America. It uses the paid-in capital of its donor members to extend "hard" loans. It uses the callable capital subscribed by donor members as backing for borrowings in the private capital markets, the proceeds of which are loaned out. And it channels contributions to its Fund for Special Operations to the poorest countries in the region on concessional terms.

But the Bank has in fact exhausted its hard currency resources available for ordinary loan commitments. No further capital subscriptions by other countries can become effective under the replenishment until the United States makes the subscriptions for which we are seeking appropriations. This situation results from arrangements necessary to prevent the U.S. vote from falling below 34.5 percent, thereby causing the United States to lose its veto in the Fund for Special Operations. In the Fund for Special Operations, resources are available for anticipated operations only through April. All other member countries have contributed to the first installment of the current replenishment, but the U.S. contribution is essential to make the replenishment effective since it requires no less than 75 percent of the total contribution before the installment can be committed.

The FY 1977 supplemental bill also contains $25 million to complete the $150 million U.S. contribution to the initial resource mobilization of the concessional Asian Development Fund. As of today, that fund has only $17 million available for new loan commitments to its poorest Asian members—the equivalent of less than 2 weeks' commitments. Most other donors have completed their contributions to the 1973–75 resource mobilization of the fund, and most have made their first contributions to the 1976–78 ADF replenishment. But further contributions from these donors will, under the current replenishment resolution, not become available to the fund until the United States makes the contribution requested in the FY 1978 appropriations bill. Since this would not occur until after October 1, the $25 million being requested for the ADF in the FY 1977 supplemental bill is likely to be its only new source of funds over the next 6 months.

The final item in the supplemental request is $55 million for IDA IV, which is closely related to the forthcoming negotiation on IDA V which I mentioned at the outset of this testimony. As I indicated then, the administration fully accepts the decision of the Congress that the U.S. pledge to that replenishment be made "subject to appropriation." We believe that this approach is fiscally prudent, as well as a necessary element in the new structure of cooperation between Congress and the administration which we seek to forge.

In all candor, however, I must report that this decision has caused some uneasiness on the part of other major donor countries. Indeed, I have agreed to their request to attend a special meeting with them in Paris, tentatively scheduled for February 25, to explain and defend our new approach prior to the scheduled negotiating session in Vienna on March 14–15. It is my firm belief that this concern is indicative of a deep concern on the part of both donor and recipient countries over the willingness of the United States to play its fair share in IDA, and perhaps more broadly. Indeed, this concern is a major element underlying the decision of this administration, through working more closely with the Congress, to henceforth make proposals internationally only when we have reasonable assurance that those policies are sustainable domestically.

At the same time, the confidence of other countries in the sustainability of our policies would be enormously enhanced by early action on the IDA IV (and other) supplemental requests. Positive action would provide tangible evidence of a new working relationship within the U.S. Government. Coupled with the extensive discussions between Congress and the administration which will have gone into determining the U.S. negotiating position on IDA V, it would make a major contribution to early progress for several of the basic thrusts of President Carter's foreign policy. In addition, it would prove of great value in supporting a constructive and sensible U.S. position when the North-South dialog resumes in the next few weeks.

Hence there would be major political benefits for the United States from early congressional action on the FY 1977 supplemental appropriations. But the fundamental reason why we urge their support is that the money is needed badly by the poor people in developing countries for which it would be spent. We urge you to approve the proposed contributions of $540 million, of which $340 million would produce budget outlays and $200 million represent callable capital. All of these sums have, of course, been authorized by the Congress, included in the budget proposals of both President Carter and President Ford, and included in the Third Concurrent Resolution by the Budget Committees of both the House and Senate.

The supplemental also requests an appropriation of $30 million in Israeli pounds for the U.S. contribution to the endowment of the Israel-U.S. Binational Industrial Research and Development Foundation. The Foundation's endowment will be created by contributions of $30 million in Israeli pounds from each government. The U.S. share will be derived from simultaneous prepayment by Israel of a portion of its Public Law 480 local currency debt to us. There will be no dollar outlay. An appropriation is necessary for the United States to participate, however, because Israel is no longer an excess currency country.

Appropriation requests for FY 1978

I would like to turn now to the issue of U.S. funding for the continued operations of the development banks. We are requesting appropriations of $2,616.2 million for them in FY 1978. Of this total, $1,602.3 million would require Treasury outlays and $1,013.9 million is in the form of callable capital. Callable capital will allow the banks to raise funds in international capital markets, but in all likelihood never will result in actual expenditures from the U.S. Treasury. The requests consist of:

World Bank group

- $523 million for the first of three U.S. installments for a selective capital increase for the International Bank for Reconstruction and Development ($52.3 million of paid-in capital and $470.7 million of callable capital);
- $44.6 million as the first U.S. installment to the first replenishment of the International Finance Corporation since its establishment in 1956;
- $375 million for the third U.S. installment of the fourth replenishment of the International Development Association;
- $800 million as the first U.S. installment of the proposed fifth replenishment of the International Development Association, if after discussion with you and others in the Congress we decide to proceed with IDA V on that basis.

Inter-American Development Bank

- $400 million for the third installment of the present replenishment of the Inter-American Development Bank's capital ($40 million of paid-in interregional capital, $160 million of callable interregional capital, and $200 million of ordinary callable capital);
- $200 million for the second installment of the replenishment of the resources

of Inter-American Development Bank's soft-loan window, the Fund for Special Operations.

Asian Development Bank

- $203.6 million for the first of four U.S. installments to the second replenishment of the Ordinary Capital resources of the Asian Development Bank ($20.4 million of paid-in capital and $183.2 million of callable capital);
- $60 million as the first of three U.S. installments to the first replenishment of the resources of the Asian Development Bank's soft-loan window, the Asian Development Fund;

African Development Fund

- $10 million to the resources of the African Development Fund.

Detailed discussions of these appropriations requests are contained in the statements of the individual institutions that will be presented to the committee in the course of the next 2 days. Each represents the U.S. share of a multinational funding effort in which our contributions have been shrinking steadily as a percentage of the whole, as I indicated earlier.

In closing this statement, I would like to discuss directly the magnitude of our request for FY 1978, which represents a sizable increase over past years. There are essentially five reasons for the jump:

a. Rapid rates of inflation require large increases in nominal contributions simply to keep the real value of assistance from declining. For example, the IDA V package would have had to total at least $6.5 billion simply to maintain the real value of the IDA IV total of $4.5 billion.

b. Our decision to revert to the traditional procedure of appropriating all callable capital, in response to your proposal, increases the magnitude which must be included in the budget.

c. A bunching of U.S. contributions, caused mainly by previous decisions to (i) begin the U.S. contribution to IDA IV a year later than other donor countries, and (ii) stretch that contribution over 4 years instead of the usual 3. As a result, appropriations are needed for both IDA IV and IDA V in FY 1978 (and again in FY 1979).

d. The growing importance of the North-South dialog, and the concomitant need for the United States to take positions in that forum which are both constructive and supportive of overall U.S. interests. As I indicated earlier, increased assistance is far superior to such other proposals, being made in this context, as generalized debt relief and indexation of commodity prices.

e. Most important, the increased needs of the poorer countries due to (i) the world recession and (ii) higher oil prices. These cyclical factors have superimposed heavy new burdens on those countries, whose structural needs are already immense. To an important extent, they stem from our own economic mismanagement—as well as OPEC's increase of the price of oil. Hence the need for development finance has risen sharply for the years immediately ahead, and our proposals for FY 1978 seek to respond prudently to them.

Mr. Chairman and members of the committee, the Carter administration strongly supports these proposed contributions to the international lending institutions. We believe that development of the poorer countries is of utmost importance to U.S. humanitarian, security, political, and economic interests. We believe that foreign assistance can play a vital role in promoting development. We believe that the international development lending institutions are an extraordinarily valuable instrument for channeling such assistance. The President will be addressing these issues personally, on a number of occasions, over the coming months. We urge you to support the funding requests which are under discussion today, and we look forward to the continuing opportunity to discuss with you, in depth, the whole array of underlying issues.

Exhibit 58.—Statement by Secretary Blumenthal, March 9, 1977, before the Subcommittee on Foreign Assistance and Economic Policy of the Senate Foreign Relations Committee, on proposed replenishment of the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, the Asian Development Bank, and the Asian Development Fund

Mr. Chairman and members of the subcommittee, I am delighted to appear before you today to testify on the Carter administration's request for your support for measures to continue, strengthen, and expand multilateral assistance for economic and social development in the borrowing member countries of the World Bank group and the Asian Development Bank and Fund.

Because we are seeking substantial sums—over $5 billion in authorizing authority—under the proposed resource replenishments, I believe that, before turning to the specifics, it would be appropriate to spell out in some detail the basic philosophy and policy approach of this administration.

First, close consultation with the Congress will be central to the approach of this administration on all of its foreign assistance programs, including contributions to the development banks. I am very happy with the timing of this hearing because it allows us, Mr. Chairman, to discuss formally with your committee a pending U.S. international financial contribution—our proposed share in the fifth replenishment of the International Development Association (IDA V)—prior to determining and indicating at Vienna next week our position on the terms of the U.S. contribution to that operation. During an informal meeting in late February with the other IDA donor countries, we informed them that we were following this procedure before deciding on our pledge. As you know, Mr. Chairman, I have invited Members of the Congress to accompany our delegation to the Vienna meeting as a further step toward intensifying our process of consultation and collaboration.

Treasury has also decided to undertake a thorough review of the lending policies and practices, and the internal administration, of all international lending institutions of which the United States is a member. I have already discussed some of these latter questions with the institutions. We will be discussing with you and your colleagues in the Congress the subjects to be considered in that review. We look forward to working with you on this, as well as on all aspects of current U.S. policy toward the institutions.

The objective of this administration, across the entire range of international economic issues, is to develop sustainable policies. We will avoid making pledges, or proposals, in international forums which are unlikely to command support with our own Congress and our public. We believe that such an approach is essential to strengthen the credibility, and hence the capacity for influence and leadership, of the United States in international affairs.

U.S. support for development

This administration strongly supports the proposed replenishments of the resources of the international development lending institutions before you today because we firmly believe that they support fundamental U.S. humanitarian, security, political, and economic objectives.

Poverty and misery remain endemic in many parts of the world. Our very spirit as a Nation requires that we do our part toward alleviating those conditions. When World Bank loans bring drinkable water to urban slums in Lima and Lahore for the first time, our *humanitarian* purposes are advanced. So are they when an Asian Development Bank loan brings water, health, and education facilities to rural Bangladesh, and when an IDA loan brings primary education to rural Malawi. We simply cannot turn our backs on the basic human needs which now go unmet for millions of families around the world, needs which demonstrably can be met effectively through the international development lending institutions.

At the same time, our most urgent *security* concerns relate closely to effective development of the poorer countries. International instability in such countries can often be fostered—or even produced—by lack of economic progress. This can, in turn, create international tension and conflict, which can draw the United States into dangerous situations. The efforts of this administration to curb both nuclear proliferation and massive transfers of conventional arms can be significantly promoted by effective U.S. leadership of the international development process. And there is a close, albeit sometimes indirect, relationship between the process of development and the ability and willingness of the developing countries to provide us (and our allies) with oil and other vital resources on terms which are consistent with our own security requirements.

These security concerns blend into even more far-reaching *political* relationships. We are at this moment at a historic movement in relations among the industrialized and developing countries—now taking place through the North-South dialog. In that discussion, the developing countries are seeking wide-ranging accommodation by the industrialized countries to their many needs. The administration is reviewing extensively that whole range of issues, with the goal of developing a comprehensive set of proposals which would meet those needs in ways consistent with our own national interests and ability to contribute.

One conclusion is already clear, however: Direct resource transfers must play a central role in our response. Such transfers, particularly those channeled through the international development lending institutions, can be focused on those who need them most. They can be linked to projects and programs which assure that they will be used effectively. The costs of providing the transfers can be shared equitably among the donor countries, thereby avoiding frictions with our traditional allies as well as ensuring fairness in meeting the needs of the poor. Such results cannot be assured through some of the other devices proposed by the developing countries such as widespread debt relief and artificial increases of commodity prices. Hence we believe that a constructive U.S. program of foreign assistance, and particularly a program of strong support for the international development lending institutions, is of consummate political importance to the United States across the entire range of North-South issues.

Finally, and once more closely related, U.S. support for development serves some of our most important *economic* objectives. The developing countries now represent a major market for U.S. exports, and in recent years have been one of our fastest growing markets. Similarly, they host a sizable share of U.S. foreign investments—a share which, in recent years, has been growing for our manufacturing companies. As already noted, these countries provide a large share of a large number of the growing list of industrial raw materials for which the United States depends heavily on imports.

In short, U.S. support for development in the poorer countries is inextricably linked to a wide range of fundamental U.S. interests. These interests relate both to our own economy and to our overall foreign policy. They require our commitment to a constructive program of international economic assistance.

Traditionally, "development" has been defined as rapid expansion of gross national products and other aggregate economic indicators. On these criteria, the postwar record has been one of stunning success. During the 1960's, the developing world exceeded the ambitious growth targets of the first Development Decade. Since the mid-1960's, the exports of manufactured goods of these countries—excluding OPEC—have grown by about 25 percent annually, raising their share of world manufacturing output from 3 percent to over 7 percent. Many countries have "graduated" from the rolls of aid recipients to where they can now rely on the private markets for capital, and some have even begun to extend assistance themselves. The postwar record of development is indeed unprecedented in human history. It enables us to reject fully the despair which all too often creeps into discussions of the outlook for the developing world.

Our concept of development has now broadened, however, to encompass much more specific objectives: satisfaction of basic human needs, reduced rates of unemployment, better distribution of income, and greater agricultural productivity. Even on these criteria, there are numerous success stories. But it is clear that these goals can be met more effectively, and more quickly, when they are the explicit targets of development lending.

One key area is increased production of food, and rural development more broadly. The progress of the international development lending institutions here has been impressive:

- Agriculture accounted for the largest share of IBRD loans to any sector in fiscal 1976 (24 percent). It has received twice as much support, in real terms on an annual basis, in fiscal years 1974–76 as in the previous 5 years. Fifty-five percent of this program in the last 3 years has focused on the rural poor.

- Since its inception, IDA has lent more funds to agriculture than to any other sector (29 percent).
- Twenty-six percent of ADB lending in 1976 went to agriculture.

Specific projects reveal the contribution of these programs to meeting the needs of the rural poor far better than the aggregate statistics. A $57 million IDA loan to India is bringing rural electrification to 55,000 small farmers, providing power for irrigation pumping, small industries, and residential and street lighting in over 6,000 villages. A $22 million IDA loan to Bangladesh helped finance an 18,600 hectare irrigation project, which will boost rice production by more than 50 percent in 6 years and raise annual per capita incomes of 20,000 farm families from $90 to $120. An IBRD loan to Egypt is helping to create 10 to 15,000 jobs in fruit and vegetable production. An ADB loan of $14 million to Afghanistan will increase wheat production by 323,000 tons and seed cotton production by 32,500 tons, raising income of about 200,000 farmers by $17 to $80 per hectare. The development banks are thus actively, and successfully, pursuing programs to bring major help to the rural poor and to farm production throughout the developing world.

The role of the international development lending institutions

There are three major reasons why the administration believes that the international development lending institutions are particularly effective instruments for promoting development in the poorer countries.

First, the international development lending institutions can—and do—insist on sound projects and programs in the recipient countries themselves. They can do so with particular effectiveness because of their political independence and collective representation of donor interests. Hence they are a good bet to carry out programs which will effectively implement our wide-ranging interests in the development process.

Second, and closely related, use of the international banks to channel development assistance lessens the political risks which are inherent in any donor-client relationship. Insertion of an independent intermediary between lenders and borrowers significantly depoliticizes the process and enhances the likely developmental impact.

Third, use of the international development lending institutions assures burden-sharing between the United States and other donors. The U.S. share of the lending levels of each of the banks is declining—

In the World Bank, from an original 41 percent to about 19 percent in the current selective capital increase before you today.

In IDA, from an original 43 percent to about 31 percent in the currently proposed replenishment.

In the International Finance Corporation (IFC), from an original 33 percent to 23 percent of the currently proposed replenishment.

In the Asian Development Bank, from an original 20 percent to 16 percent in the current replenishment.

In the Asian Development Fund, from 28 percent to 22 percent.

It will be the policy of this administration to encourage other countries to continue to increase their share of the financing of these institutions. We will seek involvement by new donors, notably OPEC countries, but other rapidly developing countries as well. We believe that the international development lending institutions are an ideal means through which underlying changes in the relative economic strength of nations can be translated into actual contributions to the development process.

Indeed, we view the individual development banks as components of an international network which stands increasingly at the center of the development process. Their loan disbursements now amount to over 20 percent of all official development assistance flows, but their commitments represent a share almost twice as high. For the reasons already indicated, they are extremely effective instruments for supplying development. The IBRD, IDA, and the IFC operate globally and emphasize different problems—the more advanced developing countries in the case of the IBRD, the poorest in the case of IDA, and the role of the private sector in the IFC. The Asian Development Bank, along with the other regional banks, attends to the particular problems of its region. As the banks mature and cooperate with each other further, we can look to them to play a growing role in the entire development process.

Summary of authorization requests

I would like now to summarize the Carter administration's requests for authorizing legislation for the international development banks that are being considered today. Specifically, congressional approval is requested to authorize the following:

International Bank for Reconstruction and Development (*IBRD*).—A vote by the U.S. Governor for an increase of 70,000 shares ($8.4 billion) in the authorized capital stock of the IBRD and, if such an increase becomes effective, a U.S. subscription to 13,005 of those shares ($1,568.9 million).

International Finance Corporation (*IFC*).—A vote by the U.S. Governor for an increase of 540,000 shares ($540 million) in the authorized capital stock of the Corporation and, if such an increase becomes effective, a U.S. subscription to 111,493 of those shares ($111,493,000).

International Development Association (*IDA*).—A U.S. contribution of $2.4 billion as the U.S. share of the fifth replenishment of IDA, which will total $7.5–$8 billion.

Asian Development Bank (*ADB*).—A U.S. subscription to 67,500 shares of ADB capital stock ($814.3 million) as the U.S. share of the $5 billion capital increase.

Asian Development Fund (*ADF*).—A U.S. contribution of $180 million as the U.S. share of the $809 million first replenishment of the Asian Development Fund, the ADB's soft-loan window.

Let me turn now to the situation in each of these banks which necessitates these authorization requests.

World Bank group

The World Bank was founded over 30 years ago as part of the Bretton Woods agreement with 44 nations participating in the initial subscription. It was established to help restore the economies disrupted or destroyed by war, to encourage the development of productive facilities and resources in less developed countries, and to promote the long-range balanced growth of international trade. Since the reconstruction of Europe, Bank operations have centered almost entirely on the developing world, and Bank membership has nearly tripled to 128 members with the emergence of the nations of the Third World.

In recent years, the IBRD has broadened the scope of its lending programs. Its commitments have increased from $2 billion in fiscal 1972 to an estimated $5.8 billion in fiscal 1977. Although traditional investments in infrastructure, especially transportation and electric power, still comprise a significant portion of Bank lending, the Bank has begun to focus, with the emergence of poorer countries of Africa and Asia, on other resources such as food and human skills. Also, in order to improve the living standards and productivity of those inhabiting the less developed countries, the Bank has expanded its efforts in the areas of education, water supply, health, and population. In addition, the Bank has sought to expand its lending for rural development so as to expand the share of the rural poor in the benefits of economic growth. This latter activity is aimed at increasing agricultural output through a comprehensive, cross-sectoral approach.

As a consequence, Bank lending to the poorer countries of Africa and Asia, particularly for agricultural development, has expanded substantially. Agricultural projects accounted for an average of 26 percent of total commitments in fiscal 1975 and fiscal 1976, compared to an average of 22 percent in the previous 2 fiscal years. In contrast, lending in the Bank's traditional sectors—power, transportation, and telecommunications—decreased from 46 percent of total commitments in fiscal 1973 and fiscal 1974 to 35 percent in fiscal 1975 and fiscal 1976. The share of Bank lending to Africa and Asia, as a percentage of the total lending, has increased from 34 percent of the total fiscal 1974 and 45 percent in fiscal 1976.

Under the original capitalization of the IBRD, the authorized stock of the Bank was valued at $10 billion of the weight and fineness of the U.S. dollar in effect on July 1, 1944. A total of $7,670 million of the authorized capital was subscribed by June 30, 1946, of which the U.S. subscription was $3,175 million. In 1959, the authorized capital of the Bank was increased by $11 billion. Subsequent increases in 1963, 1965, and 1971 have brought the Bank's authorized capital to $27 billion in 1944 dollars, or $32.4

billion in current dollars. The U.S. subscription has been increased to $6,473 million in 1944 dollars, or $7,808 million in current dollars, representing a gradual reduction of our relative share to 25 percent of total Bank capital.

Of the IBRD's capital, 10 percent is in the form of paid-in capital. The remaining 90 percent of subscribed capital is in the form of callable capital and is not available for lending. It is subject to call if required to meet obligations on Bank borrowings. This callable portion of member countries' subscriptions, amounting to $27.8 billion in current dollars, guarantees the servicing by the Bank of its obligations, and distributes the risk in accordance with the economic strength of each member. The Bank, however, has never had a default on any of its loans, and it has never had to call on this guarantee authority. In the remote chance of loan defaults by its borrowers, the Bank would first have recourse to its ample reserves before making calls on guarantee capital subscribed by its members.

The IBRD derives funds for lending programs from five sources: capital subscriptions, borrowings, loan sales, retained earnings, and loan repayments. With the expansion of Bank lending commitments during the late 1960's and early 1970's, borrowings and loan repayments have become the principal source of funds for the Bank. Between fiscal years 1970 and 1976 net borrowings accounted for 68 percent of Bank resources, and loan repayments provided an additional 20 percent. Retained earnings, loan sales, and capital subscriptions furnished 7, 3, and 2 percent of total resources, respectively.

In order to continue to play a major role in the development process and promote sound economic policies among its borrowing members, the Bank needs additional capital. Without a capital replenishment, the Bank will be unable to sustain its annual loan commitments at their present level or expand lending activity into new areas to benefit poorer borrowers. Under its Articles of Agreement, the volume of loans which may be disbursed and outstanding must not exceed its total unimpaired subscribed capital, surplus, and reserves. Based on projected disbursements, the proposed special capital increase of $8.4 billion would allow the Bank to sustain its present level of commitments without reaching the limitation in the Articles and without any further capital increases.

The U.S. share of the proposed increase would be $1,569 million. This represents 19 percent of the total capital replenishment, as compared to the 25 percent of the Bank's subscribed capital that the United States currently holds. With this reduction, the U.S. voting strength in the Bank would drop from 22.60 percent to 21.86 percent. This reduction would allow the capital surplus countries to play a larger role in financing the Bank, while not significantly affecting our voting strength. However, failure of the United States to take part in the special increase would mean that our voting strength would fall to 18.91 percent. Since it takes 80 percent of total voting power to amend the Bank's Articles of Agreement or expand its Board of Directors, the United States would lose its veto power with regard to such changes if it did not participate in the capital increase.

In the case of the International Development Association, we are dealing with a different kind of problem. In our view, the most important objective of foreign aid is to meet the minimum human needs of people in the developing countries. This is precisely what IDA is trying to do. Its clients are the poorest nations in the world.

The living conditions of the poorest people of these nations, earning under $100 annually per capita, are tragic. Their mortality rates, life expectancy, adult literacy rates, and nutritional levels are far below the standards we have in the developed world.

The need for IDA to address these human problems has increased in recent years. The lowest income nations have been the most seriously affected by recent international economic events. They lack the resources, particularly the capital, with which to rebound. Their terms of trade have deteriorated. Many have simply been unable to attract sufficient capital from external sources to sustain their growth or even to maintain their import volumes. As a result, countries with per capita incomes below $200 have had little or no growth in per capita income since 1970; in the previous decade, they had grown at 2 percent per capita per year.

IDA's task is clearly of a long-term nature. Its borrowers must be helped both with money and technical assistance to diversify agriculture, improve literacy levels, dampen population growth, and adopt economic policy measures aimed at stable growth. But immediate conditions have sharply deepened the difficulties of IDA borrowers, and call for increases in its lending capacity.

The IDA formally came into existence as an affiliate of the World Bank in September 1960, commenced operations shortly thereafter, and made its first loan in mid-1961.

As an affiliate of the World Bank, IDA benefits from the same high-caliber management as the Bank itself and has the same Board of Governors and Board of Executive Directors as the Bank. The World Bank's President serves as Chairman of the IDA Executive Directors and as President of the Association. IDA has no staff separate from that of the Bank; its operations are carried out entirely by the Bank's regular staff.

IDA is the world's largest single source of multilateral development finance for lending on concessionary repayment terms. IDA's credits are made for sound economic projects that measure up to the rigorous standards for loans offered by the World Bank itself. IDA, however, makes its loan funds available on unique terms that take into account the severely limited external debt servicing capacity of the poorer developing countries.

IDA's standardized credit terms involve a 50-year maturity period, including a 10-year grace period. All credits are repayable in convertible currency.

During its first 16 years of operations, through fiscal 1976, IDA has authorized a total of 624 development credits aggregating $10.1 billion in 68 member countries.

The main sources of funds for IDA are (a) its initial capital subscriptions, (b) replenishment and special contributions, and (c) transfers from the World Bank. Other sources such as net earnings and repayments are of minor importance at this time.

Let me discuss briefly the situation with regard to IDA V. Since November 1975, five IDA V negotiating sessions have been held—the last in Kuwait in January, plus an informal meeting in Paris on February 25. The World Bank originally proposed a $9 billion replenishment, with $3 billion to be contributed by the United States.

Having reviewed the situation in detail, the administration would now propose the following package on the major IDA issues for consideration by the Congress:

- $7.2 billion from IDA's traditional donors, including $2.4 billion from the United States (the same 33 1/3-percent share for the United States as under IDA IV), payable in three equal annual installments;
- Maximum possible contributions from the nontraditional IDA donors, mainly in OPEC (which would now appear to total at least $500 million, reducing the U.S. share further to about 31 percent);
- A voluntary advance contribution procedure to enable IDA to avoid a hiatus in new lending after July 1, 1977 (which the United States will accept, but not participate in).

There are other IDA V issues outstanding which we hope to resolve soon. The most significant is the need for a thorough review of the country allocation of IDA loans. No such review has been made since 1973, despite the dramatic changes which have occurred since that time in the world economy and the situation of many individual nations. Management and other donor countries agree that such a review is needed, and it will be completed before any IDA V funds are committed.

As I said earlier, we seek your views on this proposal prior to the pledging session scheduled for Vienna next week. We seek to take a sustainable package into that pledging session, and need your support to enable us to do so.

The administration regards the expansion of the International Finance Corporation as a major element in our program for aiding the developing countries. The United States has always stressed that the development process involves a cooperative effort between the public and private sectors—domestic and foreign. But we have not provided sufficient support for private sector development, which is the purpose of the IFC. IFC has never had a substantial capital increase and continues to operate essentially with its original $100 million base. As a consequence, its contribution to development is declining relative to other sources. It is time to reestablish the balance in support for the private sector that was contemplated when IFC was founded.

The IFC was established in 1956 to further economic development by promoting private investment in its developing member countries. It is unique among multilateral development institutions to which the United States belongs in that it operates without a government guarantee on its loans and purchases equity participations.

The Corporation functions like a private investment bank with respect to such matters as lending terms, purchases and sales of stock, and relationships with private investors. It also has the advantage, however, of being able to borrow from the IBRD. In fiscal year 1976, the Corporation made $245 million in new investment commitments. The largest source of funds the Corporation utilized in fiscal year 1976 was sales of loans and equity investments with borrowings from the IBRD constituting the second principal source. Loan repayments and net income provided the bulk of the remaining funds. Cumulative gross investment commitments of the Corporation as of June 30, 1976, amounted to $1.5 billion.

The Corporation's principal function is to stimulate the flow of private capital into productive investments by bringing together investment opportunities, domestic and foreign private capital, and experienced management. The Corporation makes an investment only in the event that sufficient private capital cannot be obtained by the private enterprise on reasonable terms and the investment would make a useful contribution to the development of the economy of the member country in which it is made. The investment must also have good prospects of being profitable.

The participation of the Corporation in an investment has been, in many cases, a determining factor in the decision of foreign investors to participate in projects in developing countries. The Corporation has had a significant multiplier effect, generating $4 of private investment for every $1 of its own in the projects in which it has participated. Since its inception, the Corporation has been associated with about $7.8 billion of investments and has assisted in financing some 271 enterprises in 61 developing countries. Most of these enterprises have been medium-size firms, which are locally controlled and locally managed.

The Corporation has a record of prudent, effective, and imaginative management. Its current diversified portfolio includes investments in 52 countries. Its investment losses have been less than 1 percent of its total cumulative commitments for its own account. In fiscal year 1976, the average annual rate of return on loan and equity investments held by the Corporation was about 9 percent.

The suggested U.S. share of the total replenishment is $111.5 million, or approximately 23 percent of the $480 million of the proposed increase, and that will be immediately taken up by present IFC members. The remaining $60 million of authorized capital will be reserved for further subscriptions by present members or for new members. The U.S. share compares with the roughly 33 percent of issued capital that the United States currently holds. When the replenishment is completed, the U.S. share would be reduced to about 25 percent and U.S. voting power would drop from about 26.5 percent to 24 percent.

The share of subscriptions of other developed countries and OPEC members will rise from 45 percent to 51 percent. Among the countries which are expected to increase their relative shares in IFC are Germany, Canada, Japan, Iran, Saudi Arabia, and Venezuela.

Asian Development Bank and Fund

Mr. Chairman, I would like now to turn to our request for legislation authorizing a U.S. subscription of $814.3 million to the Asian Development Bank's capital stock and a U.S. contribution of $180 million to the ADB's concessional window, the Asian Development Fund.

Today more than ever the continent of Asia has become an important element in the economic strength and progress of our own country. Several East Asian countries have become major trading partners of the United States. U.S. investment in the region has grown rapidly in the past decade and has potential of increasing much further. Asia is also an important and stable supplier of raw materials, providing, for example, nearly all of our natural rubber, tin, and coconut oil. It has become a stable alternative source of a portion of our petroleum imports.

In order to maintain our political and economic interests in this important part of the world, a fundamental U.S. foreign policy objective over the years has been to prevent any major potentially hostile power or grouping of powers from establishing its hegemony in Asia.

However, an appropriate equilibrium cannot be maintained in Asia solely through military force or political maneuver. The traditional division between Communist and non-Communist nations is no longer the only axis in international affairs.

The intensifying dialog between developed and developing nations has complicated any simple view of U.S. foreign objectives and policies. The interrelationship between this North-South dialog and more traditional East-West tensions is dynamic, complex, and often confusing. However, it would appear that, over time, continuing poverty and a lack of economic progress is conducive to political instability and the establishment of governments hostile to Western political and economic systems. Therefore, the growth of outwardlooking Asian economies open to foreign investment and international trade is a major U.S. foreign economic policy objective.

The Asian Development Bank fosters these U.S. goals of political stability and market-oriented economic growth at a relatively modest cost to the United States. The Bank lends to Asian rim countries—Korea, the Philippines, Thailand, Malaysia, Indonesia—countries whose independence is necessary to Asian political stability. It is effective in promoting appropriate kinds of national economic policies and regional cooperative efforts. Also, the Bank, particularly through its soft-loan window, seeks to aid the poorest segments of society. U.S. participation in the Bank visibly demonstrates our concern for the aspirations of the poor for economic improvement.

Clearly U.S. participation in the ADB, or any of the international development banks, will not, of itself, assure a stable, progressive world. However, world interdependence is no longer an idealistic aspiration, but rather, an occasionally painful reality. Given our inability to feed or finance all of Asia or, on the other hand, ignore its festering problems, U.S. participation in the Asian Development Bank, for its cost, is a wise investment in a constructive future.

The Asian Development Bank was created in 1966 to foster economic growth and cooperation in the poorer countries of Asia and the Pacific. The Bank, which is headquartered in Manila, has 28 regional members which provide 63 percent of its capital, and 14 nonregional members—including the United States, Canada, and 12 West European countries—which provide 37 percent of its capital. The aggregate voting power of the developed member countries, which includes all the nonregional members plus Japan, Australia, and New Zealand, represents 58 percent of the total. The United States participated actively in the establishment of the Bank, and its subscription to the Bank's capital currently amounts to $603.2 million, or 16.4 percent of the total. The U.S. contribution of $125 million to the Fund equals 13.5 percent of total ADF resources.

After 10 years of operations, the Asian Development Bank has become a major source of capital and, as a regional organization, plays an important role in mobilizing self-help resources and bringing local knowledge to bear on Asian development problems.

As of December 31, 1976, total loan funds committed by the Bank amounted to $3,355 million for 264 individual projects. Of these projects, 171 totaling $2,465 million are being financed from Ordinary Capital resources at near-market rates of interest and maturities of from 10 to 25 years. The remaining $890 million represents 117 concessional loans financed from Asian Development Fund resources. These loans carry an interest rate of 1 percent and have maturities of 40 years. In calendar year 1976, the Board of Directors approved Ordinary Capital and concessional loans totaling $776 million.

In terms of geography, the Bank has made loans to 23 of its developing member countries from Afghanistan to Western Samoa. Much of this activity has taken place in countries which are important to the political and economic foreign policy interests of the United States. For example, by the end of 1976, $548 million of Ordinary Capital resources has been lent to Korea, $449 million to the Philippines, $305 million to Thailand, and $291 million to Malaysia. Major borrowers from the Asian Development Fund include Bangladesh ($179 million), Pakistan ($133 million), and Nepal ($100 million). These and other countries whose economic and social progress is significant to stability in Asia have benefited from the Bank's resources at small cost to the United States.

At the end of December 1976, the total estimated cost of projects for which the Bank has approved direct financing reached $6,159 million, of which Bank loans accounted for 45 percent. In addition, the Bank had provided indirect financing through intermediate credit institutions for projects with an estimated total cost of about $1,751 million, of which the Bank's portion amounted to 22 percent. The difference between the Bank's cumulative lending level and the total cost of Bank-related projects is primarily attributable to the self-help efforts of individual recipient countries who are mobilizing their own domestic resources for Bank-assisted development projects. The ADB also joins with other multilateral, bilateral, and private sector sources to cofinance development projects.

The ADB pays close attention to the social impact of its operations. Of particular concern to the Bank are efforts to create employment opportunities and reach lower income groups. During the past few years, lending for agriculture and agro-industry has increased significantly.

The Bank's Ordinary Capital lending is financed primarily from (1) the paid-in capital subscriptions of members and (2) proceeds of borrowings in international capital markets. Members' callable capital subscriptions are used exclusively to guarantee these borrowings and thus would represent a budgetary outlay only in the highly unlikely event that the Bank could not meet its obligations to bondholders.

As of December 31, 1976, the Bank's subscribed capital stock amounted to $3,688 million, consisting of 32 percent paid-in capital and 68 percent callable capital. This stock is the sum of the Bank's original capitalization, the first general capital increase agreed to in 1971, and special capital increases subscribed by various member governments in 1973–76. The U.S. subscription of $603.2 million is the largest (with the Japanese) and amounts to 16.4 percent of the total.

The Bank's first general increase in capital, of which the United States provided $362 million, or 18.2 percent, has financed lending from 1973 to the present. However, the ADB's currently subscribed capital will be insufficient to finance lending after 1977.

Given this impending exhaustion of commitment authority, the Bank's Board of Directors undertook a study, in late 1975, of the institution's resource position. The study examined the needs of the recipient countries for external financing and the capability of the Bank to process various levels of development project proposals. In light of higher energy prices, world recession, and the increasing requirements for external capital to finance expanding economies, an increase in annual lending from $625 million in 1977 to $925 million in 1981 was decided upon. This implied a rise in the Bank's Ordinary Capital lending of $75 million per year, or an increase in real terms of about 5 percent annually. Achievement of this lending program over the 1977–81 period would result in an overall replenishment figure of about $5 billion, or an increase of 135 percent in the existing capital stock.

On October 29, 1976, the Board of Governors adopted a resolution to increase the authorized capital stock of the Bank by $5,003.9 million. Under the agreed arrangements, 10 percent of the increase is to be paid-in shares and the remaining 90 percent is in the form of callable capital.

The United States would subscribe to $814.3 million or 16.3 percent of the total in four equal annual tranches, beginning in fiscal 1978. Ninety percent, or $732.9 million, would be callable capital. Appropriation of $203.6 million ($183.2 million callable and $20.4 million paid-in) is being sought for fiscal 1978. Of the U.S. paid-in portion, 40 percent would be in cash and 60 percent in non-interest-bearing letters of credit to be drawn down as needed to meet disbursement needs of the Bank. The callable capital portion does not increase Treasury outlays. It does, however, give financial analysts and the bond market greater confidence in the Bank's bond issues. Thus, with no real cost to the U.S. Government, the ADB will be able to borrow at better rates and longer terms than otherwise.

When the Bank was established it was recognized that it should provide financing on concessional terms to meet the needs of its poorest developing member countries. Prior to 1973 the Bank's soft-loan special funds were contributed on an unscheduled basis through bilateral arrangements between donor countries and the Bank. In 1973, the Bank's Board of Governors, with U.S. support, adopted a resolution creating a new multilateral special fund, the Asian Development Fund, to which all contributions would be made and used on the same terms and conditions. Subsequently, agreement was reached among the Bank's developed country members on an initial resource mobilization of $525 million. The U.S. share authorized by the Congress was $150 million, of which $125 million has been appropriated.

This original resource mobilization of the Fund was designed to finance concessional lending through the end of 1975. Given the impending exhaustion of commitment authority, the Board of Directors presented a report at the Bank's 1975 annual meeting urging attention to the pressing need for a resource replenishment to permit concessional lending to continue after 1975. Fund borrowers—the Bank's least developed members—were now faced with increased economic difficulties and worsening balance of payments situations growing out of the 1973 oil price increase and the ensuing world recession. While any member country with a 1972 per capita income of less than $300 is theoretically eligible for ADB loans, most borrowers are countries with per capita incomes below $200.

Following the 1975 annual meeting, multilateral negotiations were held and agreement ultimately reached on an $809 million replenishment to the Asian Development Fund. The U.S. share of this total is $180 million, or 22.2 percent, down from the 28.5-percent U.S. share of the original resource mobilization. The largest share of the replenishment, 33.7 percent, is being contributed by Japan.

Early congressional action on the authorizing legislation for the U.S. $180 million contribution is necessary to assure the success of the ADF replenishment. Under the terms of the replenishment resolution, the three annual installments of donors' contributions become available to the ADF only when certain trigger levels are reached. This assures that there is in fact an equitable burden-sharing among fund donors. The first trigger level of $475 million in commitments to contribute was reached in June 1976. However, the second and third triggers cannot be attained in the absence of U.S. action.

Because the U.S. contribution would make nearly $200 million in contributions from other countries available to the fund, the United States has become the financial and political linchpin of the replenishment. As of today the fund has only $10.7 million available for new loans to the poorest Asian nations. ADF lending may cease in mid-1977 pending receipt of the first U.S. installment of this replenishment. Therefore, timely action on this ADF authorizing legislation would both demonstrate to Asians that the United States supports their development and reassure other donor countries that we will provide our fair share of the replenishment.

Conclusion

Mr. Chairman and members of the committee, the Carter administration strongly supports the proposed replenishments before you today. We believe that development of the poorer countries is of utmost importance to U.S. humanitarian, security, political, and economic interests. We believe that foreign assistance can play a vital role in promoting development. We believe that the international development lending institutions are an extraordinarily valuable instrument for channeling such assistance. The President has personally and publicly expressed this view. We urge you to support the authorizing requests which are under discussion today.

Exhibit 59.—Statement by Under Secretary for Monetary Affairs Solomon, June 16, 1977, before the Subcommittee on Foreign Economic Policy of the Senate Committee on Foreign Relations, on the results of the Conference on International Economic Cooperation (CIEC)

It is my pleasure to appear before you today to report on the results of the Conference on International Economic Cooperation (CIEC), in which the United States has participated during the past 18 months. At the outset of my remarks, I want to make clear that I view the CIEC as part of the ongoing, evolving dialog between the industrialized and developing countries. Because of this, it would not only be difficult, but also probably not very useful to strike a balance on CIEC alone. North-South issues have been discussed in numerous fora over the past few years and significant results have been achieved to the benefit of developed and developing countries alike. In addition to the outcome of CIEC, I am thinking, for example, of the liberalization of the compensatory financing facility of the International Monetary Fund (IMF), the establishment of a trust fund for the benefit of the poorest nations, also in the IMF, the replenishment of the capital resources of the International Development Association now before the Congress, and the participation of the United States in negotiations on individual commodity agreements that aim at stabilization of commodity prices around their long-term trend. To what extent these results might have been different in the absence of CIEC is hard to say. I believe that, at a minimum, the Conference was useful in setting out the problems facing developed and developing countries, in increasing mutual understanding, at least in regard to some issues, and in creating an atmosphere in which cooperative action and policy recommendations could be fashioned.

It may be useful to remember how the Conference came about. It first was conceived by the developed countries as a forum in which consultations between oil-importing and oil-exporting countries could go forward in the aftermath of the OPEC price increases of 1973/74. But the successful cartel action of OPEC brought about a greater sense of political impetus and cohesion, not only among the oil-exporting countries, but also among the developing countries generally. This development led to the formulation of a far-reaching set of economic demands that has become known as the new international economic order (NIEO) and to the view that energy issues should be discussed only within the context of the wider range of North-South economic problems. As a consequence, CIEC was charged with conducting substantive discussions covering all major areas of North-South issues. The 19 participants from LDC's (the G–19) in CIEC thus derived their mandate from the Group of 77 which had shaped the NIEO and they, consequently, had very little negotiating flexibility. This was an important element in the dynamics of the Conference and it also meant that anything short of a full endorsement of all elements of the NIEO by the Conference could not be considered a success by the G–19. In addition, the fact that Conference decisions were taken by consensus meant that a lone participant could block a decision. While we saw this as a procedural safeguard, it did have the effect of narrowing the area of possible agreement. Nevertheless, beneath all the rhetoric that inevitably accompanies international conferences, a considerable amount was in fact accomplished. This is reflected in the Conference communique, which—as such documents go—is a very workmanlike document. In outlining clearly the basic areas of agreement and disagreement in the North-South dialog, it shows that a major contribution of CIEC was to help delineate the realistic limits to demands and commitments of the developed and developing countries.

The industrialized countries participating in CIEC showed a willingness to back their rhetoric on global interdependence and the value they put upon a cooperative approach to North-South issues with concrete and meaningful action. The actuality of interdependence was underscored by the fact, brought out in the discussions, that LDC demand for the exports of developed countries was a significant sustaining element during the recession and, conversely, that recovery in the industrialized world benefited first commodity producers and then other LDC's materially. Thus, the commitments made to seek congressional approval to increase the volume and effectiveness of aid flows, to assure adequate availability of official international financial resources, and to strengthen the international trading system, in particular by reaffirming the pledge made at the outset of the current multilateral trade negotiations to provide LDC's access to the markets of industrial countries, reflected both the self-interests of developed countries and a growing recognition of the needs of developing countries. Similarly, we see our agreement to negotiate a common fund, which would pool financial resources of various buffer stock organizations, as an integral part of our overall goal to stabilize commodity prices around their long-term trend and thereby reduce the risk of inflationary pressures for consumers and producers alike.

The oil-producing countries recognized during the course of the Conference that in shaping their supply policies they bear a particular responsibility for economic stability worldwide. And, the nonoil LDC's recognized the importance of private investment flows to their development plans. Thus, despite the continued rhetoric reflecting their love/hate relationship with multinational corporations, there emerged a considerable amount of pragmatic recognition regarding the elements that constitute a favorable investment climate.

On a large number of basic issues, however, no agreement could be reached. Throughout the Conference, the industrialized countries insisted that the dialog must seek to achieve improvements within rather than a basic restructuring of the existing economic framework. In addition, the industrialized countries sought to demonstrate that indirect ways of transferring resources from developed to developing countries, e.g., by granting generalized debt relief or by indexation of developing countries' export prices, would start us down roads the endings of which, at best, were unclear and in most cases disadvantageous to us all. The developing countries, on their part, insisted that a reordering of the economic system, giving the LDC's inter alia more automatic access to international financial resources and a greater voice in decisionmaking, was essential. No agreement could be reached on issues that involved the view of LDC's of the exercise of their sovereign rights such as determination of the export price of oil and the settlement of private investment disputes. Even in the areas of fundamental disagreement, however, the educational process involved will probably prove helpful in future North-South discussions.

The Conference proceeded in two stages: The first 6 months were devoted to an exhaustive analytical examination of North-South economic issues followed by a second stage during which the actual proposals and conclusions of the Conference were being negotiated. Most of the proposals and conclusions, except perhaps in the energy area, were not substantively new, but were articulated more sharply than in earlier discussions. In some cases, nuances in policy views were highlighted by large amounts of time devoted to drafting changes that to outside negotiating circles would have little meaning and would appear to be struggles over semantics only. The work proceeded in four separate commissions dealing with (1) energy, (2) raw materials, (3) development, and (4) financial affairs.

On energy, the general objective of the industrialized countries was to broaden the base of international understanding of the interrelationship of energy prices and the performance of the world economy. The G–8 never attempted, nor did they think it appropriate to try, to obtain agreements regarding the actual setting of oil prices or the avoidance of embargoes. Progress was made on the basic G–8 energy objectives, except for obtaining a CIEC recommendation for an ongoing energy dialog. The CIEC participants agreed to a general set of guidelines that (1) recognize the essentiality of adequate and stable energy supplies to global growth and the responsibilities of all nations, including the oil-exporting countries, to ensure that such supplies are available; (2) call for intensified national and international cooperative efforts to expand energy conservation and accelerate the development of conventional and nonconventional energy supplies during the energy transition period and beyond; (3) affirm that special efforts should be made to help alleviate the energy burdens of oil-importing LDC's; (4) recommend that the IBRD, in the context of a general capital increase, expand its activities so as to increase capital flows into the development of indigenous energy resources, particularly in energy-importing developing countries; (5) call for new international efforts to facilitate the transfer of energy technology to LDC's wishing to acquire such technologies; (6) endorse enhanced international cooperation in energy R. & D., which will probably lead to participation by some oil-exporting and other developing countries in some R. & D. work in the International Energy Agency (IEA); and (7) recognize the desirability and inevitability of the integration of the downstream processing industries of the oil-exporting countries into the expanding world industrial structure as rapidly as practicable.

Under the general subject of raw materials, the Conference dealt with a full range of issues concerning international trade in commodities, practically all of which are the subject of discussions elsewhere and many of which were covered in UNCTAD Resolution 93 (IV), an Integrated Programme for Commodities, which was agreed on at the UNCTAD meeting in Nairobi in May 1976, but against certain parts of which the United States and some other G–8 countries registered reservations.

The issues we reserved against involved indexation of the export prices of commodity producers and measures to harmonize the production of synthetics with that of natural products. And these matters continued to meet with fundamental disagreement in CIEC as did G–19 proposals in the areas of transportation, marketing, and distribution. With regard to compensatory financing to cover shortfalls in LDC earnings from exports of primary products, the G–8 proposed that the IMF/IBRD Development Committee study this issue, but this proposal foundered over G–19 insistence on UNCTAD participation and on defining terms of reference that effectively would have prejudged the outcome of the study.

In the wake of the decision of participants in the London economic summit that there should be a "common fund" and that CIEC should seek to give impetus to resumed negotiations on this issue in November, CIEC participants reached agreement in principle on the "establishment of a common fund with purposes, objectives and other constituent elements to be further negotiated in UNCTAD." Throughout the Conference we have made it clear that we cannot agree to negotiate on the UNCTAD version of the common fund, which would finance not only buffer stocks, but also a whole range of other activities included in the Nairobi Resolution. The type of common fund we have in mind is limited to a financial pooling arrangement for buffer stocks where they are part of individual negotiated agreements. Such an arrangement would result in efficiencies that would reduce the overall commitment of financial resources needed to back up the individual buffer stock organizations; it would not finance any measure or measures which would go beyond commodity price stabilization.

In the development area, there was intensive and prolonged discussion on some of the most important issues facing the Conference. The participants were able to reach agreement on the need for progressively and substantially increasing the flows of official development assistance, the desirability of a substantial increase in the general capital of the World Bank, the provision of assistance to infrastructure development, with particular reference to transportation and communications development in Africa, and assistance to food and agricultural production in developing countries. We did make clear, however, that we could not commit to any fixed target ratio of official development assistance to GNP.

I believe the lengthy discussions in the Conference resulted in an increased understanding by all of the necessity, not only of increasing aid volumes, but also, and of equal importance, of increasing the effectiveness with which these funds are used to enhance the development process. We stressed the responsibilities of the recipient developing countries in this regard and I think the message was understood.

The Conference took particular account of the pressing economic and financial difficulties of the poorest of the developing nations. The G–8 agreed to provide a $1 billion Special Action program for low-income countries with the most acute financial needs; as our contribution to that program, Secretary Vance indicated that President Carter will seek congressional approval in FY–79 for $375 million over current levels in U.S. bilateral aid to the poorest.

We were not, however, able to resolve several difficult issues in the development area. The industrialized countries insisted that debt service problems of developing countries should be addressed on a flexible, case-by-case basis and could not agree to G–19 proposals for generalized debt relief, for consolidation of commercial debts, and other objectives of debt reorganization. There was also disagreement on the issue of unrestricted access to industrial countries' markets for manufactured goods from developing countries and on G–19 proposals relating to the responsibilities of multinational corporations.

In the financial area, agreement was largely reached on the following issues: private foreign direct investment, developing country access to capital markets, other financial flows (monetary issues), and cooperation among developing countries.

On private direct foreign investment, considerable progress was made in identifying the essential elements that constitute a favorable investment climate. But those issues that touched upon the sovereignty of the host countries could not be resolved. Regarding access to capital markets, the final results support the work of the IMF/IBRD Development Committee and urge the speedy implementation of its recommendations. These primarily involve technical assistance of various sorts.

With respect to monetary issues, the participants noted with satisfaction that the work program laid out for the IMF by the Interim Committee reflected largely the concerns expressed during the Conference. Strong support was expressed for the initiative taken to establish a supplementary credit facility in the IMF. A number of G–19 participants advanced specific proposals for structural changes in the international monetary system and for easier access to international financial resources. The G–8 resisted inclusion of such proposals as these are matters for discussion in the IMF and not within the competence of the CIEC. The G–19, preferring to have monetary issues remain on the table, withdrew their specific proposals in order to reach an agreed text on these issues, noting, however, that the consensus reached did not cover all areas of interest to them. The paper on cooperation among developing countries largely reflected text agreed earlier in various U.N. fora and deals with ways and means by which bilateral and multilateral financial assistance could help promote economic and financial cooperation among developing countries.

Disagreement on the text on measures against inflation reflected divergent views on the sources of inflation. The G–19 insisted that the only matter of concern was inflation imported from industrialized countries and that the appropriate measure against such inflation is indexation of export prices of commodities. The G–8 maintained that inflation is largely homegrown, and requires appropriate domestic demand management measures. However, the G–8 noted that those countries whose actions have worldwide repercussions—i.e., large industrial countries and countries with important exports such as oil and some other commodities—have a particular responsibility to combat inflation. On financial assets of oil-exporting developing countries, participants agreed that some oil-exporting developing countries, in order to accommodate world energy requirements and thereby contribute to world economic growth and stability, have been maintaining production levels that, at current prices, yield external resources in excess of their current requirements. However, the G–8 could not agree that, therefore, such assets should receive preferential treatment. Although it appeared possible to come to an agreed text on this issue that would reflect both OPEC and G–8 concerns, agreement fell apart at the last minute and participants returned to their original positions.

As I noted earlier, a full assessment of results of CIEC is difficult to make. The Conference started in an atmosphere of near confrontation, and discussions in the closing meetings were difficult; but it did result in a consensus communique which stated that CIEC had contributed to a broader understanding of the international economic situation and had been useful to all participants. In fact, while it would be difficult to prove, it is possible that this increased understanding, if not directly serving to moderate OPEC oil price increases, may have enabled those producers who supported moderate pricing decisions to do so more forcefully. Thus, my overall assessment is a positive one. This does not mean, as the dialog proceeds in other fora, that the developing countries will drop any of their demands. However, to the extent that the discussions in CIEC have produced an increased sense of realism among the participants, the Conference will ease future negotiations and should be judged on that basis.

Exhibit 60.—Statement by Under Secretary for Monetary Affairs Solomon, September 30, 1977, before the Senate Foreign Relations Committee, regarding the economic aspects of the Panama Canal Treaty and the economic arrangements

I am pleased to be here to discuss the economic aspects of the Panama Canal Treaty and the economic arrangements.

You have already heard testimony on the annuity and royalty payments Panama will receive according to the new treaty. My understanding is that these payments represent Panama's share of the benefits from operation of the canal: They will be paid out of canal revenues, and not out of U.S. tax revenues. These payments provisions will also serve U.S. interests by enlarging Panama's stake in the secure and efficient operation of the canal.

In addition to the payments provisions of the treaty, we have extended to Panama, as Under Secretary Cooper has noted, an offer of economic cooperation involving as much as $295 million in U.S. loans, guarantees, and insurance, which I will presently discuss in detail.

The benefits to Panama from the financial provisions of the treaty and the economic cooperation arrangements will be significant and timely. In the decade prior to 1974, Panama's GDP increased at an annual average rate of 7.3 percent. In 1974, however, economic growth abruptly slowed to 2.6 percent, and last year there was no growth. A major cause of Panama's economic slowdown was uncertainty over the future of the canal, resulting in a marked decrease in private investment (which increased only slightly in 1974 and 1975 and fell by 25 percent in 1976). In addition, worldwide recession, the increase in the price of oil, and the recent decrease in sugar prices also contributed to Panama's large current account deficits.

The Government of Panama attempted to maintain overall investment levels by increasing public investment to offset the decline in private investment. As a result, the central government budget deficit increased from $69 million in 1973 to $122 million in 1976. This, combined with borrowings to finance Panama's current account deficits, caused total public sector debt to rise from $0.6 billion in 1973 to $1.4 billion in 1976.

There is reason, however, for some optimism about the future of Panama's economy. Panama has negotiated two stabilization agreements with the IMF (one last year and one in March 1977), and has taken steps to reduce the government deficit and limit public sector debt. World economic recovery will help to narrow Panama's current account deficit. Above all, the single most important factor in bringing returned vigor to the Panamanian economy will be settlement of the canal issue, and the resulting restoration of a favorable investment climate in Panama. We expect that, as a consequence, foreign and domestic private investment will rise appreciably, leading to increases in employment, reduced budgetary pressure on the Panamanian Government, and improvements in its external accounts.

Panama's new economic program and settlement of the canal issue are the fundamental requirements for returning Panama to its former path of economic growth. The payments provisions of the new treaty and the economic cooperation arrangements are ancillary to these developments, but we believe they will provide the extra boost to contribute to Panama's long-term economic development.

This is of importance to the United States, in the sense that economic stability and an improved standard of living in Panama will strengthen the ability of Panama to act as our partner in the canal enterprise, bearing its share of the responsibilities. We have designed arrangements for economic cooperation with this goal in mind, selecting financial assistance programs which are nonconcessional, befitting Panama's stage of development, and directed at meeting Panama's present economic needs for low-income housing and a revived private sector. The United States will benefit additionally from these economic arrangements, through participation by U.S. investors and business in the Export-Import Bank, Overseas Private Investment Corporation (OPIC), and housing investment guarantee programs the arrangements entail.

I would now like to turn to the two aspects of the treaty effort in which I had a direct role. Treasury did not directly participate in the treaty negotiations. My contribution was to recommend economic cooperation arrangements, and to provide advice on the financing arrangements for the new Panama Canal Commission.

1. Economic cooperation arrangements

The proposed economic cooperation arrangements consist of: (1) An offer by OPIC to guarantee up to $20 million in borrowings in the U.S. capital market by the Panamanian development bank, (2) an offer by the Eximbank to provide up to $200 million in loans, loan guarantees, and insurance for individual U.S. export sales over a 5-year period, and (3) a pledge by the administration to consider providing up to $75 million in housing investment guarantees over a 5-year period. In addition, we will provide up to $50 million in guarantees over a 10-year period under our foreign military sales program.

These particular arrangements were selected not only for the benefits they are expected to bring to both the United States and Panama, but also for the reasonable level of risk they present and their compatibility with the financial assistance programs involved. All of these offers are subject to compliance with legal and managerial requirements, and, as necessary, availability of funds.

The housing guarantee aspect of the economic cooperation arrangements and the FMS offer have been addressed by Under Secretary Cooper.

As for the offer by Eximbank to provide up to $200 million in loans, guarantees, and insurance, I would like to point out that the portfolio risk to Eximbank as a result of its offer will be small. With an additional $200 million to Panama over 5 years, exposure in Panama will amount to less than 1.37 percent of Eximbank's total existing portfolio. Project risk will be controlled in the usual manner, since each transaction will be subject to normal Eximbank financial, legal, and engineering criteria—including Eximbank's statutory requirement to find a reasonable assurance of repayment.

Once the canal issue is settled and investment in Panama accelerates, Panama will become an expanding market for U.S. exports. This projected market expansion is expected to give rise to more applications for Eximbank support, and Eximbank has indicated that its business in Panama could well amount to $200 million over the next 5 years.

A guarantee by OPIC of $20 million in borrowings by the Panamanian development bank would raise OPIC's exposure in Panama to only 8.5 percent of its total existing portfolio, a reasonable level of portfolio risk. The risk to OPIC will be further reduced by a Government of Panama guarantee. OPIC has also stipulated that its offer to Panama depends on terms being negotiated which are acceptable to the OPIC Board.

This will be the first time OPIC has participated in financing the expansion of a government-owned development bank, although OPIC is permitted to do so by longstanding OPIC Board policy guidelines. The Panamanian development bank, COFINA, is engaged in supporting the development of private enterprises in Panama through project lending. This function is both wholly compatible with OPIC's mission and in accord with our view that it should help strengthen the private sector of Panama's economy.

2. Future financing of the Panama Canal Commission

Turning now to the financial aspects of the canal operations, an essential point in negotiating the treaty was that any new entity established to operate the canal must be self-financing over the life of the treaty. Our negotiators made it clear to the Panamanians that any arrangements which did not conform to this principle would not be acceptable to the United States. I assure you that we will continue to be guided by that principle. The administration will make every possible effort to see that costs of the canal operation are contained and that revenues are sufficient to cover liabilities. However, as a normal provision for management flexibility, I feel it is appropriate for the Panama Canal Commission to have the authority to borrow, as does its predecessor agency, the Panama Canal Company. Thus, the administration will request a continuation of this authority in the implementing legislation.

I believe the following guidelines should be followed by the Commission in its borrowings. First, any borrowing by the Panama Canal Commission should be strictly limited to an amount sufficient to support the Commission's operations. The Commission should not have the authority to borrow for any other purpose such as the general economic development of Panama. Second, all borrowing should be at a rate of interest equal to the cost of money to the U.S. Treasury for the period of time under consideration. Third, the repayment schedule should be tailored so that all borrowings will be fully repaid before the expiration date of the treaties.

TESTIMONY ON INTERNATIONAL MATTERS

Exhibit 61.—Other Treasury testimony in hearings before congressional committees

Secretary Blumenthal

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, U.S. Senate, 95th Congress, first session, on the administration's request for U.S. funding for the international development banks for fiscal 1978, March 2, 1977, pp. 207–24.

Under Secretary for Monetary Affairs Solomon

Statement before the Subcommittee on Foreign Economic Policy of the Committee on Foreign Relations, U.S. Senate, on legislation to authorize U.S. participation in the International Monetary Fund Supplementary Financing Facility, September 21, 1977.

Assistant Secretary Parsky

Statement published in hearings before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, 95th Congress, first session, entitled "Implications of Oil Price Decisions," January 6, 1977, pp. 81–107.

Assistant Secretary Bergsten

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, U.S. Senate, 95th Congress, first session, regarding the administration's foreign assistance policy, February 10, 1977, pp. 4–11.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 95th Congress, first session, in support of a fiscal 1978 and a fiscal 1977 supplementary appropriation request for the Asian Development Bank and the Asian Development Fund, February 16, 1977, pp. 271–83.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 95th Congress, first session, regarding a fiscal 1978 appropriation request for the African Development Fund, February 16, 1977, pp. 462–64.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 95th Congress, first session, regarding a fiscal 1978 and a fiscal 1977 supplementary appropriation request for the Inter-American Development Bank, February 16, 1977, pp. 493–97.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 95th Congress, first session, regarding the administration's fiscal 1978 appropriation request for the International Bank for Reconstruction and Development, February 17, 1977, pp. 371–76.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 95th Congress, first session, regarding a fiscal 1978 appropriation request for the International Finance Corporation, February 17, 1977, pp. 213–14.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 95th Congress, first session, regarding a fiscal 1978 and a fiscal 1977 supplementary appropriation request for the International Development Association, February 17, 1977, pp. 427–31.

Statement published in hearings before the Task Force on National Security and International Affairs of the Committee on the Budget, House of Representatives, 95th Congress, first session, on U.S. funding for the international development banks for fiscal 1978, March 11, 1977, pp. 81–7.

Statement published in hearings before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 95th Congress, first session, on proposed replenishment of the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, the Asian Development Bank and the Asian Development Fund, March 22, 1977, pp. 16–49.

Supplemental statement published in a hearing before the Subcommittee on African Affairs and the Subcommittee on Foreign Assistance of the Committee on Foreign Relations, U.S. Senate, 95th Congress, first session, on increasing the U.S. contribution to the African Development Fund, April 18, 1977, pp. 16–18. (Full statement in committee files.)

Statement published in a hearing before the Subcommittee on Economic Stabilization of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 95th Congress, first session, entitled "The Policy of the United States Toward International Commodity Agreements," June 8, 1977, pp. 8–22.

Statement before the Subcommittee on International Economic Policy and Trade of the Committee on International Relations, House of Representatives, entitled "Administration Policy Toward the Overseas Private Investment Corporation (OPIC)," June 23, 1977.

Statement before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, regarding the rapid growth of international debt, August 29, 1977.

Organization and Procedure

Exhibit 62.—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 September 11, 1789, to January 20, 1977, and the Presidents under whom they served

Term of service		Official	Served under—	
From—	To—		Secretary of the Treasury	President
		Secretaries of the Treasury		
Sept. 11, 1789	Jan. 31, 1795	Alexander Hamilton, New York		Washington.
Feb. 3, 1795	Dec. 31, 1800	Oliver Wolcott, Connecticut		Washington, Adams.
Jan. 1, 1801	May 13, 1801	Samuel Dexter, Massachusetts		Adams, Jefferson.
May 14, 1801	Feb. 9, 1814	Albert Gallatin, Pennsylvania [1]		Jefferson, Madison.
Feb. 9, 1814	Oct. 5, 1814	George W. Campbell, Tennessee		Madison.
Oct. 6, 1814	Oct. 21, 1816	Alexander J. Dallas, Pennsylvania		Madison.
Oct. 22, 1816	Mar. 6, 1825	Wm. H. Crawford, Georgia		Madison, Monroe.
Mar. 7, 1825	Mar. 5, 1829	Richard Rush, Pennsylvania [2]		Adams, J. Q.
Mar. 6, 1829	June 20, 1831	Samuel D. Ingham, Pennsylvania [3]		Jackson.
Aug. 8, 1831	May 28, 1833	Louis McLane, Delaware		Jackson.
May 29, 1833	Sept. 22, 1833	Wm. J. Duane, Pennsylvania		Jackson.
Sept. 23, 1833	June 25, 1834	Roger B. Taney, Maryland		Jackson.
July 1, 1834	Mar. 3, 1841	Levi Woodbury, New Hampshire		Jackson, Van Buren.
Mar. 6, 1841	Sept. 11, 1841	Thomas Ewing, Ohio		Harrison, Tyler.
Sept. 13, 1841	Mar. 1, 1843	Walter Forward, Pennsylvania		Tyler.
Mar. 8, 1843	May 2, 1844	John C. Spencer, New York [4]		Tyler.
July 4, 1844	Mar. 7, 1845	Geo. M. Bibb, Kentucky		Tyler, Polk.
Mar. 8, 1845	Mar. 5, 1849	Robt. J. Walker, Mississippi		Polk.
Mar. 8, 1849	July 22, 1850	Wm. M. Meredith, Pennsylvania		Taylor, Fillmore.
July 23, 1850	Mar. 6, 1853	Thos. Corwin, Ohio		Fillmore.
Mar. 7, 1853	Mar. 6, 1857	James Guthrie, Kentucky		Pierce.
Mar. 7, 1857	Dec. 8, 1860	Howell Cobb, Georgia		Buchanan.
Dec. 12, 1860	Jan. 14, 1861	Philip F. Thomas, Maryland		Buchanan.
Jan. 15, 1861	Mar. 6, 1861	John A. Dix, New York		Buchanan.
Mar. 7, 1861	June 30, 1864	Salmon P. Chase, Ohio		Lincoln.

Footnotes at end of table.

July 5, 1864	Mar. 3, 1865	Wm. P. Fessenden, Maine	Lincoln.
Mar. 9, 1865	Mar. 3, 1869	Hugh McCulloch, Indiana [5]	Lincoln, Johnson.
Mar. 12, 1869	Mar. 16, 1873	Geo. S. Boutwell, Massachusetts	Grant.
Mar. 17, 1873	June 3, 1874	Wm. A. Richardson, Massachusetts	Grant.
June 4, 1874	June 20, 1876	Benj. H. Bristow, Kentucky	Grant.
July 7, 1876	Mar. 9, 1877	Lot M. Morrill, Maine	Grant, Hayes.
Mar. 10, 1877	Mar. 3, 1881	John Sherman, Ohio	Hayes.
Mar. 8, 1881	Nov. 13, 1881	Wm. Windom, Minnesota [6]	Garfield, Arthur.
Nov. 14, 1881	Sept. 4, 1884	Chas. J. Folger, New York	Arthur.
Sept. 25, 1884	Oct. 30, 1884	Walter Q. Gresham, Indiana	Arthur.
Oct. 31, 1884	Mar. 7, 1885	Hugh McCulloch, Indiana [5]	Arthur, Cleveland.
Mar. 8, 1885	Mar. 31, 1887	Daniel Manning, New York	Cleveland.
Apr. 1, 1887	Mar. 6, 1889	Chas. S. Fairchild, New York	Cleveland, Harrison.
Mar. 7, 1889	Jan. 29, 1891	Wm. Windom, Minnesota [6]	Harrison.
Feb. 25, 1891	Mar. 6, 1893	Chas. Foster, Ohio	Harrison, Cleveland.
Mar. 7, 1893	Mar. 5, 1897	John G. Carlisle, Kentucky	Cleveland, McKinley.
Mar. 6, 1897	Jan. 31, 1902	Lyman J. Gage, Illinois	McKinley, Roosevelt.
Feb. 1, 1902	Mar. 3, 1907	L. M. Shaw, Iowa	Roosevelt.
Mar. 4, 1907	Mar. 7, 1909	George B. Cortelyou, New York	Roosevelt.
Mar. 8, 1909	Mar. 5, 1913	Franklin MacVeagh, Illinois	Taft.
Mar. 6, 1913	Dec. 15, 1918	W. G. McAdoo, New York	Wilson.
Dec. 16, 1918	Feb. 1, 1920	Carter Glass, Virginia	Wilson.
Feb. 2, 1920	Mar. 3, 1921	David F. Houston, Missouri	Wilson.
Mar. 4, 1921	Feb. 12, 1932	Andrew W. Mellon, Pennsylvania	Harding, Coolidge, Hoover.
Feb. 13, 1932	Mar. 3, 1933	Ogden L. Mills, New York	Hoover.
Mar. 4, 1933	Dec. 31, 1933	William H. Woodin, New York	Roosevelt.
Jan. 1, 1934	July 22, 1945	Henry Morgenthau, Jr., New York	Roosevelt, Truman.
July 23, 1945	June 23, 1946	Fred M. Vinson, Kentucky	Truman.
June 25, 1946	Jan. 20, 1953	John W. Snyder, Missouri	Truman.
Jan. 21, 1953	July 28, 1957	George M. Humphrey, Ohio	Eisenhower.
July 29, 1957	Jan. 20, 1961	Robert B. Anderson, Connecticut	Eisenhower.
Jan. 21, 1961	Apr. 1, 1965	Douglas Dillon, New Jersey	Kennedy, Johnson.
Apr. 1, 1965	Dec. 20, 1968	Henry H. Fowler, Virginia	Johnson.
Dec. 21, 1968	Jan. 20, 1969	Joseph W. Barr, Indiana	Johnson.
Jan. 22, 1969	Feb. 10, 1971	David M. Kennedy, Utah	Nixon.
Feb. 11, 1971	June 12, 1972	John B. Connally, Texas	Nixon.
June 12, 1972	May 8, 1974	George P. Shultz, Illinois	Nixon.
May 8, 1974	Jan. 20, 1977	William E. Simon, New Jersey	Nixon, Ford.

Footnotes at end of table.

Term of service		Official	Served under—	
From—	To—		Secretary of the Treasury	President
		Deputy Secretaries [7]		
June 12, 1972	Jan. 17, 1973	Charls E. Walker, Texas	Shultz	Nixon.
Jan. 22, 1973	May 8, 1974	William E. Simon, New Jersey [8]	Shultz	Nixon.
July 31, 1974	Feb. 13, 1976	Stephen S. Gardner, Pennsylvania	Simon	Nixon, Ford.
Mar. 3, 1976	....	George H. Dixon, Minnesota	Simon	Ford.
		Under Secretaries [9]		
July 1, 1921	Nov. 17, 1923	S. Parker Gilbert, Jr., New Jersey	Mellon	Harding, Coolidge.
Nov. 20, 1923	Feb. 1, 1927	Garrard B. Winston, Illinois	Mellon	Coolidge.
Mar. 4, 1927	Feb. 12, 1932	Ogden L. Mills, New York [8]	Mellon	Coolidge, Hoover.
Feb. 13, 1932	May 15, 1933	Arthur A. Ballantine, New York	Mills, Woodin	Hoover, Roosevelt.
May 19, 1933	Nov. 16, 1933	Dean G. Acheson, Maryland	Woodin	Roosevelt.
Nov. 17, 1933	Dec. 31, 1933	Henry Morgenthau, Jr., New York [8]	Woodin	Roosevelt.
May 2, 1934	Feb. 15, 1936	Thomas Jefferson Coolidge, Massachusetts	Morgenthau	Roosevelt.
Jan. 29, 1937	Sept. 15, 1938	Roswell Magill, New York	Morgenthau	Roosevelt.
Nov. 1, 1938	Dec. 31, 1939	John W. Hanes, North Carolina	Morgenthau	Roosevelt.
Jan. 18, 1940	Dec. 31, 1945	Daniel W. Bell, Illinois	Morgenthau, Vinson	Roosevelt, Truman.
Mar. 4, 1946	Jan. 14, 1947	O. Max Gardner, North Carolina	Vinson, Snyder	Truman.
Jan. 23, 1947	July 14, 1948	A. L. M. Wiggins, South Carolina	Snyder	Truman.
July 15, 1948	Jan. 20, 1953	Edward H. Foley, New York	Snyder	Truman.
Jan. 28, 1953	July 31, 1955	Marion B. Folsom, New York	Humphrey	Eisenhower.
Aug. 3, 1955	Jan. 31, 1956	H. Chapman Rose, Ohio	Humphrey	Eisenhower.
Aug. 9, 1957	Jan. 20, 1961	Fred C. Scribner, Jr., Maine	Anderson	Eisenhower.
Feb. 3, 1961	Apr. 10, 1964	Henry H. Fowler, Virginia [8]	Dillon	Kennedy, Johnson.
Apr. 29, 1965	Dec. 20, 1968	Joseph W. Barr, Indiana [8]	Fowler	Johnson.
Jan. 27, 1969	June 12, 1972	Charls E. Walker, Texas [10]	Kennedy, Connally	Nixon.
		Under Secretaries for Monetary Affairs [11]		
Aug. 3, 1954	Sept. 25, 1957	W. Randolph Burgess, Maryland	Humphrey, Anderson	Eisenhower.
Sept. 30, 1957	Jan. 20, 1961	Julian B. Baird, Minnesota	Anderson	Eisenhower.

Footnotes at end of table.

Jan. 31, 1961	Dec. 31, 1964	Robert V. Roosa, New York	Dillon	Kennedy, Johnson.
Feb. 1, 1965	Jan. 20, 1969	Frederick L. Deming, Minnesota	Fowler, Barr	Johnson.
Jan. 27, 1969	July 8, 1974	Paul A. Volcker, New Jersey	Kennedy, Connally, Shultz, Simon	Nixon.
July 9, 1974	June 30, 1975	Jack F. Bennett, Connecticut	Simon	Nixon, Ford.
Aug. 5, 1975	Jan. 20, 1977	Edwin H. Yeo III, Pennsylvania	Simon	Ford.

Under Secretaries (Counselors) [12]

June 12, 1972	Mar. 17, 1973	Edwin S. Cohen, Virginia	Shultz	Nixon.
Mar. 15, 1974	July 8, 1974	Jack F. Bennett, Connecticut	Shultz, Simon	Nixon.
July 9, 1974	Oct. 28, 1975	Edward C. Schmults, New York	Simon	Nixon, Ford.
Apr. 14, 1976	Jan. 20, 1977	Jerry Thomas, Florida	Simon	Ford.

General Counsels [13]

June 20, 1934	Jan. 11, 1939	Herman Oliphant, Maryland	Morgenthau	Roosevelt.
May 19, 1939	July 24, 1942	Edward H. Foley, Jr., New York [14]	Morgenthau	Roosevelt.
Aug. 7, 1942	Mar. 22, 1944	Randolph E. Paul, New York	Morgenthau	Roosevelt.
May 10, 1944	Aug. 11, 1947	Joseph J. O'Connell, Jr., New York	Morgenthau, Vinson, Snyder	Roosevelt, Truman.
June 10, 1948	Jan. 20, 1953	Thomas J. Lynch, Ohio	Snyder	Truman.
Jan. 30, 1953	Sept. 1, 1954	Elbert P. Tuttle, Georgia	Humphrey	Eisenhower.
Jan. 26, 1955	Aug. 2, 1955	David W. Kendall, Michigan [15]	Humphrey	Eisenhower.
Sept. 22, 1955	Apr. 17, 1957	Fred C. Scribner, Jr., Maine [14]	Humphrey	Eisenhower.
Jan. 28, 1958	Oct. 1, 1959	Nelson P. Rose, Ohio	Anderson	Eisenhower.
Oct. 2, 1959	Jan. 20, 1961	David A. Lindsay, New York	Anderson	Eisenhower.
Apr. 5, 1961	Oct. 6, 1962	Robert H. Knight, Virginia	Dillon	Kennedy.
Nov. 16, 1962	Jan. 31, 1965	G. d'Andelot Belin, Massachusetts	Dillon	Kennedy, Johnson.
Apr. 12, 1966	Jan. 20, 1969	Fred B. Smith, Maryland	Fowler, Barr	Johnson.
Apr. 1, 1969	Mar. 20, 1970	Paul W. Eggers, Texas	Kennedy	Nixon.
July 1, 1970	June 1, 1973	Samuel R. Pierce, Jr., New York	Kennedy, Connally, Shultz	Nixon.
June 2, 1973	July 8, 1974	Edward C. Schmults, New York [16]	Shultz, Simon	Nixon.
Aug. 1, 1974	Dec. 2, 1976	Richard R. Albrecht, Washington	Simon	Nixon, Ford.

Assistant Secretaries [17]

Mar. 12, 1849	Oct. 9, 1849	Charles B. Penrose, Pennsylvania	Meredith	Taylor.
Oct. 10, 1849	Nov. 15, 1850	Allen A. Hall, Pennsylvania	Meredith, Corwin	Taylor, Fillmore.
Nov. 16, 1850	Mar. 13, 1953	William L. Hodge, Tennessee	Corwin, Guthrie	Fillmore, Pierce.

Footnotes at end of table.

Term of service		Official	Served under—	
From—	To—		Secretary of the Treasury	President
		Assistant Secretaries—Continued		
Mar. 14, 1853	Mar. 12, 1857	Peter G. Washington, District of Columbia	Guthrie, Cobb	Pierce, Buchanan.
Mar. 13, 1857	Jan. 16, 1861	Philip Clayton, Georgia	Cobb, Thomas, Dix	Buchanan.
Mar. 13, 1861	July 11, 1865	George Harrington, District of Columbia [18]	Chase, Fessenden, McCulloch	Lincoln, Johnson.
Mar. 18, 1864	June 15, 1865	Maunsell B. Field, New York	Chase, Fessenden, McCulloch	Lincoln, Johnson.
Jan. 5, 1865	Nov. 30, 1867	William E. Chandler, New Hampshire	Fessenden, McCulloch	Lincoln, Johnson.
July 11, 1865	May 4, 1875	John F. Hartley, Maine	McCulloch, Boutwell, Richardson, Bristow	Johnson, Grant.
Dec. 2, 1867	May 31, 1868	Edmund Cooper, Tennessee	McCulloch	Johnson.
Mar. 20, 1869	Mar. 17, 1873	William A. Richardson, Massachusetts	Boutwell	Grant.
Mar. 8, 1873	June 11, 1874	Frederick A. Sawyer, South Carolina	Richardson, Bristow	Grant.
July 1, 1874	Apr. 3, 1877	Charles F. Conant, New Hampshire	Bristow, Morrill, Sherman	Grant, Hayes.
Mar. 4, 1875	June 30, 1876	Curtis F. Burnam, Kentucky	Bristow	Grant.
Aug. 12, 1876	Mar. 9, 1885	Henry F. French, Massachusetts	Morrill, Sherman, Windom, Folger, Gresham, McCulloch, Manning	Grant, Hayes, Garfield, Arthur, Cleveland.
Apr. 3, 1877	Dec. 8, 1877	Richard C. McCormick, Arizona	Sherman	Hayes.
Dec. 9, 1877	Mar. 31, 1880	John B. Hawley, Illinois	Sherman	Hayes.
Apr. 10, 1880	Dec. 31, 1881	J. Kendrick Upton, New Hampshire	Sherman, Windom, Folger	Hayes, Garfield, Arthur.
Feb. 28, 1882	Apr. 16, 1884	John C. New, Indiana	Folger	Arthur.
Apr. 17, 1884	Nov. 10, 1885	Charles E. Coon, New York	Folger, Gresham, McCulloch, Manning	Arthur, Cleveland.
Mar. 14, 1885	Apr. 1, 1887	Charles S. Fairchild, New York [8]	Manning	Cleveland.
Nov. 10, 1885	June 30, 1886	William E. Smith, New York	Manning	Cleveland.
July 12, 1886	Mar. 12, 1889	Hugh S. Thompson, South Carolina	Manning, Fairchild, Windom	Cleveland, Harrison.
Apr. 6, 1887	Mar. 11, 1889	Isaac N. Maynard, New York	Fairchild, Windom	Cleveland, Harrison.
Apr. 1, 1889	July 20, 1890	George H. Tiehner, Illinois	Windom	Harrison.

Footnotes at end of table.

Apr. 1, 1889	Oct. 31, 1890	George T. Batchelder, New York [19]	Windom	Harrison.
July 22, 1890	Dec. 1, 1892	A. B. Nettleton, Minnesota	Windom, Foster	Harrison.
July 23, 1890	June 30, 1893	Oliver L. Spaulding, Michigan	Windom, Foster, Carlisle	Harrison, Cleveland.
Apr. 27, 1891	Oct. 31, 1892	Lorenzo Crounse, Nebraska	Foster	Harrison.
Nov. 22, 1892	Mar. 3, 1893	John H. Gear, Iowa	Foster	Harrison.
Dec. 23, 1892	Apr. 3, 1893	Genio M. Lambertson, Nebraska	Foster, Carlisle	Harrison, Cleveland.
Apr. 12, 1893	Apr. 7, 1897	Charles S. Hamlin, Massachusetts	Carlisle, Gage	Cleveland, McKinley.
Apr. 13, 1893	Mar. 31, 1897	William E. Curtis, New York	Carlisle, Gage	Cleveland, McKinley.
July 1, 1893	May 4, 1897	Scott Wike, Illinois	Carlisle, Gage	Cleveland, McKinley.
Apr. 7, 1897	Mar. 10, 1899	William B. Howell, New Jersey	Gage	McKinley.
Apr. 7, 1897	Mar. 4, 1903	Oliver L. Spaulding, Michigan	Gage, Shaw	McKinley, Roosevelt.
June 1, 1897	Mar. 5, 1901	Frank A. Vanderlip, Illinois	Gage	McKinley.
Mar. 13, 1899	June 3, 1906	Horace A. Taylor, Wisconsin	Gage, Shaw	McKinley, Roosevelt.
Mar. 6, 1901	Apr. 15, 1903	Milton E. Ailes, Ohio	Gage, Shaw	McKinley, Roosevelt.
Mar. 5, 1903	Mar. 5, 1905	Robert B. Armstrong, Iowa	Shaw	Roosevelt.
May 27, 1903	Jan. 21, 1907	Charles H. Keep, New York	Shaw	Roosevelt.
Mar. 6, 1905	Nov. 1, 1909	James B. Reynolds, Massachusetts	Shaw, Cortelyou, MacVeagh	Roosevelt, Taft.
July 1, 1906	Mar. 15, 1908	John H. Edwards, Ohio	Shaw, Cortelyou	Roosevelt.
Jan. 22, 1907	Feb. 28, 1907	Arthur F. Statter, Oregon	Shaw	Roosevelt.
Apr. 23, 1907	Mar. 6, 1909	Beckman Winthrop, New York	Cortelyou	Roosevelt.
Mar. 17, 1908	Apr. 10, 1909	Louis A. Coolidge, Massachusetts	Cortelyou, MacVeagh	Roosevelt, Taft.
Apr. 5, 1909	June 8, 1910	Charles D. Norton, Illinois	MacVeagh	Taft.
Apr. 19, 1909	Apr. 3, 1911	Charles D. Hilles, New York	MacVeagh	Taft.
Nov. 27, 1909	July 31, 1913	James F. Curtis, Massachusetts	MacVeagh, McAdoo	Taft, Wilson.
June 8, 1910	July 3, 1912	A. Piatt Andrews, Massachusetts	MacVeagh	Taft.
Apr. 4, 1911	Mar. 3, 1913	Robert O. Bailey, Illinois	MacVeagh	Taft.
July 20, 1912	Sept. 30, 1913	Sherman P. Allen, Vermont	MacVeagh, McAdoo	Taft, Wilson.
Mar. 24, 1913	Feb. 2, 1914	John Skelton Williams, Virginia	McAdoo	Wilson.
Aug. 1, 1913	Aug. 9, 1914	Charles S. Hamlin, Massachusetts	McAdoo	Wilson.
Oct. 1, 1913	Sept. 30, 1917	Byron R. Newton, New York	McAdoo	Wilson.
Mar. 24, 1914	Jan. 26, 1917	William P. Malburn, Colorado	McAdoo	Wilson.
Aug. 17, 1914	Mar. 15, 1917	Andrew J. Peters, Massachusetts	McAdoo	Wilson.
Apr. 17, 1917	Aug. 28, 1918	Oscar T. Crosby, Virginia	McAdoo	Wilson.
June 22, 1917	Nov. 20, 1919	Leo S. Rowe, Pennsylvania	McAdoo, Glass	Wilson.
Oct. 5, 1917	Aug. 26, 1921	James H. Moyle, Utah	McAdoo, Glass, Houston, Mellon	Wilson, Harding.

Footnotes at end of table.

Term of service		Official	Served under—	
From—	To—		Secretary of the Treasury	President
		Assistant Secretaries—Continued		
Oct. 30, 1917	July 5, 1920	Russell C. Leffingwell, New York [20]	McAdoo, Glass, Houston	Wilson.
Dec. 15, 1917	Jan. 31, 1919	Thomas B. Love, Texas	McAdoo, Glass	Wilson.
Sept. 4, 1918	June 30, 1920	Albert Rathbone, New York	McAdoo, Glass, Houston	Wilson.
Mar. 5, 1919	Nov. 15, 1920	Jouett Shouse, Kansas	Glass, Houston	Wilson.
Nov. 21, 1919	June 14, 1920	Norman H. Davis, Tennessee	Glass, Houston	Wilson.
June 15, 1920	Apr. 14, 1921	Nicholas Kelley, New York	Houston, Mellon	Wilson, Harding.
July 6, 1920	June 30, 1921	S. Parker Gilbert, Jr., New Jersey [16]	Houston, Mellon	Wilson, Harding.
Dec. 4, 1920	May 31, 1921	Ewing Laporte, Missouri	Houston, Mellon	Wilson, Harding.
Dec. 4, 1920	Mar. 4, 1921	Angus W. McLean, North Carolina	Houston	Wilson.
Mar. 16, 1921	Mar. 31, 1925	Eliot Wadsworth, Massachusetts	Mellon	Harding, Coolidge.
May 4, 1921	July 9, 1923	Edward Clifford, Illinois	Mellon	Harding.
Dec. 23, 1921	July 25, 1922	Elmer Dover, Washington	Mellon	Harding.
Mar. 3, 1923	June 13, 1926	McKenzie Moss, Kentucky	Mellon	Harding, Coolidge.
July 9, 1923	Nov. 19, 1923	Garrard B. Winston, Illinois [16]	Mellon	Harding, Coolidge.
July 1, 1924	Nov. 5, 1927	Charles S. Dewey, Illinois	Mellon	Coolidge.
Apr. 1, 1925	July 31, 1927	Lincoln C. Andrews, New York	Mellon	Coolidge.
Dec. 28, 1926	June 25, 1929	Carl T. Schuneman, Minnesota	Mellon	Coolidge, Hoover.
Aug. 1, 1927	Mar. 15, 1933	Seymour Lowman, New York	Mellon	Coolidge, Hoover.
Nov. 7, 1927	Sept. 1, 1929	Henry Herrick Bond, Massachusetts	Mellon	Coolidge, Hoover.
June 26, 1929	Apr. 17, 1933	Ferry K. Heath, Michigan	Mellon	Hoover.
Nov. 21, 1929	Mar. 15, 1931	Walter Ewing Hope, New York	Mellon	Hoover.
Mar. 16, 1931	Feb. 12, 1932	Arthur A. Ballantine, New York [16]	Mellon	Hoover.
Mar. 9, 1932	June 11, 1933	James H. Douglas, Jr., Illinois	Mills	Hoover.
Apr. 18, 1933	Feb. 15, 1936	Lawrence W. Robert, Jr., Georgia	Woodin, Morgenthau	Roosevelt.
June 6, 1933	Sept. 30, 1939	Stephen B. Gibbons, New York	Woodin, Morgenthau	Roosevelt.
June 12, 1933	Dec. 12, 1933	Thomas Hewes, Connecticut	Woodin	Roosevelt.
Dec. 1, 1934	Nov. 1, 1937	Josephine Roche, Colorado	Morgenthau	Roosevelt.
Feb. 19, 1936	Feb. 28, 1939	Wayne C. Taylor, Illinois	Morgenthau	Roosevelt.
July 1, 1938	Oct. 31, 1938	John W. Hanes, North Carolina [16]	Morgenthau	Roosevelt.

Footnotes at end of table.

June 23, 1939	Dec. 2, 1945	Herbert E. Gaston, New York	Morgenthau, Vinson	Roosevelt, Truman.
Jan. 18, 1940	Nov. 30, 1944	John L. Sullivan, New Hampshire	Morgenthau	Roosevelt.
Jan. 24, 1945	May 1, 1946	Harry D. White, Maryland	Morgenthau, Vinson	Roosevelt, Truman.
Apr. 15, 1946	July 14, 1948	Edward H. Foley, New York [14]	Vinson, Snyder	Truman.
July 16, 1948	Jan. 20, 1953	John S. Graham, North Carolina	Snyder	Truman.
Feb. 8, 1949	Mar. 31, 1951	William McChesney Martin, Jr., New York	Snyder	Truman.
Jan. 24, 1952	Feb. 28, 1957	Andrew N. Overby, District of Columbia	Snyder, Humphrey	Truman, Eisenhower.
Jan. 28, 1953	Aug. 2, 1955	H. Chapman Rose, Ohio [16]	Humphrey	Eisenhower.
Sept. 20, 1954	Jan. 20, 1961	Laurence B. Robbins, Illinois [21]	Humphrey, Anderson	Eisenhower.
Aug. 3, 1955	Dec. 15, 1957	David W. Kendall, Michigan	Humphrey, Anderson	Eisenhower.
Apr. 18, 1957	Aug. 8, 1957	Fred C. Scribner, Jr., Maine [14]	Humphrey, Anderson	Eisenhower.
Dec. 4, 1957	Dec. 15, 1958	Tom B. Coughran, California	Anderson	Eisenhower.
Dec. 16, 1957	Dec. 19, 1961	A. Gilmore Flues, Ohio	Anderson, Dillon	Eisenhower, Kennedy.
Dec. 17, 1958	Dec. 18, 1960	T. Graydon Upton, Pennsylvania	Anderson	Eisenhower.
Dec. 20, 1960	Jan. 20, 1961	John P. Weitzel, Rhode Island	Anderson	Eisenhower.
Apr. 5, 1961	Oct. 31, 1962	John M. Leddy, Virginia	Dillon	Kennedy.
Apr. 24, 1961	Jan. 20, 1969	Stanley S. Surrey, Massachusetts	Dillon, Fowler, Barr	Kennedy, Johnson.
Dec. 20, 1961	Sept. 1, 1965	James A. Reed, Massachusetts	Dillon, Fowler	Kennedy, Johnson.
Dec. 18, 1962	Oct. 15, 1964	John C. Bullitt, New Jersey	Dillon	Kennedy, Johnson.
Sept. 18, 1963	Jan. 20, 1969	Robert A. Wallace, Illinois [22]	Dillon, Fowler, Barr	Kennedy, Johnson.
Apr. 29, 1965	June 10, 1966	Merlyn N. Trued, New Jersey	Fowler	Johnson.
Sept. 14, 1965	Jan. 15, 1968	W. True Davis, Jr., Missouri	Fowler	Johnson.
Aug. 2, 1966	Jan. 31, 1968	Winthrop Knowlton, New York	Fowler	Johnson.
Mar. 19, 1968	Jan. 20, 1969	Joseph M. Bowman, Georgia	Fowler, Barr	Johnson.
May 15, 1968	Feb. 25, 1972	John R. Petty, New York	Fowler, Barr, Kennedy, Connally	Johnson, Nixon.
Mar. 11, 1969	June 12, 1972	Edwin S. Cohen, Virginia [16]	Kennedy, Connally	Nixon.
Apr. 1, 1969	Jan. 21, 1973	Eugene T. Rossides, New York	Kennedy, Connally, Shultz	Nixon.
June 23, 1969	Aug. 14, 1971	Murray L. Weidenbaum, Missouri	Kennedy, Connally	Nixon.
Dec. 12, 1971	July 16, 1975	Edgar R. Fiedler, New York	Connally, Shultz, Simon	Nixon, Ford.
June 12, 1972	July 1, 1974	John M. Hennessy, Massachusetts	Shultz, Simon	Nixon.
Aug. 18, 1972	Sept. 2, 1975	Frederic W. Hickman, Illinois	Shultz, Simon	Nixon, Ford.
Jan. 22, 1973	Feb. 1, 1974	Edward L. Morgan, Arizona	Shultz	Nixon.
May 8, 1974	Sept. 14, 1976	David R. Macdonald, Illinois	Simon	Nixon, Ford.
Aug. 1, 1974	Nov. 15, 1975	Charles A. Cooper, Florida	Simon	Nixon, Ford.
July 17, 1975	Jan. 20, 1977	Sidney L. Jones, Michigan	Simon	Ford.
Sept. 3, 1975	Jan. 20, 1977	Charles M. Walker, California	Simon	Ford.
Apr. 14, 1976	Jan. 20, 1977	Robert A. Gerard, District of Columbia	Simon	Ford.

Footnotes at end of table.

Term of service		Official	Served under—	
From—	To—		Secretary of the Treasury	President
		Deputy Under Secretaries for Monetary Affairs		
Dec. 21, 1961	Nov. 28, 1963	J. Dewey Daane, District of Columbia	Dillon	Kennedy, Johnson.
Dec. 3, 1963	Nov. 23, 1965	Paul A. Volcker, New Jersey	Dillon, Fowler	Johnson.
Nov. 24, 1965	Nov. 11, 1967	Peter D. Sternlight, New York	Fowler	Johnson.
Feb. 12, 1968	Mar. 31, 1969	Frank W. Schiff, New York	Fowler, Barr, Kennedy	Johnson, Nixon.
Apr. 1, 1969	June 30, 1971	Bruce K. MacLaury, New York	Kennedy, Connally	Nixon.
Sept. 23, 1971	Aug. 17, 1972	Jack F. Bennett, Connecticut [23]	Connally, Shultz	Nixon.
		Deputy Under Secretaries [24]		
Aug. 18, 1972	Mar. 14, 1974	Jack F. Bennett, Connecticut	Shultz	Nixon.
Aug. 22, 1972	July 4, 1973	James E. Smith, Virginia	Shultz	Nixon.
Aug. 3, 1973	Apr. 13, 1974	William L. Gifford, New York	Shultz	Nixon.
May 28, 1974	Sept. 1, 1975	Frederick L. Webber, Virginia [25]	Simon	Nixon, Ford.
June 24, 1974	Jan. 20, 1977	Gerald L. Parsky, District of Columbia [25]	Simon	Nixon, Ford.
Nov. 6, 1975	Jan. 20, 1977	Harold F. Eberle, California [25]	Simon	Ford.
		Fiscal Assistant Secretaries [26]		
Mar. 16, 1945	June 17, 1955	Edward F. Bartelt, Illinois	Morgenthau, Vinson, Snyder, Humphrey	Roosevelt, Truman, Eisenhower.
June 19, 1955	Mar. 31, 1962	William T. Heffelfinger, District of Columbia	Humphrey, Anderson, Dillon	Eisenhower, Kennedy.
June 15, 1962	July 28, 1975	John K. Carlock, Arizona	Dillon, Fowler, Barr, Kennedy, Connally, Shultz, Simon	Kennedy, Johnson, Nixon, Ford.
July 29, 1975	....	David Mosso, Virginia	Simon	Ford.
		Assistant Secretaries for Administration [27]		
Aug. 2, 1950	Aug. 31, 1959	William W. Parsons, California	Snyder, Humphrey, Anderson	Truman, Eisenhower.
Sept. 14, 1959	Oct. 25, 1970	A. E. Weatherbee, Maine	Anderson, Dillon, Fowler, Barr, Kennedy	Eisenhower, Kennedy, Johnson, Nixon.

Footnotes at end of table.

Oct. 25, 1970	Jan. 7, 1972	Ernest C. Betts, Jr., Wisconsin	Kennedy, Connally	Nixon.
Apr. 11, 1972	....	Warren F. Brecht, Connecticut	Connally, Shultz, Simon...	Nixon, Ford.

Treasurers of the United States [28]

Dec. 17, 1971	Feb. 14, 1974	Romana Acosta Banuelos, California	Connally, Shultz	Nixon.
June 21, 1974	Jan. 19, 1977	Francine I. Neff, New Mexico	Simon	Nixon, Ford.

1 While holding the office of Secretary of the Treasury, Mr. Gallatin was commissioned envoy extraordinary and minister plenipotentiary Apr. 17, 1813, with John Quincy Adams and James A. Bayard, to negotiate peace with Great Britain. On Feb. 9, 1814, his seat as Secretary of the Treasury was declared vacant because of his absence in Europe. William Jones, of Pennsylvania (Secretary of the Navy), acted as ad interim Secretary of the Treasury from Apr. 21, 1813, to Feb. 9, 1814.

2 Rush was nominated Mar. 5, 1825, confirmed and commissioned Mar. 7, 1825, but did not enter on duty until Aug. 1, 1825. Samuel L. Southard, of New Jersey (Secretary of the Navy), served as ad interim Secretary of the Treasury from Mar. 7 to July 31, 1825.

3 Asbury Dickens (Chief Clerk), ad interim Secretary of the Treasury from June 21 to Aug. 7, 1831.

4 Spencer resigned as Secretary of the Treasury May 2, 1844; McClintock Young (Chief Clerk) was ad interim Secretary of the Treasury from May 2 to July 3, 1844.

5 McCulloch was Secretary from Mar. 9, 1865, to Mar. 3, 1869, and from Oct. 31, 1884, to Mar. 7, 1885.

6 Windom was Secretary from Mar. 8, 1881, to Nov. 13, 1881, and also from Mar. 7, 1889, to Jan. 29, 1891.

7 Office established by act of May 18, 1972; appointed by the President.

8 Later became Secretary.

9 Office established by act of June 16, 1921; appointed by the President.

10 Later became Deputy Secretary.

11 Office established by act of July 22, 1954; appointed by the President.

12 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.

13 Office established by act of May 10, 1934 (31 U.S.C. 1009); appointed by the President.

14 Later became Assistant Secretary and subsequently Under Secretary.

15 Later became Assistant Secretary.

16 Later became Under Secretary.

17 Office established by act of Mar. 3, 1849; appointed by the Secretary. Act of Mar. 3, 1857, made the office subject to Presidential appointment.

18 Act of Mar. 14, 1864, provided for an additional Assistant Secretary.

19 Act of July 11, 1890, provided for an additional Assistant Secretary.

20 Act of Oct. 6, 1917, provided for two additional Assistant Secretaries for the duration of war and 6 months thereafter.

21 Act of July 22, 1954, provided for an additional Assistant Secretary.

22 Act of July 8, 1963, provided for a fourth Assistant Secretary.

23 Later became Deputy Under Secretary and subsequently Under Secretary and Under Secretary for Monetary Affairs.

24 Act of May 18, 1972, provided for two Deputy Under Secretaries, to be designated Assistant Secretaries by the President as desired.

25 Designated by the President an Assistant Secretary.

26 Office established by Reorganization Plan No. 3 of 1940.

27 Office established by Reorganization Plan No. 26, of 1950. Title changed from "Administrative Assistant Secretary" to "Assistant Secretary for Administration" by Public Law 88-426, approved Aug. 14, 1964; appointed by the Secretary with the approval of the President. Act of May 18, 1972, provided for appointment by the President.

28 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.

NOTE.—Robert Morris, the first financial officer of the Government, was Superintendent of Finance from 1781 to 1784. Upon the resignation of Morris, the powers conferred upon him were transferred to the "Board of the Treasury." Those who finally accepted positions on this Board were John Lewis Gervais, Samuel Osgood, and Walter Livingston. The Board served until Alexander Hamilton assumed office in 1789.

Exhibit 63.—Treasury Department orders relating to organization and procedure

NO. 150–85, NOVEMBER 5, 1976.—ESTABLISHMENT OF NEW OFFICE

By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950:

(1) There shall be in the National Office of the Internal Revenue Service the office of Assistant Commissioner (Data Services).

(2) Approval is given to the transfer of such personnel, records, equipment, and funds as are determined by the Commissioner of Internal Revenue and the Assistant Secretary for Administration to be appropriate in connection therewith.

This Order shall become effective upon such date as the Commissioner of Internal Revenue may determine.

WILLIAM E. SIMON,
Secretary of the Treasury.

NO. 250, MAY 3, 1977.—DISESTABLISHMENT OF THE POSITION AND OFFICE OF ASSISTANT SECRETARY (ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS)

By virtue of the authority vested in me as Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950, the following organizational changes are ordered.

1. The position and the Office of Assistant Secretary (Enforcement, Operations, and Tariff Affairs) are hereby disestablished. The functions, responsibilities, and personnel formerly assigned to the Assistant Secretary (Enforcement, Operations and Tariff Affairs) are hereby temporarily transferred to the Under Secretary, pending review and further disposition of these functions and responsibilities.
2. Additional changes in organization, and reassignments of functions, responsibilities, and personnel necessitated by this order will be finalized as soon as possible.
3. Treasury Department Orders No. 128 (Revision 5), No. 147 (Revision 3), No. 191–3, No. 217 (Revision 1), and No. 220 are hereby amended.

This order is effective immediately.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 251, MAY 3, 1977.—ESTABLISHMENT OF THE OFFICE OF THE ASSISTANT SECRETARY (PUBLIC AFFAIRS)

By virtue of the authority vested in me as Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950, it is ordered that:

1. The position of the Assistant Secretary (Public Affairs) is hereby established. The incumbent will report to the Secretary, and will be responsible for:
    a. Establishing general operating policies and guidelines, and providing leadership, direction and management strategy for administering public affairs programs and activities in all Treasury offices and bureaus;
    b. Formulating and executing public information policies and programs which will increase the public's knowledge and understanding of Treasury's activities and services;

c. Providing continuing public information support to the Office of the Secretary; and
d. Serving as the principal advisor to the Secretary, the Deputy Secretary, and senior officials throughout the Treasury Department on matters affecting the public's understanding of Treasury policies and programs.

2. The Office of the Assistant Secretary (Public Affairs) is hereby established. Under the supervision of the Assistant Secretary (Public Affairs) this Office performs the following functions:
   a. Developing materials to inform the public of the Department's policies, programs, activities, and services;
   b. Serving the day-to-day needs of the print and electronic media, including the writers who specialize in economic reporting and analysis, and the media who base their daily operations in the Treasury headquarters;
   c. Serving the specialized needs of specific Treasury officials for releasing public information;
   d. Providing editorial support services such as preparation of Congressional and public statements, and research, correspondence, clipping service and files;
   e. Coordinating public affairs policies throughout the Department.
3. All of the functions, positions, personnel, records and property assigned to the Office of the Special Assistant to the Secretary (Public Affairs) are transferred to the Office of the Assistant Secretary (Public Affairs).
4. Responsibility for maintaining the Secretary's current issues briefing book and for answering correspondence, and the positions, personnel, records, and property associated with these responsibilities are transferred to the Office of the Assistant Secretary (Public Affairs) from the immediate office of the Secretary.
5. The Assistant Secretary (Public Affairs) is authorized to define the organizational structure and the specific responsibilities of the positions and personnel assigned to the Office of the Assistant Secretary (Public Affairs).

This Order is effective immediately.
Treasury Department Order No. 99 is hereby rescinded.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 249, MAY 17, 1977.—ESTABLISHMENT OF THE OFFICE OF INTELLIGENCE SUPPORT

By virtue of the authority vested in me as Secretary of the Treasury including the authority of Reorganization Plan No. 26 of 1950, the following organizational changes are ordered.

1. The Office of Intelligence Support (OIS) is hereby established within the Office of the Secretary, and is placed under the supervision of the Special Assistant to the Secretary (National Security). The Office of National Security (ONS) is hereby disestablished. All functions, positions, personnel, records, property, and funds previously assigned to ONS are transferred to OIS, except for the following:
   a. Functions involving national security issues, including security assistance and foreign military sales programs, all substantive work with the National Security Council, and other defense related matters and the related positions, personnel, records, property, and funds are transferred to the Office of the Assistant Secretary (International Affairs).

b. Functions described below and related positions, personnel, records, property, and funds are transferred to the Executive Secretariat:
   (1) Screen and distribute to appropriate Treasury officials sensitive State Department telegrams;
   (2) Prepare daily cable summaries on international items of interest to Treasury officials;
   (3) Regarding Treasury's role in the work of the National Security Council, distribute papers, assign actions, prepare status reports, and assist Treasury offices in the preparation of papers.

2. The Special Assistant to the Secretary (National Security) will report to the Secretary through the Executive Secretary.
3. The Office of Intelligence Support will provide day-to-day intelligence support to the Secretary and other Treasury officials by performing the following functions previously performed by the Office of National Security:
   a. Represent Treasury on intelligence community committees, e.g. the National Foreign Intelligence Board, and maintain continuous liaison with elements of the community.
   b. Screen and distribute intelligence reports and publications to appropriate Treasury officials. Contribute to the daily summary prepared by the Executive Secretariat.
   c. Provide intelligence support to the Secretary and designated Treasury officials, as appropriate.
   d. Review all proposals for support, or other arrangements of a continuing nature, between any Treasury office or bureau and the Central Intelligence Agency or other intelligence agencies (except for the Federal Bureau of Investigation), in accordance with the provisions of Treasury Department Order No. 240, dated September 27, 1975.
4. Treasury Department Order No. 207 is hereby rescinded, and Treasury Department Orders No. 240 and 246 are amended accordingly.
5. This Order is effective immediately.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 242 (REVISION 1), MAY 17, 1977.—ASSISTANT SECRETARY (CAPITAL MARKETS AND DEBT MANAGEMENT) IS RETITLED ASSISTANT SECRETARY (DOMESTIC FINANCE)

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 retitled Assistant Secretary (Domestic Finance). The Assistant Secretary (Domestic Finance) 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, general capital markets policy and state/local financial affairs, 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 legislation;

- 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;
- Treasury operations under the New York City Seasonal Financing Act of 1975 (P.L. 94–143);
- development of policy relating to monitoring of municipal markets and assessment of needs of urban areas for federal financial assistance; and
- Treasury operations relating to the Treasury Department Office of Revenue Sharing.

2. The Office of the Deputy Assistant Secretary for Urban Finance is hereby established under the supervision of the Assistant Secretary (Domestic Finance).
   a. Supervision of the Office of Municipal Finance is hereby transferred from the Deputy Assistant Secretary for Capital Markets Policy to the Deputy Assistant Secretary for Urban Finance.
   b. The Office of the Deputy to the Assistant Secretary for New York Finance is hereby retitled the Office of New York City Finance under the supervision of the Deputy Assistant Secretary for Urban Finance.
   c. The Office of Urban Economics is hereby established, to conduct research and analysis regarding the degree of need of urban areas for federal financial assistance, and is placed under the supervision of the Deputy Assistant Secretary for Urban Finance.
3. The Office of the Deputy Assistant Secretary (Debt Financing) is hereby retitled the Office of the Deputy Assistant Secretary for Debt Financing.
   a. The functions, duties and responsibilities of the Deputy Assistant Secretary for Debt Financing will be assumed by the Special Assistant to the Secretary (Debt Management).
   b. Supervision of the Senior Advisor (Debt Research) is hereby assigned to the Special Assistant to the Secretary (Debt Management).
4. Supervision of the Office of Revenue Sharing is reassigned from the Under Secretary to the Assistant Secretary (Domestic Finance).

This Order supersedes Treasury Department Order No. 242 (dated March 27, 1976), and amends Treasury Order No. 224 (dated January 26, 1973) and Treasury Order No. 170–14 (June 11, 1973).

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 190 (REVISION 13), MAY 17, 1977.—SUPERVISION OF BUREAUS AND OFFICES, DELEGATION OF CERTAIN AUTHORITY, AND ORDER OF SUCCESSION IN THE TREASURY DEPARTMENT

1. The Deputy Secretary shall be under the direct supervision of 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
   Assistant Secretary (Legislative Affairs)
   Assistant Secretary (Economic Policy)
   Assistant Secretary (Domestic Finance)
   Assistant Secretary (Public Affairs)
   Executive Secretary

3. The following officials shall be under the supervision of the Under Secretary for Monetary Affairs, and shall exercise supervision over those officers and organizational entities indicated thereunder:
    - Assistant Secretary (International Affairs)
        - Deputy Assistant Secretary for Trade and Investment Policy
        - Deputy Assistant Secretary for Commodities and Raw Materials
        - Deputy Assistant Secretary for International Monetary Affairs
        - Deputy Assistant Secretary for Developing Nations
        - Deputy to the Assistant Secretary for Saudi Arabian Affairs
        - Deputy to the Assistant Secretary and Secretary of International Monetary Group
        - Inspector General for International Finance
    - (The Assistant Secretary (Domestic Finance) reports through the Under Secretary for Monetary Affairs for debt management purposes.)
    - Fiscal Assistant Secretary
4. The following officials shall be under the supervision of the Under Secretary, and shall exercise supervision over those officers and organizational entities indicated thereunder:
    - Assistant Secretary (Administration)
        - Deputy Assistant Secretary
        - 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
    - Chief Deputy to the Under Secretary (Enforcement and Operations)
        - United States Secret Service
        - Bureau of Alcohol, Tobacco and Firearms
        - Federal Law Enforcement Training Center
        - United States Customs Service
        - Bureau of Engraving and Printing
        - Office of Foreign Assets Control
    - Treasurer of the United States
        - United States Savings Bond Division
        - Bureau of the Mint
5. The following officials shall exercise supervision over those officers and organizational entities indicated thereunder:
    - General Counsel
        - Deputy General Counsel
        - Legal Division
        - Office of Director of Practice
        - Office of Tariff Affairs
    - Assistant Secretary (Tax Policy)
        - Deputy Assistant Secretary for Tax Legislation
        - Deputy Assistant Secretary for Tax Policy Economics
            - 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
    - Assistant Secretary (Legislative Affairs)
        - Deputy Assistant Secretary (Legislative Affairs)
        - Office of Legislative Affairs
    - Assistant Secretary (Economic Policy)
        - Deputy Assistant Secretary for Domestic Economic Analysis
            - Office of Financial Analysis

Deputy Assistant Secretary for International Economic Analysis
Assistant Secretary (Domestic Finance) (Also reports to Under Secretary for Monetary Affairs for debt management purposes.)
Deputy Assistant Secretary for Capital Markets Policy
Office of Securities Market Policies
Office of Capital Markets Legislation
Deputy Assistant Secretary for Urban Finance
Office of Municipal Finance
Office of New York City Finance
Office of Urban Economics
Deputy Assistant Secretary for Debt Financing
Senior Adviser (Debt Research)
Office of Government Financing
Office of Agency Finance and Market Policies
Office of Revenue Sharing
Assistant Secretary (Public Affairs)
Deputy Assistant Secretary (Public Affairs)
Office of Public Affairs
Fiscal Assistant Secretary
Deputy Fiscal Assistant Secretary
Bureau of Government Financial Operations
Bureau of the Public Debt
Commissioner of Internal Revenue
Deputy Commissioner
Internal Revenue Service
Comptroller of the Currency
First Deputy Comptroller
Office of the Comptroller of the Currency

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. 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 12) is rescinded, effective this date.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

No. 202-3, May 17, 1977.—Transfer of Positions and Functions from the Office of the Assistant Secretary (International Affairs) to the Office of the Assistant Secretary (Economic Policy)

By virtue of the authority vested in me as Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950, it is ordered that:

1. The position of Deputy Assistant Secretary (Research and Planning) and all functions, positions, records, office equipment, other property, and funds, heretofore assigned to the Office of the Deputy Assistant Secretary (Research and Planning) in the Office of Assistant Secretary (International Affairs), are transferred to the supervision of the Assistant Secretary (Economic Policy). Exchange Stabilization Funding of all positions will continue.
2. The position of Deputy Assistant Secretary (Research and Planning) is retitled Deputy Assistant Secretary for International Economic Analysis.
3. That portion of Treasury Department Order No. 202 (Revision 2) which refers to the Deputy Assistant Secretary (Research and Planning) is superseded.
4. This Order is effective immediately.

W. Michael Blumenthal,
Secretary of the Treasury.

No. 250-1, June 16, 1977.—Administration of the Countervailing Duty Law and Antidumping Act

By virtue of the authority vested in me as Secretary of the Treasury, including the authority of Reorganization Plan No. 26 of 1950, and pursuant to Treasury Order No. 190, (Revision 13), May 17, 1977, responsibility for the administration of the countervailing duty law and the Antidumping Act, 1921, as amended, (but not the administration of the Customs Service), and Section 232 of the Trade Expansion Act of 1962, as well as for representing Treasury with regard to such matters, has been transferred from the Under Secretary to the General Counsel. The Commissioner of Customs will receive direction from the General Counsel on matters relating to administration of the countervailing duty and antidumping laws.

The position of Deputy Assistant Secretary (Tariff Affairs) and the Office of Tariff Affairs, and such positions, personnel, records, and equipment which are determined by the Assistant Secretary (Administration) in consultation with the General Counsel and the Under Secretary to be necessary to carry out the responsibilities transferred by this order, shall be transferred from the Under Secretary to the General Counsel.

The General Counsel is authorized to define the organizational structure and the specific responsibilities of the positions and personnel transferred by authority of this order.

Treasury Department Order No. 250, May 3, 1977, and No. 220, April 23, 1971 are hereby amended accordingly.

W. Michael Blumenthal,
Secretary of the Treasury.

No. 250-2, June 20, 1977.—Establishment of the Office of Tariff Affairs in the Office of the General Counsel and the Delegation of Authority to the Deputy to the General Counsel for Tariff Affairs

Under authority of Treasury Department Order No. 190 (Revised), the Office of Tariff Affairs is established within the Office of the General Counsel. Pursuant to the authority delegated to me by Paragraph 6 of that order, I hereby delegate to the Deputy to the General Counsel for Tariff Affairs the following authority, subject to the limitations prescribed herein:

1. To supervise the Office of Tariff Affairs and to make recommendations relative to the employment, promotion and evaluation of personnel therein.

2. To review all antidumping and countervailing duty cases investigated by the United States Customs Service and to recommend their disposition to the General Counsel.
3. To represent the General Counsel on Departmental, interdepartmental and international meetings or committees concerned with tariff matters within the jurisdiction of the General Counsel's office.
4. To handle all other matters falling within the responsibility of the Office of Tariff Affairs, or as further assigned by me.
5. In the absence of both the General Counsel and the Deputy General Counsel, the Deputy to the General Counsel for Tariff Affairs will sign antidumping and countervailing duty notices and determinations in his own name and under his own title.
6. In other respects the Office of Tariff Affairs will conform to the orders and directives issued for the administration of the Legal Division.

HENRY C. STOCKELL, JR.,
Acting General Counsel.

NO. 190 (REVISION 13, AMENDMENT 1), JUNE 22, 1977.—SUPERVISION OF BUREAUS AND OFFICES, DELEGATION OF CERTAIN AUTHORITY, AND ORDER OF SUCCESSION IN THE TREASURY DEPARTMENT

1. The Deputy Secretary shall be under the direct supervision of 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
   - Assistant Secretary (Legislative Affairs)
   - Assistant Secretary (Economic Policy)
   - Assistant Secretary (Domestic Finance)
   - Assistant Secretary (Public Affairs)
   - Executive Secretary
3. The following officials shall be under the supervision of the Under Secretary for Monetary Affairs, and shall exercise supervision over those officers and organizational entities indicated thereunder:
   - Assistant Secretary (International Affairs)
     - Deputy Assistant Secretary for Trade and Investment Policy
     - Deputy Assistant Secretary for Commodities and Natural Resources
     - Deputy Assistant Secretary for International Monetary Affairs
     - Deputy Assistant Secretary for Developing Nations
     - Deputy to the Assistant Secretary for Saudi Arabian Affairs
     - Deputy to the Assistant Secretary and Secretary of International Monetary Group
     - Inspector General for International Finance
   - (The Assistant Secretary (Domestic Finance) reports through the Under Secretary for Monetary Affairs for debt management purposes.)
   - Fiscal Assistant Secretary
4. The following officials shall be under the supervision of the Under Secretary, and shall exercise supervision over those officers and organizational entities indicated thereunder:
   - Assistant Secretary (Administration)
     - Deputy Assistant Secretary
     - 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
Chief Deputy to the Under Secretary (Enforcement and Operations)
Office of Enforcement
Office of Operations
United States Secret Service
Bureau of Alcohol, Tobacco and Firearms
Federal Law Enforcement Training Center
United States Customs Service
Bureau of Engraving and Printing
Office of Foreign Assets Control
Treasurer of the United States
United States Savings Bonds Division
Bureau of the Mint

5. The following officials shall exercise supervision over those officers and organizational entities indicated thereunder:

General Counsel
Deputy General Counsel
Legal Division
Office of Director of Practice
Office of Tariff Affairs
Assistant Secretary (Tax Policy)
Deputy Assistant Secretary for Tax Legislation
Deputy Assistant Secretary for Tax Policy Economics
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
Assistant Secretary (Legislative Affairs)
Deputy Assistant Secretary (Legislative Affairs)
Office of Legislative Affairs
Assistant Secretary (Economic Policy)
Deputy Assistant Secretary for Domestic Economic Analysis
Office of Financial Analysis
Deputy Assistant Secretary for International Economic Analysis
Assistant Secretary (Domestic Finance) (Also reports to Under Secretary for Monetary Affairs for debt management purposes.)
Deputy Assistant Secretary for Capital Markets Policy
Office of Securities Market Policies
Office of Capital Markets Legislation
Deputy Assistant Secretary for State and Local Finance
Office of Municipal Finance
Office of the Deputy to the Assistant Secretary for New York City Finance
Office of Urban Economics
Deputy Assistant Secretary for Debt Management
Senior Adviser (Debt Research)
Office of Government Financing
Office of Agency Finance and Market Policies
Office of Revenue Sharing
Assistant Secretary (Public Affairs)
Deputy Assistant Secretary (Public Affairs)
Office of Public Affairs
Fiscal Assistant Secretary
Deputy Fiscal Assistant Secretary

Bureau of Government Financial Operations
Bureau of the Public Debt
Commissioner of Internal Revenue
Deputy Commissioner
Internal Revenue Service
Comptroller of the Currency
First Deputy Comptroller
Office of the Comptroller of the Currency

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. 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 13) is amended by two types of changes. The Offices of Enforcement and Operations are added to the organizations supervised by the Chief Deputy to the Under Secretary (Enforcement and Operations). Changes are made in the titles of certain officials in the Offices of the Assistant Secretary (International Affairs) and the Assistant Secretary (Domestic Finance).

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 200 (AMENDMENT 8), JUNE 22, 1977.—TRANSFER OF PERSONNEL FUNCTIONS

By virtue of the authority vested in me as Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950, it is ordered that:

1. The Office of the Secretary Personnel Division (OSPD) is hereby abolished and all functions and responsibilities currently assigned to OSPD are hereby transferred from the Office of Management and Organization to the Office of Personnel. Such positions, personnel, records, and other property which are determined by the Assistant Secretary (Administration) to be necessary to perform these functions and responsibilities shall likewise be transferred and placed under the supervision of the Director of Personnel.
2. The Administration and Personnel Staff, Office of the Assistant Secretary (International Affairs) (OASIA) is hereby abolished and all personnel functions and responsibilities currently assigned to this staff are hereby transferred from OASIA to the Office of Personnel. Such positions, personnel,

records, and other property which are determined by the Assistant Secretaries (Administration) and (International Affairs) to be necessary to perform these functions and responsibilities shall likewise be transferred and placed under the supervision of the Director of Personnel.

Existing delegations of personnel authority with respect to the operations of the OSPD and the OASIA Administration and Personnel Staff are hereby cancelled and revert to the Director of Personnel.

This Order amends Treasury Order No. 200 (Amendment 6), March 8, 1976, and Treasury Order No. 202 (Revision 2), December 20, 1976.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 202–4, JUNE 29, 1977.—REORGANIZATION OF ENERGY FUNCTIONS

By virtue of the authority vested in me as Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950, it is ordered that:

1. Certain energy functions currently assigned to the Assistant Secretary (International Affairs) are reassigned as follows:
   a. The Assistant Secretary (Domestic Finance) is to be responsible for those energy finance functions involving the analysis of and development and coordination of policies relative to the role of private capital markets in financing energy investments and the effects of government policies and regulations on capital formation in the energy sector.
   b. The Assistant Secretary (Economic Policy) is to be responsible for:
      (1) economic analysis of the consequences of international and domestic energy proposals and policies; and
      (2) monitoring energy-related regulations and legislation and developing recommended Treasury positions on these matters.
2. The Assistant Secretary (International Affairs) is responsible for formulating and implementing Treasury Department policy and positions on questions relating to international energy policy and for Treasury participation on international energy matters in international fora, such as the International Energy Agency, the United Nations Conference on Trade and Development, the international financial institutions, the Organization for Economic Cooperation and Development, and in bilateral relationships with foreign countries.
3. The Assistant Secretaries (Administration), (Domestic Finance), (Economic Policy), and (International Affairs) will determine which positions, personnel, records, and property, currently assigned to the Assistant Secretary (International Affairs), are necessary to support the energy responsibilities reassigned by the Order and reassign the personnel and other resources accordingly.
4. The Assistant Secretaries affected by this Order are authorized to define the organizational structure and the specific responsibilities of the positions and personnel assigned to them.
5. Treasury Department Orders No. 202 dated December 20, 1976, No. 242 (Revision 1) dated May 17, 1977, and No. 242–1, May 11, 1976, are hereby amended.
6. This Order is effective immediately.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

No. 190 (Revision 14), July 1, 1977.—Supervision of Bureaus and Offices, Delegation of Certain Authority, and Order of Succession in the Treasury Department

1. The Deputy Secretary shall be under the direct supervision of 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
   - Assistant Secretary (Legislative Affairs)
   - Assistant Secretary (Economic Policy)
   - Assistant Secretary (Domestic Finance)
   - Assistant Secretary (Public Affairs)
   - Executive Secretary
3. The following officials shall be under the supervision of the Under Secretary for Monetary Affairs, and shall exercise supervision over those officers and organizational entities indicated thereunder:
   - Assistant Secretary (International Affairs)
     - Deputy Assistant Secretary for Trade and Investment Policy
     - Deputy Assistant Secretary for Commodities and Natural Resources
     - Deputy Assistant Secretary for International Monetary Affairs
     - Deputy Assistant Secretary for Developing Nations
     - Deputy to the Assistant Secretary for Saudi Arabian Affairs
     - Deputy to the Assistant Secretary and Secretary of International Monetary Group
     - Inspector General for International Finance
   - (The Assistant Secretary (Domestic Finance) reports through the Under Secretary for Monetary Affairs for debt management purposes.)
   - Fiscal Assistant Secretary
4. The following officials shall be under the supervision of the Under Secretary, and shall exercise supervision over those officers and organizational entities indicated thereunder:
   - Assistant Secretary (Administration)
     - Deputy Assistant Secretary
     - 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
   - Chief Deputy to the Under Secretary (Enforcement and Operations)
     - Office of Enforcement
     - Office of Operations
     - United States Secret Service
     - Bureau of Alcohol, Tobacco and Firearms
     - Federal Law Enforcement Training Center
     - United States Customs Service
     - Office of Foreign Assets Control
   - Treasurer of the United States
     - United States Savings Bonds Division
   - Director of the Mint
     - Bureau of the Mint

Director, Bureau of Engraving and Printing
    Bureau of Engraving and Printing

5. The following officials shall exercise supervision over those officers and organizational entities indicated thereunder:

- General Counsel
    - Deputy General Counsel
    - Legal Division
    - Office of Director of Practice
    - Office of Tariff Affairs
- Assistant Secretary (Tax Policy)
    - Deputy Assistant Secretary for Tax Legislation
    - Deputy Assistant Secretary for Tax Policy Economics
        - 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
- Assistant Secretary (Legislative Affairs)
    - Deputy Assistant Secretary (Legislative Affairs)
    - Office of Legislative Affairs
- Assistant Secretary (Economic Policy)
    - Deputy Assistant Secretary for Domestic Economic Analysis
        - Office of Financial Analysis
    - Deputy Assistant Secretary for International Economic Analysis
- Assistant Secretary (Domestic Finance) (Also reports to Under Secretary for Monetary Affairs for debt management purposes.)
    - Deputy Assistant Secretary for Capital Markets Policy
        - Office of Securities Market Policies
        - Office of Capital Markets Legislation
    - Deputy Assistant Secretary for State and Local Finance
        - Office of Municipal Finance
        - Office of the Deputy to the Assistant Secretary for New York City Finance
        - Office of Urban Economics
    - Deputy Assistant Secretary for Debt Management
        - Senior Adviser (Debt Research)
        - Office of Government Financing
        - Office of Agency Finance and Market Policies
    - Office of Revenue Sharing
- Assistant Secretary (Public Affairs)
    - Deputy Assistant Secretary (Public Affairs)
        - Office of Public Affairs
- Fiscal Assistant Secretary
    - Deputy Fiscal Assistant Secretary
        - Bureau of Government Financial Operations
        - Bureau of the Public Debt
- Commissioner of Internal Revenue
    - Deputy Commissioner
    - Internal Revenue Service
- Comptroller of the Currency
    - First Deputy Comptroller
    - Office of the Comptroller of the Currency

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. 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 Orders No. 190 (Revision 13) and No. 190 (Revision 13—Amendment 1) are rescinded effective this date.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 202 (REVISION 3), AUGUST 25, 1977.—ORGANIZATION AND RESPONSIBILITIES OF THE OFFICE OF THE ASSISTANT SECRETARY (INTERNATIONAL AFFAIRS)

By virtue of the authority vested in the Secretary of the Treasury, including the authority vested in me by Reorganization Plan No. 26 of 1950, it is ordered that:

1. The Assistant Secretary (International Affairs) is the principal advisor to the Secretary of the Treasury and the Under Secretary (Monetary Affairs) in exercising policy direction and control over Treasury Department positions in areas dealing with international financial, economic, monetary, trade, and commercial matters as well as energy policies and programs.
2. Within the Office of the Assistant Secretary (International Affairs) (OASIA), there are four Deputy Assistant Secretaries: Developing Nations, International Monetary Affairs, Trade and Investment Policy, and Commodities and Natural Resources. The functions and responsibilities of the Deputy Assistant Secretaries are defined by the Assistant Secretary and the Deputy Assistant Secretaries serve under the policy guidance of the Assistant Secretary. Each Deputy Assistant Secretary supervises a number of offices managed by Directors. The functions and responsibilities of the Deputy Assistant Secretaries shall include, but not be limited to, the following:
   a. Deputy Assistant Secretary (Developing Nations)
      (1) The Office serves as the principal policy advisor to the Assistant Secretary in formulating and implementing Treasury Department positions on U.S. economic and financial programs with respect to developing nations. The Office helps initiate, review, and oversee U.S. policies toward the less developed nations on such issues as debt owed to private and public sector entities, foreign assistance, food, population and financial policies, and evaluate the development and financial impact on the less developed nations of U.S. policies on trade, investment and commodities. Staff support is provided to senior Treasury officials in the formulation of U.S. policies on developed/developing nations relations generally, especially in connection with multilateral fora such as the UN General Assembly, UN Conference on Trade and Development (UNCTAD) and the IBRD/IMF Development Committee and its subordinate bodies. The Office maintains represen-

tatives in key developing nations who are responsible for analyzing local economic conditions and recommending appropriate policies. It also maintains liaison with and reviews policies of other USG agencies on development issues.

(2) The Office provides comprehensive analyses and forecasts of the economic, financial and political situation in developing countries for use in formulating Treasury policy on financial assistance, debt rescheduling, and other matters. The Office collects and maintains data on all LDCs including the OPEC countries, giving particular attention to balance of payments, official and private capital flows, debt and IMF credit. The Office also has the responsibility for providing support to the Secretary of Treasury in his capacity as a member of the joint economic commissions which have been established with individual developing countries, other than Saudi Arabia.

(3) The Office formulates, reviews, and oversees Treasury Department positions on policies, operations, and activities of the international lending institutions and the activities of the International Monetary Fund related to developing nations. The Office maintains liaison with and reviews policies of international, United States, and interagency development finance and policy formulating bodies, such as the Development Assistance Committee of the OECD and the Development Loan Staff Committee. The Office administers the Secretariat of the National Advisory Council on International Monetary and Financial policies (NAC). The NAC operates under the authority of Executive Order No. 11269.

b. Deputy Assistant Secretary (International Monetary Affairs)

(1) The Office serves as the principal policy advisor to the Assistant Secretary in formulating and implementing Treasury Department policies concerned with (a) the maintenance and operation of a smoothly-functioning international monetary system, including the role of the private money and capital markets; (b) coordination of economic policy among industrial nations; (c) the development and conduct of U.S. financial relations with the market economy industrial nations; (d) monetary relationships with the U.S. Government sought by other nations; (e) foreign exchange operations and management of U.S. reserve assets; (f) international borrowing, portfolio investment and insurance. In carrying out these functions the Office provides support for U.S. participation in multilateral financial institutions, principally the International Monetary Fund and the OECD, as well as in other fora related to its functional areas of responsibility.

(2) The Office provides analyses and forecasts of economic developments in and policies of the major industrial nations, both domestic and external. It maintains Treasury Department representatives in key industrial countries and in the OECD. It also analyzes and forecasts regional and global payments patterns and their implications for the functioning of the monetary system.

(3) With guidance furnished by senior Treasury Department officials, direction is given to the Federal Reserve Bank of New York concerning ESF operations and liaison is maintained to assure that foreign operations of the Federal

Reserve System are coordinated. In this regard, foreign exchange markets are intensively monitored. Continuing oversight of gold markets and related developments is also maintained.

(4) The Office provides analyses and assembles information relevant to international banking, portfolio investment and insurance matters and the international practices of U.S. and foreign banks, their regulatory authorities and the impact of their activities on the operation of the international monetary system.

c. Deputy Assistant Secretary (Trade and Investment Policy)

The Office serves as the principal policy advisor to the Assistant Secretary in the areas of trade policy, trade with nonmarket economy countries, and international investment.

(1) The Office formulates and implements Treasury Department positions on: (a) U.S. trade and commercial policy in general; (b) multilateral and bilateral trade negotiations; (c) trade finance matters; (d) U.S. military sales abroad; (e) U.S. economic relationships with the U.S.S.R., Eastern Europe, China, and such other nonmarket economy countries as may be designated, including support for operations of the East-West Foreign Trade Board and its Working Group; (f) programs in relation to the Secretary's responsibilities for trade relations with other countries; (g) direct investment issues, including matters pertaining to multinational corporations; expropriation and the Overseas Private Investment Corporation, and (h) serves as Secretariat for the interagency Committee on Foreign Investment in the United States established by Executive Order No. 11858.

d. Deputy Assistant Secretary (Commodities and Natural Resources)

(1) The Office serves as the principal policy advisor to the Assistant Secretary in formulating and implementing Treasury Department policy and positions on questions relating to (a) international energy policy, with special emphasis on the economic, financial and investment aspects of such policy, (b) other basic natural resources, particularly non-fuel minerals and agricultural commodities, (c) U.S. commodity policy, and (d) oceans policy matters, including "Law of the Sea" negotiations.

(2) In carrying out these functions, the Office (a) assembles information and provides analyses relevant to the formulation of commodity and international energy policies; (b) advises the Assistant Secretary and senior Treasury officials on economic and financial implications of natural resource and international energy issues which may be considered at inter-agency or international levels; (c) develops and implements Treasury Department policy with respect to natural resource issues arising in international fora, such as the International Energy Agency, the United Nations Conference on Trade and Development, the Development Committee of the International Monetary Fund and the International Bank for Reconstruction and Development (IMF/IBRD) and various committees of the Organization for Economic Cooperation and Development (OECD).

3. Within the Office of the Assistant Secretary (International Affairs), there also are the Office of the Deputy to the Assistant Secretary (Saudi Arabian Affairs), the Deputy to the Assistant Secretary and the Secretary of the

International Monetary Group, the Office of the Inspector General, the Administrative and Personnel Staff, and the OASIA Secretariat. The functions and responsibilities of these offices, which are defined by the Assistant Secretary, are:

a. The Office of the Deputy to the Assistant Secretary (Saudi Arabian Affairs) is composed of an Office of Saudi Arabian Affairs in Washington and an Office of the U.S. Representation to the Joint Commission in Riyadh, Saudi Arabia, and serves as the principal policy advisor to the Assistant Secretary in formulating and implementing the projects and programs undertaken by the U.S.-Saudi Arabian Joint Commission on Economic Cooperation established on June 8, 1974, and chaired by the Secretary of the Treasury. The Office is also responsible for the development of Treasury Department policy with respect to U.S. economic relations with Saudi Arabia.
b. The Deputy to the Assistant Secretary and Secretary of the International Monetary Group serves as a policy advisor to the Assistant Secretary in the formulation and implementation of policies relating to the international monetary system. In this connection he serves as Executive Secretary of the International Monetary Group, an interagency body chaired by the Under Secretary for Monetary Affairs, which consults with the Under Secretary on substantive matters and on negotiating positions; in this capacity he provides documentation to the Group for both briefing and current updating purposes.
c. The Office of the Inspector General provides the Assistant Secretary and other senior level Treasury Department officials with a reliable and independent internal appraisal of selected international financial activities and programs for which OASIA has primary operational responsibility. The Inspector General also performs such reviews as requested. Major areas of concern include the efficiency and economy of the use of U.S. investments in the International Monetary Fund, the International Bank for Reconstruction and Development, and regional multilateral banks, as well as procedures governing the use of the ESF.
d. The Administrative Staff and OASIA Secretariat perform administrative and other support operations for the Assistant Secretary.

4. With the exception of the Office of the Inspector General, the Assistant Secretary may reassign programs, functions, and associated positions and resources among the subordinate offices established above as deemed necessary, consistent with the policies and procedures governing the ESF.
5. This Order supersedes Treasury Order No. 202 (Rev. 2), December 20, 1976. Treasury Orders No. 94, No. 109 and No. 186–1 are rescinded.

ROBERT CARSWELL,
Acting Secretary of the Treasury.

NO. 250–2 (REVISION 1), SEPTEMBER 23, 1977.—ESTABLISHMENT OF THE OFFICE OF TARIFF AFFAIRS IN THE OFFICE OF THE GENERAL COUNSEL AND THE DELEGATION OF AUTHORITY TO THE DEPUTY ASSISTANT SECRETARY (TARIFF AFFAIRS)

Under authority of Treasury Department Orders Nos. 190 (Revised) and 250–1, the Office of Tariff Affairs is established within the Office of the General Counsel. Pursuant to the authority delegated to me by those orders, I hereby delegate to the Deputy Assistant Secretary (Tariff Affairs) the following authority, subject to the limitations prescribed herein:

1. To supervise the Office of Tariff Affairs and to make recommendations relative to the employment, promotion and evaluation of personnel therein.

2. To review all antidumping and countervailing duty cases investigated by the United States Customs Service and to recommend their disposition to the General Counsel.
3. To represent the General Counsel on Departmental, interdepartmental and international meetings or committees concerned with tariff matters within the jurisdiction of the General Counsel's office.
4. To handle all other matters falling within the responsibility of the Office of Tariff Affairs, or as further assigned by me.
5. In the absence of both the General Counsel and the Deputy General Counsel, the Deputy Assistant Secretary (Tariff Affairs) will sign antidumping and countervailing duty notices and determinations in his own name and under his own title.
6. In other respects the Office of Tariff Affairs will conform to the orders and directives issued for the administration of the Legal Division.

ROBERT H. MUNDHEIM,
General Counsel.

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