U.S. Department of the Treasury

PRESS RELEASES

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

TEXT AS PREPARED FOR DELIVERY
April 20, 1995

REMARKS OF TREASURY SECRETARY ROBERT RUBIN
U.S.-INDIA BUSINESSMEN
BOMBAY, INDIA

Good afternoon.

Before beginning the remarks I prepared to give, I want to speak for one minute about something that happened in the United States yesterday. As many of you probably know, there was a devastating explosion in Oklahoma City which has destroyed a federal building, killed and injured people, including children, and put in danger a number of Treasury Department employees who work for me. This was a terrible tragedy and it is being treated as an act of terrorism.

I want to express my condolences to the families of the victims of the Oklahoma City bombing. I have directed the Bureau of Alcohol, Tobacco and Firearms, which is a bureau of the Treasury Department, to work with the other law enforcement agencies and devote every bit of manpower available to find the responsible parties.

I have a great deal of territory to cover in my remarks today so I'll plunge right in because I want to leave time to answer your questions.

First, however, permit me an observation based on my brief visit to India and the meetings I have had with the President, the Prime Minister, the Minister of Foreign Affairs, the Minister of Commerce, the RBI governor and of course my host, the Minister of Finance. Each of those meetings were substantive and focused seriously on the accomplishments of reform and the challenges ahead. It was an exceedingly impressive leadership group and what India has done since 1991 in the way of economic reform, in trade policy, in opening up to foreign investment and increasing competition in many sectors is remarkable.

Economic reform is producing tangible results, economic growth and a good beginning of widespread and well-warranted attention for India -- attention that I believe will rapidly increase as you continue to pursue reform.

I asked someone on my staff the other day to look up the last time a Treasury Secretary visited India. It turns out I arrived in New Delhi 20 years to the day from the last visit, by William Simon. My visit, following that of Mrs. Clinton, three other cabinet secretaries and three of our senior State Department officials, clearly demonstrates the priority the United States attaches to our relationship with India.

Earlier this week I observed that the life of a finance minister has changed dramatically as the world has grown in economic linkage and as so many countries -- especially in Asia -- have had dramatic economic growth. Ten or 20 years ago to visit the cities absolutely critical to the U.S. economy, a Treasury Secretary would go to London, Paris, Bonn and Tokyo.

Today that list is far longer, and New Delhi and Bombay are on it, because of India's growth and our deepening economic relationship. Clearly, what happens in India, in Mexico, in Indonesia and China now has important consequences for the lives and economic well-being of Americans. I meet regularly with American business leaders, and they are increasingly telling me that they are, or are considering, investing here, building relationships and trade -- and obviously deepening our bilateral economic partnership. One benefit of my trip is that I can better discuss with them the opportunities India offers and what has happened here since 1991.

I was asked today to talk a bit about how the United States is preparing itself for the global economy, in addition to offering a few thoughts about the remarkable transformation under way in India.

We have two pivotal debates taking place in the United States, the first on what approach is best for the domestic economy, and the second on whether the United States will compete in the global economy, and provide leadership in dealing with its problems, or turn inward.

These are fundamental, philosophical debates, unlike the more incremental differences our politics often revolve around. I believe the approach chosen by the Clinton administration -- domestically, with investment in our work force and fiscal discipline, and internationally, with engagement -- is the correct choice.

There are some people in the United States who want to retreat from the world, but retrenchment cannot work as we face the 21st Century. It is true in the United States, and it is true in India. India is a clear example of how adopting sound economic policies and looking outward can create jobs and opportunity, not just for one nation but for many -- India and all its economic partners.

The President's economic strategy focusses on fiscal discipline -- reducing our deficit -- and on public investments in education, training, technology, the serious problems of our inner cities and other areas critical to productivity. In addition, his strategy includes opening markets, reforming our government and its regulations, and continuing to seek health care and welfare reform.

In short, the breadth of the President's strategy is consistent with the complexity of a modern economy and the complexity of positioning the United States for the 21st Century.

And this strategy has been successful.

Economic growth in the first two years has averaged about 3.6 percent. Inflation is under 3 percent a year. Some 6.3 million new jobs have been created in our economy in the past 26 months. Our national unemployment rate has come down to 5.5 percent. Business investment is at a historic high as a percentage of GDP, and we are well along with a process of streamlining our government, reducing civilian federal employment levels and eliminating outdated methods and programs.

I spoke at the outset about a debate in the United States about how we approach international matters -- by turning our backs and turning inward, or by preparing to take advantage of the opportunities available to us and providing leadership in dealing with the problems that affect the global economy.

The U.S. agenda includes not only preparing the work force and the economy for the future, but also aggressively promoting greater openness in trade and in global financial markets, and actively supporting the contribution to development and economic growth and stability being made by the international financial institutions.

Many in the United States are questioning whether we should put money into the international financial institutions. We're cutting domestic programs and that makes it harder to spend money abroad. And critics are questioning whether the World Bank and its sister institutions are sufficiently sensitive to the environment and people

These are serious issues. But I see the World Bank working hard on reforms. I want the United States to be fully engaged in the institutions. I am committed to doing all that I can to achieve full funding for the U.S. commitment to the institutions because it is in our interest to promote economic development, to create a larger and healthier world economy and bigger and better trading partners.

The United States has been instrumental in encouraging the Bank to increase its emphasis on open market structural reform, on programs that support, not supplant the private sector, on paying greater attention to human resource development, including the role of women, to viewing microenterprises as a key tool in development, and supporting education and health care. I believe the change in emphasis is beginning to pay off.

In fact, let me take just a moment to tell you about something I had the opportunity to see yesterday. I visited a watershed improvement project near Udaipur supported by the World Bank. I heard from men and women who live in fragile economic circumstances, whose standard of living is being lifted by a program that operates simple agricultural reform projects focussed on women and environmental sustainable development, education and communal decision-making. It was an inspiration that gives life and context to the debates we have in Washington about congressional funding for the World Bank.

I told the people I met of my support for what they were doing for themselves. Let me say to you what I said to the people in that village yesterday: we live in a world today where all of us will benefit together or suffer together.

I have no doubt that if simple projects like the development of the Eklingji watershed project work, that in turn will improve India's economy and lead to a more prosperous India. And a more prosperous India will be a better trading partner for the United States. So, aside from the community of all human beings, a value I believe should matter to us all, I believe it is strongly in our economic interest to support these Eklingjis of India, though that can be a difficult message to convey to Congress in Washington.

Having said that, I want to expand for a few minutes on the economic relationship between India and the United States, and areas that may contribute to strengthening both our bilateral relationship and India's growing economy.

The meetings I have had here have been as much a listening and learning experience for me as they were meetings in which to make the points my government wants to raise.

In my meetings with both Prime Minister Rao and Finance Minister Singh we discussed how impressive the change has been in the Indian economy since economic reforms began in 1991. There has been a real change of direction: India's enormous potential is being unleashed.

We -- the United States and India -- have a common stake in the continued success of India's reform effort.

We well recognize reform is not easy, and takes courage and perseverance. We face problems in economic reform in our country, but we share the view that forward-looking reform is, in both our countries, the right answer for the future. In both our countries, much has been accomplished, but much remains to be done.

One key to success is broadening and deepening capital markets, to mobilize savings, to allocate savings efficiently, and to attract foreign capital.

It must be recognized, however, that there is a tremendous demand for capital worldwide. We need only look at the infrastructure needs here in India. I heard an estimate in New Delhi Tuesday that India needs on the order of $20 billion a year in infrastructure work. The Asian Development Bank estimates the entire region needs about $200 billion a year through the end of the century. India has problems with respect to its roads, airports and docks -- but these problems are global.

Capital in the global financial markets most readily will flow where the supervisory structure provides disclosure and effectively guards against manipulation practices, where the market mechanisms and clearing systems are effective and efficient, and where there are adequately trained personnel and good communications infrastructure. India is clearly moving in these directions, but in the highly competitive world of capital, continued and rapid progress is essential. Your leadership in Delhi clearly recognizes this need, but has the always difficult task of weighing the pace against legitimate competing considerations.

I have heard a great deal about the performance of the banking sector in India, including what I believe to be the spurs to efficiencies and capital availability in this market from foreign competition. That competition can bring to India's capital markets new instruments, technology, efficiencies, and access to global credit. I also was interested in the recent initiatives to enhance regulatory and supervisory capabilities and reduce the degree of intervention in the banking sector. A good deal of progress has been made -- several recent deregulation steps are encouraging, particularly freeing rates on larger loans -- but there are issues that need further attention, and as I said, your leadership in Delhi well recognizes what needs to be done.

Let me turn now to opening to opening to global capital flows. I know that this raises concerns about being buffeted by those capital flows. I want to take just a few moments and focus a bit on Mexico in this connection, because I've found over the past days it is of interest here in India.

I'm at the end of an extensive trip in which I've had the opportunity to consult not only with Finance Minister Singh but also with the finance ministers of a number of other emerging markets in this region. Those discussions have been useful in looking at the issues the Mexico situation has raised in developing economies, as well as well as in thinking how to better protect the global economy against the impacts of such a case.

There is a natural tension between economic reform as the requisite for growth, and on the other the potential for volatility and vulnerability that open markets bring. The answer, I believe, is to pursue reform, but take the measures necessary to minimize the likelihood of instability.

There are clear lessons that can be drawn from the Mexican experience -- such as the importance of sound macroeconomic, monetary, debt management and exchange rate policies, and the availability of market-relevant data, on a timely basis, and the importance of developing deep and effective capital markets. In my meetings with your ministers, they had a keen and clear understanding of these matters.

As I said, one lesson of Mexico is how important sound, credible policies are to sustain capital inflows. India is on solid footing in this regard, with respect to most areas -- the low current account deficit, reserve strengths, and a modest short-term external debt component. There is no analogy to the problems of Mexico. But, just as it is true for any country, very much including the United States, there are areas in India where there is more that could be accomplished.

I'd like to take a few questions -- so I'd like to end up my remarks with this observation. The Clinton Administration is committed to looking outward and engaging with the global marketplace in ways that will enable Americans to share in the benefits of that marketplace -- exports, jobs and profits. Such engagement includes taking a leadership role in supporting international efforts to promote development in developing economies and to deal with problems such as those in Mexico.

India has also made the decision to engage with the global marketplace, as India has always taken its role in the world with great seriousness in other respects, and India's economic reform package is most impressive. The parallel paths that we have chosen are bringing us into a closer relationship and a critical one. It can be fruitful for the people of both our countries, a partnership that promotes jobs and a better way of life in India and the United States. Thank you.

-30-

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 20, 1995

STATEMENT OF DEPUTY SECRETARY OF THE TREASURY FRANK N. NEWMAN

On behalf of Secretary Rubin, I want to underscore the Treasury Department's commitment to working with the Justice Department and state and local authorities to find those responsible for the savage attack in Oklahoma City yesterday.

As the President said yesterday, this heinous act will not go unpunished. Treasury's law enforcement bureaus continue to devote every available resource to the effort, and this reward signifies the seriousness of our resolve.

We share the concerns for the victims of this tragedy, including those members of the Treasury family -- from the U.S. Secret Service, the Bureau of Alcohol, Tobacco and Firearms, the U.S. Customs Service and the Internal Revenue Service.

-30-

RR-229

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 21, 1995

Contact: Hamilton Dix
(202) 622-2960

MEDIA ADVISORY

Out of respect for the victims of the attack on the Federal Building in Oklahoma City, the introduction of the currency bearing Treasury Secretary Robert E. Rubin's signature, originally scheduled for 10 a.m., April 24, 1995, at the Bureau of Engraving and Printing, has been postponed.

A new date will be announced.

-30-

RR-230

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT 2:30 P.M.
April 21, 1995

CONTACT: Office of Financing
202/219-3350

TREASURY'S 52-WEEK BILL OFFERING

The Treasury will auction approximately $17,750 million of 52-week Treasury bills to be issued May 4, 1995. This offering will provide about $1,150 million of new cash for the Treasury, as the maturing 52-week bill is currently outstanding in the amount of $16,593 million. In addition to the maturing 52-week bills, there are $27,563 million of maturing 13-week and 26-week bills.

Federal Reserve Banks hold $11,205 million of bills for their own accounts in the three maturing issues. These may be refunded at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,686 million of the three maturing issues as agents for foreign and international monetary authorities. These may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $530 million of the maturing 52-week issue.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

Details about the new security are given in the attached offering highlights.

oOo

Attachment

RR-231

HIGHLIGHTS OF TREASURY OFFERING OF 52-WEEK BILLS TO BE ISSUED MAY 4, 1995

April 21, 1995

Offering Amount	$17,750 million
Description of Offering:	
Term and type of security .	364-day bill
CUSIP number	912794 Y5 7
Auction date	April 27, 1995
Issue date	May 4, 1995
Maturity date	May 2, 1996
Original issue date	May 4, 1995
Maturing amount.	$16,593 million
Minimum bid amount	$10,000
Multiples	$1,000
Submission of Bids:	
Noncompetitive bids	Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids
Competitive bids . . .	(1) Must be expressed as a discount rate with two decimals, e.g., 7.10% (2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position are $2 billion or greater. (3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.
Maximum Recognized Bid at a Single Yield . . .	35% of public offering
Maximum Award	35% of public offering
Receipt of Tenders:	
Noncompetitive tenders . .	Prior to 12:00 noon Eastern Daylight Saving time on auction day
Competitive tenders	Prior to 1:00 p.m. Eastern Daylight Saving time on auction day
Payment Terms	Full payment with tender or by charge to a funds account at a Federal Reserve bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 21, 1995

Contact: Jon Murchinson or Michelle Smith
(202) 622-2960

MEDIA ADVISORY

The following is a tentative press schedule for the G-7 Finance Ministers meeting hosted by Treasury Secretary Robert E. Rubin next Tuesday, April 25, 1995. Unless otherwise noted, events are at Blair House, 1651 Pennsylvania Avenue NW. This schedule is for planning purposes only and is not for publication. Times are tentative and subject to change.

Noon — Cameras should be in place in front of Blair House for arrivals of finance ministers.

2:30 p.m. — Cameras should be in place for finance ministers and central bank governors group photo.

2:45 p.m. — Pooled photo opportunity of finance ministers' afternoon session.

6 p.m. — Briefing by Treasury Secretary Rubin.
Location: Secretary's Conference Room (MT 3327)
1500 Pennsylvania Avenue NW
Cameras should be in place by 5:45 p.m.

Media without Treasury, White House, State, Defense or Congressional credentials planning to cover any of these events should contact the Office of Public Affairs at (202) 622-2960, with the following information: name, Social Security number and date of birth, by 5 p.m., Monday, April 24. This information may be faxed to (202) 622-1999.

RR-232

-30-

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 21, 1995

Contact: Chris Peacock
(202) 622-2960

STATEMENT BY TREASURY SECRETARY ROBERT RUBIN

I want to compliment the hard work and quick action by law enforcement officials, including those of the Treasury Department, which has resulted in the apprehension of suspects connected with the Oklahoma City bombing.

We will not rest until we bring all those responsible for this vicious act to justice.

The law enforcement bureaus of the Treasury Department will continue to devote all necessary resources to this effort as we work with the Department of Justice and state and local authorities.

-30-

RR-233

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 22, 1995

Contact: Chris Peacock
(202) 622-2960

STATEMENT BY TREASURY SECRETARY ROBERT RUBIN

It is with great sadness that I announce the deaths of Assistant Special Agent in Charge Alan G. Whicher, Special Agents Cynthia L. Brown, Donald R. Leonard and Mickey B. Maroney, and Investigative Assistant Kathy L. Seidl, who served our country with the Secret Service, and Chase and Colton Smith, children of IRS employee Edye Smith and grandchildren of IRS employee Kathryn Graham.

Alan, Cynthia, Donald, Mickey, Kathy, Chase and Colton have been taken from family and the Treasury Department by a despicable act of murder and terror. We mourn their loss, and our thoughts are with the survivors and the other victims of the bombing.

Our colleagues dedicated their lives to fighting crime and protecting Americans, and we value the work and courage of each and every one.

I speak on behalf of everyone at Treasury charged with upholding the law that we will continue to work relentlessly with the Justice Department and state and local authorities to bring to justice the perpetrators of the Oklahoma City bombing and the murderers of Alan, Cynthia, Donald, Mickey, Kathy, Chase and Colton.

-30-

RR-234

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 24, 1995

Contact: Michelle Smith
(202) 622-2960

RUBIN TO HOLD G-7 BRIEFING AT TREASURY

Treasury Secretary Robert E. Rubin will hold a press briefing on tomorrow's meeting of the G-7 finance ministers at the Treasury Department today, Monday, April 24, at 1 p.m.

The briefing will take place in the Secretary's Conference Room, Room 3327, Main Treasury, 1500 Pennsylvania Avenue NW.

Cameras should be set up by 12:30 p.m. Media without Treasury, White House, State, Defense or Congressional credentials wishing to attend should contact the Office of Public Affairs at (202) 622-2960, with the following information: name, social security number and date of birth, by noon today.

-30-

RR-235

DEPARTMENT OF THE TREASURY
TREASURY NEWS
OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGO TO BE SET AT BRIEFING
Remarks as prepared for delivery
April 24, 1995

REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
G-7 PRESS BRIEFING

We have the pleasure of hosting in Washington this week the finance ministers and central bank governors of the member nations of the G-7 for the traditional Spring assessment of the world economy. In addition to our customary discussion of the economic outlook for the G-7 nations, and a review of the encouraging economic developments in Russia, we'll also examine the review of the international financial system now under way in preparation for the Halifax Summit.

There have been tremendous changes in the world in recent years, and it is important -- as was recognized at Naples -- that we work together in dealing with the problems of the international economy. For instance, developing nations are more important than ever to the industrialized world. And global capital flows have reached a size and speed that have the potential to affect every nation.

Before I discuss the broader issues of the international financial system, I want to touch on the encouraging economic outlook within the G-7. Recovery is now firmly established in continental Europe, employment is growing, and there has been some encouraging progress toward fiscal consolidation.

In the United States, growth is now slowing to a pace which will help ensure a sustained expansion with continued low inflation. Our fiscal position is the strongest it has been in a decade; because of the powerful deficit reduction plan passed in 1993 and our consistent efforts at fiscal discipline, our budget deficit is now the lowest in the G-7.

RR-236 (MORE)

Make no mistake. We are committed to further progress on deficit reduction. In our current budget before Congress we add $80 billion in deficit reduction to the more than $500 billion already in law. Because health care spending exerts the greatest upward pressure on the deficit, we must seriously address these cost issues within the context of substantial health care reform. We await enactment of line-item veto legislation to enable the President to exercise additional discipline over the process. And among our criteria for assessing tax policy changes will be rock solid requirement that any tax cut be fully paid for. Many members of Congress have also expressed a commitment to deficit reduction. At the same time, we must continue to focus on areas such as education and training that will increase productivity.

Despite strong fundamentals in the G-7, there are some risks to the outlook. As the action by the major monetary authorities over the last several weeks illustrate, recent exchange market movements are a source of general concern.

The nascent recovery in Japan now looks more vulnerable. Finance Minister Takemura said in Bali that in a month or two the specifics to the newest economic package will be available, and we look forward to that. Unemployment remains very high across Europe, underlining the importance of removing structural barriers to job creation, and further fiscal consolidation appears unavoidable in some countries.

On balance, we are encouraged by the IMF's view that the prospects for a sustained expansion in the G-7 remain quite favorable.

As I mentioned, after reviewing the economic outlook we will turn to the discussion we began in Toronto, and that will continue at the Interim and Development Committee meetings later this week, on how to create a financial architecture that is as modern as the financial markets and the challenges of the today's world economy.

This means addressing the new dimensions of the financial system:

- Financial markets which move capital at great speed.
- New forms of finance.
- A more diverse group of creditors.
- And a substantial increase in new destinations for private capital.

And it means addressing the problem of growth in developing nations which do not yet have access to the global financial market.

The proposals I expect we will be considering include:

- **More effective early warning and prevention:**

Most important, this requires comprehensive and timely public disclosure of monetary and financial data. Effective surveillance also requires that the IMF develop a greater capacity for ongoing and more intensive monitoring of countries, and of capital market developments, that present potential risks to the system.

- **An emergency financing mechanism:**

We need a mechanism capable of mobilizing relatively large amounts of conditional financial assistance quickly in support of a strong economic policy programs.

One possible approach would be to expand and modify the General Arrangement to Borrow, and to trigger that arrangement in those exceptional circumstances where large IMF programs may be necessary. In this possible approach, it would seem to make sense to invite into appropriate arrangements with the GAB those new countries which benefit from a stable international monetary system and have the capacity to contribute to maintaining it.

As a complement to a new emergency financing mechanism, we also see some merit in the cautious exploration of ways to facility an orderly work out of international debt obligations.

- **Managing systemic risk:**

We need closer and more intensive cooperation among the regulatory and supervisory authorities of the major financial centers to safeguard the system against potential systemic risks.

- **The special challenges of the poorest:**

In addition to the new requirements of today's capital markets, the international financial institutions face an enduring challenge in promoting sustainable development in those countries which do not yet have access to the private capital markets.

We believe it is time to consider mobilizing a modest portion of the IMF's gold to support a special capacity to provide targeted concessional assistance to help deal with the special needs of the poorest developing countries and those countries which are emerging from economic and political disruption. This capacity could be developed in the context of a modified Enhance Structural Adjustment Facility in the IMF.

I will be outlining some of these proposals in more detail in my statements to the Interim and Development Committees.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

TRANSCRIPT OF G-7 PRESS BRIEFING
U.S. DEPARTMENT OF THE TREASURY
MONDAY, APRIL 24, 1995

Citation Information

Document Type: Transcript

Number of Pages Removed: 38

Author(s):

Title: Transcript of G-7 Press Briefing, U.S. Department of the Treasury

Date: 1995-04-24

Journal:

Volume:

Page(s):

URL:

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
April 24, 1995

Contact: Peter Hollenbach
(202) 219-3302

U.S. SAVINGS BONDS STUDENT POSTER CONTEST WINNERS ANNOUNCED; MINNESOTA, MICHIGAN, AND VIRGINIA STUDENTS ARE TOP THREE

Treasury's Bureau of the Public Debt announced today the three winners of the annual U.S. Savings Bonds National Student Poster Contest for students in grades 4 though 6.

First place went to Ethan Custer, a fourth-grader from Bible Baptist Christian School, East Grand Forks, Minnesota; second place went to Kevin Dufendach, a fifth-grader at Noah Webster Academy, Ionia, Michigan; and third place went to Sara Beth Silling, a sixth-grader at Open Door Christian School, Troy, Virginia.

"Invest In Your Future Today -- Buy U.S. Savings Bonds," the 1995 Savings Bonds Campaign slogan, was the theme of this year's poster contest.

William Ferguson, retired Chairman and Chief Executive Officer of NYNEX Corporation, White Plains, New York, said that the contest, "by teaching children to invest at an early age will promote good savings habits and help them reach future goals." Mr. Ferguson served as the 1994 Chair of the U.S. Savings Bond Volunteer Committee.

State winners were selected earlier this year. First place entries from each state and the District of Columbia then were forwarded to New York where a panel of judges headed by Joyce Ferguson selected the national winners. A $1,000, $500, and $200 U.S. Savings Bond was awarded to first, second and third place winners, respectively, in each State by local sponsors.

-MORE-

PA - 180
(RR-237)

A $5,000, $1,000, and $500 U.S. Savings Bond also will be presented respectively to national first, second, and third place national winners at a special awards ceremony Thursday, May 18, at 2 p.m. in the Cash Room of the Treasury Department. Treasurer of the United States Mary Ellen Withrow and Joyce Ferguson will present the awards.

In addition to Mrs. Ferguson and Mrs. Withrow, the panel of judges included: Betty Beene, President, Tri-State United Way; Alexander Julian, Fashion Designer; Shirley Mow, Executive Director, Westchester Education Coalition; and Tony Randall, Chairman, The National Players Company.

The three winners will be flown to Washington, D.C. for the awards ceremony. First place posters from each State and the District of Columbia will be displayed at the Treasury's Bureau of Engraving and Printing in Washington during the summer.

A list of state winners is attached.

o0o

1995 U.S. SAVINGS BONDS STUDENT POSTER CONTEST WINNERS

FIRST PLACE	SECOND PLACE	THIRD PLACE
Alabama		
Rob McGowin Trinity Presbyterian Montgomery, AL	Emily Beth Dickinson Indian Valley School Sylacauga, AL	Hector Villarreal Central Elementary Hunstville, AL
Alaska		
Amanda Dickens Brevig Mission School Brevig Mission, AK	Bernadette Jack Noorvik Middle School Noorvik, AK	Arianna Smith Iditarod Elementary Wasilla, AK
Arizona		
Andreanna Blaine Loma Linda Elementary Phoenix, AZ	Jessica Shell Mount Carmel School Tempe, AZ	Shelbi Jane Lanue Loma Linda Elementary Phoenix, AZ
Arkansas		
James Gregory Sherwood Elementary Sherwood, AR	Jason Colson Westside Elementary DeWitt, AR	Zachary Robert Payne Pulaski Academy Little Rock, AR
California		
Ava Hermine Porter Dixie Canyon Sherman Oaks, CA	Jennifer Fein Township Elementary Simi Valley, CA	Julie Adversalo Zamorano Elementary San Diego, CA
Colorado		
Krystle Cipolla Mountainside Fort Carson, CO	Vividiana Chavez Fort Lupton Middle Fort Lupton, CO	Christopher Berk Florida Mesa Elementa Durango, CO
Connecticut		
Julie Dunn Hebron Avenue School Glastonbury, CT	Lisa Cook Stepney Elementary Monroe, CT	Daniel Goldstein Elizabeth Shelton Sch Shelton, CT
Delaware		
Mega Portlock Gunning Bedford Middle Delaware City, DE	Andre Porter St. Anthony of Padua Wilmington, DE	Jaclyn L. Quinn Caravel Academy Bear, DE
District of Columbia		
Jeanny Lee Thomson Elementary District of Columbia	Shannon Ambush J.G. Whittier District of Columbia	Joi Nash and John Paul Mock Amidon Elementary District of Columbia
Florida		
Jessica Speicher Tropical Elementary Merritt Island, FL	Joshua Hoye Beaches Chapel School Neptune Beach, FL	Joseph L. Millado Sacred Heart Catholic Jacksonville, FL
Georgia		
Edd Holland St. Mary's Elementary St. Mary's, GA	Courtney Laura Wigren Memorial Day School Savannah, GA	Aracelis Denise Vicen St. Mary's Elementary St. Mary's, GA
Hawaii		
Kelly Nguyen Kalakaua Intermediate Honolulu, HI	Heizhelle Beltran Kalakaua Intermediate Honolulu, HI	Earnest Clore Ahuimanu Elementary Kaneohe, HI

Idaho

Chad Smith
Butte View Elementary
Emmett, ID

Myla King
Buhl Middle School
Buhl, ID

April Hallam
Butte View Elementary
Emmett, ID

Illinois

Bonnie Rooney
Dongola Unit School
Dongola, IL

Peter Zane
Salt Creek School
Elk Grove Village, IL

Tony Guido
St. Scholastica School
Woodridge, IL

Indiana

Aaron Rush
Oakland Elementary
Lafayette, IN

Aaron McEvoy
Montpelier Middle
Montpelier, IN

Laura Miller
Carlin Park School
Angola, IN

Iowa

Reginald McGhee
Grant Elementary
Waterloo, IA

Evan Anderson
Arthur Elementary
Cedar Rapids, IA

Lindsey Calvert
Waukee Middle School
Waukee, IA

Kansas

Melissa Kate Steel
West Elementary
Eudora, KS

Casey L. Riley
Derby 6th Grade Center
Derby, KS

Christopher G. Lee
Derby 6th Grade Center
Derby, KS

Kentucky

Keri Beth Myers
Monroe County Middle
Tompkinsville, KY

Breezy Jude
Warfield Elementary
Warfield, KY

Jason Russell
Holy Family Catholic
Covington, KY

Louisiana

Jodi Renee Sylvester
Westminster Christian
Opelousas, LA

Ken Wilkerson
Mitchell Elementary
West Monroe, LA

Megan Soileau
Opelousas Catholic
Opelousas, LA

Maine

Lily Gacki
Rangeley Lakes Regional
Rangeley, ME

Kristen J. Hopkins
Orland Consolidated
Bucksport, ME

Jason Dionne
Yarmouth Elementary
Yarmouth, ME

Maryland

Veronica Sabdivak
Fox Chapel Elementary
Germantown, MD

Sally Penner
Thomas Pullen Arts
Landover, MD

Andrea Lyddane
The Calverton School
Huntington, MD

Masschusetts

Vladislav Yazhbin
Elias Brookings School
Springfield, MA

Oksana Shabunin
Forest Park Middle
Springfield, MA

Laura R. McTague
Kennedy Middle School
Woburn, MA

Michigan

Kevin Dufendach
Noah Webster Academy
Ionia, MI

Daniel Schmitt
Poupard School
Harper Woods, MI

Colette Marie Puchacz
Hemlock Middle School
Hemlock, MI

Minnesota

Ethan Custer
Bible Baptist Christian
E. Grand Forks, MN

Gabriel Durand
Biple Baptist Christian
E. Grand Forks, MN

Susannah Kristine Carlson
Washington Middle School
Brainerd, MN

Mississippi

Kenny Ray Thompson, Jr.
Pearl River Central
Carriere, MS

Robert R. Stranghoener
Power Apax School
Jackson, MS

Ben Xiang
Power Apax School
Jackson, MS

Missouri

Andrew Carrender
Russellville Middle
Russellville, MO

Stephanie Bishop
Russellville Middle
Russellville, MO

Tyler Williams
Russellville Middle
Russellville, MO

Montana

Dugan D. Gravage
St. Mary's Parochial
Livingston, MT

Trenon L. Thomas
Albion School
Alzada, MT

Vann P. Gravage
St. Mary's Parochial
Livingston, MT

Nebraska

Adam Jeffrey Hinrichs
Verdigre Public School
Verdigre, NE

Amy C. Kucera
Verdigre Public School
Verdigre, NE

Tara A. Buss
Centennial Public School
Gresham, NE

Nevada

Natalie Wilbur
The Meadows School
Las Vegas, NV

Stephanie Mastalarz
Ruthe Deskin Elementary
Las Vegas, NV

Shelby Francoeur
Bordewich-Bray
Carson City, NV

New Hampshire

Sarah Ashley Sleeper
Calvary Christian
Plymouth, NH

Leah Kemner
Claremont Christian
Claremont, NH

Amy Lander
Pollard Elementary
Plaistow, NH

New Jersey

Dwayne Beckford
Alexander Street
Newark, NJ

Ali King Kamara
Elmwood School
East Orange, NJ

Angela Ongoco
Roosevelt School
Lyndhurst, NJ

New Mexico

Candice Adams
Des Moines Elementary
Des Moines, NM

Karen Hatch
Paul D. Henry
Las Vegas, NM

Albert Trujillo
Whittier Elementary
Albuquerque, NM

New York

Alzaber Rubayat
Doris Cohen P.S. 230
Brooklyn, NY

David Qiu
Mark Twain I.S. 239
Brooklyn, NY

Claudiv Irina
Mark Twain I.S. 239
Brooklyn, NY

North Carolina

Christy Ford
Thomasville Middle
Thomasville, NC

Kristin Hines
Sparta Elementary
Sparta, NC

Brent Nelson
South Elementary
Mebane, NC

North Dakota

Mary Schuh
Roosevelt Elementary
Mandan, ND

Jeri Schmiess
Munich Public School
Munich, ND

Timothy Houck
Twining Middle School
Grand Forks AFB, ND

Ohio

Hannah Collingwood
Heritage Christian
Findlay, OH

Mark Zuberny
Fields Sweet Elementary
N. Ridgeville, OH

Shayna Geiss
Garfield Elementary
Warren, OH

Oklahoma

Jeremy Taylor
Will Rogers Elementary
McAlester, OK

Monica Sawyers
Lincoln Elementary
Ponca City, OK

Tiffany Forbes
Purcell Middle School
Ponca City, OK

Oregon

Monica Whitney
Western View Middle
Corvallis, OR

Nick Nuth
Adams Elementary
Corvallis, OR

Cara Miller
Adams Elementary
Corvallis, OR

Pennsylvania

Tegan Brozyna
M.M. Seylar
Perkasie, PA

Marcie Brozyna
M.M. Seylar
Perkasie, PA

Bernadette Giovanelli
Ave Maria School
Ellsworth, PA

Rhode Island

Anthony Baldino
St. Thomas Regional
Providence, RI

Julie Ahn
St. Mary's Bayview
East Providence, RI

Mary Liem
Williams D'Abate School
Providence, RI

South Carolina

Sarah Dillow
Alcolu Elementary
Alcolu, SC

William L. Blackmon
Alcolu Elementary
Alcolu, SC

Kelly Thompson
Powdersville Middle
Greenville, SC

South Dakota

Daniel Paulson
Brandon Elementary
Brandon, SD

Sam Rollefson
Elkton Public School
Elkton, SD

Kyle Williamson
Sturgis Williams Middle
Sturgis, SD

Tennessee

Lakesha Shinae Moore
Meigs Magnet School
Nashville, TN

Jennifer Jogner
St. Mary's Episcopal
Memphis, TN

Rebecca Tylor
Meigs Magnet School
Nashville, TN

Texas

Carrie Barnhart
Northwest Academy
Houston, TX

Cliff Jones
Magnolia Jr. High
Magnolia, TX

Dario Tiburcio
St. Peter's Memorial
Laredo, TX

Utah

Erin Wharton
Sunrise Elementary
Sandy, UT

Jennifer Biggs
Sunrise Elementary
Sandy, UT

Emily Ochsenhirt
Bellview Elementary
Sandy, UT

Vermont

Danyelle Shover
Brownington Central
Orleans, VT

Anna Hurd
Brownington Central
Orleans, VT

Bill Morelli
Charleston Elementary
West Charleston, VT

Virginia

Sara Beth Silling
Open Door Christian
Troy, VA

Sean Patrick Cannon
Forest Middle School
Forest, VA

Dari Nogarr
Peninsula Christian
Smithfield, VA

Washington

Piper Woodruff
Montessori School
Tacoma, WA

Carrie Checkos
Granite Falls Middle
Granite Falls, WA

Joel Nunez
Mt. Adams Middle
White Swan, WA

West Virigina

Kalah Gentry
Ravenswood Middle
Ravenswood, WV

Ashley Helmick
Union Elementary
Buckhannon, WV

Krystal Lynn Botkin
Upper Tract Elementary
Upper Tract, WV

Wisconsin

Tyler R. Knowles
Eagle Orion
Muscoda, WI

Dan Nueller
Holy Family School
Green Bay, WI

Jennifer Schlosser
Holy Family School
Green Bay, WI

Wyoming

Samantha K. Barnhill
Sibylee School
Wheatland, WY

Coleman M. Griffth
Lucerne Intermediate
Thermopolis, WY

Amber G. Martin
Guernsey Sunrise
Guernsey, WY

CONSUMPTION TAX
(FLAT TAX)
INFORMATION PACKAGE
AS OF MARCH 10, 1995

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

For Immediate Release
Text As Prepared for Delivery
March 1, 1995

REMARKS OF LESLIE B. SAMUELS
ASSISTANT SECRETARY (TAX POLICY)
U.S. DEPARTMENT OF THE TREASURY
Federal Bar Association
19th Annual Tax Law Conference
National Press Building

Today, I would like to discuss a topic that has recently captured a lot of attention in Congress and the media. The subject is fundamental reform of the tax system. Several plans have been presented that would replace all or part of the income tax and payroll taxes with a tax on consumption. These reform proposals originate in large part from frustration with the complexity of our existing tax system as well as concerns about our national savings rate. These frustrations and concerns are valid. The most important reason to consider replacing the income tax with a consumption tax is that the change could increase saving and capital formation. This would raise our standard of living in the long run. Depending on how it is designed, a consumption tax could also improve economic efficiency and simplify the tax system.

Some economists believe that a consumption tax would be an effective way to encourage savings. Proponents also argue that a consumption tax would improve economic efficiency and simplify the tax system. Most of our major trading partners rely more heavily than the United States on consumption taxes, particularly value-added taxes. Therefore, adoption of a VAT in the United States would be compatible with international practices.

At this point in the discussion on consumption tax proposals, I believe it is time to have a framework to analyze these proposals. I will briefly outline the criteria which we believe should be used in judging the merits of reform ideas. For a more detailed discussion of these matters, I refer you to the testimony last week of Eric Toder, the Deputy Assistant Secretary (Tax Analysis) before the Senate Budget Committee.

RR-121

First, I would like to review briefly the categories of consumption taxes. Broad-based consumption taxes can be collected wholly from businesses, either on final sales to consumers or on the value-added by all businesses at each stage of production. They can be collected in part from businesses and in part from wage-earners by allowing businesses to deduct wages and taxing them at the individual level. They can be collected wholly from individuals by modifying the current individual income tax to allow taxpayers to claim a deduction for all net saving. Regardless of how they are collected, they are all consumption-based taxes if income is taxed only when it is spent on consumer goods and services; or, in other words, if income that is saved is effectively exempt from tax. I would mention that parts of our current income tax system resemble a consumption tax. For example, two important sources of saving -- homeownership and contributions to retirement plans -- are treated in a reasonably similar way as they would be treated under a consumption tax.

Three plans have received particular attention: Representative Armey's plan would replace the current corporate and personal income taxes with a two-part flat rate consumption tax. Representative Gibbons' plan would adopt a subtraction method VAT in place of the corporate income tax, the payroll tax, and most of the personal income tax. And a plan by Senators Nunn and Domenici would replace the individual and corporate income taxes with two types of consumption tax: a flat-rate tax on business cash flow and a progressive-rate individual expenditure tax. Although the basic outline of these plans have been presented, important parts are not yet finalized.

Framework for analyzing consumption tax plans

As with all tax proposals, these consumption tax plans should be carefully evaluated according to their ability to achieve fundamental tax policy objectives -- fairness, efficiency and simplicity.

Any reform should also include rules to minimize windfall gains and unexpected losses during the period of transition to a new system. In particular, special transition rules are needed to prevent taxing consumption paid with previously-taxed income. Otherwise, the consumption tax could impose severe tax burdens on elderly Americans.

Also, it is widely acknowledged that consumption tax proposals will need special rules for certain sectors, such as financial services businesses. Another issue in considering a federal-level consumption tax is coordination with state and local governments, which have depended heavily on retail sales taxes for revenues. The adoption of a national sales tax or federal VAT is likely to be seen as an infringement upon this important revenue source for state and local governments.

The current Federal income tax promotes widely-held social and economic goals, such as home ownership, private charitable giving, and the provision of medical insurance by employers. We expect that a new consumption tax system would still promote certain social and economic goals. But continued use of the tax system for these purposes would greatly lessen the possibilities for simplification and tax rate reduction from replacing our current income tax with a broad-based consumption tax.

We recognize that the U.S. income tax system has many defects, and we welcome discussion on how to reform it. But radical changes to our tax system involve major costs and risks. Replacing the entire income tax with a consumption tax would be a grand experiment of applying theory to a practical application that no other country in the world has chosen to undertake. Proponents of these plans must, therefore, overcome a significant hurdle -- they must show that it is worthwhile to conduct this experiment on the world's largest and most complex economy.

Distributional effects of replacing the income tax with a consumption tax

A broad-based consumption tax, when compared with an income tax using the same tax rate structure, would typically place a higher burden on low- and middle-income families. Replacing graduated rates with a flat rate would further shift the tax burden from high-income families to middle- and low-income families. This point is obvious when one looks to savings patterns of middle-income and high-income families, and the fact that higher-income families receive the bulk of capital income.

For example, a general consumption tax (with no exemptions) at a revenue-neutral flat rate of 14.3% would result in a tax increase for families with incomes below $100,000, while those with incomes of $100,000 or more would receive a tax cut. This baseline proposal is the simplest and most regressive form of a consumption tax. Expressed as a percentage of after-tax income under current law, the conversion to a 14.3% broad-based consumption tax would reduce the income of families below $100,000 by 2.2% to 10.8%; while families with incomes of $200,000 or more would receive a 14.4% increase in after-tax income.

There are, of course, a number of ways to make consumption taxes less regressive or even progressive. European countries reduce the regressivity of value-added taxes by exempting specific goods and services from the tax, or by taxing them at a lower rate. This approach does not make the VAT much less regressive, however, because tax relief from exempting specific goods and services is not directly targeted to low-income families.

Consumption taxes that are collected from individuals rather than businesses can more easily be made progressive. This can be achieved by providing standard deductions for low income families or by applying graduated rates of tax. But a consumption tax that is collected solely from individuals would be more complex than our current income tax.

Addressing the regressivity problem is a key challenge in designing a consumption tax that will not add to the tax burdens of lower- and middle-income families. Thus, in analyzing any of the proposals, this is the first question to be asked -- is it fair? Comparing a proposal to our current system, who will be the winners and losers?

Effects on the Rate of Saving

A consumption tax would not tax the return to saving and new investment. An income tax does tax this return, and thereby discourages saving and investment to some degree. Consequently, one might expect that replacing the income tax with a consumption tax would encourage domestic saving and capital formation.

The national saving rate in the United States declined in the 1980s compared to the previous three decades, due to both a decline in private saving and an increase in Federal deficits. We consider the low rate of U.S. saving to be a very serious concern. But we must responsibly ask ourselves how much the proposals under public discussion would help. Part of the answer may be found in the fact that the decline in saving does not appear directly related to changes in tax policy. Marginal tax rates were lowered substantially during the 1980s and new saving incentives were introduced. But the overall rate of saving still fell.

So, how much would substituting a consumption tax for the income tax boost total private saving? If the rate of return on savings goes up, one might expect that individuals would increase savings. However, most statistical research by economists finds that the effect of increasing the rate of return on saving is small or negligible.

An alternative way to use tax policy to increase private saving is to broaden saving incentives within the framework of the existing income tax. Provisions that directly encourage people to deposit some of their earnings in tax-favored accounts, such as IRAs and 401(k) plans, could be more cost-effective ways of increasing saving without replacing the entire income tax system. The President's fiscal 1996 budget proposes to expand the eligibility rules for contributing to IRAs.

Simplification of tax system

Simplification of the tax system is an important goal of many tax reform proposals, and one which we support. Three important sources of complexity -- provisions to distribute the tax burden equitably; rules to measure the consumption component of business income properly; and provisions that use the tax system to advance certain social and economic policies -- would continue under any consumption tax.

Unlike the existing income tax, a consumption tax collected directly from individuals would require the measurement of net annual changes in wealth. The result could be at least as complex as the current income tax, requiring numerous new taxpayer- reporting requirements and introducing new tax concepts and calculations. For example, a requirement to produce annual balance sheet statements for the tax collector would be viewed as a new and very onerous reporting burden.

As we all know, a theoretical model will be changed as it is adapted to the real world. When we think about these proposals, we should consider them not as mere theories, but how they will evolve in our political process. What will these proposals look like when they emerge from a House-Senate Conference? As a lesson in the political process, recall the changes to the BTU tax in the Ways and Means Committee. Thus, the political crucible can be expected to greatly reduce the possibilities for simplification and tax rate reduction.

For example, suppose that it is desirable to have a consumption tax that continues to promote home-ownership. Because consumption taxes, unlike the income tax, would exempt interest income from tax, continuing to allow a deduction for mortgage interest paid would encourage homeowners to incur additional borrowing beyond their financing needs. Rules to prevent this type of tax arbitrage would be complex and difficult to enforce.

Transition to a consumption tax

A very significant issue in converting from an income to a consumption tax system is deciding how to treat the return to wealth that was accumulated out of after-tax income under the income tax. Transition rules would be required to relieve the tax burden on savers who have already paid income taxes on their savings and would be taxed again when those savings were spent under a consumed-income tax.

For example, without a transition rule for past savings, a retiree who accumulated $100,000 in a savings account out of income that was taxed before the conversion to a consumption tax would be taxed on withdrawals from the account that are used for consumption. It would be difficult to design rules that differentiate between the retiree who is living off accumulated savings and individuals who only rearrange assets among accounts.

Conclusion

We are not at this time convinced that the case for completely replacing the income tax with a consumption tax is compelling. The most frequently cited economic benefit of such a change, an increase in private saving, is uncertain and could be small or negligible. Savings incentives within the existing income tax -- such as the President's proposal to expand the use of IRAs -- can increase saving without replacing the entire tax system.

In examining consumption tax proposals, it is inappropriate to compare a theoretically ideal consumption tax and the income tax system in place today. Instead, we should analyze a consumption tax that is likely to emerge from the political process. Exclusions would be made under a consumption tax -- either for administrative or political reasons or to support social and economic goals -- and those exclusions would reduce the economic benefits of the proposals and increase complexity.

We commend the efforts to develop consumption tax proposals that are progressive and revenue-neutral. A consumption tax collected at the individual level could, with appropriate rates, come close to replicating the distribution of tax burdens under current law. We are concerned, however, that such a consumption tax could be excessively complex. Also, we can only speculate as to how introducing such a tax to replace our existing income tax would actually work. There is no experience upon which to gauge its effects on the U.S. economy or its administrative and compliance costs. And there is no way to anticipate all the potential tax avoidance schemes that could be designed to exploit the new tax rules.

In conclusion, when you consider a consumption tax proposal, apply the criteria of fairness, efficiency and simplicity. And do not forget the effects of the political system on grand experiments.

Thank you.

-30-

A PRELIMINARY ANALYSIS OF A FLAT RATE CONSUMPTION TAX[1]

Representative Armey has proposed that the United States adopt a two-part "flat tax" which would replace the current individual and corporate income taxes. He would maintain the current employer and employee payroll taxes that finance the Old Age and Survivors Insurance Trust Fund (OASI), the Federal Disability Trust Fund (DI), the Unemployment Insurance Trust Fund (UI), and the hospital insurance trust fund (HI). The proposed flat tax is similar to the simple flat tax developed by Robert E. Hall and Alvin Rabushka.[2] Setting the administrative details aside, the common features of these proposals are:

1. a flat rate tax on individuals' wage income,
2. a tax on business cash flow with a deduction for wages[3], levied at the same rate as the individual tax, and
3. standard deductions for individual taxpayers and dependents.

A flat tax with these characteristics is essentially equivalent to a tax on total consumption, with some relief offered to low-wage individuals through the standard deduction.

The purpose of this paper is to analyze the revenue and distributional effects of a stylized flat tax similar to the one proposed by Representative Armey. The second and third sections of the paper describe the revenue estimates of a stylized flat tax proposal and how the flat tax could be made revenue neutral by increasing the tax rate or reducing the standard deduction amounts. The fourth section describes the distributional effects of replacing the current income taxes with a flat tax. The fifth section describes the effect on the revenue and distributional estimates of assuming that the proposal repeals the earned income tax credit. The sixth section of the paper explains why the Armey flat tax is equivalent to a tax on consumption. The final section of the paper identifies structural and design issues that would need to be addressed by most consumption tax proposals. An appendix lists detailed assumptions used in estimating the proposal.

---

[1]In October, 1994, the Treasury Department's Office of Tax Analysis prepared an analysis of the revenue and distributional effects of replacing the current income tax with a stylized flat tax similar to the one proposed by Representative Armey in H.R. 4585. Subsequently, Representative Armey's staff clarified several features of the flat tax proposal. This analysis reflects our understanding of the Armey flat tax proposal as of February, 1995. Subsequent clarifications or changes in the proposal would alter the estimates.

[2]Robert E. Hall and Alvin Rabushka, *Flat Tax* (Stanford: Hoover Institution, 1985).

[3]Business cash flow is equal to gross receipts less wages and purchases from other firms. Purchases of capital are immediately deductible from business cash flow, but under the Armey proposal, fringe benefits (other than pension contributions) supplied to employees are not deductible, making non-wage compensation taxable at the business level.

Revenue Estimates

In order to estimate the revenue effects associated with a flat rate consumption tax, a number of assumptions need to be made. First, we assume that the basic structure of the proposal follows Representative Armey's proposal. That is, the flat rate consumption tax examined below includes three major elements:

1. a flat 17 percent rate on wages and pension distributions,

2. a flat 17 percent rate on the cash flow of businesses (without a deduction for non-pension fringe benefits), and

3. a standard deduction for all filers ($12,350 for single filers, $24,700 for joint filers and $16,200 for head-of-household filers), and an additional standard deduction for each dependent ($5,000).[4]

Other features of the flat tax discussed below (and in the attached appendix) may deviate from Representative Armey's specific proposal. The Armey flat tax proposal does not address many of the specifics. In addition, some of the features implied by the statutory language (e.g., the apparent retention of the corporate and individual alternative minimum tax (AMT)) are probably unintended.

Second, no attempt is made to estimate the tax-induced behavioral responses of either individuals or corporations. Following the standard revenue estimating conventions used by both the Office of Tax Analysis and the Joint Committee on Taxation, the macroeconomic aggregates, such as the level of compensation, prices, employment, and gross domestic product, have been assumed to be unchanged by the proposal. In addition, we assume no shifts in other forms of behavior, such as portfolio allocations, the allocations of investment, or realizations of capital gains. Because the proposal taxes all forms of income of non-financial businesses at the same rate and exempts realized capital gains, interest, and dividends, such behavioral shifts would, for the most part, not affect revenue.[5]

Third, estimates for only a single year, using the fully-phased in rate (17 percent), are presented. However, the effects and details of the transition from current law to the flat tax have not been considered. For example, unused foreign tax credits, general business credits, AMT credits, depreciation on pre-1995 investment, and stocks of net operating losses from

---

[4]We understand that Representative Armey is now proposing standard deduction amounts that are larger than those that appeared in H.R. 4585.

[5]There may be behavioral adjustments, however, that reduce revenue. For example, businesses would have an incentive to provide cash wages instead of fringe benefits to low-wage workers because the former, but not the latter, would be offset by the standard deduction.

current law would likely be subject to transitional rules that could affect revenue by tens of billions of dollars of tax liability during the transitional phase.

The estimates presented below reflect the change in tax liability, as opposed to the change in tax receipts, which reflect how tax payments are made (e.g., through withholding, estimated tax payments, final payments, tax refunds). Therefore, the estimates do not incorporate any changes in revenues attributable to how the tax is collected. (Representative Armey would repeal withholding, but require individual taxpayers to remit payments in 12 monthly installments. Although this change would have a large negative impact on the revenue estimates, no attempt has been made to incorporate this feature of the Armey proposal.)

The revenue estimates are presented in Table 1. The 17 percent flat tax, under the assumptions described above, would increase tax liabilities by $532 billion at 1995 levels of income -- $305 billion from the wage tax on individuals, $163 billion from the cash flow tax on corporations, and $64 billion from the cash flow tax on non-corporate businesses. Repealing the current corporate and individual income taxes (except the earned income tax credit (EITC)) would reduce tax liabilities by $718 billion at 1995 income levels --$581 billion from the individual income tax and $137 billion from the corporate income tax. The proposal would therefore lose about $186 billion per year at 1995 income levels.

Revenue Neutral Proposals

Major proponents of replacing the income tax with a consumption tax, such as, for example, Senator Domenici, have stressed the importance of maintaining the same level of Federal revenues. Representative Armey's proposal does not meet the goal of revenue-neutrality at the tax rate and standard deduction amounts he proposes. To make the proposal revenue-neutral, the $186 billion reduction in tax liabilities could be offset by either increasing the flat rate or by lowering the standard deduction (or some combination of both). A 22.9 percent rate would be needed for the proposal to be self-financing, given the standard deductions specified in the proposal. Alternatively, the proposal could be made revenue neutral at the 17 percent flat rate by reducing the specified standard deductions by about 68 percent, to $3,950 for single filers, $7,900 for joint filers, $5,200 for head-of-household filers, and an additional standard deduction of $1,600 for each dependent.

Distributional estimates

The three major elements of the proposed flat tax are distributed separately to families by income class. First, the flat tax on wages and pension benefits is assumed to be borne by wage earners and pension beneficiaries, and is distributed proportionately to recipients of wages and pensions in excess of their specified standard deduction. Second, the tax on employer-provided fringe benefits (except pension contributions) is assumed to be borne by employees and is distributed in proportion to their receipt of these benefits. Third, the flat tax on business cash flow is assumed to be borne in proportion to capital income generally.

The $186 billion increase in the deficit under the proposal would have to be financed in some way. Different assumptions about the method of financing the increase in the deficit could result in quite different distributional estimates. For purposes of the distributional estimates presented here, it is assumed that the proposal is made revenue neutral either by increasing the flat tax rate to 22.9 percent, or by reducing the standard deduction amounts by 68 percent (to 32 percent of the amounts specified in the proposal). An alternative assumption would be that the increase in the deficit is financed by across-the-board reductions in expenditures for entitlement programs. Since entitlement benefits are generally distributed quite progressively (i.e., make up a much larger share of the incomes of lower-income families), this financing assumption would make the proposal more regressive.

The distributional effect of a 22.9 percent flat tax with Representative Armey's proposed standard deductions appears in Table 2. While the total change in after-tax income of adopting this proposal would be zero, the aggregate after-tax income for the group of families with incomes below $200,000 would be lower under the proposal (i.e., a net tax increase), while the aggregate after-tax income for the group of families with incomes of $200,000 or more would be higher under the proposal (a net tax cut). Expressed as a percentage of after-tax income under current law, the proposal would cause a reduction in aggregate after-tax income of between 0.8 percent and 3.0 percent for the group of families with incomes below $200,000 and a 8.1 percent increase for the group of families with incomes of $200,000 or more. This amounts to a 26.0 percent reduction in Federal taxes for the group of families with incomes of $200,000 or more and aggregate tax increases ranging from 6.9 percent to 17.1 percent for the group of families with income under $200,000.

The distributional effect of a 17 percent flat tax with standard deductions reduced by 68 percent of their proposed values appears in Table 3. Under this proposal, families with incomes of $200,000 or more would receive a tax reduction of almost $124 billion, or about 39 percent of their current Federal income taxes. Families with incomes below $200,000 would have corresponding tax increases averaging between 1.2 percent to 39.1 percent.

The distributional estimates shown in Tables 2 and 3 are based on the assumption, described above, that the flat rate tax is borne by income recipients. Since the flat-rate tax is equivalent to a consumption tax with a credit (standard deduction) for wages, alternative assumptions could be made about who bears the burden of the tax. A traditional assumption is that a consumption tax is borne by consumers in proportion to their consumption. Following this traditional approach, and assuming that the wage credit benefits workers on wages up to the standard deduction amounts, would result in a far more regressive distribution of the proposal. For example, under this traditional approach families with incomes of $200,000 or more under either revenue-neutral proposal would be shown as receiving tax cuts of $170 billion or more, which is nearly two-thirds of their current Federal tax burden. Middle-income families, and especially low-income families, would be shown to have correspondingly much larger tax increases. We have not followed this traditional approach in Tables 2 and 3 because it overstates the tax cut for high-income families, and the tax increases for low- and middle-income families, by failing to adjust for temporary income fluctuations and normal life-cycle patterns of consumption and income. In addition, lack of reliable data on consumption by families with very high and very low incomes may make any distributional estimates based on the traditional approach less reliable than the estimates shown in Tables 2 and 3.

Revenue and distributional effect of repealing the EITC

The revenue and distributional estimates presented above are all based on the assumption that the Armey proposal would retain the earned income tax credit (EITC). However, it is not clear that Representative Armey intends his proposal to retain the EITC.[6] If the EITC were not retained under the flat tax, the deficit effect of the proposal at 1995 income levels would be reduced by $25 billion (the cost of the EITC in 1995) to $161 billion. The flat tax rate required to make the proposal revenue neutral would then be 22.1 percent.

The distributional effect of replacing the current income tax (including the EITC) with a 22.1 percent flat tax is shown in Table 4. Families with incomes of $200,000 or more would receive a tax cut of about $89.6 billion, or 28.3 percent of their current Federal taxes. Families with incomes below $200,000 would have corresponding tax increases averaging from 4.4 percent to 60.5 percent. Comparing these results with the results in Table 2, in which the EITC is retained and the revenue-neutral flat tax rate is 22.9 percent, indicates that repealing the EITC makes the proposal much more regressive. The increase in tax burden from repealing the EITC falls mostly on low-income working families with children.

Why is the Armey flat tax a consumption tax?

To see why the flat tax is effectively levied on consumption, consider two other forms of a consumption tax: a retail sales tax (RST) of the type employed by most States, and a subtraction-method value-added tax, also called a business transfer tax (BTT).

---

[6]Although H.R. 4585, introduced by Representative Armey on June 16, 1994, which contains his flat tax proposal as well as other non-tax proposals, refers to the EITC in a non-tax section, the flat tax return form that appeared in his Wall Street Journal article on the same day has no line for the EITC. Furthermore, in an appearance before the Bipartisan Commission on Entitlement and Tax Reform (the "Kerrey Commission") on October 6, 1994, Representative Armey stated, in response to a question from Commission member Thomas Downey, that he believes that a direct income supplement rather than a tax credit should be used to transfer income to the poor. H.R. 4585 contains no such spending proposal.

A RST is collected from businesses and applied to sales of goods and services to households. While difficult to accomplish, governments generally attempt to tax *only* sales to consumers by exempting from the RST sales between businesses. That is, most states generally attempt to tax only final or retail sales as opposed to sales between producers. Consider the example in Figure 1. In an economy with three stages of production, a 5% retail sales tax collects revenue of \$50 on retail sales of \$1050 (\$1000 of pre-tax sales plus \$50 of tax) and collects no revenue from the manufacturer or wholesaler.[7] If the RST is levied on a broad base (i.e., the tax is applied to *all* purchases by consumers, including purchases of necessities like food and medical care which are commonly exempted from State sales taxes), it is a tax on *total* consumption.

Under a BTT, a business pays tax on the difference between its sales and the cost of its purchases from other businesses, including purchases of buildings and equipment.[8] The deduction for business purchases ensures that the tax falls only on final consumption. In the example in Figure 1 (second panel), a portion of the total BTT is paid at each stage of production, but the 5% tax still raises a total of \$50 on final consumer sales of \$1050.

With only two modifications to the BTT, it can be seen why the Armey flat tax is equivalent to a flat tax on consumption. First, suppose that businesses are allowed a deduction for wages paid to workers. Second, suppose that individuals must pay tax *at the same rate as the business tax* on their wages. If there are no exemptions or a standard deduction, this tax is a simple flat tax, and its base is the same as that of a broad-based RST or BTT -- total consumption. As illustrated in Figure 1, total revenue under the flat tax is still \$50: \$35 collected from businesses and \$15 collected from workers.

In the example described above, we have assumed that the full amount of the flat tax -- including the portion that is collected from workers -- is passed on to consumers in the form of higher prices. Under this assumption, after-tax wages are unchanged, and the flat tax has the same effect on prices as a consumption tax that is collected entirely from businesses. In fact, the price effect will depend on the willingness of the Federal Reserve to accommodate a higher price level by increasing the money supply. Absent an increase in the money supply, the business portion of the flat tax will initially squeeze profits and ultimately force a reduction in wages. In the long-run, real incomes will decline by the full amount of the tax whether prices increase, or money wages or profits fall.

---

[7]A tax of 4.762% on a base that includes the tax is the same as a tax of 5% on a base that does not include the tax. In this example and in the ones that follow, it is assumed that businesses pass the full amount of the tax on to their customers.

[8]Most countries that have a national value-added tax (VAT) system administer it with the credit-invoice method. Under this system, businesses pay VAT on their sales, but receive a credit against their tax liabilities for VAT they paid on inputs purchased from other businesses. If the tax is applied to all goods and services at the same rate, a credit-invoice method VAT will collect the same amount of revenue and affect consumers in the same way as a similarly broad-based BTT.

Therefore, the flat tax has the same long-run effect on the purchasing power of most people as a consumption tax that is collected entirely from businesses. If prices do not ultimately increase by the full amount of the flat tax, however, people who receive income under fixed contracts will be affected differently. For example, lenders who receive interest income that is fixed in dollar terms will be better off than they would have been if prices had increased fully, and borrowers will be worse off.

Most proponents of a flat tax, including Representative Armey, support the inclusion of a standard deduction or personal exemptions to relieve some part of earnings from the tax. Indeed, one of the attributes of a flat tax is that some degree of progressivity can be achieved by providing tax relief directly to low-wage individuals.

Consumption Taxes: Further Comments

The flat rate tax proposed by Representative Armey is only one of many ways to impose a tax on consumption. Other variants of consumption taxes include:

- a retail sales tax, which is collected from retailers and imposed on the value of final sales to consumers;

- a credit-invoice value-added tax, which is collected from all businesses and is imposed on the value of sales, with a credit for tax-paid purchases from other firms;

- a subtraction method value-added tax (or business transfer tax), which is collected from all businesses and is imposed on the value of sales less purchases from other firms; and

- a direct cash flow consumption tax, which is collected from individuals and imposed (at either flat or graduated rates) on a base that equals income less net saving. Under this type of tax, contributions to qualified savings accounts would be deductible, and withdrawals from accounts would be taxable; net proceeds from borrowing would be taxable, and repayments of loans would be deductible.

The Armey flat rate tax, as noted above, is equivalent to a subtraction method value-added tax, but with a deduction for wages at the business level and a tax on wages at the individual taxpayer level. One possible modification of the Armey flat rate tax is to impose a graduated rate schedule, instead of a single tax rate, on the wages of individuals.

A consumption tax could be used either to replace the entire individual and corporate income taxes (as does the Armey flat rate tax), to replace all income and payroll taxes, or to replace only partially the income or payroll taxes.

Any consumption tax proposal, in combination with the taxes it replaces, needs to address a number of concerns. To merit serious consideration, a proposal should raise sufficient revenue, maintain the progressivity of the entire tax system, include transition rules to minimize windfall gains and losses, and avoid additional costs of compliance and administration. Consumption tax proposals also require provisions that address sector-specific issues, such as the tax treatment of financial institutions, imports and exports, non-profit organizations and state and local governments, and housing and consumer durables. The Armey flat tax proposal does not satisfy many of these important concerns.

Appendix: Detailed Assumptions

A number of assumptions were made regarding the specifics of the stylized proposal. These assumptions include:

For the flat rate cash flow tax on Corporations:

- Current law pass-through entities are subject to the business flat tax. These entities include S corporations, RICs and REITs.
- Interest income, dividends received, and capital gains income are exempt from tax. This exemption holds for both financial and non-financial corporations.
- Income from foreign subsidiaries is exempt from tax.
- Income from the sale of business property (section 4797 property) is subject to tax.
- Wages and salaries are deductible, as are contributions to pension funds. Deductions for other fringe benefits are disallowed.
- All interest deductions are disallowed for all corporations (because interest income is exempt from tax).
- The dividends-received deduction is disallowed (because dividends received are exempt from tax).
- The taxes paid deduction is disallowed.
- New investment in plant, equipment, and structures is expensed instead of capitalized and depreciated as under current law. This is consistent with the "cash-flow" nature of the flat tax.
- The cost-of-goods-sold deduction under current law would be replaced by a deduction for current year purchases and related costs, regardless of when the items are ultimately sold. This is consistent with the "cash-flow" nature of the flat tax. Under current law, the cost of goods that are actually sold are deducted, regardless of when they are assumed to be purchased.
- Bad debt write-offs are disallowed.
- Firms with negative net income pay no tax in the current year and are allowed to carry forward the net operating losses indefinitely to offset future income. These loss carry-forwards are indexed for inflation.

- All additional modifications to tax liability, such as tax credits (e.g., foreign tax credit), the alternative minimum tax, or recapture taxes, are assumed to be repealed.

- Because there are no border tax adjustments, exports are subject to tax and imports are free of tax.

For the flat-rate tax on earnings and non-corporate entities:

- Earnings are defined as the sum of wage and salaries, pension distributions, IRA distributions and 30 percent of active business income (including sole proprietors' income, farm proprietors' income and active partnership income).

- The remaining 70 percent of active business income and all passive business income is taxed at the entity level. Taxable business income can be reduced by the carryover of prior business losses. However, passive losses can only offset passive income.

- Business taxable income (from sole proprietors, farm proprietors, and partnerships) is adjusted to reflect the "cash flow" of businesses similar to the adjustments made for corporations.

- 30 percent of the net income of pass-through entities (such as partnerships) that do not allow the payment of wages to its owners under current law are treated as wage income, subject to the tax on earned income, and may be offset by the standard deduction.

- All itemized deductions are repealed.

- The phase-out of the personal exemption (PEP) and the limitation on itemized deductions (Pease) for high income taxpayers are both assumed to be repealed.

- All tax credits, except the Earned Income Tax Credit (EITC), are assumed to be repealed.

- The individual Alternative Minimum Tax is assumed to be repealed.

- Although governments and non-profits are not taxed, the wages and non-pension fringe benefits of government employees are taxed.

Office of Tax Analysis
March 10, 1995

TABLE 1

COMPARISON OF TAX LIABILITIES FROM 17% FLAT TAX AND CURRENT LAW
(estimates are static, fully phased in, 1995 income levels)

		(CY: $ in billions)
1. 17% Flat Tax		
a.	Corporate entity-level tax	163
b.	Non-corporate entity-level tax	64
c.	Individual tax	305
	Total	532
2. Current Law		
a.	Corporate income tax	137
b.	Individual income tax 1/	581
	Total	718
3. Difference (flat tax less current law)		-186

1/ Estimate excludes the effect of the EITC on both revenues and outlays. Total budgetary effect of the EITC is identical under the 17% flat tax and current law.

Table 2

Replace Current Individual and Corporate Income Taxes with a 22.9% (Modified) Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax (except EITC) ($B)	22.9% Tax on Wages Over Stand. Ded. (5) ($B)	22.9% Tax on Fringes and Payroll Tax (6) ($B)	22.9% Tax on Business Cash Flow ($B)	Total Change ($B)	Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
0 - 10	65.2	0.8	-0.3	-1.1	-0.4	-1.0	-1.5	17.1
10 - 20	221.9	8.1	-2.4	-3.8	-3.7	-1.7	-0.8	8.0
20 - 30	325.6	20.6	-10.4	-7.0	-7.6	-4.4	-1.3	8.7
30 - 50	738.5	68.6	-41.5	-18.1	-21.9	-13.0	-1.8	8.3
50 - 75	902.8	104.9	-74.5	-21.9	-28.0	-19.5	-2.2	8.7
75 - 100	735.0	97.8	-79.1	-17.4	-23.1	-21.9	-3.0	11.2
100 - 200	1,077.0	181.0	-137.0	-20.0	-44.9	-20.8	-1.9	6.9
200 & over	1,019.0	275.7	-97.7	-5.4	-90.4	82.2	8.1	-26.0
Total (7)	5,054.7	758.6	-443.7	-94.9	-220.0	0.0	0.0	0.0

Department of the Treasury
Office of Tax Analysis

March 7, 1995

(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral rate of 22.9 percent (approximately).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period (i.e. before 2000) are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on employer-provided fringe benefits (except pension contributions) and payroll taxes is assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow is assumed to be borne by capital income generally.

(5) The standard deduction (in 1995$) is $24,700 (joint) or $12,350 (single) plus $5,000 for each dependent. Non-pension fringe benefits of government and nonprofit employees are included in wages.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 22.9 percent flat tax. The employer portion of payroll taxes would likewise be nondeductible.

(7) Families with negative incomes are included in the total line but not shown separately.

Table 3

Replace Current Individual and Corporate Income Taxes with a Revenue-Neutral 17% (Modified) Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax (except EITC) ($B)	17% Tax on Wages Over Stand. Ded. (5) ($B)	17% Tax on Fringes and Payroll Tax (6) ($B)	17% Tax on Business Cash Flow ($B)	Total Change ($B)	Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
0 - 10	65.2	0.8	-1.5	-0.8	-0.3	-1.8	-2.8	32.0
10 - 20	221.9	8.1	-10.9	-2.8	-2.8	-8.4	-3.8	39.1
20 - 30	325.6	20.6	-24.4	-5.3	-5.8	-14.9	-4.6	29.7
30 - 50	738.5	68.6	-71.9	-13.7	-16.6	-33.5	-4.5	21.4
50 - 75	902.8	104.9	-103.7	-16.6	-21.2	-36.6	-4.1	16.3
75 - 100	735.0	97.8	-92.2	-13.2	-17.4	-25.1	-3.4	12.8
100 - 200	1,077.0	181.0	-135.5	-15.1	-33.9	-3.5	-0.3	1.2
200 & over	1,019.0	275.7	-79.7	-4.1	-68.3	123.7	12.1	-39.1
Total (7)	5,054.7	758.6	-520.7	-71.7	-166.2	0.0	0.0	0.0

Department of the Treasury
Office of Tax Analysis

March 7, 1995

(1) This table distributes the estimated change in after-tax income due to the proposal.

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period (i.e., before 2000) are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on employer-provided fringe benefits (except pension contributions) and payroll taxes is assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow is assumed to be borne by capital income generally.

(5) The standard deduction (in 1995$) is $7,900 (joint) or $3,950 (single) plus $1,600 for each dependent. Non-pension fringe benefits of government and nonprofit employees are included in wages.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 17 percent flat tax. The employer portion of payroll taxes would likewise be nondeductible.

Table 4

Replace Current Individual and Corporate Income Taxes (Including the EITC) with a 22.1% (Modified) Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income Under Proposal (4): Repeal Income Tax ($B)	22.1% Tax on Wages Over Stand. Ded. (5) ($B)	22.1% Tax on Fringes and Payroll Tax (6) ($B)	22.1% Tax on Business Cash Flow ($B)	Total Change ($B)	Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
0 - 10	65.2	-1.5	-0.3	-1.0	-0.4	-3.2	-5.0	56.8
10 - 20	221.9	-3.5	-2.3	-3.6	-3.5	-13.0	-5.9	60.5
20 - 30	325.6	11.1	-10.0	-6.8	-7.3	-12.9	-4.0	25.8
30 - 50	738.5	64.1	-39.9	-17.4	-21.1	-14.3	-1.9	9.1
50 - 75	902.8	104.0	-71.6	-21.1	-27.0	-15.6	-1.7	7.0
75 - 100	735.0	97.6	-76.1	-16.8	-22.2	-17.4	-2.4	8.9
100 - 200	1,077.0	180.9	-131.7	-19.2	-43.1	-13.2	-1.2	4.4
200 & over	1,019.0	275.7	-93.9	-5.2	-86.9	89.6	8.8	-28.3
Total (7)	5,054.7	729.4	-426.6	-91.2	-211.6	0.0	0.0	0.0

Department of the Treasury
Office of Tax Analysis

March 7, 1995

(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral rate of 22.1 percent (approximately).

(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income, IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits, inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period (i.e., before 2000) are excluded.

(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on employer-provided fringe benefits (except pension contributions) and payroll taxes is assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow is assumed to be borne by capital income generally.

(5) The standard deduction (in 1995$) is $24,700 (joint) or $12,350 (single) plus $5,000 for each dependent. Non-pension fringe benefits of government and nonprofit employees are included in wages.

(6) The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 22.1 percent flat tax. The employer portion of payroll taxes would likewise be nondeductible.

(7) Families with negative incomes are included in the total line but not shown separately.

Figure 1: Examples of Different Types of Consumption Taxes
(tax-inclusive base, single 5% rate)

Case 1: Retail sales tax (RST)

	Stage of production			
	Manufacturer	Wholesaler	Retailer	Total
1. Sales (including RST)	300	700	1050	
2. RST on sales (4.762% of line 1)	0	0	50	50
3. Purchases	0	300	700	
4. Wages	100	100	100	300
5. After-tax profit	200	300	200	700
6. *After-tax profit + after-tax wages + total tax*				*1050*

Case 2: Subtraction method VAT (or business transfer tax)

	Stage of production			
	Manufacturer	Wholesaler	Retailer	Total
1. Sales (including VAT)	315	735	1050	
2. Purchases (including VAT)	0	315	735	
3. Wages	100	100	100	300
4. VAT-inclusive base (line 1-line 2)	315	420	315	
5. VAT owed (4.762% of line 4)	15	20	15	50
6. After-tax profit	200	300	200	700
7. *After-tax profit + after-tax wages + total tax*				*1050*

Case 3: Flat rate consumption tax without personal exemptions

	Stage of production			
	Manufacturer	Wholesaler	Retailer	Total
Taxation of businesses:				
1. Sales (including tax)	315	735	1050	
2. Purchases (including tax)	0	315	735	
3. Wages	105	105	105	315
4. Tax-inclusive base (line 1-line 2-line 3)	210	315	210	
5. Tax owed (4.762% of line 4)	10	15	10	35
6. After-tax profit	200	300	200	700
Taxation of individuals:				
7. Tax base (wages)	105	105	105	315
8. Tax owed (4.762% of line 7)	5	5	5	15
9. After-tax wages	100	100	100	300
10. Total tax				50
11. *After-tax profit + after-tax wages + total tax*				*1050*

Note: A VAT of 4.762% on a tax-inclusive base is equivalent to a VAT of 5% on a tax-exclusive base. These examples assume that businesses pass forward the full amount of the tax to their customers.

Replace Current Individual and Corporate Income Taxes with a 22.9% (Modified) Flat Rate Tax (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	Federal Taxes Under Current Law (3) ($B)	Federal Taxes with 22.9% Flat Rate Tax (4) ($B)	Change in Federal Taxes ($B)	Taxes as a Percent of Pre-Tax Income Under Current Law (%)	Taxes as a Percent of Pre-Tax Income Under with 22.9% Flat Rate Tax (%)
0 - 10	5.7	6.7	1.0	8.0	9.4
10 - 20	21.5	23.2	1.7	8.8	9.5
20 - 30	50.1	54.5	4.4	13.3	14.5
30 - 50	156.3	169.3	13.0	17.5	18.9
50 - 75	224.0	243.5	19.5	19.9	21.6
75 - 100	196.1	218.0	21.9	21.1	23.4
100 - 200	303.0	323.8	20.8	22.0	23.5
200 & over	316.6	234.4	-82.2	23.7	17.5
Total (5)	1,275.1	1275.1	0.0	20.1	20.1

Department of the Treasury
Office of Tax Analysis

April 6, 1995

(1) This table distributes the estimated change in Federal taxes due to a (modified) flat rate tax with a revenue-neutral rate of 22.9 percent (approximately) which replaces the current individual and corporate income taxes.

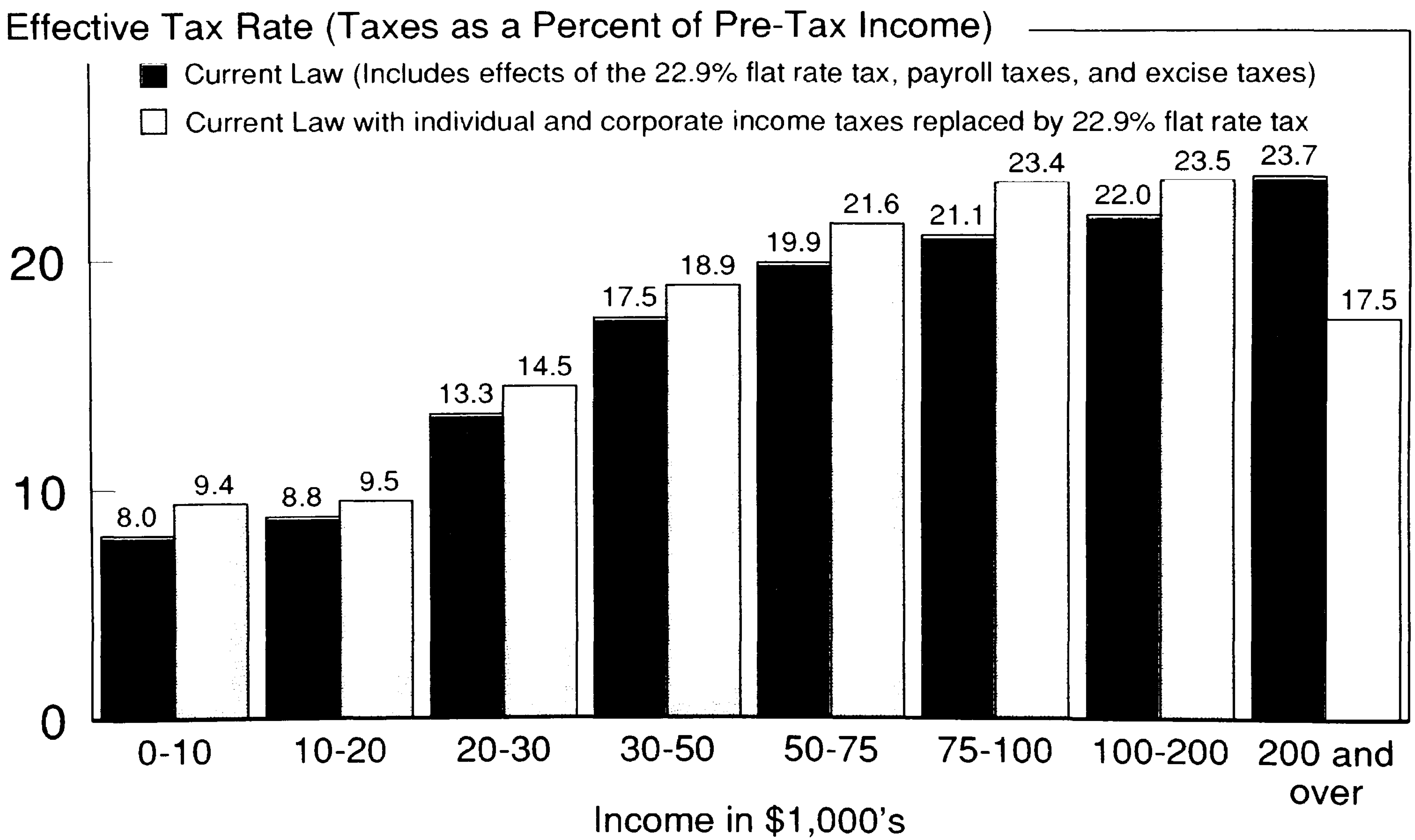
(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest, and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period (i.e., before 2000) are excluded.

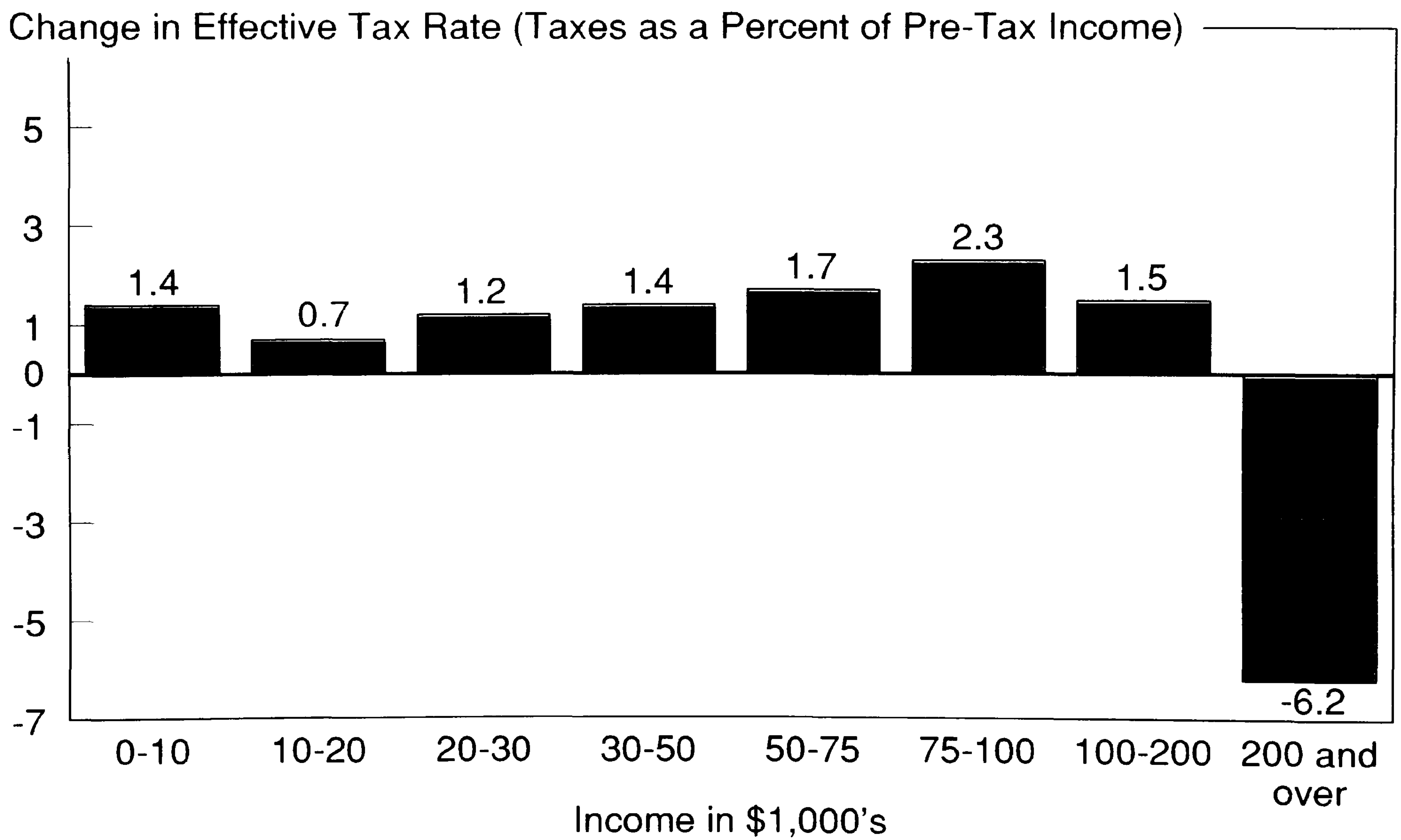
(4) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The flat tax on wages (plus pension benefits received) is assumed to be borne by wages plus pension benefits received in excess of the standard deduction. The flat tax on employer-provided fringe benefits (except pension contributions) and payroll taxes is assumed to be borne by employees in proportion to benefits or taxes. The flat tax on business cash flow is assumed to be borne by capital income generally.
The standard deduction (in 1995$) is $24,700 (joint) or $12,350 (single) plus $5,000 for each dependent. Non-pension fringe benefits of government and nonprofit employees are included in wages.
The proposal would disallow a deduction for employer-provided fringe benefits (except pension contributions) making these benefits (primarily employer-provided health insurance) subject to the 22.9 percent flat tax. The employer portion of payroll taxes would likewise be nondeductible.

(5) Families with negative incomes are included in the total line but not shown separately.

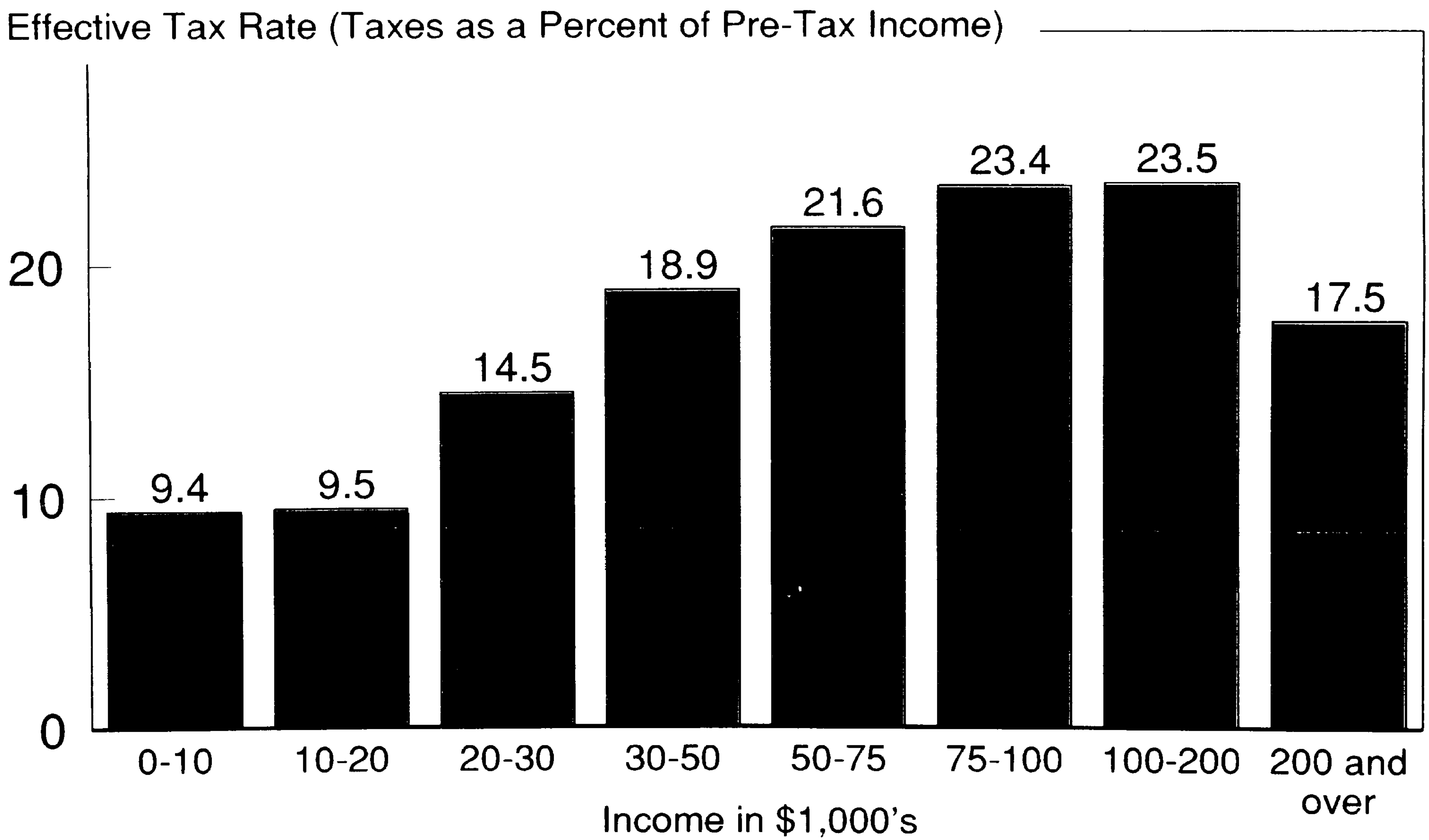
Distributional Effect of Federal Tax System Under Current Law and With the Individual and Corporate Income Taxes Replaced by a 22.9% Flat Rate Tax



Distributional Effect of Replacing Indvidual and Corporate Income Taxes With a 22.9% Flat Rate Tax

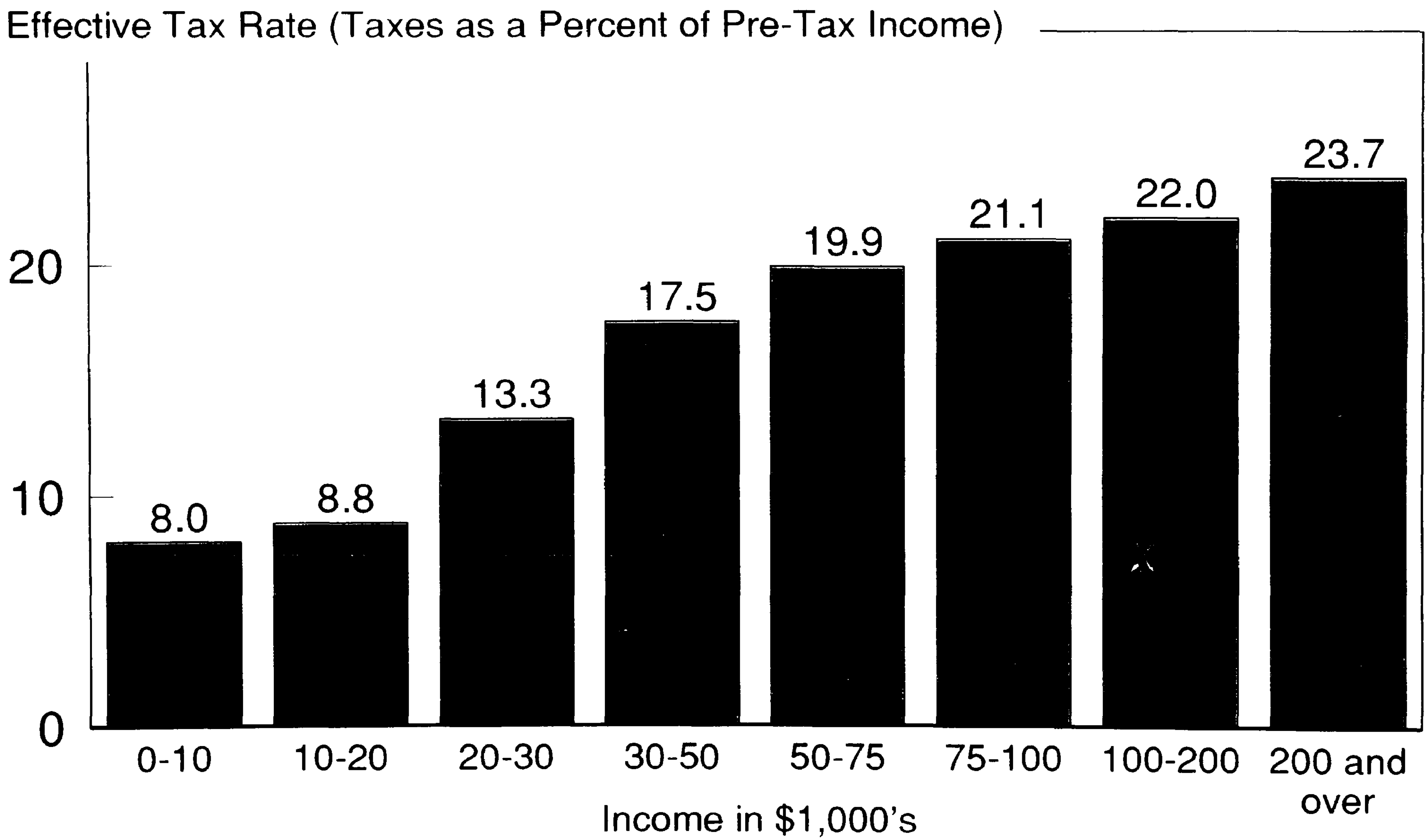


Distributional Effect of Federal Tax System With the Individual and Corporate Income Taxes Replaced by a 22.9% Flat Rate Tax [1/]



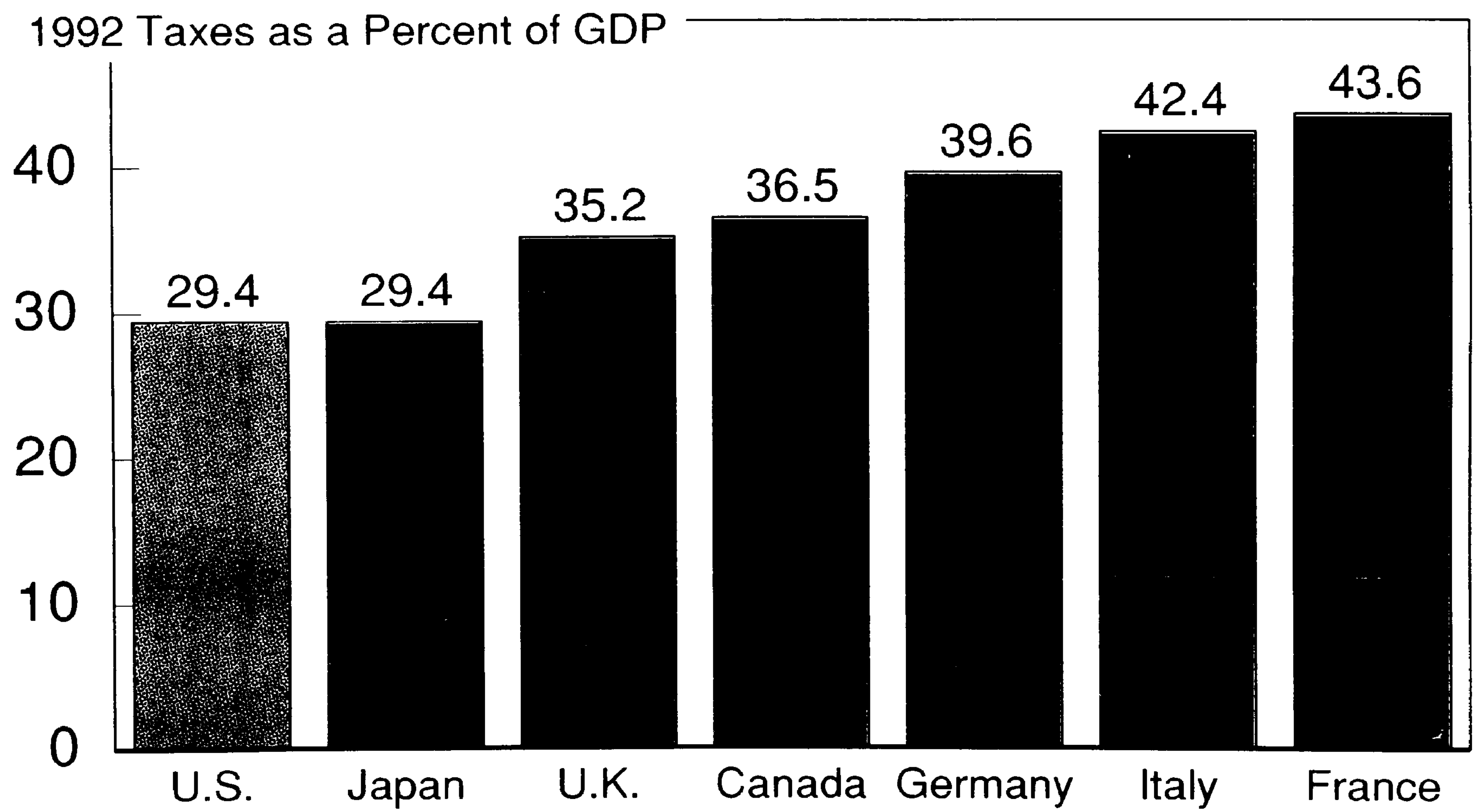
[1/] Includes effects of the 22.9% flat rate tax, payroll taxes, and excise taxes.

Distributional Effect of Current Federal Tax System [1]

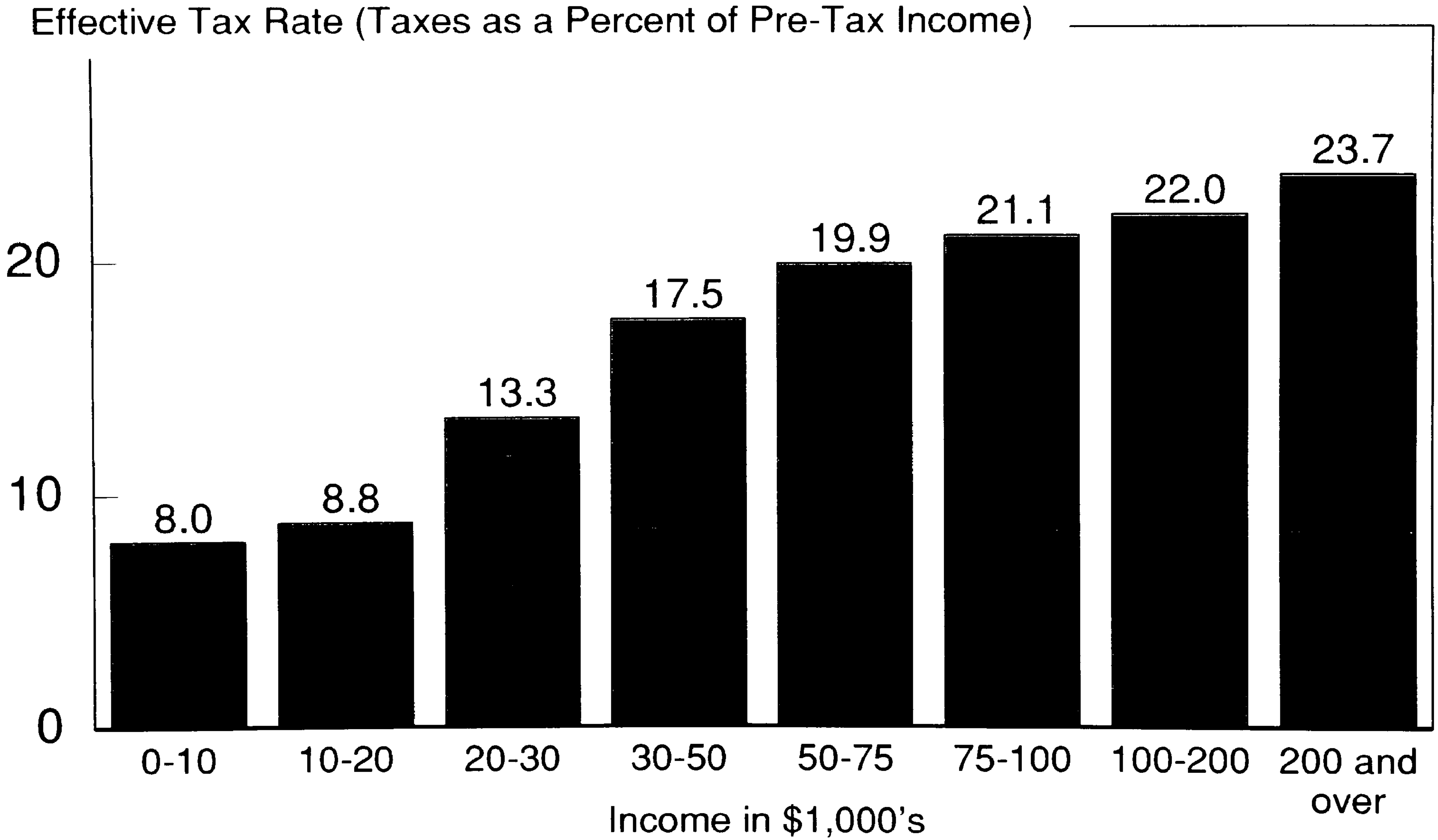


[1] Includes effects of individual and corporate income taxes, payroll taxes, and excise taxes.

U.S. Among Lowest Taxed of Major Economies

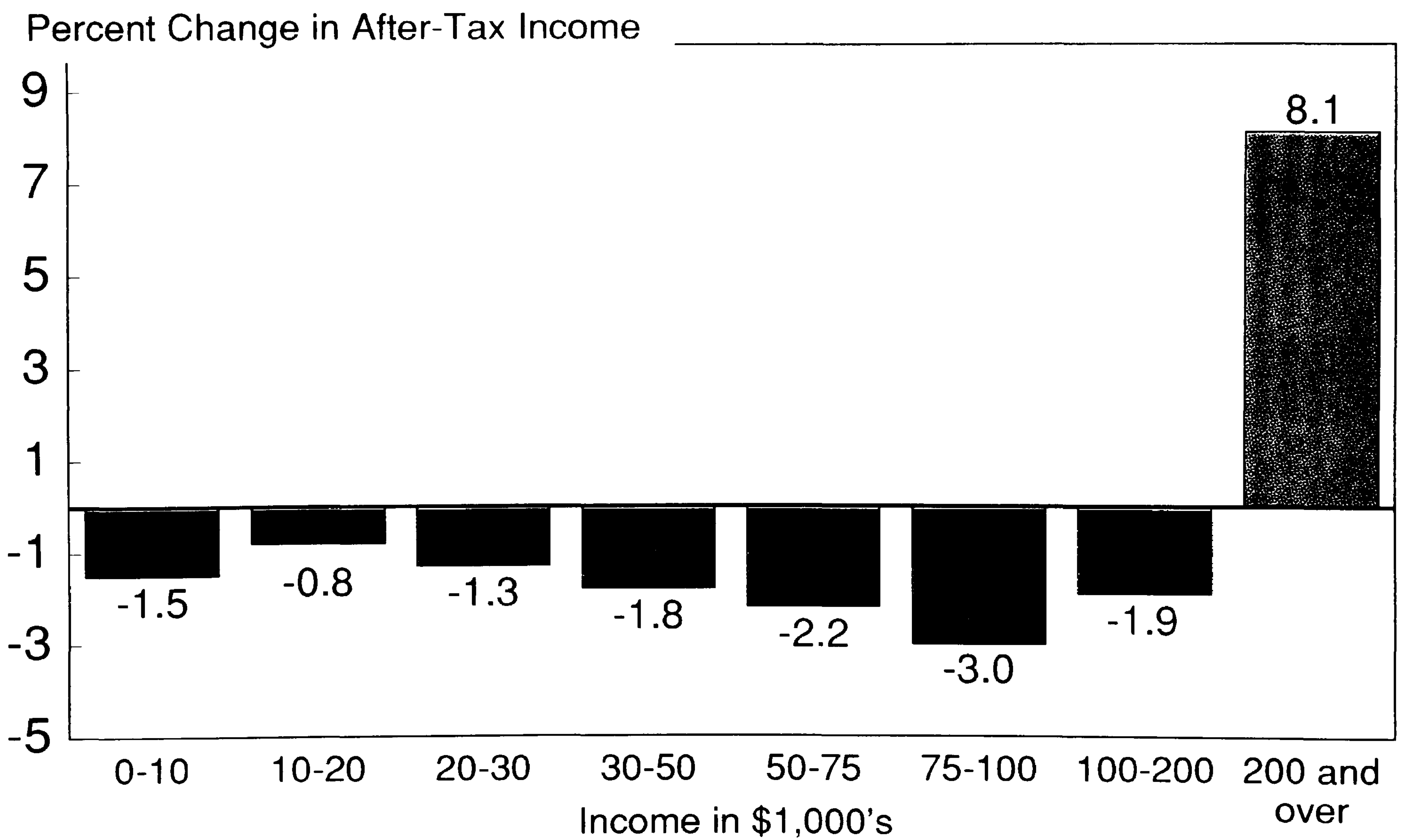


Distributional Effect of Current Federal Tax System [1/]

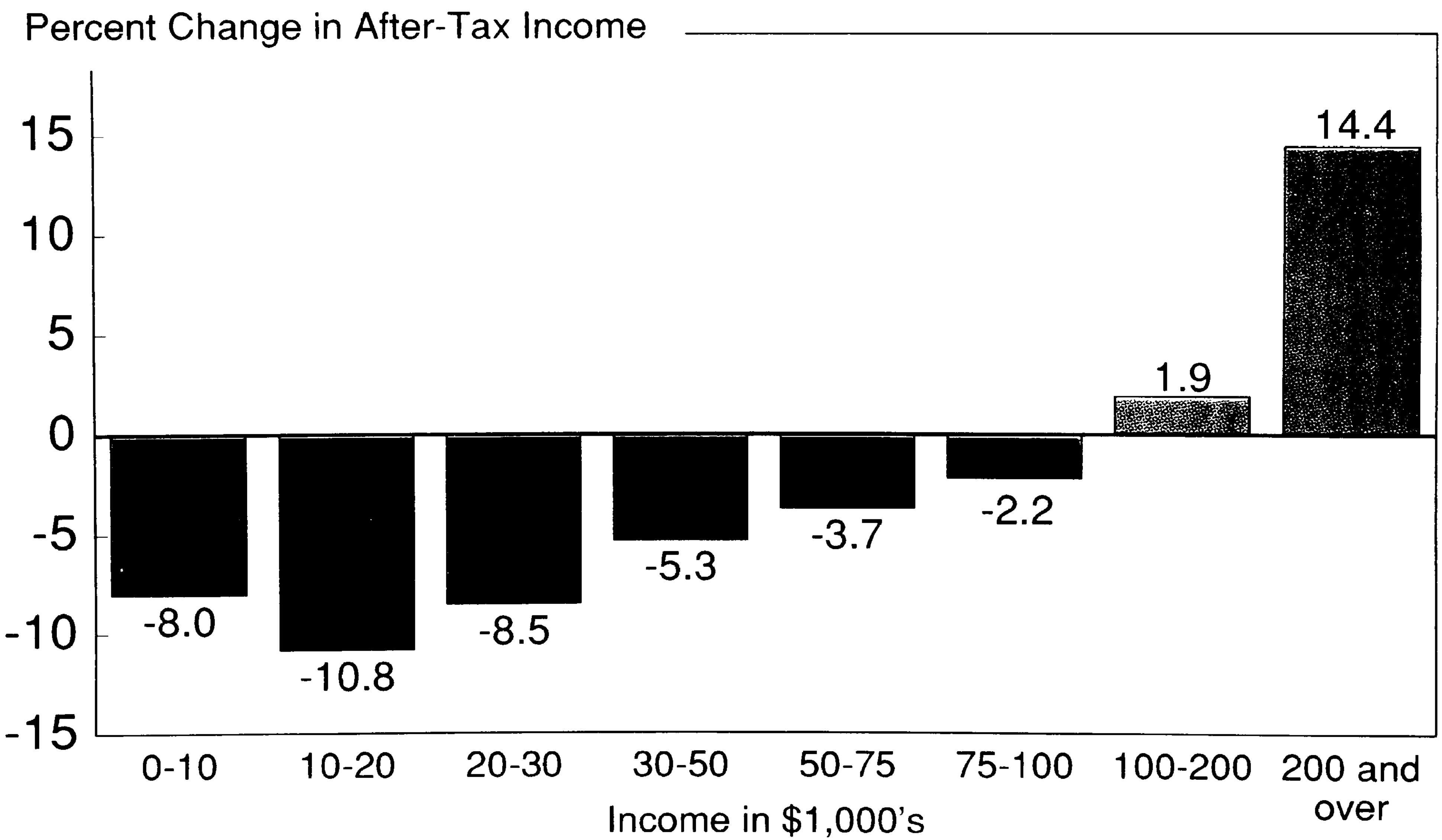


[1/] Includes effects of individual and corporate income taxes, payroll taxes, and excise taxes.

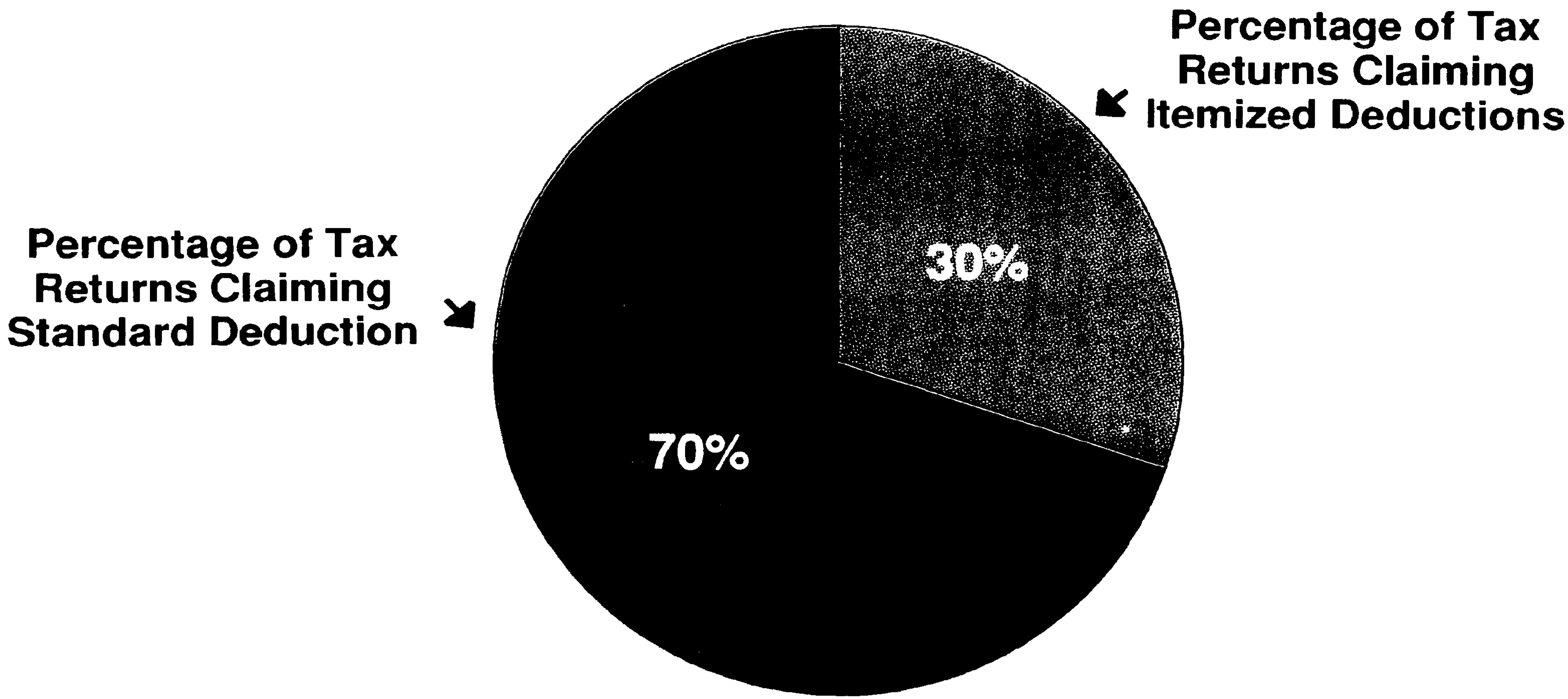
Distributional Effect of Replacing Income Taxes with a 22.9% Revenue-Neutral Flat Tax with Standard Deductions



Distributional Effect of Replacing Income Taxes with an Illustrative 14.3% Flat Rate Consumption Tax



Most Taxpayers Claim the Standard Deduction



DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

For Release Upon Delivery
Expected at 9:30 a.m.
February 22, 1995

STATEMENT OF ERIC TODER
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
DEPARTMENT OF THE TREASURY
BEFORE THE
SENATE BUDGET COMMITTEE

RR - 97

Table of Contents

For Release Upon Delivery
Expected at 9:30 a.m.
February 22, 1995

STATEMENT OF ERIC TODER
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
DEPARTMENT OF THE TREASURY
BEFORE THE
SENATE BUDGET COMMITTEE

Introduction

Mr. Chairman and Members of the Committee:

I am pleased to discuss today proposals for fundamental reform of the tax system. During the last two years, several proposals have been made that would replace all or part of the income tax and payroll taxes with a tax on consumption. The conceptual proposals under current discussion include Representative Armey's plan to adopt a two-part flat consumption tax in place of the current corporate and personal income taxes, Representative Gibbons' plan to adopt a subtraction method value-added tax (VAT) in place of the corporate income tax, the payroll tax, and most of the individual income tax; and a plan by Senators Nunn and Domenici to replace the individual and corporate income taxes with two consumption taxes: a flat-rate tax on business cash flow and a progressive-rate individual expenditure tax. Some of these proposals have been introduced as bills, but we understand that they are not yet in final form.

The interest in consumption taxes apparently arises for several reasons. The most frequently cited benefit of moving from a system that taxes income toward one that taxes consumption is that a consumption tax will improve saving rates and capital formation, and our standard of living in the long run. Proponents of consumption taxes also argue that a consumption tax would improve economic efficiency -- and thereby increase national output -- and simplify the tax system. Some supporters of consumption taxes point out that most of our major trading partners rely more heavily on consumption taxes, particularly VATs, and that adoption of a VAT in the United States would be more compatible with international practices.

Mr. Chairman, we recognize that the current U.S. income tax system has many defects, and we welcome the discussion on how to reform it. Since radical changes to the tax system -- especially changes that would completely replace the existing system -- involve costs and risks, they should be carefully evaluated according to their ability to achieve the fundamental objectives of a tax system -- fairness, efficiency, and simplicity. We believe a tax system should:

- raise sufficient revenue,
- distribute the burden of taxes equitably,
- avoid excessive intrusion of tax considerations into private economic decisions,
- promote economic prosperity and growth,
- and limit the costs to families and businesses of complying with the tax and the costs to the government of administering it.

Reforms should also include rules to minimize windfall gains and losses during the period of transition to a new system. Consumption tax proposals, in particular, should address the effect of the transition on the tax burden of the elderly, should include rules for the treatment of certain hard-to-tax economic sectors, such as financial institutions, and should address the coordination of a Federal consumption tax with State and local retail sales taxes.

In addition to these general tax policy objectives, the Federal income tax has, over the years, been used to promote widely-held social and economic goals, such as home ownership, private charitable giving, and provision of medical insurance by employers. It is likely that these goals would continue to be seen as pursuits worthy of preference under a reformed tax system. To the extent that a reformed system is to be used to promote social and economic goals, possibilities for simplification and tax rate reduction would be materially reduced.

A very careful scrutiny of consumption tax proposals is necessary to determine whether any proposal yet designed can reasonably satisfy the objectives described above. In this regard, it is noteworthy that the details of these tax reform proposals have not yet been provided, and that the details will affect the analysis of any proposal.

The strongest argument for a consumption tax is that it will probably increase saving and investment, but the amount of any increase is highly uncertain and could be small. Other ways of increasing national saving -- such as further deficit reduction or expanding saving incentives within the income tax -- can accomplish the same objective either more surely or with less overall disruption than a wholesale replacement of the existing income tax.

Replacing the income tax with a consumption tax also raises concerns about fairness, because many consumption tax alternatives would increase the tax burden on low- and middle-income families. Efforts to improve the progressivity of consumption taxes would, however, require significant increases in costs of compliance and administration. Moving from one tax system to another would also be complex and costly and would create both intended and unintended winners and losers.

Replacing the entire income tax with a consumption tax would be a grand experiment of applying theory to a practical application that no other country in the world has chosen to undertake. Proponents of these plans must, therefore, overcome a significant hurdle -- they must show that it is worthwhile to conduct this experiment on the world's largest and most complex economy.

The remainder of my testimony will describe (i) various types of consumption taxes, (ii) the distributional and economic effects of replacing the income tax with a consumption tax (including the international aspects of the proposals), (iii) transition issues, (iv) some issues related to specific economic sectors that would have to be addressed in implementing a consumption tax, and (iv) coordination of proposals with State and local retail sales taxes.

Background

What is a consumption tax?

Broad-based consumption taxes can be collected wholly from businesses, either on final sales to consumers or on the value-added by all businesses at each stage of production. They can be collected in part from businesses and in part from wage-earners by allowing businesses to deduct wages and taxing them at the individual level. They can be collected wholly from individuals by modifying the current individual income tax to allow taxpayers to claim a deduction for all net saving. Regardless of how they are collected, they are all consumption-based taxes, if income is taxed only when it is spent on consumer goods and services; or, in other words, if income that is saved is exempt from tax.

Consumption taxes that are collected from businesses grant an immediate deduction for purchases of new capital. This immediate deduction -- or "expensing" -- effectively eliminates tax on the return from new investment. Relieving new saving and new investment from tax is seen as the primary benefit of taxing consumption instead of income. Because the after-tax return to savers will increase, families will have an incentive to save more. But exempting the return to new saving reduces the tax base, requiring higher tax burdens on wage income. Moreover, because lower-income households typically do not save as large a percentage of their incomes as higher-income households, flat rate consumption taxes are regressive -- effective tax rates decline as family incomes rise. Addressing the regressivity problem is a key challenge in designing a consumption tax that will not add to tax burdens of lower- and middle-income families.

Options for taxing consumption

There are a number of ways to administer a consumption tax, and while the various forms would all not tax the return from new saving, the distributional effects and administrative costs would differ. A consumption tax can be collected from businesses, individuals, or in part from each. The statutory rates can be flat, or they can differ across individuals or across different types of consumption. And a consumption tax that is collected from businesses can be broad-based, or it can exempt certain goods and services or businesses from tax.

The descriptions below generally describe the theoretical model for each plan. Applying theory to practice will involve compromises with the theory. The degree of the deviations will be important in assessing the possible viability of any particular proposal.

1. Retail sales tax (RST). Businesses are the sole collection agents for retail sales taxes -- like those used by most States -- and VATs. A RST is applied to sales of goods and services to households. In order to tax only sales to consumers, the RST should exempt sales between businesses. If the RST is levied on a broad base, it is a tax on total consumption. However, State sales taxes in the United States are not broad-based, because certain purchases, including purchases of necessities like food and medical care, are tax-exempt. Because a RST is collected on all retail sales to domestic consumers, it automatically taxes imports and exempts exports.

2. Value-added tax. Most countries that have a national consumption tax administer it as a credit-invoice VAT. Under this system, businesses are liable for VAT on their sales, but receive a credit against their tax liabilities for VAT they paid on inputs purchased from other businesses. Credit-invoice VATs in effect in other countries tax imports and exempt exports. They achieve this result by exempting export sales, while allowing exporters a credit for all purchased inputs, and imposing tax on inputs purchased from other countries.

Under a subtraction method VAT (also called a "business transfer tax" or BTT), a business is liable for tax on the difference between its sales and its purchases from other businesses, including purchases of buildings and equipment. If the tax is applied to all goods and services at the same rate, a credit-invoice method VAT is economically equivalent to a similarly broad-based subtraction method VAT or RST.

3. Two-part individual/business consumption tax. Another form of consumption tax is collected in part from individuals and in part from businesses. The tax could be administered in the same way as a subtraction method VAT, except that it would allow wages to be deducted from the business tax base and would tax them at the individual level. If wages are subject to the same, single tax rate that is applied to businesses, the tax is "flat." Alternatively, the individual portion of the tax could be levied at graduated rates. With no exemptions or deductions, the base of this two-part tax is the same as that of a broad-based VAT or RST -- total consumption.

4. Consumed income tax. A consumption tax collected solely from individuals would be levied directly on their reported income, just like the current income tax, but would allow a deduction for net saving. The base of this tax is equal to consumption, because consumption is the difference between income and net saving. In order to measure income properly, proceeds from all forms of borrowing would need to be included in the tax base, and all forms of saving would be deductible.

Distributional effects of replacing the income tax with a consumption tax

Replacing the income tax with a flat-rate consumption tax

The effect on the distribution of the tax burden of replacing the income tax with a consumption tax depends on the form of tax that is adopted and on which taxes are replaced. Generally, however, taxing consumption places a higher burden on low- and middle-income families -- who typically do not save much of their income -- relative to an income tax. Because capital income is concentrated among high-income families, eliminating the tax on income from new capital will disproportionately benefit high-income families. The change will, therefore, shift the tax burden away from high-income families to middle-and low-income families.

Table 1 shows the distributional effect of replacing the revenue of the corporate and personal income taxes (including the earned income tax credit) with a general consumption tax with no exemptions.[1] At a revenue-neutral tax rate of 14.3 percent, the aggregate after-tax income for the group of families with incomes below $100,000 would be lower under the flat tax (i.e., a net tax increase), while the aggregate after-tax income for the group of families with incomes of $100,000 or more would be higher under the flat tax (a net tax cut).[2] Expressed as a percentage of after-tax income under current law, the proposal would cause a reduction in aggregate after-tax income of between 2.2 percent and 10.8 percent for the group of families with incomes below $100,000 and a 14.4 percent increase in after-tax income for the group of families with incomes of $200,000 or more.[3] This amounts to aggregate increases in Federal taxes ranging from 8.6 percent to 104 percent for the group of families with income under $100,000, and a 47.6 percent reduction in taxes for the group of families with incomes of $200,000 or more.[4,5]

---

[1]For an explanation of how to design a consumed income tax that is distributionally neutral across income quintiles, see U.S. Congressional Budget Office, *Estimates for a Prototype Saving-Exempt Income Tax*, Congressional Budget Office, 1994, pp. 19-28.

[2]The 14.3 percent tax rate would be applied on a tax-inclusive basis, in a manner similar to the income tax. The equivalent rate calculated on a tax-exclusive basis, as would be relevant under a VAT, is 16.7 percent.

[3]These results are illustrated in Chart 1.

[4]The distributional estimates shown in the Table 1 are based on the assumption that the consumption tax is borne by taxpayers in proportion to their earnings and capital income. Alternative assumptions could be made about who bears the burden of the tax. A traditional assumption is that a consumption tax is borne by consumers in proportion to their consumption. We have not followed this approach, because it overstates the tax cut for high-income families and the tax increases for low- and middle-income families by failing to adjust for temporary income fluctuations and normal life-cycle patterns of consumption and income. In addition, lack of reliable data on consumption by families with very high and very low incomes make distributional estimates based on the traditional approach less reliable than those shown in Table 1. Following this approach would lead

In this analysis, the burden of the consumption tax is distributed to taxpayers according to components of current income. But individuals may base current expenditures on their expectation of future income as well as on current income. For example, college students who earn very little while they are in school might, nevertheless, have high current consumption expenditures if they are able to borrow against the expectation that they will have high incomes in the future. In such cases, annual income understates economic well-being. Annual income may overstate economic well-being in a year when a family receives income from a transitory source, such as a large bonus. For these reasons, some economists argue that lifetime income is a better measure of an individual's long-term economic well-being than annual income. Our analyses, however, do not distribute tax burdens according to lifetime income because future earnings are uncertain, and even if future earnings were known, lifetime income would be difficult to measure with accuracy. In addition, lifetime income is an inappropriate measure of current well-being if individuals are unable to smooth their consumption over their lifetime by borrowing and saving. For example, if the college students mentioned above are not able to borrow against their uncertain future earnings, it may be inappropriate for the tax system to view them as well-off currently.[6] Nevertheless, some studies show that distributing a general consumption tax to families according to their estimated lifetime income makes the tax appear to be less regressive.

Redistributing the consumption tax burden

An important difference among the various forms of consumption taxes lies in the mechanisms available for distributing the tax more equitably among families with different incomes. One way that European countries reduce the regressivity of the VAT is by exempting specific goods and services from the tax or taxing them at a lower rate. This approach does not reduce regressivity effectively because tax relief from exempting specific goods and services is difficult to target to low-income families. While the tax preference does relieve the burden on low-income families, middle- and upper-income households also benefit when they purchase tax-preferred goods and services, requiring higher rates on other goods and services that low-income families buy to raise the same revenue. Other

---

to a more regressive distribution of the tax than that shown in the attached table.

[5]The finding that replacing the income tax with a flat-rate consumption tax would redistribute tax burdens from low-income to high-income families is consistent with previous analyses. For example, CBO and JCT find that, under a broad-based VAT, low-income families would pay a higher fraction of their income in tax compared to high-income families. See U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, U.S. Congressional Budget Office, 1992, pp. 32-7, and Joint Committee on Taxation, *Methodology and Issues in Measuring Changes in the Distribution of Tax Burdens*, U.S. Government Printing Office, 1993, p. 54-5.

[6]For a more detailed discussion of these points, see Joint Committee on Taxation, *Methodology and Issues in Measuring Changes in the Distribution of Tax Burdens*, U.S. Government Printing Office, 1993, pp. 82-6.

approaches, such as refundable credits and expansion in government transfer programs are more effective ways to offset regressivity, but would add to administrative costs and require explicit increases in government outlays.

A consumption tax that is collected at least in part from individuals can better account for differences in ability to pay among families and individuals than one that is collected solely from businesses. Such a tax can be made less regressive through standard deductions and/or graduated rates. Refundable credits like the earned income tax credit (EITC) can also be used to reduce the tax burden on low-income families, but credits carry with them administrative costs. For example, low-income families, who otherwise might be excluded from the tax system, would be required to file a return in order to receive the credit.

Alternatively, a VAT or BTT could be imposed at a moderate rate to replace a portion of income tax revenues. This approach would retain the income tax system to ensure that high income individuals with low consumption relative to their income continue to pay an equitable share of taxes, and refundable credits could be used to offset the effects of the consumption tax on low-income families.

While consumption taxes can be made less regressive, there is a clear and important tradeoff between progressivity and simplicity. The forms of tax that are the simplest and probably the least costly to administer and with which to comply (the RST and VAT) are not easily made progressive. The forms that are collected solely from individuals are more easily made progressive, but would be at least as complex -- and probably *more* complex -- than our current tax system. A pure consumed income tax, for example, would impose numerous reporting requirements on taxpayers and would introduce complicated tax calculations in ways that would be new to taxpayers, tax preparers, and the IRS. I will describe some of these complexities in more detail later in my testimony when I evaluate the effects of tax reform on simplicity.

Transition from the existing income tax to a new consumption tax raises an additional series of equity and compliance issues. These are also discussed below.

Economic effects of replacing the income tax with a consumption tax[7]

Saving and investment[8]

The main reason to consider replacing the income tax with a consumption tax is that this change could encourage domestic saving and capital formation and promote economic growth. A consumption tax would not tax the return to savings and new investment. The income tax does tax this return, and thereby discourages saving and investment to some degree. The key issue is whether substituting a consumption tax for an income tax will raise saving enough to overcome its other problems.

1. National saving. The low rate of U.S. saving is a serious concern. The national saving rate in the United States has declined in the 1980s compared to the previous three decades (Table 2). Although private saving decreased during this period, it remained positive. Public saving, however, has been consistently negative as a result of Federal budget deficits.

The reasons for the decline in private saving rates in the United States are unclear. It could be due to demographic factors that may reverse as the baby boom generation enters later middle age and saves for retirement. It may also be attributable to an increase in the availability of insurance and Social Security benefits, which reduce the necessity for private saving.[9] The decline in saving does not appear to have been caused by changes in tax policy. Marginal tax rates were lowered substantially during the 1980s and new saving incentives were introduced, but the rate of saving still fell.

According to a recent report by the Organization for Economic Cooperation and Development, the saving rates of our major trading partners also have declined since the 1960s.[10] All of these countries except Japan, however, rely more heavily on consumption

---

[7]This section analyzes the long-run economic effects of switching to a consumption tax system. The short-run effects could be quite different from the long-run effects, but analysis of short-run effects is beyond the scope of this testimony.

[8]Discussion of the points made in this section of the testimony appears in Joint Committee on Taxation, *Factors Affecting the Competitiveness of the United States*, U.S. Government Printing Office, 1991, pp. 44-52; U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, Congressional Budget Office, 1992, pp. 51-5; and Joint Committee on Taxation, *Description and Analysis of Tax Proposals Relating to Individual Saving*, U.S. Government Printing Office, 1995, pp. 63-72.

[9]For a more detailed discussion, see Joint Committee on Taxation, *Description and Analysis of Tax Proposals Relating to Individual Saving*, U.S. Government Printing Office, 1991, p 72.

[10]Organization for Economic Cooperation and Development, *Taxation and Household Saving*, 1994, pp. 17-24.

taxes for revenues than does the United States, both as a percentage of gross domestic product (GDP) and as a share of total tax revenues (Tables 3 and 4). While Japan depends the least on consumption taxes for revenues, it also had the highest saving rate during the 1980s (Table 5) and the highest rate of growth in real per capita GDP (Table 6).

The most direct way to increase national saving is to reduce the Federal budget deficit. The Federal government may also be able to affect private saving through changes in tax policy. However, if tax policy changes also increase the Federal budget deficit, there may be no net increase in national saving.

2. Tax policy and private saving. Two effects from substituting a consumption tax for the income tax could boost total private saving. Economic theory suggests that if the rate of return on savings goes up, individuals would increase saving to consume more in the future since the "price" of future consumption in terms of foregone current consumption is lower. However, most empirical studies find that the effect of increasing the rate of return on the level of saving would be quite small.[11] In addition, some people are "savers," while others consume essentially all their income. Shifting the overall burden of taxes from saver to consumer households can increase aggregate private saving, but it would also result in an increased concentration of private wealth.

While a pure consumption tax would encourage private saving more than a pure income tax, the effect on saving of substituting a consumption tax for our existing income tax is less clear. Our current income tax includes powerful incentives for employers to provide retirement saving plans for all their employees -- including low-income employees who would not be likely to respond to tax incentives. The incentive for employers to establish retirement plans would be much weaker under a consumption tax.

An alternative way to use tax policy to increase private saving is to broaden saving incentives within the framework of the existing income tax. Provisions that directly encourage people to deposit some of their earnings in tax-favored accounts, such as IRAs and 401(k) plans, could be more cost-effective ways of increasing saving without replacing the entire tax system. Toward that end, the Administration's budget has proposed an expansion in the eligibility rules for contributing to IRAs.

3. Saving and investment. Advocates of replacing the income tax with a consumption tax often discuss effects on saving and investment as if they are interchangeable. But saving and investment can diverge significantly because of the increased amount of international capital flows in today's global economy. More specifically, the relative effects on saving and investment would depend on the extent to which the consumption tax were used to reduce corporate or individual income tax rates. Eliminating the corporate tax would

[11] See Joint Committee on Taxation, *Description and Analysis of Tax Proposals Relating to Individual Saving*, U.S. Government Printing Office, 1995, p. 46.

increase domestic investment more than private saving, and eliminating the individual tax would increase private saving more than domestic investment.

Under U.S. tax rules, corporate income tax is imposed on the return to equity-financed capital used in the United States regardless of who owns it,[12] whereas the individual income tax is imposed on the return to capital owned by U.S. residents regardless of where it is used. Eliminating the corporate tax would increase domestic investment more than saving, because it would reduce the cost of capital to both U.S. corporations and foreign corporations investing in the United States by much more than it would increase the after-tax return to U.S. savers. In contrast, eliminating the individual income tax would increase saving more than domestic investment because it would increase the after-tax return to U.S. personal saving invested both in the United States and abroad, but, with internationally-linked capital markets, would not provide a relative advantage to capital invested in the United States.

4. Interest rates. It is not clear how a switch to a consumption tax would affect U.S. interest rates in the long run.[13] The net demand by U.S. investors for interest-bearing assets would increase, pushing bond prices up and yields down. This would occur because the consumption tax would remove interest flows from tax calculations. Also, under a consumption tax, domestic borrowers would not be willing to pay as high a rate of interest because interest would no longer be deductible, and U.S. lenders would be willing to accept a lower rate of interest because interest income would no longer be taxed. But in today's world economy, the U.S. interest rate is closely linked to rates in other advanced countries. With foreign interest rates unchanged and debt capital flowing freely across international borders, any reduction in U.S. interest rates would be dampened significantly. The likely result is that U.S. interest rates would fall somewhat, but by much less than the initial tax benefit to savers. After-tax yields to U.S. savers and after-tax interest costs to U.S. borrowers would increase.

Allocation of capital

Because a consumption tax does not tax the return to new investment and treats all businesses uniformly, it would not favor some assets or industries over others. Unlike the

---

[12]U.S. corporations are taxed on their worldwide income, but receive a tax credit for foreign income taxes paid. The residual U.S. tax rate on active foreign-source income of U.S. corporations, after accounting for foreign taxes, is generally quite low.

[13]The short-run effects on interest rates would depend on actions taken by the Federal Reserve during the period of transition to a new tax system. Similarly, some forms of consumption taxes could also affect the overall price level, but this effect is difficult to predict, because it will depend largely on actions taken by the Federal Reserve. For a discussion of the effects on prices of adopting a VAT, see U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, Congressional Budget Office, 1992, pp. 64-65.

current U.S. income tax, it would not favor non-corporate over corporate investment or investments in capital owned by State and local governments, owner-occupied housing, consumer durables, and other personal assets over business investments. As a consequence, investors would be encouraged to hold assets that were expected to produce the highest economic returns. Investment would be expected to shift out of the sectors that enjoy favor under the income tax -- owner-occupied housing, other personal assets, and noncorporate and State and local capital -- and into corporate capital. In addition, a consumption tax, unlike the current income tax, would not favor corporate debt over equity financing, reducing tax considerations from business financial decisions.

The resulting gains in economic efficiency are substantially reduced if the replacement consumption tax departs from a very broad base. However, such departures may be desired for a number of reasons. For example, most countries attempt to reduce the number of taxpayers in the system by exempting small businesses from the VAT. Some industries, such as banking and insurance, are typically excluded from the VAT because their tax bases are difficult to define. Some forms of capital, such as owner-occupied housing, might be given a preference to support social and economic goals. Each such exemption reduces the efficiency and simplification benefits attributable to the uniform treatment of capital.

Labor supply and wage tax avoidance

Both an income tax and a consumption tax affect the choice between work and leisure by reducing the relative purchasing power of wages. An income tax reduces the relative value of wages by taxing them directly. A consumption tax that is collected from businesses reduces the value of wages to the extent that the business tax is passed forward to consumers in the form of higher prices or back to workers in the form of lower wages.[14]

The effect on labor supply of switching to a consumption tax depends on changes in effective tax rates. Effective tax rates reflect the combined effects of the statutory rate structure and other tax proposal provisions, such as denying deductions for wages and employee fringe benefits at the business level and retaining payroll taxes. Examining the proposed statutory rate structure alone would overstate the possible decline in tax rates and the increase in work incentives.

A tax that is collected from individuals and businesses at different tax rates can create an incentive for business owners to reduce their tax burden by classifying their income as either a return to business capital or a return to labor. If the top tax rate applied to businesses is lower than the top rate applied to individuals, business owners will have an incentive to pay themselves lower salaries, ensuring that the income is taxed as business

---

[14]See U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, U.S. Congressional Budget Office, 1992, p. 57.

income. To reduce these distortions under a two-part, graduated-rate consumption tax, the top statutory rate applied to individuals should be the same as the business tax rate.

International trade

It is sometimes argued that because indirect taxes can be refunded on exports, the adoption of a VAT or other indirect consumption tax to replace part or all of our current income taxes would encourage U.S. exports. However, trade economists generally agree that such a tax change would not permanently improve either U.S. exports or the U.S. trade balance.[15]

Eliminating or substantially reducing income taxes could affect the trade balance, however, because income taxes may discourage both saving by U.S. residents and investment in the United States, and lowering U.S. income taxes could affect private saving and investment by different amounts. If private saving increased more than investment, the United States would import less capital and net exports would increase; if investment increased more than private saving, net exports would decline. Which effect would dominate depends on the specific form of the income tax cut and on the relative responsiveness of saving and investment.

Eliminating or reducing U.S. income taxes could also affect the relative competitiveness of different industries, because the income tax imposes different effective tax rates on production in different economic sectors. For example, reducing the cost of capital in the United States would generally favor the production of capital-intensive goods over labor-intensive goods. This differential benefit would affect the composition of trade, because goods that became relatively more expensive to produce in the United States would be increasingly imported, and goods that became relatively inexpensive to produce at home would be increasingly exported. However, there is little reason to believe that the net trade balance would be much affected by this change in relative trade positions.

While border tax adjustments for consumption taxes have no permanent effect on the trade balance, it should be noted that some types of consumption taxes are accepted as border-adjustable under the General Agreement on Tariffs and Trade (GATT), and others are not. Indirect taxes, such as credit-invoice VATs used in most other countries, are border-adjustable under the GATT. Consumption taxes collected from individuals, such as the consumed income tax, are unlikely to be refundable under the GATT. Although a broad-based, single-rate subtraction method VAT is economically equivalent to a similarly broad-

---

[15]See U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, U.S. Congressional Budget Office, 1992, p. 63.

based credit-invoice VAT, a GATT ruling would consider other factors. Whether a subtraction method VAT would survive a GATT challenge is an untested issue.[16,17]

Sector-specific issues of adopting a consumption tax[18]

Special treatment may be appropriate for specific business sectors under those forms of tax that are collected at least in part from businesses. High administrative and compliance costs relative to revenue collected may justify special treatment for certain sectors and for small businesses. Special rules are required for taxing goods and services with hard-to-measure tax bases, such as financial services.[19] The tax base for these services is not explicitly separated from other charges, and it is difficult to apportion the benefit from financial services to those who receive them. For example, the charge for intermediation services provided by banks is included in the difference between the interest rates charged to borrowers and paid on deposits. That difference also includes the return to equity-holders. Moreover, it is difficult to allocate the intermediation charge to a specific savings account or loan.

Taxing governments and non-profit organizations is difficult because there often is no market price for their production and many are currently not subject to tax. Most countries with VATs attempt to tax the commercial operations of this sector, but this approach requires differentiating between taxable and non-taxable activities which can be administratively complex. While special treatment for specific sectors might ease administration of a consumption tax, exclusions from the tax base would increase economic distortions relative to a very broad-based consumption tax.

Taxation of housing and consumer durables can also be problematic. To minimize economic distortions, rental housing, owner-occupied housing, and other durable goods

---

[16]These points are discussed in more detail in Joint Committee on Taxation, *Factors Affecting the Competitiveness of the United States*, U.S. Government Printing Office, 1991, pp. 302-4, and U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, U.S. Congressional Budget Office, 1992, pp. 63-4.

[17]The Treasury department has previously responded to a query by Senators Nunn and Domenici on this issue.

[18]These issues are discussed in detail in Joint Committee on Taxation, *Factors Affecting the Competitiveness of the United States*, U.S. Congressional Budget Office, 1991, pp. 314-20, and U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, U.S. Congressional Budget Office, 1992, pp. 26-30.

[19]For a discussion of the difficulties related to taxing insurance and other financial services under a VAT, see Joint Committee on Taxation, *Factors Affecting the Competitiveness of the United States*, U.S. Government Printing Office, 1991, pp. 315-18.

should be treated similarly. When businesses are allowed to expense capital purchases, purchases of buildings or durables for use as rentals would be deductible, and rental receipts would be taxed. However, the same treatment of owner-occupied housing and consumer durables would be difficult to administer, since it would be based on an imputed annual amount of rental services from these assets.[20] An alternative approach is to tax the total purchase price of homes and durable goods, but not the rental services from them. This approach can lead to significant tax bills for buyers and windfall gains for current owners.

Many consumption tax proposals assume that exports will be relieved of the tax and imports will be taxed. Making the appropriate adjustments can be difficult if the tax base is not broad or if tax rates vary. In addition, it can be difficult to collect the tax on services that businesses purchase from abroad.

Simplicity

Simplification of the tax system is a primary goal of many tax reform proposals, and one which we support. To evaluate reform proposals on the basis of this objective, however, it is useful to examine the sources of the complexity that plagues our current system. One source of complexity, the measurement of capital income, would be largely eliminated under some forms of consumption tax. Three others, the desire to distribute the tax burden equitably, the necessity to measure the consumption component of business income properly, and the use of the tax system to advance certain non-tax social and economic policies, would likely persist under any consumption tax. If a consumption tax were implemented in the United States, the final form of the tax would likely differ from the ideal for these same reasons. Divergence from the simple, broad-based, flat-rate, consumption tax model -- for whatever reason -- will tend to lead to more complicated tax calculations, higher tax rates overall, and reduced efficiency gains.

Correctly measuring capital income is difficult, and approximations designed to reduce that complexity can invite tax avoidance and an inefficient use of economic resources. Therefore, one of the attractions of a consumption tax is that many of the onerous calculations related to capital income would be eliminated. Depreciation and other cost-recovery provisions, for example, would be replaced with expensing, and it would not be necessary to maintain records on asset costs in order to compute capital gains.

Unlike the existing income tax, however, a consumed income tax collected from individuals would require the measurement of annual changes in wealth. As suggested earlier in this testimony, a consumed income tax system could, therefore, be at least as complex as the current system, posing numerous new taxpayer reporting requirements and

[20]See U.S. Congressional Budget Office, *Effects of Adopting a Value-Added Tax*, U.S. Congressional Budget Office, 1992, pp. 28-9.

introducing new tax concepts and calculations. Under one approach to a consumed income tax, proceeds from all forms of borrowing -- whether through a loan or a balance carried over to the next year on a credit card -- would be added to a family's tax base. The net contribution to all forms of savings would be deducted from the tax base and withdrawals from savings would be taxed. It might not be complicated to calculate tax liability under this approach for a family that borrowed no money during the year, had no end-of-the-year credit card balance, and only made contributions to a passbook savings account. But in the modern U.S. economy, even a moderate-income family might in a typical year purchase deductible mutual fund shares through a dividend reinvestment plan, cash in a taxable bond, and carry taxable balances on several credit cards. Some proposals might not require families to pay tax on short-term credit or might allow tax-free withdrawals from savings in cases of hardship, but such reductions in the tax base would require higher tax rates overall and complex rules to determine eligibility for exemptions and to prevent tax avoidance.

Redistributing the tax burden

Most of the mechanisms available under a consumption tax for redistributing the burden of the tax introduce complexities. Exempting certain goods and services from a VAT and taxing others at alternate rates increases the compliance burden on businesses that would have to determine which rates to charge for their products and, in some cases, would be required to apportion their deductible costs among taxable and non-taxable sales. To make up the revenue loss from reducing tax on some goods and services, tax rates on the remaining goods and services would have to be raised.

A tax that is collected wholly or in part from individuals can be applied at graduated tax rates, which would complicate the tax only slightly: it is not much more difficult for taxpayers to look up their tax liability on a table -- as they do now -- than it would be for them to apply a single rate to all taxable income. But in the case of a two-part consumption tax, as noted above, ensuring that the same top statutory rate applies to both individuals and businesses would ease administration and improve compliance.

Many consumption tax proposals offer large standard deductions and exemptions for dependents in order to relieve some income from tax and to remove large numbers of people from the tax system altogether. The latter benefit is reduced, however, if refundable tax credits -- like the EITC -- are used to redistribute the burden of the tax. Low-income families that otherwise might not be required to file a tax return would have to fill out a return in order to receive the credit. So that credits can be targeted to needy households, a family might be required to calculate income, which it otherwise would not have to report under some forms of consumption tax. The relative increase in burden of offering refundable credits might be small in the case of a consumed income tax, under which much of the income tax structure would be retained. The relative burden would be more significant, however, if the income tax had been completely replaced by a business-level consumption tax.

Measuring consumption

Like the existing income tax, a consumption tax that is collected from businesses would require rules for determining deductible business costs. Some business purchases have a consumption component that should be excluded from deductible business purchases. For example, a business' purchase of a company car that is also available for an employee's personal use has a consumption component, as do many business expenditures for travel and entertainment. The rules for determining allowable costs under a consumption tax would be similarly complex to the related rules under the income tax. Moreover, the timing of deductions for capital purchases would make the problem more serious under a consumption tax. Under a consumption tax, business assets would be expensed, leaving only a single year of records for each asset, and accelerating the benefit received -- and tax revenue lost -- from circumventing the rules.

Promoting social and economic goals

A U.S. consumption tax is likely to be used to advance certain widely-held social and economic goals. Home-ownership is treated preferentially under the current income tax primarily by allowing families a deduction for interest they paid on their home mortgages. Allowing current law treatment of mortgage interest under a consumption tax would encourage homeowners to incur additional borrowing beyond their financing needs. Because mortgage loan proceeds under current law are not included in taxable income, while the amounts deposited in a savings account under a consumption tax would be deductible, mortgage loans used to transfer money to a savings account would reduce tax liability. In addition, allowing only some forms of loans to be exempt would introduce distortions relative to a system that treated all borrowing equally. As under the existing income tax, taxpayers would have an incentive to reclassify all forms of household debt as mortgage debt to maximize the benefit of the tax preference.

Deductions for charitable contributions and State and local taxes paid could be allowed for families under a consumed income tax and for wage-earners and businesses under a two-part consumption tax. A tax preference for employer purchases of health insurance and fringe benefits could be provided under a two-part consumption tax by allowing businesses to deduct these costs. Under an individual-level consumption tax, employer-provided health insurance and other fringe benefits could be taxed by imputing their value to the recipients and including the imputed value in taxable income; not imputing the value to recipients would treat these benefits preferentially relative to other forms of compensation. Each of these tax preferences, however, would require rules to determine which fringe benefits and business expenses are included in or excluded from the tax base, and these rules would be equally complex as those under current law. Such tax base reductions would also require overall tax rates to be raised and would reduce the efficiency gains from taxing all forms of consumption equally.

Transition to a consumption tax

The most significant issue in converting from an income to a consumption tax system is deciding how to treat the return to wealth that was accumulated out of after-tax income under the income tax. The return to new saving and investment would be exempt under a consumption tax, but without an explicit exemption for old wealth, the return to and withdrawals from the stock of existing assets that are not reinvested will be taxed. For example, imposing a Federal VAT would automatically tax all withdrawals from existing savings that are used for consumption -- even if those savings were accumulated out of after-tax income. To illustrate the magnitude of this problem, consider the value of current household wealth. The total wealth of U.S. households is estimated at about $23 trillion.[21] Much of this wealth is in the form of assets such as pensions and unrealized capital gains, which have not yet been taxed. But, excluding housing, the basis of private assets in the United States could be as much as $10 trillion. Transition rules governing the treatment of consumption financed by existing wealth will determine to what extent this significant amount of previously taxed savings is subject to the consumption tax.

Transition rules would be required to relieve the tax burden on savers who have already paid income taxes on their savings and would be taxed again when those savings were spent under a consumed income tax. For example, without a transition rule for past savings, a retiree who accumulated $100,000 in a savings account out of after-tax income before the imposition of a consumption tax would be taxed on withdrawals from that account that are for consumption expenditures. A transition rule could allow savings that were accumulated under the income tax to be segregated from "new" savings and deducted from income. This rule would treat the $100,000 as tax-paid savings and would enable the retiree to make tax-free withdrawals from the savings account. It is difficult, however, to design rules that differentiate between individuals who reduce their accumulated savings in order to consume, and individuals who only rearrange assets among accounts. Allowing tax-free withdrawals from past savings, for example, would enable any individual with accumulated wealth to gain a tax deduction simply by transferring old assets into "new" savings accounts. Such a rule would enable a millionaire living off the interest on her accumulated assets, for example, to receive the equivalent of tax-free interest income -- a substantial benefit compared with current law.[22]

---

[21] Board of Governors of the Federal Reserve System, *Balance Sheets of U.S. Households*.

[22] Under a transition rule that treats withdrawals from existing savings that are deposited into new savings accounts as new savings, an individual could draw down existing savings, deposit the amount in a new savings vehicle, and receive a tax deduction for the amount deposited. If the return to this "new" savings is used for consumption, the individual would pay tax on that return. But the original tax deduction would provide a benefit that would be equivalent to receiving the interest income tax-free.

A similar problem exists for businesses that have purchased equipment prior to the tax change and have unused depreciation allowances. Denying depreciation deductions under the consumption tax would mean that businesses would not be able to recover fully the cost of those capital purchases, and that income from capital purchased before the effective date would be overtaxed. It would impose windfall losses on firms that invested prior to the effective date, placing them at a disadvantage relative to businesses that purchased equipment just after the effective date of the new consumption tax.

Transition rules could reduce windfall losses in this case, but they would likely sacrifice tax revenue and lead to greater complexity. For example, if the consumption tax is collected only at the business level, businesses could be allowed to deduct immediately the balance of their depreciation allowances, though little revenue would be collected from businesses during the early years of the tax under this scheme. Extending the depreciation deductions over a number of years would spread out the revenue loss, but it would require businesses to segregate old and new assets during the transition period and, therefore, would increase complexity.

Coordination with State and local sales taxes

An additional administrative consideration is the coordination of a Federal consumption tax with State and local government tax systems. Historically, States have depended heavily on retail sales taxes and excise taxes for revenues. The adoption of a national sales tax or Federal VAT is likely to be seen as an infringement upon this important revenue source for State and local governments. In addition, a Federal VAT or national sales tax would create a new type of tax for businesses to administer. Some businesses would be responsible for either the VAT (or national sales tax) or a State sales tax, while others would be liable for both. The amount of State sales tax or VAT (or national sales tax) collected would depend on which tax was applied first and whether that tax was included in the tax base for the other one. Particular goods and services might be taxable under a VAT (or national sales tax) and exempted under the State sales tax, or vice versa, thereby creating additional administrative problems. Although sales taxes are generally under the purview of the States, the closeness of the tax bases would put the States under pressure to conform to Federal law.

Conclusion

A change as dramatic as replacing the income tax system with a consumption tax should only be attempted if the expected economic benefits of taxing consumption are reasonably certain to be larger than the total costs, burdens, and risks of moving to a completely new tax system. In making such a determination, it is misleading to compare a theoretically ideal consumption tax and the income tax system in place today. A realistic comparison would recognize that exclusions would likely be made under the replacement system -- either for administrative reasons or to support social and economic goals -- and that those exclusions would reduce the economic benefits of the change and increase complexity. A realistic comparison would also recognize that what we call an income tax in the United States is really a hybrid tax system. While it is based on income, it incorporates a number of consumption tax features that help promote saving. For example, contributions to pensions, deductible IRAs, and other types of retirement savings are deducted from taxable income, and the earnings on these savings are not taxed until they are withdrawn. Most of the savings of middle-income Americans are in assets such as pensions and home equity that are already exempt from tax. Proposals for further reduction in taxes on income from savings of middle-income Americans, such as the proposal in the President's budget to expand the use of IRAs, should be carefully examined before we consider doing away with the income tax.

Based on all of the considerations described in my testimony today, we are not convinced that the case for completely replacing the income tax with a consumption tax is compelling. The most frequently cited economic benefit of such a change, an increase in private saving, is uncertain and could be small. The fairness of replacing the income tax with a consumption tax is also a concern. Moving to a flat-rate consumption tax would increase the tax burden on low-income families and lower the tax burden on high-income families. Efforts to improve the progressivity of consumption tax proposals result in complexity.

In general, divergence from the simple, broad-based, flat-rate, consumption tax model -- for administrative reasons, to address distributional problems, or to promote social and economic goals -- will result in more complicated tax calculations, higher tax rates overall, and reduced efficiency gains. In addition, the transition could take many years to complete, and could be very costly and complex. Absent special transition rules, the move to a consumption tax could create many unintended winners and losers. New savers would be advantaged relative to those who saved in the past, including many of the elderly. Businesses that invest after enactment of the consumption tax would have a competitive advantage over businesses that invested just prior to the change. Rules that would address these situations would be complex.

We commend efforts to develop consumption tax proposals that are progressive and revenue-neutral. We recognize that the details of recent tax reform proposals have not yet been provided, and that the details will affect the analysis of any particular proposal. However, we believe that replacing the income tax with a consumption tax ultimately could be excessively complex and could create economic disruption. Moreover, adopting a form of consumption tax other than a credit-invoice VAT or RST would be venturing into the unknown. We can only speculate as to how a consumption tax collected at the individual taxpayer level would work. There is no experience upon which to gauge its effects on the U.S. economy or its administrative and compliance costs, and no way to anticipate all the potential tax avoidance schemes that could be designed to exploit the new tax rules.

Other countries have typically introduced consumption taxes, not as replacements for progressive income taxes, but in place of existing distorting sales or turnover taxes. Most of our trading partners now rely on a mixed tax system that combines income and consumption taxes. Consequently, a wholesale replacement of the income tax with a consumption tax would represent a grand international experiment. The burden lies with the proponents of consumption taxes to show that it is worthwhile to conduct this experiment on the world's largest and most complex economy.

Mr. Chairman, we look forward to working with the Congress on improving our tax system. In particular, we will give serious consideration to proposals that meet the tax policy objectives set forth above -- proposals that would simplify the tax system and improve economic incentives without sacrificing revenue or fairness.

Table 1
Replace Current Individual and Corporate Income Taxes (Including the EITC) with a 14.3% Flat Rate Consumption Tax with No Exemptions(1)

(1994 Income Levels)

Family Economic Income Class (2) (000)	After-Tax (3) Income Under Current Law ($B)	Change in After-Tax Income from Proposal (4): Repeal Income Tax ($B)	Flat Rate Consumption Tax with No Exemptions ($B)	Total Change: Amount ($B)	Total Change: Percentage Change (%)	Percentage Change In Total Federal Taxes (%)
0 - 10	79.3	-1.2	-5.1	-6.3	-8.0	97.9
10 - 20	249.4	-1.6	-25.2	-26.8	-10.8	104.0
20 - 30	342.6	13.7	-42.7	-29.0	-8.5	53.0
30 - 50	728.8	61.8	-100.2	-38.4	-5.3	25.2
50 - 75	865.4	92.4	-124.1	-31.7	-3.7	15.5
75 - 100	680.2	86.5	-101.6	-15.1	-2.2	8.6
100 - 200	902.5	148.8	-131.8	17.0	1.9	-7.0
200 & over	906.8	240.1	-109.2	130.9	14.4	-47.6
Total (5)	4,711.2	641.1	-641.1	0.0	0.0	0.0

Department of the Treasury
Office of Tax Analysis

February 14, 1995

(1) This table distributes the estimated change in after-tax income due to the proposal with a revenue-neutral rate of 14.3 percent.

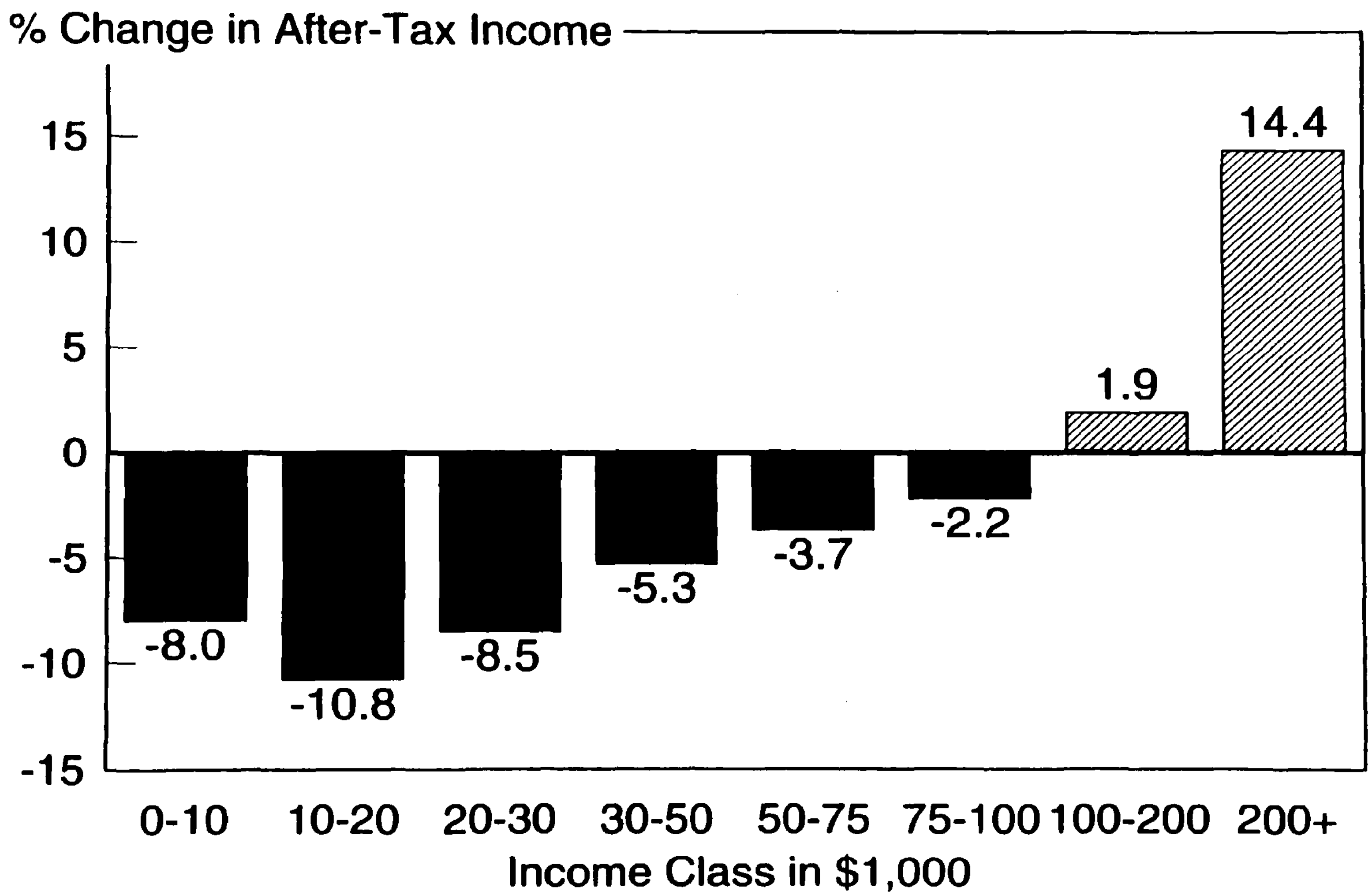
(2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(3) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period (i.e., before 1999) are excluded.

(4) The change in Federal taxes is estimated at 1994 income levels but assuming fully phased in law and static behavior. The incidence assumptions for the repealed income taxes is the same as for the current law taxes (see footnote 3). The portion of the flat rate consumption tax that falls on wages, fringe benefits, and pension benefits is assumed to be borne proportionately by wages, fringe benefits, and pension benefits. The remaining portion of the flat rate consumption tax, which falls on business cash flow, is assumed to be borne by capital income generally.

(5) Families with negative incomes are included in the total line but not shown separately.

Chart 1: Distributional Effect of Replacing Current Individual and Corporate Income Taxes with a 14.3% Flat Rate Consumption Tax



Source: Department of the Treasury (See Table 1 for details)

Table 2.
Components of Net U.S. National Savings as a Percentage of GDP
1929 – 1994

Year	Net Personal Saving	Net Business Saving	Total Net Private Saving	Public Saving	Total Net National Saving
1929	2.4	2.8	5.2	1.0	6.2
1939	1.9	0.8	2.6	−2.6	0.0
1949	2.7	4.2	6.9	−1.2	5.7
1959	4.5	3.2	7.7	−0.6	7.1
1969	4.5	2.6	7.1	1.0	8.1
1979	5.0	2.5	7.5	0.4	7.9
1989	2.9	1.7	4.6	−1.5	3.1
1990	3.1	1.6	4.7	−2.5	2.2
1991	3.7	1.7	5.4	−3.2	2.2
1992	4.1	1.2	5.4	−4.3	1.1
1993	3.0	2.2	5.3	−3.4	1.9
1994	3.0	2.0	5.0	−1.9	3.0
Average 1950−59	4.7	2.9	7.6	−0.1	7.5
Average 1960−69	4.7	3.6	8.2	−0.1	8.1
Average 1970−79	5.5	2.6	8.1	−1.0	7.2
Average 1980−89	4.5	1.5	6.0	−2.4	3.6
Average 1990−94	3.4	1.8	5.1	−3.1	2.1

Office of Tax Analysis February 1995
U.S. Department of the Treasury

Source: Department of Commerce, Bureau of Economic Analysis

Table 3

Tax Revenues by Type of Tax as a Percentage of GDP for Selected Countries: 1992

	Total	Income & Profits	Social Security	Property	Goods & Services	Other[1]
Canada	36.5	16.4	6.0	4.0	9.5	0.5
France	43.6	7.6	19.5	2.2	11.7	2.7
Germany	39.6	12.7	15.2	1.1	10.6	0
Italy	42.4	16.6	13.3	1.0	11.4	0.1
Japan	29.4	12.5	9.7	3.1	4.1	0.1
United Kingdom	35.2	12.7	6.3	2.8	12.1	1.3
United States	29.4	12.2	8.8	3.3	5.0	-

Source: Organization for Economic Cooperation and Development, Revenue Statistics of OECD Member Countries, 1965-1993, 1994.

[1] Includes certain payroll taxes that are not earmarked for social security, taxes imposed on other bases not otherwise identified or identifiable and fines and penalties.

Table 4

Tax Revenues by Type of Tax as a Percentage of Total Taxation for Selected Countries: 1992

	Income & Profits	Social Security	Property	Goods & Services	Other[1]
Canada	45.0	16.5	11.1	26.1	1.4
France	17.3	44.6	5.0	26.8	6.3
Germany	32.0	38.4	2.7	26.9	-
Italy	39.1	31.3	2.4	26.9	0.3
Japan	42.4	32.8	10.5	14.0	0.3
United Kingdom	36.1	17.8	7.9	34.4	3.7
United States	41.5	29.9	11.4	17.1	-

Source: Organization for Economic Cooperation and Development, Revenue Statistics of OECD Member Countries, 1965-1993, 1994.

[1] Includes certain payroll taxes that are not earmarked for social security, taxes imposed on other bases not otherwise identified or identifiable and fines and penalties.

Table 5

Average Net National Saving Rates for Selected Countries

Country	1980's	1990	1991	1992
Canada	8.4	5.0	2.5	1.5
France	7.9	8.6	7.6	6.5
Germany	9.8	12.5	10.4	9.8
Italy	9.8	7.8	6.8	5.2
Japan	18.2	19.8	20.0	18.2
United Kingdom	4.8	3.6	2.4	2.0
United States	4.5	3.1	2.8	1.9

Source: OECD, National Accounts 1980-1992, 1994.

Note: Data are based on the OECD System of National Accounts (SNA) methodology which differs slightly from the U.S. National Income Accounts System.

Table 6
Average Annual Growth Rates of Real Per Capita GDP in G7 Countries, 1980 – 1992

Country	1980 to 1990	1990 to 1992
	(percent)	
Canada	1.9	−1.9
France	1.8	0.4
Germany	2.0	2.0
Italy	2.0	0.9
Japan	3.5	2.4
United Kingdom	2.5	−1.8
United States	1.8	−0.1

Office of Tax Analysis
U.S. Treasury Department

February 1995

Source: Organization for Economic Cooperation and Development

AUCTION RESULTS

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
April 24, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $11,694 million of 13-week bills to be issued April 27, 1995 and to mature July 27, 1995 were accepted today (CUSIP: 912794S96).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.64%	5.82%	98.574
High	5.66%	5.84%	98.569
Average	5.66%	5.84%	98.569

$10,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 47%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$48,637,887	$11,693,761
Type		
Competitive	$43,299,910	$6,355,784
Noncompetitive	1,277,377	1,277,377
Subtotal, Public	$44,577,287	$7,633,161
Federal Reserve	3,544,400	3,544,400
Foreign Official Institutions	516,200	516,200
TOTALS	$48,637,887	$11,693,761

5.60 -- 98.584   5.65 -- 98.572

RR-238)

AUCTION RESULTS

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
April 24, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $11,736 million of 26-week bills to be issued April 27, 1995 and to mature October 26, 1995 were accepted today (CUSIP: 912794V43).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.72%	5.99%	97.108
High	5.75%	6.02%	97.093
Average	5.75%	6.02%	97.093

Tenders at the high discount rate were allotted 21%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$49,105,994	$11,735,929
Type		
Competitive	$42,586,560	$5,216,495
Noncompetitive	1,040,034	1,040,034
Subtotal, Public	$43,626,594	$6,256,529
Federal Reserve	3,150,000	3,150,000
Foreign Official Institutions	2,329,400	2,329,400
TOTALS	$49,105,994	$11,735,929

5.73 - 97.103   5.74 - 97.098

(RR-239)

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

April 25, 1995

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of March 1995.

As indicated in this table, U.S. reserve assets amounted to $86,761 million at the end of March 1995, up from $81,439 million in February 1995.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1995					
February	81,439	11,050	11,158	46,378	12,853
March	86,761	11,053	11,651	50,639	13,418

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Includes holdings of Treasury and Federal Reserve System; beginning November 1978, these are valued at current market exchange rates or, where appropriate, at such other rates as may be agreed upon by the parties to the transactions.

RR-240

AUCTION RESULTS

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
April 25, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Tenders for $17,751 million of 2-year notes, Series AD-1997, to be issued May 1, 1995 and to mature April 30, 1997 were accepted today (CUSIP: 912827T51).

The interest rate on the notes will be 6 1/2%. All competitive tenders at yields lower than 6.524% were accepted in full. Tenders at 6.524% were allotted 76%. All noncompetitive and successful competitive bidders were allotted securities at the yield of 6.524%, with an equivalent price of 99.956. The median yield was 6.500%; that is, 50% of the amount of accepted competitive bids were tendered at or below that yield. The low yield was 6.480%; that is, 5% of the amount of accepted competitive bids were tendered at or below that yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$41,203,984	$17,751,448

The $17,751 million of accepted tenders includes $1,005 million of noncompetitive tenders and $16,746 million of competitive tenders from the public.

In addition, $533 million of tenders was awarded at the high yield to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $350 million of tenders was also accepted at the high yield from Federal Reserve Banks for their own account in exchange for maturing securities.

RR-241

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT 2:30 P.M.
April 25, 1995

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $24,400 million, to be issued May 4, 1995. This offering will result in a paydown for the Treasury of about $3,175 million, as the maturing 13-week and 26-week bills are outstanding in the amount of $27,563 million. In addition to the maturing 13-week and 26-week bills, there are $16,593 million of maturing 52-week bills. The disposition of this latter amount was announced last week.

Federal Reserve Banks hold $11,205 million of bills for their own accounts in the three maturing issues. These may be refunded at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $4,611 million of the three maturing issues as agents for foreign and international monetary authorities. These may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $4,081 million of the original 13-week and 26-week issues.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

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

oOo

Attachment

RR-242

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS
TO BE ISSUED MAY 4, 1995

April 25, 1995

Offering Amount	$12,200 million	$12,200 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 U3 6	912794 V5 0
Auction date	May 1, 1995	May 1, 1995
Issue date	May 4, 1995	May 4, 1995
Maturity date	August 3, 1995	November 2, 1995
Original issue date	February 2, 1995	May 4, 1995
Currently outstanding	$13,560 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

EMBARGO TO BE SET AT BRIEFING
Text as prepared for delivery
April 25, 1995

REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN
POST G-7 PRESS CONFERENCE

You all have the communique, so I won't read the whole text to you.

Let me start giving you a sense of our discussion on the key issues, and then I'll take a few questions.

First, and very importantly, we reached a common view that recent exchange rate movements have gone beyond the levels justified by underlying economic conditions in the major countries, and that an orderly reversal of these movements would be desirable. We also agreed to strengthen our respective efforts to reduce internal and external imbalances and to continue to cooperate closely in exchange markets.

This statement reflects a general view that the most effective route to promote greater financial market stability is to get the fundamentals right, and to strengthen them where necessary.

Let me say, and I think it's very important, that the tone of our discussions was very constructive. The spirit was one of cooperative enterprise. We agreed to remain in close contact and to continue to work closely together as we go forward.

We had an opportunity to discuss the very substantial progress made in respect to many areas of the U.S. economy -- progress that has not been entirely understood abroad. I made it clear, as the President has on many occasions, that we are committed to further deficit reduction and that we will not support tax cuts that would increase the deficit. I expressed the view that many in Congress are committed to deficit reduction. The President has proposed a budget that further reduces the deficit as a share of our economy, and I believe that after what undoubtedly will be a lengthy process in Congress we will come out with precisely that -- a budget that continues to reduce the deficit as a share of our economy.

RR-243 (MORE)

We also had an extensive discussion of the Halifax agenda for reform of the international financial institutions.

Our priorities are first to improve our capacity to deal with the challenges presented by the changes in the global financial system, and, second, to develop more effective means to promote sustainable development, particularly in the poorest developing countries.

We reviewed the proposals I covered in my press conference yesterday, and a variety of other issues. And, although it would not be appropriate to go into the details of our discussions, I will say that we have made a reasonable amount of progress since our meeting in Toronto toward agreement on broad directions and specific proposals for reform. We will each have an opportunity over the next two days to consult on these issues with the broader membership of the IMF and the World Bank. And that will help us as we continue our preparations for the Summit over the next several weeks.

Finally, on Russia, we were encouraged by the renewed commitment by the Russian authorities toward stabilization and reform. We urged them to push ahead with their privatization efforts and with strengthening the legal framework necessary to support private sector development.

We look forward to reaching agreement in the Paris Club to reschedule Russia's official debt service payments falling due in 1995.

With that introduction, I would be happy to take your questions.

-30-

April 25, 1995

STATEMENT OF THE GROUP OF SEVEN
Finance Ministers and Central Bank Governors

1. The Ministers and Governors exchanged views on current global economic and financial conditions and issues related to the review of the international economic architecture initiated at the Naples Economic Summit. The Ministers and Governors joined by representatives of the EC also reviewed developments in the Russian Federation with Russian officials.

2. In reviewing the recent economic performance of the G-7, they agreed that the recent performance of their economies is encouraging. Growth in most of the major industrial countries has been stronger than expected, and the broad-based expansions now in place will contribute to increased employment. As recovery spreads, the pattern of growth will help promote adjustment of external imbalances.

3. Considerable progress has been made in establishing the conditions conducive to achievement and maintenance of price stability. The Ministers and Governors agreed that policies should continue to be directed towards the objective of sustaining non-inflationary growth, which will in turn contribute to financial market stability.

4. Fiscal imbalances have been reduced in a number of countries. However, further efforts to raise savings and improve confidence in financial markets will be required in many countries to establish conditions conducive to lower long-term interest rates and thus underpin continued economic growth. In this context, governments need to implement existing consolidation efforts and strengthen them as necessary.

5. The Ministers and Governors expressed concern about recent developments in exchange markets. They agreed that recent movements have gone beyond the levels justified by underlying economic conditions in the major countries. They also agreed that orderly reversal of those movements is desirable, would provide a better basis for a continued expansion of international trade and investment, and would contribute to our common objectives of sustained non-inflationary growth. They further agreed to strengthen their efforts in reducing internal and external imbalances and to continue to cooperate closely in exchange markets.

6. In preparation for the annual Economic Summit, the Ministers and Governors reaffirmed their strong support for the Bretton Woods Institutions, and discussed how their role could be adapted to meet the challenges of today's global economy. In this context, they reviewed the lessons that can be drawn from Mexico's recent financial problems and had an extensive discussion of approaches which may be desirable to facilitate continued progress toward sustained growth and employment, the maintenance of financial stability, and the promotion of sustainable development.

7. The Ministers and Governors met with Russian economic officials, led by First Deputy Prime Minister Chubais, and exchanged views on the Russian economy. They welcomed Russia's economic reform program, which has earned the IMF's support under a $6.8 billion standby program, and expressed approval that the program aims at achieving a lasting stabilization of the Russian economy and the liberalization of the energy sector, which is a vital key to Russia's economic future. The Ministers and Governors urged Russia to expedite the second stage of its mass privatization program and the legal framework needed to support the private sector. Finally, they noted that firm implementation of Russia's 1995 economic program is essential to build the

confidence of Russia's people and foreign investors in the future of Russian reform. Subject to completion of all outstanding bilateral agreements, they invited official bilateral creditors to provide an appropriate rescheduling of Russia's debt service obligations due in 1995. They also invited official bilateral creditors to include a strong good will clause pointing towards the possibility of a comprehensive rescheduling which addresses Russia's medium-term debt problems.

8. The Ministers and Governors congratulated Ukraine on its $1.5 billion stand-by agreement with the IMF, which will support Ukraine's ambitious economic reform goals for 1995. It will also facilitate the necessary energy sector reform and thus lay the basis for early closure of Chernobyl. The Ministers and Governors pledge their continued support for ongoing economic reforms in Ukraine.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

TRANSCRIPT OF POST G-7 PRESS BRIEFING
DEPARTMENT OF THE TREASURY
TUESDAY APRIL 25, 1995

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 26, 1995

STATEMENT OF TREASURY SECRETARY ROBERT E. RUBIN
IMF INTERIM COMMITTEE
WASHINGTON, D.C.

I am pleased to be attending my first meeting of the Interim Committee of the International Monetary Fund. This committee plays a central role as a forum for consultations and cooperation on the critical issues confronting the international monetary system and the world economy. I look forward to working with each of you in trying to make the next 50 years of the International Monetary Fund as successful as the first 50 years.

World Economic Outlook

We are living in a curious time. The fundamental health of the global economy looks stronger than it has in thirty years. Yet, the opportunities created by the rapid development of global capital markets have created new challenges, and recent turbulence in financial markets casts a shadow of uncertainty over the outlook.

The industrial economies, with the notable exception of Japan, are experiencing strong expansions. There is enough momentum to the growth to generate employment, but not enough to create serious inflationary pressures. Indeed, in many countries inflation is at levels not seen for 30 years.

Better performance in the industrial countries has been reinforced by strong forces already in motion in developing countries. Emerging market economies of Asia continue to set remarkable standards for growth. Some African economies are beginning to see growth as their efforts at structural transformation take hold. Several of the transition economies have turned the corner and are once again growing. Russia and Ukraine have recently adopted stabilization programs that merited the strong support of the IMF. The outlook for Latin America is somewhat less rosy in the wake of Mexico's crisis, but the initial repercussions for the region have been contained.

With appropriate policies, the improved fundamentals across much of the world economy provide the basis for continued expansion, despite the risks posed by recent financial market developments.

RR-244 (MORE)

In the United States we are shifting to a period of more moderate but solid growth that should allow us to maintain high levels of employment and low inflation. We are committed to continuing fiscal consolidation, building on the major reductions in the budget deficit that were accomplished in the first two years of the Administration. Under the President's budget proposal, the government deficit -- currently the lowest among G-7 countries -- will decline further as a share of GDP over the balance of this decade. As the President has often stated, it is our firm intent to reform the health care system, which is essential to contain costs and achieve additional improvements in the underlying fiscal position of the United States. Our shared commitment with the Federal Reserve to the goals of sustaining growth with low inflation has paid off. Soft landing may be a journalistic cliche, but I think it pretty well captures current developments in the United States.

While the fundamentals look solid in the United States and in many other countries, there are some risks to the outlook, and recent financial market developments warn us against slipping into complacency.

In this regard, developments in exchange markets have been a matter of concern. Yesterday, the G-7 agreed that recent movements have gone beyond the levels justified by underlying economic conditions in the major countries, and they also agreed that orderly reversal of these movements is desirable.

The movement of the dollar has coincided with a sharper movement of some other currencies, most notably the yen. Japan, unlike the other industrialized countries, has not participated in the revival of activity that took hold in 1994. The recent monetary policy measures are welcome, and we look forward to the additional and more specific measures on fiscal stimulation that have been announced and are expected to be forthcoming in the near future to revitalize the Japanese economy. Japan needs to import more and to absorb more of its available savings, so that its external surplus adjusts to a more sustainable level.

In other parts of the industrial world, the expansion presents an opportunity to correct underlying structural problems. Fiscal positions are benefiting from the cyclical upturn, but continued efforts will be needed in many countries to put deficits on a clearly declining path. Unemployment remains high and employment growth relatively slow despite the expansion, which attests to the importance of structural reforms in labor markets to provide more flexibility and greater incentives.

The Mexican financial crisis demonstrated just how important it is not to mistake surface stability for true sustainability. The markets can be unforgiving if latent problems go uncorrected too long. Mexico has now faced its difficulties resolutely. It is implementing a strong stabilization program that is already beginning to show progress such as a reduction of the money supply. Demand for peso assets is beginning to recover. We are cautiously optimistic. Nevertheless, financial support will continue to be needed.

We remain ready to make available $20 billion in bilateral support. Full implementation of the $17.8 billion IMF stand-by will be essential for the successful conclusion of this major undertaking.

One region where hard work on the fundamentals is beginning to pay off is the economies in transition. Many of the economies of central Europe have stabilized. Market forces are taking root, and growth is beginning. One or two countries face the novel but not unwelcome problem of dealing with surges in capital inflows. The job won't be finished for years to come, but the path ahead looks clearer. We are particularly pleased that both Russia and Ukraine have recently concluded stand-by arrangements with the IMF. The preparatory work that was done under earlier IMF agreements greatly increases the likelihood that these programs will succeed. Stabilization of these two major economies will set the stage for the full integration of all the countries of the former Soviet Union into the global economy.

The evolving role of the IMF

The international financial system has changed dramatically since the IMF was created 50 years ago. Capital markets have become truly global in size and scope. Today, foreign exchange transactions exceed in a week the value of international trade for a year. Markets have become decentralized, with instruments that are increasingly complex. The distinction between domestic and international finance is increasingly blurred.

Our international financial institutions must adapt to these new realities. The IMF has proven itself adept in dealing with emerging problems such as Mexico. However, we need to be able to stay ahead of and influence events, not merely react to them. And, we must not lose sight of the needs of those countries which rely primarily on official financing to support reform efforts, particularly the countries emerging from political and economic chaos and the poorest, most heavily indebted countries.

We need an architecture for the IMF that is as modern as the financial markets, while also being responsive to the needs of countries that do not rely on the private markets. This will require an IMF that is capable of:

- serving as an effective early warning and prevention mechanism;
- responding quickly and effectively to liquidity crises that pose a broader threat; and
- dealing with the unique challenges faced by heavily indebted poorer countries and those countries emerging from protracted political and economic disruption.

An ounce of prevention

Surveillance has been at the center of the IMF's efforts to spot emerging problems and to encourage policy responses that will prevent crises from erupting. The effectiveness of surveillance depends critically on the willingness of members to cooperate with the Fund, by providing the comprehensive and timely data essential for sound analysis, and a commitment to enter into a dialogue with the Fund on the core issues of economic policy within its mandate. The failure of a member to provide the necessary information which the IMF has a right to expect under its Articles of Agreement, or to engage in consultations as needed, should be viewed as a "red flag" that a problem exists requiring Executive Board consideration. Repeated failure should be considered a violation of a members' obligations, with potential consequences for its ability to obtain IMF financing.

The Fund also has to change the way it operates. It has to build a capacity for more intensive ongoing assessments of countries whose underlying financial position poses potential risks even if they are not under or emerging from an IMF program. It needs an improved capability for assessing capital market developments. It needs to be willing to be direct and candid with member countries in identifying policy risks. The IMF is not and should not become a global rating agency; however, in discharging its responsibilities it needs to be more transparent and accountable.

Surveillance is not the function solely of the IMF. The financial markets conduct their own assessments of our economic policies and performance every day, and with a degree of frankness that is often uncomfortable. The opening of capital markets and the globalization of finance have contributed to a more efficient allocation of resources and have helped to boost investment and growth. At the same time, recent experience has demonstrated that international capital can move quickly and with force in response to actual and perceived risks, reducing the room for maneuver that policy makers may have felt they enjoyed in the past and increasing the intensity of the penalty for policy mistakes. In these circumstances, the benefits of globalization can be maximized and the downside risks minimized when foreign capital is used in moderation to supplement domestic savings for productive investment, when the authorities respond promptly to emerging problems through measures to reduce reliance on external finance, and when inflation threats are confronted before they emerge.

The days when governments could influence market judgements by withholding or manipulating information or adjusting the timing for the release of data are long gone. The effort to do so contributes to the very volatility that governments are seeking to avoid by fueling rumors and mistrust. In today's global market place where capital has many suitors, transparency is of overwhelming importance. The timely and frequent publication of comprehensive data on national accounts, on monetary conditions, and on central bank balance sheets can make an important contribution to international confidence in those countries which practice full disclosure.

It also serves to signal problems, at an early stage, and thus can encourage policy responses to deal with market reactions. And, perhaps most importantly, transparency exercises important policy discipline by reducing the ability to sweep problems under the rug.

Transparency is an important complement to IMF surveillance and a legitimate objective of the Fund. To this end, therefore, we believe that the IMF should encourage greater transparency by, for example, developing standards to guide members' policies on the publication of data, indicating publicly those countries which meet the standards and requiring commitments to greater transparency as part of IMF programs. The recent decisions by APEC finance ministers to support timely publication of key financial data reflects a growing recognition of the new realities and acceptance of the benefits of more openness in this area.

Emergency financing mechanism

Even the best early warning and prevention system, however, cannot be fail-safe. Governments make policy mistakes. Markets overreact. Liquidity and confidence problems occur, sometimes posing broader risks.

The IMF was created to help members deal with balance of payments problems without recourse to measures disruptive of its own or the world economy. The globalization of financial markets heightens, not lessens, the need for the Fund to consider how better to position itself to deal with those problems which, like Mexico, may pose a serious threat to the system.

Concerns that an enhanced IMF capacity may create moral hazard are legitimate and have been at the center of every debate on the role of the Fund since its inception 50 years ago. The challenge is to design an emergency financing mechanism which minimizes these risks. This requires that any loan carry substantial policy conditionality. While the amount of financing provided must be credible in dealing with potential problems, any expectation of automaticity or entitlement to financial support must be avoided. The interest charged on such loans should cover all operational costs, include a risk premium, and provide a penalty rate to encourage the borrower to return to the private markets as soon as possible.

The means of financing such a mechanism could also serve to reduce moral hazard. One possible approach would be to expand and modify the General Arrangements to Borrow, and to trigger that agreement in those exceptional circumstances where large IMF programs may be necessary. In this possible approach, it would seem to make sense to invite into appropriate arrangements with the GAB those new countries which benefit from a stable international monetary system and have the capacity to contribute to maintaining it.

Such an approach would be preferable to a large increase in the IMF's permanent quota resources, which are better suited to meeting normal financing needs. We recognize that the IMF has stepped up its lending activity substantially this year and that its liquidity position should be monitored closely. However, the IMF's financial position is strong at present and capable of meeting normal demands. In these circumstances, it would be premature to conclude now that a large, early increase in quotas is needed.

Similarly, there would appear to be little merit to designing a new safety net based on the SDR when the GAB already exists. Proposals for the IMF to borrow SDRs require a finding of global need for a general SDR allocation, which we do not believe exists at present. Proposals for special SDR allocations to finance an IMF safety net would involve a fundamental change in the role of the SDR, an issue which would be more appropriately considered in the context of a broader comprehensive review of the SDR.

The days are long past when the IMF's Managing Director could convene a small group of bankers to deal with the international debt problems of a country. Financing is now provided by a much larger and more diverse pool of largely anonymous investors rather than a few banks. Moreover, opportunities for residents in a distressed country to mobilize domestic capital and send it abroad have grown dramatically. As a consequence, even in those limited cases where an exceptional official response is justified, the IMF, in cooperation with other official lenders, is likely to be able to meet only a fraction of the resources required, and the effort to do so can create a moral hazard with respect to private creditors.

The international community -- debtors, private markets, governments and the institutions -- has a clear interest in achieving an orderly resolution of debt problems. As part of the new international architecture, consideration may also need to be given to procedures that will allow official debtors and private creditors to work out problems in a manner which retains market incentives while ensuring appropriate policy responses through conditionality.

A global financial marketplace that is decentralized, growing rapidly, and with ever more complex instruments poses new challenges for our ability to ensure that the markets remain robust in the face of potential shocks. Supervisors and regulators in large industrial countries should strengthen their own cooperative efforts and be prepared to assist their counterparts in developing countries, particularly countries where financial markets are developing rapidly. Policymakers should take actions required to ensure that financial authorities' oversight capabilities keep pace with the rapid pace of expansion in these markets.

Meeting the needs of poorer countries

As we build a new architecture to deal with the globalization of financial markets, we must not lose sight of the needs of those countries which rely primarily on official sources of finance. The IMF's Enhanced Structural Adjustment Facility has made an enormous contribution to improving access of poorer countries to more affordable financing in support of strong adjustment and reform programs. It is a tool that will continue to have a clear purpose for the foreseeable future.

We believe that the ESAF could be modified to provide targeted concessional assistance to help deal with the special needs of the poorest, most indebted countries and those which are emerging from economic and political disruption. For this purpose, consideration should be given to mobilizing a modest portion of the IMF's gold.

Conclusion

The task before the IMF is important and challenging. We must forge a consensus that will enable us to sustain and extend the global expansion now under way. At the same time, we must adapt the architecture of the IMF to enable it to better deal with the rapid changes now underway in the global financial system. And we must develop new instruments to help those countries undertaking the difficult transition from political and economic disruption and poverty so that they may also enjoy the full benefits of a growing world economy and a stable financial system.

-30-

AUCTION RESULTS

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
April 26, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Tenders for $11,502 million of 5-year notes, Series K-2000, to be issued May 1, 1995 and to mature April 30, 2000 were accepted today (CUSIP: 912827T69).

The interest rate on the notes will be 6 3/4%. All competitive tenders at yields lower than 6.815% were accepted in full. Tenders at 6.815% were allotted 43%. All noncompetitive and successful competitive bidders were allotted securities at the yield of 6.815%, with an equivalent price of 99.729. The median yield was 6.800%; that is, 50% of the amount of accepted competitive bids were tendered at or below that yield. The low yield was 6.771%; that is, 5% of the amount of accepted competitive bids were tendered at or below that yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$34,642,068	$11,502,017

The $11,502 million of accepted tenders includes $477 million of noncompetitive tenders and $11,025 million of competitive tenders from the public.

In addition, $550 million of tenders was awarded at the high yield to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $353 million of tenders was also accepted at the high yield from Federal Reserve Banks for their own account in exchange for maturing securities.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
Text as Prepared for Delivery
April 27, 1995

Testimony of Ronald K. Noble
Under Secretary of the Treasury for Enforcement
Senate Judiciary Committee

RR-246

TESTIMONY OF THE HONORABLE RONALD K. NOBLE

UNDER SECRETARY OF THE TREASURY FOR ENFORCEMENT

MR. CHAIRMAN, SENATOR BIDEN, MEMBERS OF THE COMMITTEE:

I AM PLEASED TO HAVE THE OPPORTUNITY TO SPEAK TO YOU TODAY ABOUT THE TREASURY DEPARTMENT'S EFFORTS IN THE AREA OF DOMESTIC AND INTERNATIONAL TERRORISM. SECRETARY RUBIN IS PERSONALLY COMMITTED TO THE FIGHT AGAINST TERRORISM, AND STRONGLY SUPPORTS TREASURY ENFORCEMENT'S EFFORTS IN THIS AREA.

I HAVE BEEN TO OKLAHOMA CITY TO SEE THE DEVASTATION THAT OCCURRED, AND TO TALK TO THE FAMILIES AND VICTIMS. IN THE LAST THREE DAYS, I ATTENDED FUNERALS THAT WERE NEEDLESSLY CAUSED BY THIS SENSELESS BOMBING. I HAVE ALSO SEEN THE MAGNIFICENT JOINT LAW ENFORCEMENT EFFORT TO LOCATE THE BOMBERS AND BRING THEM TO JUSTICE. WE

MUST ALL BE COMMITTED TO MAKING SURE THAT THIS KIND OF HORROR NEVER AGAIN OCCURS.

THE TREASURY DEPARTMENT PLAYS A CENTRAL ROLE IN THE FIGHT AGAINST TERRORISM. OUR ENFORCEMENT BUREAUS PROTECT THE MOST VISIBLE TERRORIST TARGETS IN THE U.S., ENFORCE LAWS DIRECTED AT THE MOST COMMON INSTRUMENTS OF TERROR, PROTECT AGAINST THE SMUGGLING OF WEAPONS OF MASS DESTRUCTION, AND ENFORCE ECONOMIC SANCTIONS AGAINST COUNTRIES AND GROUPS THAT PROMOTE TERRORISM.

MR. CHAIRMAN, LET ME FIRST TELL YOU BRIEFLY OUR PHILOSOPHY FOR APPROACHING TERRORISM THREATS, AND OUR POLICIES FOR CONDUCTING INVESTIGATIONS:

WE MUST ENFORCE THE LAW, AND WE DO. WE MUST PROTECT INNOCENT CITIZENS FROM CRIME AND TERRORISM, AND WE DO. BUT FIRST, AND FOREMOST, WE ARE

COMMITTED TO RESPECTING THE CONSTITUTIONAL RIGHTS OF ALL AMERICANS.

TO THAT END, WE CONDUCT CRIMINAL INVESTIGATIONS ONLY OF INDIVIDUALS OR GROUPS WHO WE HAVE REASON TO BELIEVE MAY BE VIOLATING LAWS THAT FALL UNDER OUR JURISDICTIONAL PURVIEW, OR ARE PLOTTING TO VIOLATE THOSE LAWS. LET ME MAKE CLEAR THAT WE DO NOT INVESTIGATE INDIVIDUALS OR GROUPS OF INDIVIDUALS MERELY BECAUSE THEY ADVOCATE UNPOPULAR OR UNCONVENTIONAL IDEAS. NOR DO WE INVESTIGATE GROUPS SOLELY BECAUSE THEY ARE LEGALLY OBTAINING FIREARMS OR AMMUNITION.

OF COURSE, WE KEEP OUR EYES AND EARS OPEN WHEN INDIVIDUALS MAKE THREATENING STATEMENTS. AS PART OF ITS PROTECTIVE FUNCTION, THE SECRET SERVICE MUST MONITOR ANY ORGANIZATION THAT POSES A POTENTIAL VIOLENT THREAT TO ITS PROTECTEES.

SCOPE OF THE PROBLEM – DOMESTICALLY

MR. CHAIRMAN, LET ME NOW TURN TO WHAT WE SEE AS THE CURRENT DOMESTIC TERRORISM SITUATION.

I AM PLEASED TO TELL YOU THAT THERE IS OUTSTANDING COOPERATION AND JOINT EFFORT AMONG FEDERAL LAW ENFORCEMENT AGENCIES IN ATTACKING THE DOMESTIC TERRORISM PROBLEM. ATF, FBI, SECRET SERVICE, CUSTOMS, IRS, THE TREASURY DEPARTMENT, AND THE JUSTICE DEPARTMENT ARE SHARING INFORMATION ABOUT THE CRIME THREAT POSED BY CERTAIN ORGANIZED GROUPS.

DOMESTIC TERRORISM IS A BROAD CONCEPT WITHOUT A PRECISE DEFINITION. WHEN I USE THAT TERM TODAY, – I AM REFERRING TO INDIVIDUALS OR GROUPS WITHIN THE UNITED STATES WHO REJECT THE LEGITIMATE AUTHORITY OF THE UNITED STATES GOVERNMENT, WHO DO NOT RECOGNIZE THE VALIDITY OF FEDERAL LAW, OR WHO

ADVOCATE THE OVERTHROW OF THE UNITED STATES GOVERNMENT, AND WHO USE OR PLAN TO USE VIOLENCE OR TO OTHERWISE VIOLATE FEDERAL LAW IN FURTHERANCE OF THESE OBJECTIVES.

TREASURY'S ENFORCEMENT AGENCIES BELIEVE THAT DOMESTIC TERRORISM HAS BEEN GROWING STEADILY. WE HAVE NOTED AN ESCALATION IN VIOLENT INCIDENTS DURING THE PAST DECADE.

BETWEEN 1983 AND 1993, THE NUMBER OF YEARLY BOMBINGS IN THE UNITED STATES MORE THAN TRIPLED. BOMBING DEATHS AND INJURIES WERE AT AN ALL TIME HIGH IN 1993 WITH 49 DEATHS AND 1,323 INJURED. THE OKLAHOMA CITY BOMBING WILL MAKE 1995 THE MOST DEADLY YEAR, YET.

OUR BEST ESTIMATE IS THAT IN THE PAST FIVE YEARS, THE VAST MAJORITY OF BOMBING INCIDENTS HAVE INVOLVED CRIMINAL DESTRUCTION OF PROPERTY OR NON-

TERRORIST RELATED REVENGE. NEVERTHELESS, IT IS CLEAR THAT THERE IS AN INCREASING TENDENCY AMONG SOME GROUPS TO ENGAGE IN ANTI-GOVERNMENT AND ANTI-LAW ENFORCEMENT VIOLENCE.

CIVILIANS, AS WELL AS FEDERAL AND LOCAL LAW ENFORCEMENT PERSONNEL, HAVE BEEN THREATENED, HARASSED, SURVEILLED, ASSAULTED, AND MURDERED. FEDERAL EMPLOYEES, SUCH AS IRS AUDITORS, EXERCISING THEIR LAWFUL DUTIES HAVE BEEN CONFRONTED BY RESISTANCE, SOMETIMES ARMED, BY GROUPS THAT CHALLENGE THE AUTHORITY OF THE FEDERAL GOVERNMENT.

LET ME TALK A LITTLE BIT ABOUT THESE GROUPS. WE HAVE INVESTIGATED VIOLENT ACTS BY INDIVIDUALS CONNECTED TO WHITE SUPREMICIST GROUPS, MILITIA OR PATRIOT GROUPS, SECTS AND CULT-TYPE GROUPS, AND ANTI-ABORTION GROUPS. I HASTEN TO SAY THAT WE DO NOT CONSIDER EVERY ONE OF THESE GROUPS TO BE

INVOLVED IN DOMESTIC TERRORISM. WE HAVE, HOWEVER, RECEIVED INFORMATION ABOUT ILLEGAL CONDUCT BY PERSONS CONNECTED TO THESE GROUPS OR ON THE FRINGES OF THESE GROUPS. WE HAVE INVESTIGATED THAT CONDUCT, AND, IN THE COURSE OF THESE INVESTIGATIONS, WE HAVE LEARNED A SIGNIFICANT AMOUNT ABOUT THESE GROUPS.

IT IS BELIEVED THAT THERE ARE SEVERAL HUNDRED VIOLENT WHITE SUPREMACIST GROUPS IN THE UNITED STATES. IN RECENT YEARS, INVESTIGATIONS OF CRIMINAL CONDUCT BY MEMBERS OF THESE GROUPS HAVE YIELDED SEIZURES OF ILLEGAL WEAPONS CACHES, AND THE DISCOVERY OF PLOTS TO COMMIT MASS MURDER AND PLOTS TO DESTROY PROPERTY.

THE MILITIA MOVEMENT IS A GRASSROOTS POPULIST MOVEMENT THAT DERIVES ITS PHILOSOPHY FROM THE SECOND AMENDMENT TO THE CONSTITUTION. MILITIAS ARE GROUPS OF INDIVIDUALS WHO ARE VIRULENTLY ANTI-GUN

CONTROL AND ANTI-FEDERAL GOVERNMENT. THEY BAND TOGETHER TO CONDUCT PARA-MILITARY TRAINING, TO ACQUIRE DESTRUCTIVE DEVICES, AND TO POSSESS FIREARMS, INCLUDING IN SOME CASES ILLEGAL FIREARMS.

SOME MILITIAS CHALLENGE THE LEGITIMACY OF THE FEDERAL GOVERNMENT, AND REFUSE TO COMPLY WITH OBLIGATIONS IMPOSED BY THE GOVERNMENT, SUCH AS PAYING TAXES. MILITIAS HAVE BEEN FORMED IN APPROXIMATELY 34 STATES, WITH MEMBERSHIP RANGING FROM TEN TO SEVERAL HUNDRED IN EACH GROUP. THEY CAN POSE A SERIOUS THREAT TO GOVERNMENT EMPLOYEES AND ESPECIALLY FEDERAL LAW ENFORCEMENT.

CURRENTLY, IT IS ESTIMATED THAT THERE ARE BETWEEN 700 AND 2,000 SECTS OR CULT-LIKE GROUPS IN THE UNITED STATES. SOME OF THESE GROUPS ARE COVERTLY OBTAINING FIREARMS AND EXPLOSIVE MATERIALS IN ORDER TO PREPARE FOR WHAT THEY BELIEVE IS THE COMING END OF THE WORLD, OR ARMAGEDDON. MANY OF THESE

FEDERAL FINANCING BANK
MARCH 1995 ACTIVITY

ORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
OVERNMENT - GUARANTEED LOANS				
RURAL UTILITIES SERVICE (continued)				
Plains Elec. #918	3/7	$946,231.37	6/30/95	5.977% Qtr.
Plains Elec. #918	3/7	$496,378.45	12/31/18	7.498% Qtr.
Plains Elec. #918	3/7	$1,684,532.14	6/30/95	5.977% Qtr.
Plains Elec. #918	3/7	$596,708.92	6/30/95	5.977% Qtr.
Central Power Elec. #395	3/13	$217,000.00	12/31/26	7.524% Qtr.
Pineland Telephone #403	3/13	$809,000.00	1/2/24	7.524% Qtr.
Oglethorpe Power #335	3/28	$22,607,000.00	3/31/97	6.690% Qtr.
Allegheny Electric #255	3/31	$3,728,438.47	4/1/96	6.503% Qtr.
Allegheny Electric #255	3/31	$5,327,005.39	4/1/96	6.503% Qtr.
Hoosier Energy Elec. #901	3/31	$39,365,538.20	6/30/95	5.840% Qtr.
Hoosier Energy Elec. #901	3/31	$16,020,816.84	6/30/95	5.840% Qtr.
Hoosier Energy Elec. #901	3/31	$9,841,384.54	6/30/95	5.840% Qtr.
Northwest Iowa Power #907	3/31	$7,819,875.90	6/30/95	5.840% Qtr.
Oglethorpe Power #916	3/31	$19,819,503.21	4/1/96	6.304% Qtr.
Oglethorpe Power #916	3/31	$23,045,785.50	4/1/96	6.304% Qtr.
Saluda River Elec. #903	3/31	$2,352,807.05	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$889,218.73	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$1,410,631.48	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$9,928,007.80	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$3,277,134.26	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$2,661,635.85	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$11,100,594.68	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$1,050,162.73	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$12,143,433.92	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$16,520,846.77	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$10,784,151.77	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$12,321,735.05	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$3,726,311.23	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$23,812,735.05	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$40,137,274.24	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$40,425,802.73	6/30/95	5.840% Qtr.
Sho-Me Power #913	3/31	$1,205,501.39	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$467,512.08	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,272.43	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,401.62	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,355.31	1/2/96	6.168% Qtr.
United Power Assoc. #911	3/31	$941,311.57	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$11,295,737.73	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,652,214.15	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,077,426.90	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,653,334.52	6/30/95	5.840% Qtr.

:r. is a Quarterly rate.
maturity extension
306C refinancing

NUCLEAR MATERIALS AND ASSOCIATED TECHNOLOGIES, WE ANTICIPATE INCREASED TERRORIST PROBLEMS. WEAPONS PROCUREMENT NETWORKS ARE BECOMING MORE ADVANCED AND CLANDESTINE.

TO COMBAT THESE PROBLEMS, TREASURY, THROUGH THE U.S. CUSTOMS SERVICE, IS INCREASING ITS LIAISON WITH THE U.S. INTELLIGENCE COMMUNITY AND FOREIGN CUSTOMS AND OTHER LAW ENFORCEMENT AGENCIES, PARTICULARLY IN EASTERN EUROPE AND THE FORMER SOVIET UNION.

ATF IS ALSO CONTINUING ITS INTERNATIONAL TRAFFIC IN ARMS (I.T.A.R.) PROGRAM,WHICH IS DESIGNED TO CURTAIL INTERNATIONAL ARMS TRAFFICKING. THE I.T.A.R. PROGRAM WAS DEVELOPED WHEN IT BECAME APPARENT THAT FIREARMS ORIGINATING FROM THE UNITED STATES WERE BEING RECOVERED WORLDWIDE IN SUCH CRIMINAL ACTS AS NARCOTICS TRAFFICKING AND TERRORISM.

FEDERAL FINANCING BANK
MARCH 1995 ACTIVITY

ORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
OVERNMENT - GUARANTEED LOANS				
RURAL UTILITIES SERVICE (continued)				
Plains Elec. #918	3/7	$946,231.37	6/30/95	5.977% Qtr.
Plains Elec. #918	3/7	$496,378.45	12/31/18	7.498% Qtr.
Plains Elec. #918	3/7	$1,684,532.14	6/30/95	5.977% Qtr.
Plains Elec. #918	3/7	$596,708.92	6/30/95	5.977% Qtr.
Central Power Elec. #395	3/13	$217,000.00	12/31/26	7.524% Qtr.
Pineland Telephone #403	3/13	$809,000.00	1/2/24	7.524% Qtr.
Oglethorpe Power #335	3/28	$22,607,000.00	3/31/97	6.690% Qtr.
Allegheny Electric #255	3/31	$3,728,438.47	4/1/96	6.503% Qtr.
Allegheny Electric #255	3/31	$5,327,005.39	4/1/96	6.503% Qtr.
Hoosier Energy Elec. #901	3/31	$39,365,538.20	6/30/95	5.840% Qtr.
Hoosier Energy Elec. #901	3/31	$16,020,816.84	6/30/95	5.840% Qtr.
Hoosier Energy Elec. #901	3/31	$9,841,384.54	6/30/95	5.840% Qtr.
Northwest Iowa Power #907	3/31	$7,819,875.90	6/30/95	5.840% Qtr.
Oglethorpe Power #916	3/31	$19,819,503.21	4/1/96	6.304% Qtr.
Oglethorpe Power #916	3/31	$23,045,785.50	4/1/96	6.304% Qtr.
Saluda River Elec. #903	3/31	$2,352,807.05	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$889,218.73	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$1,410,631.48	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$9,928,007.80	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$3,277,134.26	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$2,661,635.85	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$11,100,594.68	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$1,050,162.73	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$12,143,433.92	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$16,520,846.77	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$10,784,151.77	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$12,321,735.05	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$3,726,311.23	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$23,812,735.05	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$40,137,274.24	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$40,425,802.73	6/30/95	5.840% Qtr.
Sho-Me Power #913	3/31	$1,205,501.39	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$467,512.08	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,272.43	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,401.62	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,355.31	1/2/96	6.168% Qtr.
United Power Assoc. #911	3/31	$941,311.57	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$11,295,737.73	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,652,214.15	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,077,426.90	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,653,334.52	6/30/95	5.840% Qtr.

:r. is a Quarterly rate.
maturity extension
306C refinancing

ATF'S TECHNICAL AND INVESTIGATIVE EXPERTISE. FOR EXAMPLE, ATF'S INTERNATIONAL RESPONSE TEAMS ASSISTED IN THE INVESTIGATION OF THE 1992 BOMBING OF THE ISRAELI EMBASSY IN BUENOS AIRES, ARGENTINA.

AS WE SIT HERE TODAY, OVER 130 ATF PERSONNEL ARE IN OKLAHOMA CITY WORKING HAND-IN-HAND WITH THE FBI AND OTHER AGENCIES TO SOLVE THE EVIL BOMBING COMMITTED THERE. ATF IS PROVIDING THE TECHNICAL BOMBING EXPERTISE AT THE OKLAHOMA CITY BOMBING SITE.

- THE SECRET SERVICE IS RESPONSIBLE FOR PROTECTING THE NATION'S MOST VISIBLE TARGETS FOR TERRORISTS: THE PRESIDENT, THE FIRST FAMILY, THE VICE PRESIDENT, FORMER PRESIDENTS, FOREIGN HEADS OF STATE WHO VISIT THE UNITED STATES, THE WHITE HOUSE COMPLEX, AND FOREIGN EMBASSIES LOCATED IN THE UNITED STATES. THE SECRET SERVICE WORKS CLOSELY WITH OTHER LAW ENFORCEMENT AGENCIES AND THE INTELLIGENCE

COMMUNITY TO ENSURE THE SAFETY OF ITS PROTECTEES. THE SECRET SERVICE SEEKS TIMELY AND RELIABLE INTELLIGENCE RELATING TO THE EXISTENCE, CAPABILITY, HISTORY, PLANS AND INTENTIONS OF BOTH DOMESTIC AND INTERNATIONAL TERRORIST GROUPS. THIS INFORMATION IS ESSENTIAL TO THE ABILITY OF THE SECRET SERVICE TO ASSESS THE THREAT POSED BY THESE EXTREMIST GROUPS AND TO PREVENT AN ATTACK ON THE PRESIDENT, VICE-PRESIDENT, FOREIGN DIGNITARIES, OTHER PROTECTEES AND PROTECTED FACILITIES. IN ADDITION, THE SECRET SERVICE INVESTIGATES DIRECT THREATS TO PROTECTEES MADE BY PERSONS ASSOCIATED WITH EXTREMIST GROUPS.

- THE U.S. CUSTOMS SERVICE IS RESPONSIBLE FOR COMBATTING ILLEGAL EXPORTS AND IMPORTS OF MATERIALS THAT SUPPORT TERRORISM. THE CUSTOMS SERVICE IS CONTINUOUSLY WORKING TO DISCOVER ILLEGAL NETWORKS RESPONSIBLE FOR SUPPORTING TERRORISM. THESE ILLEGAL NETWORKS OFTEN ARE RESPONSIBLE FOR OBTAINING AND SHIPPING WEAPONS, INCLUDING WEAPONS

OF MASS DESTRUCTION AND ASSOCIATED DUAL-USE TECHNOLOGIES. TO COMBAT THESE NETWORKS, THE CUSTOMS SERVICE INTERDICTS SHIPMENTS AT THE BORDER, INVESTIGATES ILLEGAL EXPORTS, ANALYZES TACTICAL INTELLIGENCE AND ENGAGES IN INTERNATIONAL COORDINATION THROUGH JOINT OPERATIONS, TRAINING, AND INFORMATION SHARING WITH FOREIGN BORDER AGENCIES AND LAW ENFORCEMENT PERSONNEL.

IN ADDITION, THE CUSTOMS SERVICE MAINTAINS A TERRORIST DATABASE IN THE TREASURY ENFORCEMENT COMMUNICATIONS SYSTEM AND IS LINKED DIRECTLY TO THE CIA'S COUNTER TERRORISM CENTER. RECENT EXAMPLES OF CUSTOMS COUNTER TERRORISM ACTIVITIES INCLUDE THE INTERCEPTION OF SOPHISTICATED ELECTRICAL EQUIPMENT AND POISONOUS GAS PRECURSORS INTENDED FOR IRAQ.

- THE OFFICE OF FOREIGN ASSETS CONTROL (OFAC) ADMINISTERS OUR COUNTRY'S ECONOMIC SANCTIONS

PROGRAMS AGAINST SELECTED FOREIGN COUNTRIES AND GROUPS THAT SUPPORT TERRORISM OR COMMIT TERRORIST ACTS. THESE PROGRAMS INCLUDE $2.8 BILLION IN ASSET FREEZES AND TRADE EMBARGOES AGAINST SEVERAL STATE SPONSORS OF TERRORISM, INCLUDING LIBYA AND IRAQ, AND IMPORT AND PETROLEUM DEVELOPMENT SANCTIONS AGAINST IRAN. OFAC SANCTIONS ALSO TARGET DOMESTIC FUNDRAISING ACTIVITY BY MIDDLE EAST TERRORIST GROUPS.

- THE INTERNAL REVENUE SERVICE, ALTHOUGH NOT USUALLY DIRECTLY INVOLVED IN COUNTER-TERRORISM INVESTIGATIONS, CONDUCTS INVESTIGATIONS OF TAX PROTESTERS, MANY OF WHOM ARE LINKED TO ORGANIZATIONS, SUCH AS MILITIAS, THAT CHALLENGE THE LEGITIMATE AUTHORITY OF THE U.S. GOVERNMENT. IRS'S INSPECTIONS DIVISION HAS BEEN INVOLVED IN INVESTIGATING THREATS AGAINST IRS PERSONNEL MADE BY PROTESTER GROUPS.

THE FINANCIAL CRIMES ENFORCEMENT NETWORK (WHAT WE CALL FINCEN) PROVIDES VALUABLE INTELLIGENCE SUPPORT TO LAW ENFORCEMENT AGENCIES CONDUCTING INVESTIGATIONS OF TERRORISTS. IN THE PAST, FINCEN HAS PROVIDED ANALYTICAL INTELLIGENCE IN SUPPORT OF INVESTIGATIONS OF MURDER AND BOMBINGS CARRIED OUT BY SUSPECTED TERRORISTS.

THROUGH RESEARCH AND ANALYSIS OF VARIOUS LAW ENFORCEMENT AND COMMERCIAL DATABASES, FINCEN IS ABLE TO RAPIDLY DEVELOP INFORMATION CONCERNING RESIDENCES UTILIZED BY SUSPECTS, DOMESTIC AND INTERNATIONAL FINANCIAL TRANSACTIONS, FOREIGN TRAVEL, BUSINESS ACTIVITIES, NAMES OF ASSOCIATES, AND ALIASES USED BY SUSPECTS. THIS INFORMATION PROVIDES TIMELY INVESTIGATIVE LEADS THAT CAN BE USED TO IDENTIFY TERRORISTS AND THEIR ASSETS.

FINALLY, ALL OF THE TREASURY ENFORCEMENT BUREAUS ARE FOCUSED ON ATTACKING THE MEANS BY

WHICH ORGANIZED CRIMINAL GROUPS FUND THEIR OPERATIONS. WE HAVE FOUND THAT OFTEN CRIMES LIKE FINANCIAL FRAUD OR COUNTERFEITING ARE USED TO FINANCE ACTS OF TERRORISM. WE ARE DEDICATED TO USING OUR FINANCIAL CRIMES EXPERTISE TO ATTACK THESE FUNDING MECHANISMS.

RECENT PRESIDENTIAL INITIATIVES

ON JANUARY 23rd OF THIS YEAR, PRESIDENT CLINTON SIGNED AN EXECUTIVE ORDER PROHIBITING TRANSACTIONS WITH TERRORISTS WHO THREATEN TO DISRUPT THE MIDDLE EAST PEACE PROCESS. THIS ORDER IS BEING ENFORCED BY OFAC. THE ORDER BLOCKS PROPERTY OF CERTAIN TERRORIST ORGANIZATIONS, OR PERSONS ACTING ON THEIR BEHALF, THAT THREATEN THE MIDDLE EAST PEACE PROCESS. THE ORDER ALSO PROHIBITS THE TRANSFERING OF ANY CONTRIBUTION OF FUNDS, GOODS, OR SERVICES TO OR FOR THE BENEFIT OF SUCH PERSONS. THE ORDER PROVIDES A NEW TOOL TO COMBAT FUNDRAISING IN THIS COUNTRY

ON BEHALF OF ORGANIZATIONS THAT USE TERROR TO UNDERMINE THE MIDDLE EAST PEACE PROCESS AND CUTS OFF THEIR ACCESS TO SOURCES OF SUPPORT IN THE U.S. AND TO THE U.S. FINANCIAL SYSTEM.

SECTION 301 OF THE OMNIBUS COUNTERTERRORISM ACT OF 1995, WHICH WAS RECENTLY TRANSMITTED BY PRESIDENT CLINTON, CONTAINS SIMILAR BLOCKING PROVISIONS AND PROHIBITIONS AGAINST THE MAKING OR RECEIVING OF CERTAIN CONTRIBUTIONS TO DESIGNATED TERRORISTS.

THIS WEEK, THE PRESIDENT ANNOUNCED NEW ANTI-TERRORISM MEASURES IN WAKE OF THE BOMBING IN OKLAHOMA CITY. WE WELCOME THE OPPORTUNITY TO JOIN OUR RESOURCES AND EXPERTISE WITH OTHER FEDERAL LAW ENFORCEMENT AND INTELLIGENCE AGENCIES IN ATTACKING THE TERRORISM PROBLEM. THE ANTI-TERRORISM INITIATIVE THAT THE PRESIDENT DISCUSSED LAST NIGHT WITH CONGRESSIONAL LEADERSHIP ALSO CONTAINS PROVISIONS

THAT WILL ENHANCE OUR ABILITY TO ENFORCE THE EXPLOSIVES LAWS AND TO ADDRESS THE TERRORISM PROBLEM.

THAT COMPLETES MY STATEMENT. I WILL BE HAPPY TO ANSWER ANY QUESTIONS.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 27, 1995

Contact: Michelle Smith
(202) 622-2960

RUBIN, ORTIZ PHOTO OPPORTUNITY

Treasury Secretary Robert E. Rubin and Mexican Secretary of Finance and Public Credit Guillermo Ortiz will be available for a photo opportunity at 1 p.m. **TODAY**, Thursday, April 27. Cameras should be in place by 12:45 p.m. in Room 3327, the Secretary's Conference Room, at Main Treasury.

Press without Treasury or White House press credentials should contact Treasury's Office of Public Affairs at (202) 622-2960 for clearance into the building.

-30-

RR-247

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
Text as Prepared for Delivery
April 27, 1995

STATEMENT OF TREASURY SECRETARY ROBERT E. RUBIN AT THE DEVELOPMENT COMMITTEE OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND WASHINGTON, D.C.

Mr. Chairman and Committee members. I welcome this opportunity to exchange views on how we can enhance our cooperative efforts in the development arena.

As some of you may know, I recently returned from an extended trip to Asia. For me, that trip was a remarkable experience. A great sense of economic dynamism is manifest in the Asian economies. Outward-oriented, market-based policies have produced growth and advanced social progress. Poverty rates are declining and living standards are rising.

Yet even in Asia, as in other developing regions, particularly Africa, enormous challenges remain. Much needs to be done in key areas such as poverty reduction, employment generation, and environmental protection. The financing demands for infrastructure services are enormous. In today's interdependent world, these challenges faced by developing countries are also global challenges.

RR-248

The World Bank and the regional development banks are at the forefront of our collaborative efforts to meet these challenges. We rely on the banks to promote sound economic management, encourage policy reform, facilitate the flow of trade and capital, and most importantly, to reduce poverty. In India, I had the benefit of visiting a World Bank supported land management project. The project is both increasing the incomes of the poor, and improving the local environment. It demonstrates effective development in action.

Now, some in the United States -- and some in our Congress -- question whether we should continue participating in the multilateral development banks. I say to them what I say to you now. The United States must remain fully engaged in these vital institutions, including the International Development Association, and I will do all that I can to achieve full funding for our commitments. At the same time, the banks must demonstrate that they are responding effectively and efficiently to the needs of their member countries. The Halifax Review of the international economic architecture, and the work of the Development Committee Task Force, will sharpen our focus on ways to improve the effectiveness of the banks.

If the Bank is to succeed in advancing economic progress, it must put the people whose lives its work affects first, by increasing the focus on social investment. Only through direct support for social investments is there the prospect of building a durable and inclusive prosperity. That means enhancing governments' capacity to provide services as efficiently and equitably as possible. The Bank should use its leverage to ensure that there is more primary health care, and more primary schools. There must be a renewed Bank-borrower partnership to ensure that the benefits of grassroots experiences find their way into lending operations. Incorporation of local knowledge vastly improves the quality of development projects.

The World Bank has identified infrastructure as an area of particular importance and particular promise. And it has agreed that an approach that fosters a sound policy environment and private sector participation must be at the heart of development. Only the private sector has the capacity to generate the enormous financial and managerial resources needed to fuel infrastructure development. But the private sector will not respond effectively if it is hamstrung by regulation, misdirected by distorted incentives, enmeshed in a cloud of non-transparent requirements, or exposed to high levels of political risk. Attracting private capital is furthered by clearing away obstacles to success by providing the policy and institutional environment needed to attract private finance, allocate it efficiently, and allow it to work.

The World Bank and its regional counterpart banks ought no longer to be seen as the main actors in the role of financing national infrastructure. The demands go far beyond their resources. Moreover, there are critical needs in social areas, such as education and health, that private sector finance will not support, and which are more appropriate for bank and official investment.

Similarly, governments' role in developing infrastructure can be reduced. Utilities, telecommunications, and many other sectors are logical candidates for private participation. Improved services to the public are the demonstrated result.

What governments and official institutions like the banks can and must do is bolster the legal and institutional frameworks necessary to ensure private participation in infrastructure development. Domestic capital markets must be broadened and deepened, if countries are to mobilize domestic savings and allocate them efficiently. Regulatory and legal regimes must be strengthened to assure transparency, predictability, and competition.

Helping meet these challenges is one way the banks can catalyze domestic and external resources for investment. Through support for public sector reform and institution-building, the banks can bolster national efforts to create a favorable policy environment. The banks' financial sector lending programs can bring resources and expertise to bear on the essential task of developing domestic financial markets. These are areas in which the banks can best make a difference, complementing, without seeking to supplant, private finance and participation.

Global markets can supplement domestic sources of funds for infrastructure development. However, there is a tremendous demand for capital worldwide. In this highly competitive environment, very few developing countries can borrow the large amounts required long term on a project finance basis. In this respect, many countries are in transition. The World Bank's strengthened guarantee program for addressing the non-commercial risks associated with private sector investments in infrastructure can help in this context, and the United States supports this initiative. The Bank cannot stand still in this area. Much stronger coordination within the World Bank Group is needed to fully integrate the IFC and MIGA into the Bank's country assistance strategies, so that we can best deploy all the instruments at our disposal.

Many of the points I've made are of particular importance in the environmental sector. Environmental infrastructure, such as sewage treatment plants or investments in pollution prevention, is a pressing requirement. Private sector support is often inadequate to meet the need, because private investors cannot collect many of the returns offered by environmental infrastructure. The banks should make this a focus of their infrastructure investments.

Environmental concerns must also be central to the development of infrastructure in other sectors, such as power and transportation, if we are to encourage development that actually makes peoples lives better. Over the past few years, the World Bank and regional banks have adopted strong policies on environment and natural resource issues. These policies should markedly improve the economic, social and environmental content of the banks' projects, to the benefit of the banks' and their borrowers. The banks should pursue full compliance with these policies at every stage of the infrastructure program and project development process.

In addition, environmental considerations should be involved in the banks' policy dialogue with regard to the framework for private sector investment. The banks can and should assist governments in developing sound legal and regulatory frameworks in the environment and natural resource sectors.

There are sometimes environmental tradeoffs where infrastructure development is concerned. But in recognizing these tradeoffs, we must not lose sight of the enormous array of win-win approaches which the development banks should promote. Cuts in subsidies for commodities that encourage overuse of resources, sanitation and clean water efforts -- all of these foster growth even as they remove incentives for environmental degradation.

In closing, I would like to commend Lewis Preston for his outstanding leadership at the helm of the World Bank. Lew's focus on performance and efficiency have generated an impressive array of operational and administrative reforms which will have a lasting impact. We are all greatly indebted to him.

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

FOR IMMEDIATE RELEASE
April 27, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $17,884 million of 52-week bills to be issued May 4, 1995 and to mature May 2, 1996 were accepted today (CUSIP: 912794Y57).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.88%	6.26%	94.055
High	5.91%	6.29%	94.024
Average	5.90%	6.28%	94.034

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

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$64,470,776	$17,884,419
Type		
Competitive	$58,218,447	$11,632,090
Noncompetitive	1,072,329	1,072,329
Subtotal, Public	$59,290,776	$12,704,419
Federal Reserve	4,650,000	4,650,000
Foreign Official Institutions	530,000	530,000
TOTALS	$64,470,776	$17,884,419

An additional $36,700 thousand of bills will be issued to foreign official institutions for new cash.

5.89 - 94.045

RR-249

federal financing bank NEWS
WASHINGTON, D.C. 20220

April 28, 1995

FEDERAL FINANCING BANK

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of March 1995.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $98.3 billion on March 31, 1995, posting a decrease of $2,121.2 million from the level on February 28, 1995. This net change was the result of a decrease in holdings of agency debt of $1,188.8 million, in holdings of agency assets of $815.0 million, and in holdings of agency-guaranteed loans of $117.3 million. FFB made 19 disbursements during the month of March, 30 maturity extensions of REA-guaranteed loans, and 32 306C refinancings of REA-guaranteed loans. FFB also received 39 prepayments in March.

Attached to this release are tables presenting FFB March loan activity and FFB holdings as of March 31, 1995.

RR-250

FEDERAL FINANCING BANK
MARCH 1995 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
GOVERNMENT - GUARANTEED LOANS				
GENERAL SERVICES ADMINISTRATION				
HCFA Services	3/1	$87,888.00	6/30/95	6.164% S/A
Foley Services Contract	3/6	$220,464.00	12/11/95	6.544% S/A
Foley Square Office Bldg.	3/9	$2,712,609.00	12/11/95	6.564% S/A
Foley Square Courthouse	3/17	$2,342,530.00	12/11/95	6.382% S/A
Foley Services Contract	3/21	$103,889.00	12/11/95	6.400% S/A
Chamblee Office Building	3/24	$1,343.80	4/1/97	6.893% S/A
Foley Services Contract	3/24	$316,057.85	12/11/95	6.379% S/A
Miami Law Enforcement	3/24	$1,362.20	1/3/22	7.607% S/A
Atlanta CDC Office Bldg.	3/28	$1,205,882.52	9/1/95	6.118% S/A
Foley Square Office Bldg.	3/28	$2,181,810.00	12/11/95	6.268% S/A
Memphis IRS Service Cent.	3/30	$2,740,925.25	1/2/96	6.346% S/A
Foley Services Contract	3/31	$187,038.98	12/11/95	6.373% S/A
GSA/PADC				
ICTC Building	3/2	$215,000.00	11/2/26	7.599% S/A
ICTC Building	3/14	$9,377,287.85	11/2/26	7.591% S/A
RURAL UTILITIES SERVICE				
Guam Telephone Auth. #371	3/3	$2,473,000.00	12/31/14	7.496% Qtr.
Alabama Electric #393	3/6	$4,403,000.00	12/31/24	7.631% Qtr.
+Plains Elec. #918	3/7	$1,341,493.13	1/3/17	7.474% Qtr.
+Plains Elec. #918	3/7	$6,304,841.06	6/30/95	5.976% Qtr.
+Plains Elec. #918	3/7	$9,708,993.05	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$10,462,107.05	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$7,545,223.95	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$7,676,874.46	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$6,876,362.15	1/3/17	7.474% Qtr.
+Plains Elec. #918	3/7	$3,570,726.41	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$13,749,170.60	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$13,268,808.97	1/3/17	7.474% Qtr.
+Plains Elec. #918	3/7	$13,931,216.40	1/3/17	7.474% Qtr.
+Plains Elec. #918	3/7	$4,216,030.65	1/3/17	7.474% Qtr.
+Plains Elec. #918	3/7	$4,963,473.54	1/2/18	7.488% Qtr.
+Plains Elec. #918	3/7	$6,097,572.66	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$3,961,621.87	1/2/18	7.488% Qtr.
+Plains Elec. #918	3/7	$10,899,754.52	1/2/18	7.488% Qtr.
+Plains Elec. #918	3/7	$10,813,912.49	1/2/18	7.488% Qtr.
+Plains Elec. #918	3/7	$3,157,046.25	6/30/95	5.977% Qtr.
+Plains Elec. #918	3/7	$974,959.24	1/3/17	7.474% Qtr.

S/A is a Semi-annual rate: Qtr. is a Quarterly rate.
+ 306C refinancing

FEDERAL FINANCING BANK
MARCH 1995 ACTIVITY

ORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
OVERNMENT - GUARANTEED LOANS				
RURAL UTILITIES SERVICE (continued)				
Plains Elec. #918	3/7	$946,231.37	6/30/95	5.977% Qtr.
Plains Elec. #918	3/7	$496,378.45	12/31/18	7.498% Qtr.
Plains Elec. #918	3/7	$1,684,532.14	6/30/95	5.977% Qtr.
Plains Elec. #918	3/7	$596,708.92	6/30/95	5.977% Qtr.
Central Power Elec. #395	3/13	$217,000.00	12/31/26	7.524% Qtr.
Pineland Telephone #403	3/13	$809,000.00	1/2/24	7.524% Qtr.
Oglethorpe Power #335	3/28	$22,607,000.00	3/31/97	6.690% Qtr.
Allegheny Electric #255	3/31	$3,728,438.47	4/1/96	6.503% Qtr.
Allegheny Electric #255	3/31	$5,327,005.39	4/1/96	6.503% Qtr.
Hoosier Energy Elec. #901	3/31	$39,365,538.20	6/30/95	5.840% Qtr.
Hoosier Energy Elec. #901	3/31	$16,020,816.84	6/30/95	5.840% Qtr.
Hoosier Energy Elec. #901	3/31	$9,841,384.54	6/30/95	5.840% Qtr.
Northwest Iowa Power #907	3/31	$7,819,875.90	6/30/95	5.840% Qtr.
Oglethorpe Power #916	3/31	$19,819,503.21	4/1/96	6.304% Qtr.
Oglethorpe Power #916	3/31	$23,045,785.50	4/1/96	6.304% Qtr.
Saluda River Elec. #903	3/31	$2,352,807.05	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$889,218.73	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$1,410,631.48	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$9,928,007.80	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$3,277,134.26	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$2,661,635.85	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$11,100,594.68	6/30/95	5.840% Qtr.
Saluda River Elec. #903	3/31	$1,050,162.73	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$12,143,433.92	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$16,520,846.77	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$10,784,151.77	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$12,321,735.05	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$3,726,311.23	1/3/17	7.295% Qtr.
Seminole Electric #905	3/31	$23,812,735.05	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$40,137,274.24	6/30/95	5.840% Qtr.
Seminole Electric #905	3/31	$40,425,802.73	6/30/95	5.840% Qtr.
Sho-Me Power #913	3/31	$1,205,501.39	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$467,512.08	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,272.43	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,401.62	1/2/96	6.168% Qtr.
Sho-Me Power #913	3/31	$468,355.31	1/2/96	6.168% Qtr.
United Power Assoc. #911	3/31	$941,311.57	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$11,295,737.73	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,652,214.15	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,077,426.90	6/30/95	5.840% Qtr.
United Power Assoc. #911	3/31	$3,653,334.52	6/30/95	5.840% Qtr.

:r. is a Quarterly rate.
maturity extension
306C refinancing

FEDERAL FINANCING BANK
MARCH 1995 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE
GOVERNMENT - GUARANTEED LOANS				
RURAL UTILITIES SERVICE (continued)				
+United Power Assoc. #911	3/31	$3,889,349.41	6/30/95	5.840% Qtr.
+United Power Assoc. #911	3/31	$4,310,904.45	6/30/95	5.840% Qtr.
+United Power Assoc. #911	3/31	$1,208,851.70	6/30/95	5.840% Qtr.
+United Power Assoc. #911	3/31	$920,010.00	6/30/95	5.840% Qtr.
*Wolverine Power #349	3/31	$1,287,448.80	3/31/97	6.820% Qtr.

Qtr. is a Quarterly rate.
* maturity extension
+ 306C refinancing

FEDERAL FINANCING BANK
(in millions)

Program	March 31, 1995	February 28, 1995	Net Change 3/1/95-3/31/95	FY '95 Net Change 10/1/94-3/31/95
Agency Debt:				
Department of Transportation	$ 0.0	$ 0.0	$ 0.0	$ -664.7
Export-Import Bank	3,149.8	3,448.6	-298.8	-776.6
Resolution Trust Corporation	19,756.1	20,646.2	-890.1	-6,763.0
Tennessee Valley Authority	3,200.0	3,200.0	0.0	-200.0
U.S. Postal Service	7,873.1	7,873.1	0.0	-1,100.0
sub-total*	33,979.1	35,167.9	-1,188.8	-9,504.3
Agency Assets:				
FmHA-ACIF	5,453.0	5,968.0	-515.0	-610.0
FmHA-RDIF	3,675.0	3,675.0	0.0	0.0
FmHA-RHIF	23,631.0	23,931.0	-300.0	-760.0
DHHS-Health Maintenance Org.	10.5	10.5	0.0	-14.8
DHHS-Medical Facilities	33.8	33.8	0.0	-1.9
Rural Utilities Service-CBO	4,598.9	4,598.9	0.0	0.0
Small Business Administration	0.8	0.9	0.0	-0.2
sub-total*	37,403.1	38,218.1	-815.0	-1,387.0
Government-Guaranteed Loans:				
DOD-Foreign Military Sales	3,635.4	3,689.4	-54.0	-150.0
DHUD-Community Dev. Block Grant	95.9	95.9	0.0	-14.0
DHUD-Public Housing Notes	1,688.5	1,688.5	0.0	-58.0
General Services Administration +	2,189.3	2,173.1	16.2	159.8
DOI-Virgin Islands	21.2	21.2	0.0	-0.7
DON-Ship Lease Financing	1,432.1	1,432.1	0.0	-47.4
Rural Utilities Service	17,292.7	17,360.4	-67.7	-23.9
SBA-Small Business Investment Cos.	21.6	26.6	-5.0	-35.1
SBA-State/Local Development Cos.	496.2	502.9	-6.7	-26.8
DOT-Section 511	11.4	11.5	-0.1	-3.2
sub-total*	26,884.3	27,001.6	-117.3	-199.5
grand-total*	$ 98,266.4	$100,387.6	$-2,121.2	$-11,090.7

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

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
April 28, 1995

Contact: Jon Murchinson
(202) 622-2960

BORROWING ADVISORY COMMITTEE MEETING, REFUNDING PLANNED

The Treasury Department's Borrowing Advisory Committee will hold an open meeting at 11:30 a.m. Tuesday, May 2, 1995 in the Cash Room, Main Treasury, 1500 Pennsylvania Avenue NW.

Deputy Assistant Secretary (Federal Finance) Darcy Bradbury will announce the Treasury Department's quarterly refunding at 2 p.m. on Wednesday, May 3, 1995 in the Cash Room.

Media without Treasury, White House, State, Defense or Congressional credentials wishing to attend should contact the Office of Public Affairs at (202) 622-2960, with the following information: name, Social Security number and date of birth, by 5 p.m. Monday, May 1 for Tuesday's event and by 5 p.m. Tuesday, May 2 for Wednesday's event. This information can be faxed to (202) 622-1999.

-30-

RR-251

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE
April 28, 1995

Contact: Rebecca Lowenthal
(202) 622-1997

RUBIN TO ADDRESS TREASURY CONFERENCE FOR BUSINESSES

Treasury Secretary Robert E. Rubin will address the Department's PARTNERSHIPS '95 conference for small, minority and women-owned businesses in the Cash Room of the main Treasury building at 9:30 a.m. on Tuesday, May 2. The ceremony and the two-day conference will be held in the Cash Room of the main Treasury building.

Rubin will discuss how reinvention initiatives can help foster relationships with underutilized businesses. During the opening ceremony, Rubin will recognize Treasury's Small and Large Business Partners of the Year. Also speaking will be Treasury Assistant Secretary for Management George Muñoz and Steve Kelman, Administrator, Office of Federal Procurement Policy.

Over $3 million worth of contracts were available for bid at Treasury's two previous conferences in Los Angeles and Washington. At the upcoming two-day conference, Treasury bureaus will offer over $1.5 million in contract opportunities; smaller purchases will be made with the government purchase card, a credit card that eliminates paperwork and ensures swift payment to businesses. Many of Treasury's prime contractors will be available to discuss subcontracting opportunities. Conference activities include hands-on training in electronic commerce and help in registering with Treasury's vendor database. Treasurer of the United States Mary Ellen Withrow will be on hand to sign currency during the conference.

Treasury, White House, Defense, State Department or Congressional press credentials are required to gain access to the Treasury building, 1500 Pennsylvania Avenue, NW. Any journalists wishing to attend Rubin's remarks without one of these credentials must call Treasury Public Affairs at (202) 622-2960 with the following information before 5:00 p.m. on Monday, May 1: name, organization, date of birth, and social security or passport number. Journalists without Treasury or White House passes who plan to visit the conference at other times should call Public Affairs in advance for clearance.

-30-

RR-252

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
Text as Prepared for Delivery
May 1, 1995

Testimony of Ronald K. Noble
Under Secretary of the Treasury for Enforcement
Senate Appropriations Subcommittee on Treasury,
Postal Service and General Government

RR-253

DEPARTMENT OF THE TREASURY

STATEMENT OF RONALD K. NOBLE

UNDER SECRETARY (ENFORCEMENT)

MAY 1, 1995

BEFORE THE SENATE COMMITTEE ON APPROPRIATIONS

SUBCOMMITTEE ON TREASURY, POSTAL SERVICE,

AND GENERAL GOVERNMENT

GOOD AFTERNOON MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. TODAY I AM ACCOMPANIED BY THE DIRECTOR OF THE SECRET SERVICE, ELJAY BOWRON AND THE ASSOCIATE DIRECTOR OF THE BUREAU OF ALCOHOL, TOBACCO, AND FIREARMS, CHARLIE THOMSON.

IT IS AN UNSPEAKABLE TRAGEDY THAT BRINGS US TOGETHER TODAY. THE EVENTS OF APRIL 19TH, PERHAPS, HAVE FOREVER CHANGED SOME OF OUR PERCEPTIONS ABOUT OUR SOCIETY. WHAT REMAINS IMMUTABLE, HOWEVER, IS THE ABILITY

OF ALL GOOD AMERICANS TO PULL TOGETHER IN TIMES OF CRISES. WE HAVE SEEN THIS IN THE SEARCH AND RESCUE OPERATIONS IN OKLAHOMA CITY, AND WE HAVE SEEN THIS IN THE PUBLIC'S CHARITABLE OUTPOURINGS. WE ALSO HAVE SEEN THIS SPIRIT AT WORK IN THE EXCEPTIONAL COOPERATIVE EFFORTS OF LAW ENFORCEMENT IN THE AFTERMATH OF THE BOMBING.

THE TREASURY DEPARTMENT PLAYS A CENTRAL ROLE IN THE FIGHT AGAINST TERRORISM. OUR ENFORCEMENT BUREAUS PROTECT THE MOST VISIBLE TERRORIST TARGETS IN THE U.S., ENFORCE LAWS DIRECTED AT THE MOST COMMON INSTRUMENTS OF TERROR, PROTECT AGAINST THE SMUGGLING OF WEAPONS OF MASS DESTRUCTION, AND ENFORCE ECONOMIC SANCTIONS AGAINST COUNTRIES AND GROUPS THAT PROMOTE TERRORISM.

ALSO, I AM PLEASED TO TELL YOU THAT THERE IS OUTSTANDING COOPERATION AND JOINT EFFORT AMONG FEDERAL LAW ENFORCEMENT AGENCIES IN ATTACKING THE DOMESTIC TERRORISM PROBLEM. ATF, FBI, SECRET SERVICE,

CUSTOMS, IRS, THE TREASURY DEPARTMENT, AND THE JUSTICE DEPARTMENT ARE SHARING INFORMATION ABOUT THE CRIME THREAT POSED BY CERTAIN ORGANIZED GROUPS.

DOMESTIC TERRORISM IS A BROAD CONCEPT WITHOUT A PRECISE DEFINITION. WHEN I USE THAT TERM TODAY, I AM REFERRING TO INDIVIDUALS OR GROUPS WITHIN THE UNITED STATES WHO REJECT THE LEGITIMATE AUTHORITY OF THE UNITED STATES GOVERNMENT, WHO DO NOT RECOGNIZE THE VALIDITY OF FEDERAL LAW, OR WHO ADVOCATE THE OVERTHROW OF THE UNITED STATES GOVERNMENT, <u>AND</u> WHO USE OR PLAN TO USE VIOLENCE OR TO OTHERWISE VIOLATE FEDERAL LAW IN FURTHERANCE OF THESE OBJECTIVES.

WE HAVE SEEN DOMESTIC TERRORISM IN THE FORM OF THE UNABOMBER WHO HAS STRUCK 16 TIMES SINCE 1978, KILLING THREE AND WOUNDING 23 OTHERS. A SAN FRANCISCO-BASED TASK FORCE COMPRISED OF ATF, FBI, AND THE POSTAL INSPECTION SERVICE IS INVESTIGATING THIS CASE. EXPLOSIVES TECHNICIANS AND AGENTS IN ATF FIELD OFFICES NEAREST THE

SITE OF THE BOMBINGS (IN EIGHT STATES) ALSO HAVE BEEN INVOLVED CLOSELY. AFTER HIS MOST RECENT ATTACK WHICH KILLED A MAN IN SACRAMENTO ON APRIL 25, 1995, LETTERS WERE RECEIVED FROM THE UNABOMBER. THESE LETTERS AND OTHER LEADS ARE BEING EXAMINED TO ADD TO THE BOMBER'S PROFILE AND TO DETERMINE HIS MOTIVE; AND IT IS HOPED, LEAD TO HIS ARREST.

TREASURY'S ENFORCEMENT AGENCIES BELIEVE THAT DOMESTIC TERRORISM HAS BEEN GROWING STEADILY. WE HAVE NOTED AN ESCALATION IN VIOLENT INCIDENTS DURING THE PAST DECADE. BETWEEN 1983 AND 1993, THE NUMBER OF YEARLY BOMBINGS IN THE UNITED STATES MORE THAN TRIPLED. BOMBING DEATHS AND INJURIES WERE AT AN ALL TIME HIGH IN 1993 WITH 49 DEATHS AND 1,323 INJURED. THE OKLAHOMA CITY BOMBING WILL MAKE 1995 THE MOST DEADLY YEAR, YET.

OUR BEST ESTIMATE IS THAT IN THE PAST FIVE YEARS, THE VAST MAJORITY OF BOMBING INCIDENTS HAVE INVOLVED CRIMINAL DESTRUCTION OF PROPERTY OR NON-TERRORIST

RELATED REVENGE. NEVERTHELESS, IT IS CLEAR THAT THERE IS AN INCREASING TENDENCY AMONG SOME GROUPS TO ENGAGE IN ANTI-GOVERNMENT AND ANTI-LAW ENFORCEMENT VIOLENCE.

CIVILIANS, AS WELL AS FEDERAL AND LOCAL LAW ENFORCEMENT PERSONNEL, HAVE BEEN THREATENED, HARASSED, SURVEILLED, ASSAULTED, AND MURDERED. FEDERAL EMPLOYEES, SUCH AS IRS AUDITORS, EXERCISING THEIR LAWFUL DUTIES HAVE BEEN CONFRONTED BY RESISTANCE, SOMETIMES ARMED, BY GROUPS THAT CHALLENGE THE AUTHORITY OF THE FEDERAL GOVERNMENT.

SCOPE OF THE PROBLEM

ACCORDING TO THE STATE DEPARTMENT, WHICH HAS PRINCIPAL RESPONSIBILITY FOR INTERNATIONAL TERRORIST MATTERS, THERE WERE 321 INTERNATIONAL TERRORIST ATTACKS DURING 1994. SIXTY-SIX OF THEM WERE ANTI-U.S. ATTACKS. THE NUMBER OF INTERNATIONAL AND ANTI-U.S. ATTACKS IN 1994 WAS A 23-YEAR LOW AND IT WAS A DECREASE OF 25% FROM 1993.

NOTWITHSTANDING THOSE IMPROVED STATISTICS, WORLDWIDE CASUALTIES WERE 314 PERSONS KILLED AND 663 WOUNDED.

NEVERTHELESS, TREASURY'S ENFORCEMENT AGENCIES SEE NEW OPPORTUNITIES FOR INTERNATIONAL TERRORISM TO WIDEN IN SCOPE. WITH THE DISSOLUTION OF THE SOVIET UNION, AND THE END OF ITS CENTRALIZED CONTROL OVER NUCLEAR MATERIALS AND ASSOCIATED TECHNOLOGIES, WE ANTICIPATE INCREASED TERRORIST PROBLEMS. WEAPONS PROCUREMENT NETWORKS ARE BECOMING MORE ADVANCED AND CLANDESTINE.

TO COMBAT THESE PROBLEMS, TREASURY, THROUGH THE U.S. CUSTOMS SERVICE HAS A LONGSTANDING TRADITION OF OPERATING IN A FRAMEWORK OF INTERNATIONAL COOPERATION WITH FOREIGN CUSTOMS AGENCIES IN 126 COUNTRIES. THROUGH JOINT OPERATIONS, TACTICAL INTELLIGENCE, AND MUTUAL ASSISTANCE TREATIES, CUSTOMS HAS THE ABILITY TO DETECT AND DISMANTLE INTERNATIONAL SMUGGLING AND PROLIFERATION NETWORKS. THE ILLEGAL ACQUISITION

NETWORKS WHICH SUPPORT INTERNATIONAL TERRORISM ARE BECOMING MORE SOPHISTICATED AND CLANDESTINE.

CUSTOMS RECENTLY HAS MADE A NOTABLE SHIFT IN IT'S ENFORCEMENT MISSION TO EMPHASIZE THE DETECTION AND DEVELOPMENT OF SYSTEMS WHICH WILL EXPOSE SUSPICIOUS INDIVIDUALS AND CARGO (I.E., AUTOMATED EXPORT SYSTEM, OUTBOUND STRATEGY). THIS CAPABILITY WILL WARN FEDERAL AUTHORITIES OF TERRORIST ACTIVITIES BEFORE PEOPLE ARE HURT OR BUILDINGS DESTROYED.

ATF ALSO IS CONTINUING ITS INTERNATIONAL TRAFFIC IN ARMS (I.T.A.R.) PROGRAM,WHICH IS DESIGNED TO CURTAIL INTERNATIONAL ARMS TRAFFICKING. THE I.T.A.R. PROGRAM WAS DEVELOPED WHEN IT BECAME APPARENT THAT FIREARMS ORIGINATING FROM THE UNITED STATES WERE BEING RECOVERED WORLDWIDE IN SUCH CRIMINAL ACTS AS NARCOTICS TRAFFICKING AND TERRORISM.

RESOURCES

THE ADMINISTRATION HAS SUBMITTED A FUNDING PACKAGE TO YOU WHOSE PURPOSE IT IS TO ENSURE THAT THE FEDERAL GOVERNMENT HAS ADEQUATE RESOURCES TO PROTECT OUR COUNTRY FROM TERRORIST ACTIVITIES. ADDITIONAL FUNDING IS BEING SOUGHT FOR EMERGENCY EXPENSES OF THE BOMBING OF THE ALFRED P. MURRAH FEDERAL BUILDING IN OKLAHOMA CITY, AND RELATED ANTI-TERRORISM EFFORTS, INCLUDING THE PRESIDENT'S ANTI-TERRORISM INITIATIVE.

THE OVERALL PACKAGE SEEKS $150 MILLION FOR FY 1995, $500 MILLION FOR 1996, AND $1.5 BILLION FOR FY 1995-1999 (FIVE YEAR TIME FRAME). THIS INCLUDES ALL INVOLVED FEDERAL AGENCIES BUT PRINCIPALLY DOJ AND TREASURY. THE PROPOSAL REQUESTS $24 MILLION AND 200 POSITIONS FOR TREASURY ENFORCEMENT IN FY 1995.

- **ATF: $16.2 MILLION AND 175 EMPLOYEES** FOR A PERMANENT NATIONAL RESPONSE TEAM, FORENSICS LAB, EXPLOSIVES INSPECTIONS, COUNTERTERRORISM ANALYSTS, AND RELATED EQUIPMENT AND TRAVEL.

- **SECRET SERVICE: $3.8 MILLION** TO UPGRADE AND REPLACE EXISTING WEAPONRY AND PROTECTIVE GEAR TO PROVIDE ENHANCED PROTECTION OF THE WHITE HOUSE AND ENVIRONS, AND REPLACEMENT EQUIPMENT AND TRAVEL ASSOCIATED WITH THE OKLAHOMA INCIDENT.

- **CUSTOMS SERVICE: $1.2 MILLION** TO PROVIDE WORKING FACILITIES AND REPLACEMENT EQUIPMENT FOR DISPLACED OKLAHOMA EMPLOYEES, INCLUDING RELATED TRAVEL AND OVERTIME.

- **IRS/CID: $1 MILLION** TO COVER EXPENSES RELATED TO THE OKLAHOMA INCIDENT.

- **FINCEN: $.3 MILLION** TO COVER EXPENSES RELATED TO THE OKLAHOMA INCIDENT.

- **DEPARTMENTAL OFFICES: $.3 MILLION AND 10 EMPLOYEES** FOR THE OFFICE OF ENFORCEMENT TO

ASSIST IN OVERSIGHT OF THE DEPARTMENT'S ANTITERRORISM EFFORTS INCLUDING INCREASED SANCTIONS ENFORCEMENT.

WE URGE YOU TO ADOPT THIS LEGISLATION WITHOUT DIMINISHING IN ANY WAY OUR REQUEST.

TREASURY BUREAUS' ACTIVITIES

NEXT, I WOULD LIKE TO TELL YOU BRIEFLY WHAT EACH OF OUR TREASURY ENFORCEMENT BUREAUS IS DOING TO COMBAT TERRORISM.

- ATF HAS LONG PLAYED A CRUCIAL ROLE INVESTIGATING TERRORIST ACTS BOTH IN THE UNITED STATES AND ABROAD. ATF HAS CLEAR RESPONSIBILITY IN THESE INVESTIGATIONS BECAUSE ILLEGAL FIREARMS AND EXPLOSIVES, WHICH ATF HAS STATUTORY JURISDICTION TO REGULATE, ARE THE TOOLS USED TO COMMIT ACTS OF VIOLENCE AGAINST THE UNITED STATES AND ITS CITIZENS. DURING THE 1989-1993 PERIOD, THERE WERE APPROXIMATELY 12,200 ACTUAL OR ATTEMPTED BOMBINGS IN THE UNITED STATES. THE FBI ESTIMATES THAT 24 WERE

TERRORIST RELATED. THERE IS A MEMORANDUM OF UNDERSTANDING BETWEEN THE FBI, ATF, AND THE POSTAL INSPECTION SERVICE TO DETERMINE WHO HAS JURISDICTION OVER A BOMBING INCIDENT. NINETY FIVE PERCENT OF THE TOTAL BOMB INCIDENTS HAVE BEEN DETERMINED TO FALL WITHIN ATF'S JURISDICTION. ATF INVESTIGATES MORE BOMBING INCIDENTS THAN ANY OTHER U.S. LAW ENFORCEMENT AGENCY.

ATF HAS THE FOREMOST FEDERAL EXPERTISE IN EXPLOSIVES AND ARSON. THEY WORK CLOSELY WITH THE FBI AND THE POSTAL INSPECTION SERVICE. FEDERAL, STATE, LOCAL AND FOREIGN GOVERNMENTS ALIKE RECOGNIZE ATF AS BOMB INVESTIGATION EXPERTS, AND FREQUENTLY RELY ON ATF'S TECHNICAL AND INVESTIGATIVE EXPERTISE. FOR EXAMPLE, ATF'S INTERNATIONAL RESPONSE TEAMS ASSISTED IN THE INVESTIGATION OF THE 1992 BOMBING OF THE ISRAELI EMBASSY IN BUENOS AIRES, ARGENTINA.

AS WE SIT HERE TODAY, OVER 130 ATF PERSONNEL ARE IN OKLAHOMA CITY WORKING HAND-IN-HAND WITH THE FBI AND

ES TO S꞉NCIES TO SOLVE THE EVIL BOMBING COMMITTED

PROVIDF IS PROVIDING THE TECHNICAL BOMBING EXPERTISE

OMA CILAHOMA CITY BOMBING SITE. ATF'S FORENSIC'S

NABLEIES ENABLED THEIR CHEMISTS TO IDENTIFY THE

THE BOI OF THE BOMB AND THE PROPORTIONATE PRESENCE OF

NTS. AEMENTS. ATF ALSO BELIEVES IT HAS DETERMINED HOW

N WAS DSION WAS INITIATED, HOW MANY CONTAINERS OF

TERIAL MATERIAL WERE USED, AND WHERE THE CONTAINERS

NED IN ITIONED IN THE TRUCK. FURTHER, ATF HAS IDENTIFIED

ANUFACY MANUFACTURER OF THE BARRELS BELIEVED TO

IE EXPLD THE EXPLOSIVE MATERIALS.

ET SERSECRET SERVICE IS CHARGED WITH PROTECTING, THE

ND OTHT, AND OTHER PROTECTEES WHO ARE PERHAPS THE

ILE TAPROFILE TARGETS OF POTENTIAL TERRORISTS ATTACKS

). AS SUDRLD. AS SUCH, THE SECRET SERVICE IS ACTIVELY

IDENTIF IN IDENTIFYING INDIVIDUALS AND GROUPS, AS EARLY

WHO MALE, WHO MAY POSE A RISK TO ITS PROTECTEES. IN

ENT EVRECENT EVENTS, WE MUST MAKE SURE THAT THE

AT ITS HAS AT ITS DISPOSAL THE INVESTIGATIVE AND

PROTECTIVE RESOURCES NECESSARY TO BE ABLETO BE
FOR THE SAFETY OF PROTECTEES, AS WELL AS IT WELL

RELATIVE TO THE PRESIDENT'S COUNTERTECOUNTE
INITIATIVE, THE SECRET SERVICE SIGNIFICANTLYNIFICAN
BY UTILIZING ITS INVESTIGATIVE AND FORENSIC FOREN
THROUGHOUT THE WORLD, THE SECRET SERVICEET SER
RESPECTED FOR ITS UNIQUE FORENSIC EXPERTISE EXPE
INVESTIGATIVE SKILLS. IN FACT, THOSE SKILLS OSE SKI
SUCCESSFULLY ARE EMPLOYED IN SUPPORT OF ITPPORT
MISSIONS--PROTECTION OF OUR NATION'S LEADEON'S LE
FINANCIAL SYSTEMS, TO INCLUDE IDENTIFYING PENTIFYI
TERRORIST THREATS AS THEY RELATE TO THOSE TO TH
RESPONSIBILITIES.

- THE CUSTOMS SERVICE, BY VIRTUE OF ITS EUE OF I
AND SEARCH AUTHORITY, IS THE PRIMARY BORDHARY B
ENFORCEMENT AGENCY. CUSTOMS MUST SUSTAUST SU
EFFECTIVELY COORDINATE THEIR SYSTEMATIC INTEMAT
INTELLIGENCE, INTERDICTION, AND INVESTIGATINVESTIC

THESE PROGRAMS ARE CRITICAL REQUIREMENTS TO DETER EFFECTIVELY THE USE OF AIR, SEA, AND LAND BORDERS AS GLOBAL SMUGGLING ROUTES TO SUPPORT TERRORIST ACTIONS.

CUSTOMS HAS ACHIEVED NOTABLE SEIZURES THROUGH THE IMPLEMENTATION OF PRO-ACTIVE INVESTIGATIONS, UNDERCOVER OPERATIONS, AND INNOVATIVE INSPECTION TECHNIQUES. SEIZURES INCLUDE SOPHISTICATED TECHNOLOGY AND CHEMICAL PRECURSORS SUCH AS AMMONIUM PERCHLORATE, SODIUM SULFIDE, ZIRCONIUM, LASER GUIDANCE DEVICES, ENCRYPTION COMMUNICATIONS EQUIPMENT, NUCLEAR TRIGGERS, AND NON-RADIOACTIVE ISOTOPES. THESE SEIZURES ARE WORTH MILLIONS OF DOLLARS. DELIVERY OF ANY ONE OF THESE ITEMS INTO TERRORIST HANDS WOULD HAVE DEVASTATING EFFECTS TO PERSONS AND PROPERTY.

- THE OFFICE OF FOREIGN ASSETS CONTROL (OFAC) ADMINISTERS OUR COUNTRY'S ECONOMIC SANCTIONS PROGRAMS AGAINST SELECTED FOREIGN COUNTRIES AND GROUPS THAT SUPPORT TERRORISM OR COMMIT TERRORIST ACTS. THESE

PROGRAMS INCLUDE $2.8 BILLION IN ASSET FREEZES AND TRADE EMBARGOES AGAINST SEVERAL STATE SPONSORS OF TERRORISM, INCLUDING LIBYA AND IRAQ; AND IMPORT AND PETROLEUM DEVELOPMENT SANCTIONS AGAINST IRAN. OFAC SANCTIONS ALSO TARGET DOMESTIC FUNDRAISING ACTIVITY BY MIDDLE EAST TERRORIST GROUPS.

- THE INTERNAL REVENUE SERVICE, ALTHOUGH NOT USUALLY DIRECTLY INVOLVED IN COUNTER-TERRORISM INVESTIGATIONS, CONDUCTS INVESTIGATIONS OF TAX PROTESTERS, MANY OF WHOM ARE LINKED TO ORGANIZATIONS, SUCH AS MILITIAS, THAT CHALLENGE THE LEGITIMATE AUTHORITY OF THE U.S. GOVERNMENT.

- THE FINANCIAL CRIMES ENFORCEMENT NETWORK (FINCEN) PROVIDES VALUABLE INTELLIGENCE SUPPORT TO LAW ENFORCEMENT AGENCIES CONDUCTING INVESTIGATIONS OF TERRORISTS. IN THE PAST, FINCEN HAS PROVIDED ANALYTICAL INTELLIGENCE IN SUPPORT OF INVESTIGATIONS OF MURDER AND BOMBINGS CARRIED OUT BY SUSPECTED TERRORISTS.

SUCCESSFUL TERRORIST ORGANIZATIONS REQUIRE FINANCING AND FINCEN FOLLOWS THE MONEY.

THROUGH RESEARCH AND ANALYSIS OF VARIOUS LAW ENFORCEMENT AND COMMERCIAL DATABASES, FINCEN RAPIDLY DEVELOPS INFORMATION CONCERNING RESIDENCES UTILIZED BY SUSPECTS, DOMESTIC AND INTERNATIONAL FINANCIAL TRANSACTIONS, FOREIGN TRAVEL, BUSINESS ACTIVITIES, NAMES OF ASSOCIATES, AND ALIASES USED BY SUSPECTS. THIS INFORMATION PROVIDES TIMELY INVESTIGATIVE LEADS THAT CAN BE USED TO IDENTIFY TERRORISTS AND THEIR ASSETS.

FINALLY, ALL OF TREASURY ENFORCEMENT BUREAUS ARE FOCUSED ON ATTACKING THE MEANS BY WHICH ORGANIZED CRIMINAL GROUPS FUND THEIR OPERATIONS. WE HAVE FOUND THAT CRIMES LIKE FINANCIAL FRAUD OR COUNTERFEITING FREQUENTLY ARE USED TO FINANCE ACTS OF TERRORISM. WE ARE DEDICATED TO USING OUR FINANCIAL CRIMES EXPERTISE TO ATTACK THESE FUNDING MECHANISMS.

RECENT PRESIDENTIAL INITIATIVES

ON JANUARY 23rd OF THIS YEAR, PRESIDENT CLINTON SIGNED AN EXECUTIVE ORDER PROHIBITING TRANSACTIONS WITH TERRORISTS WHO THREATEN TO DISRUPT THE MIDDLE EAST PEACE PROCESS. THIS ORDER IS BEING ENFORCED BY OFAC. THE ORDER BLOCKS THE MOVEMENT, SALE, PURCHASE, OR TRANSFER OF PROPERTY OF CERTAIN TERRORIST ORGANIZATIONS, OR PERSONS ACTING ON THEIR BEHALF, THAT THREATEN THE MIDDLE EAST PEACE PROCESS. THE ORDER ALSO PROHIBITS THE TRANSFERRING OF ANY CONTRIBUTION OF FUNDS, GOODS, OR SERVICES TO OR FOR THE BENEFIT OF SUCH PERSONS. THE ORDER PROVIDES A NEW TOOL TO COMBAT FUNDRAISING IN THIS COUNTRY ON BEHALF OF ORGANIZATIONS THAT USE TERROR TO UNDERMINE THE MIDDLE EAST PEACE PROCESS AND CUTS OFF THEIR ACCESS TO SOURCES OF SUPPORT IN THE U.S. AND TO THE U.S. FINANCIAL SYSTEM. SECTION 301 OF THE OMNIBUS COUNTERTERRORISM ACT OF 1995, WHICH RECENTLY WAS TRANSMITTED TO THE CONGRESS BY PRESIDENT CLINTON, CONTAINS SIMILAR BLOCKING PROVISIONS AND PROHIBITIONS AGAINST THE MAKING OR RECEIVING OF CERTAIN

CONTRIBUTIONS TO DESIGNATED TERRORISTS. YESTERDAY, THE PRESIDENT ANNOUNCED HIS INTENTION TO IMPOSE ADDITIONAL SANCTIONS AGAINST IRAN. HE IS EXPECTED TO SIGN AN EXECUTIVE ORDER IMPLEMENTING HIS DECISION EARLY THIS WEEK.

AMONG THE IMPORTANT STEPS TAKEN BY PRESIDENT CLINTON IMMEDIATELY FOLLOWING THE NEWS OF THIS TRAGEDY WAS TO DIRECT HIS CABINET TO REVIEW EXISTING LEGISLATION, RESOURCES AND OPERATIONS TO DETERMINE WHAT ELSE NEEDED TO BE DONE IMMEDIATELY. WE COMMENCED AN INTENSE, COOPERATIVE REVIEW AND WITHIN A WEEK HAD DEVELOPED A NEW LEGISLATIVE AND RESOURCE PACKAGE WHICH IS SCHEDULED FOR SUBMISSION TO THE CONGRESS TODAY. I WOULD LIKE TO PROVIDE AN OVERVIEW OF THE PRESIDENT'S PACKAGE, INCLUDING THE NEW LEGISLATIVE INITIATIVES AND THE FY 1995 SUPPLEMENTAL. THE FY 1996 BUDGET AMENDMENT IS STILL BEING FINALIZED, BUT IT WILL BE TRANSMITTED TO THE CONGRESS LATER THIS WEEK.

-- THERE WILL BE A NEW DOMESTIC ANTI-TERRORISM CENTER, UNDER THE LEADERSHIP OF THE FBI. BECAUSE OF TREASURY'S IMPORTANT JURISDICTION AND ENFORCEMENT ACTIVITIES, TREASURY ENFORCEMENT WILL NECESSARILY PLAY AN IMPORTANT ROLE IN THIS CENTER. THE CONCEPTUAL FRAMEWORK OF THIS CENTER IS STILL BEING DEVELOPED.

-- A NEW PRESIDENTIAL DECISION DIRECTIVE IS BEING DEVELOPED ON BOTH FOREIGN AND DOMESTIC TERRORISM. AGAIN, TREASURY ENFORCEMENT IS ACTIVE IN THE DEVELOPMENT OF THE DIRECTIVE AND WILL PLAY AN IMPORTANT ROLE IN CARRYING OUT ITS MANDATE.

NEW LEGISLATIVE INITIATIVES

-- FBI WILL HAVE ACCESS TO FINANCIAL AND CREDIT REPORTS IN ANTI-TERRORISM CASES, ON THE SAME BASIS AS BANK RECORDS ARE CURRENTLY PROVIDED, ALLOWING

ENFORCEMENT AGENCIES TO TRACK THE SOURCE AND USE OF FUNDS BY SUSPECTED TERRORISTS.

-- THE SAME LEGAL STANDARD WILL BE APPLIED IN NATIONAL SECURITY CASES THAT IS CURRENTLY USED IN OTHER CRIMINAL CASES FOR OBTAINING PERMISSION TO TRACK TELEPHONE TRAFFIC WITH "PEN REGISTERS" AND "TRAP AND TRACE" DEVICES.

-- LAW ENFORCEMENT AGENCIES WILL BE ABLE TO UTILIZE THE NATIONAL SECURITY LETTER PROCESS TO OBTAIN RECORDS CRITICAL TO TERRORISM INVESTIGATIONS FROM HOTELS, MOTELS, COMMON CARRIERS, STORAGE FACILITIES, AND VEHICLE RENTAL AGENCIES.

-- LAW ENFORCEMENT WILL HAVE EXPANDED AUTHORITY TO CONDUCT ELECTRONIC SURVEILLANCE, WITHIN CONSTITUTIONAL SAFEGUARDS. THIS IS AN IMPORTANT INVESTIGATIVE TOOL FOR ATF IN CARRYING OUT ITS EXPLOSIVE ENFORCEMENT MISSION.

-- ATF WILL BE REQUIRED TO STUDY THREE ISSUES: (1) THE INCLUSION OF TAGGANTS IN STANDARD EXPLOSIVE DEVICE RAW MATERIALS TO PERMIT TRACING OF THE SOURCE OF THOSE MATERIALS AFTER AN EXPLOSION; (2) WHETHER COMMON CHEMICALS USED TO MANUFACTURE EXPLOSIVES CAN BE RENDERED INERT; AND (3) WHETHER CONTROLS CAN BE IMPOSED ON CERTAIN BASIC CHEMICALS USED TO MANUFACTURE OTHER EXPLOSIVES.

-- TAGGANTS WILL BE REQUIRED IN STANDARD EXPLOSIVE DEVICE RAW MATERIALS AFTER THE PUBLICATION OF IMPLEMENTING REGULATIONS BY THE SECRETARY OF THE TREASURY.

-- LAW ENFORCEMENT AGENCIES WILL BE ABLE TO CALL ON THE TECHNICAL EXPERTISE OF THE DEPARTMENT OF DEFENSE IN INVESTIGATING OFFENSES INVOLVING CHEMICAL AND BIOLOGICAL WEAPONS.

-- WE WILL INCREASE MANDATORY MINIMUM PENALTIES FROM 5 TO 10 YEARS FOR TRANSFERRING A FIREARM OR EXPLOSIVES WITH KNOWLEDGE THAT IT WILL BE USED TO COMMIT A VIOLENT CRIME.

-- PENALTIES WILL BE ENHANCED FOR TERRORIST ATTACKS AGAINST CURRENT AND FORMER FEDERAL EMPLOYEES AND THEIR FAMILIES WHEN THE CRIME IS COMMITTED BECAUSE OF THE EMPLOYEE'S OFFICIAL DUTIES.

o0o

-- THROUGH A SURCHARGE ON CIVIL FINES, FUNDING WILL BE AVAILABLE FOR THE DIGITAL TELEPHONY BILL PASSED BY CONGRESS LAST SESSION, ENSURING COURT-AUTHORIZED LAW ENFORCEMENT ACCESS TO ELECTRONIC SURVEILLANCE OF DIGITIZED COMMUNICATIONS.

THAT COMPLETES MY STATEMENT. AFTER SECRET SERVICE'S DIRECTOR ELJAY BOWRON AND ATF'S ASSOCIATE DIRECTOR CHARLIE THOMSON PRESENT THEIR STATEMENTS, WE WILL BE GLAD TO RESPOND TO ANY QUESTIONS YOU MAY HAVE.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT 3 p.m.
May 1, 1995

Contact: Jon Murchinson
(202) 622-2960

TREASURY ANNOUNCES MARKET BORROWING ESTIMATES

The Treasury Department on Monday announced that its net market borrowing for the April-June 1995 quarter is estimated to be $25.8 billion, with a $45.0 billion cash balance on June 30. The Treasury also announced that its net market borrowing for the July-September 1995 quarter is estimated to be in a range of $40 billion to $45 billion, with a $30 billion cash balance at the end of September. The estimates do not include new cash to be raised in the September 2- and 5-year notes, which will be issued on October 2.

In the quarterly announcement of its borrowing needs on January 30, 1995, the Treasury estimated net market borrowing during the April-June quarter to be a paydown of $5 billion to $10 billion, assuming a $35 billion cash balance on June 30. The increase in the borrowing estimate is due to a shift of tax refunds from the prior quarter into the April-June quarter, higher outlays, and an increase in the June 30 cash balance assumption.

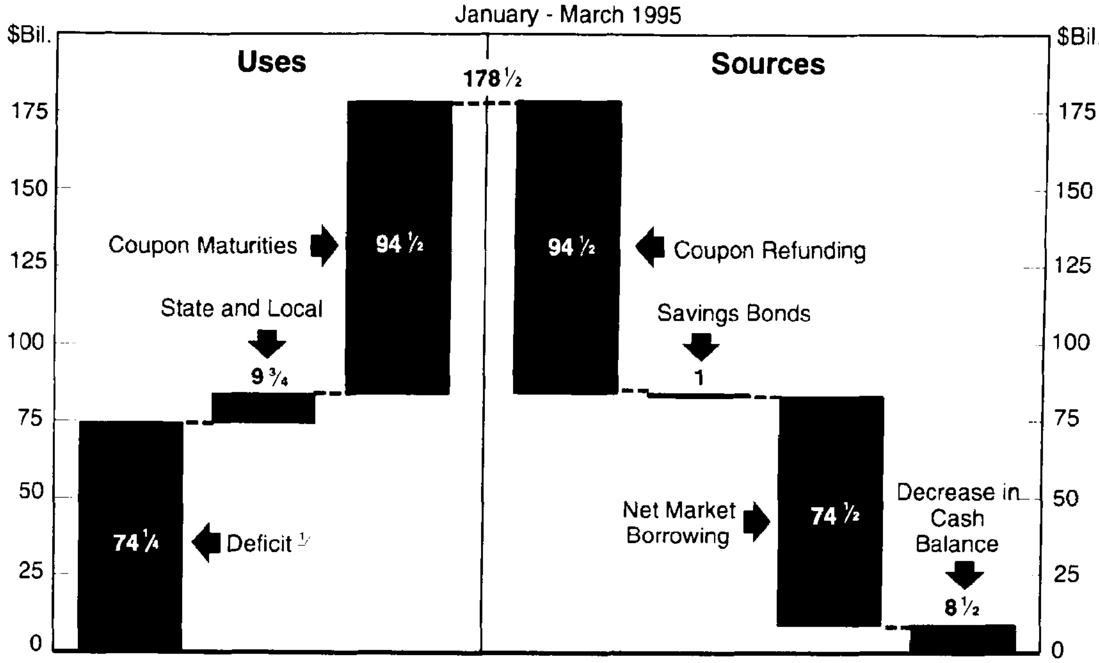
Actual net market borrowing in the quarter ended March 31, 1995 was $74.5 billion, while the end-of-quarter cash balance was $18.1 billion. On January 30, the Treasury had estimated net market borrowing for the January-March quarter to be $93.7 billion, with a $20 billion cash balance on March 31. The lower-than-expected market borrowing reflected in part the slow down in tax refund payments, compared with the Treasury estimate in January, and lower outlays. The actual cash balance was little changed from the January 30 estimate.

-30-

RR-254

TREASURY FINANCING REQUIREMENTS

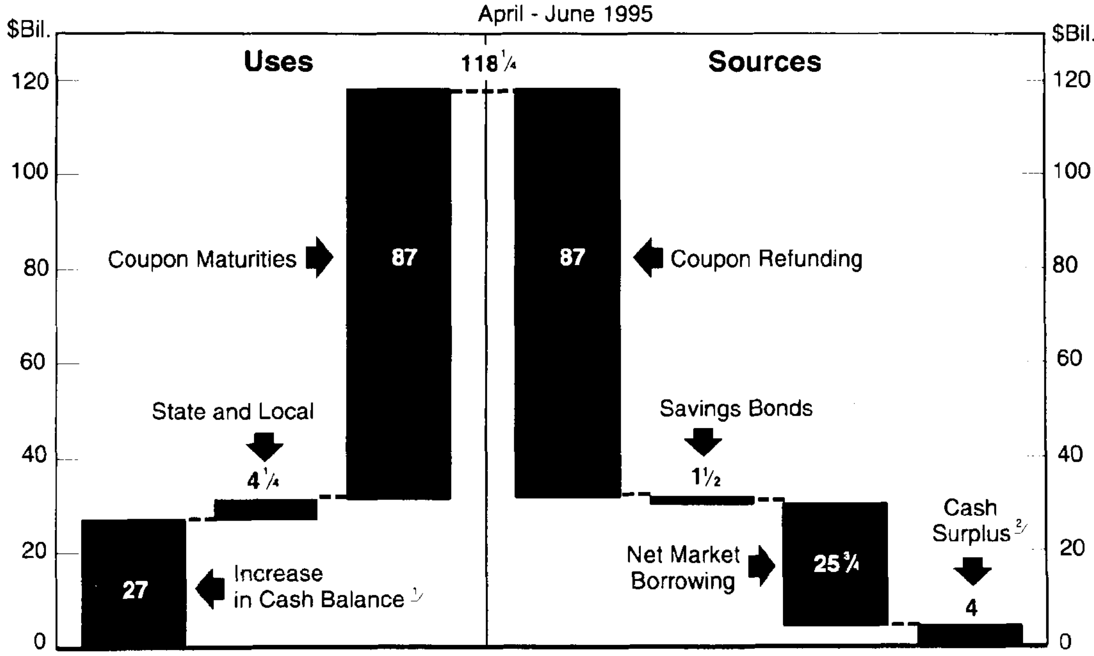
January - March 1995



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

TREASURY FINANCING REQUIREMENTS

April - June 1995



1/ Assumes a $45 billion cash balance June 30, 1995.

2/ Includes budget surplus, changes in accrued interest and checks outstanding and miscellaneous debt transactions.

NET MARKET BORROWING

April – June 1995

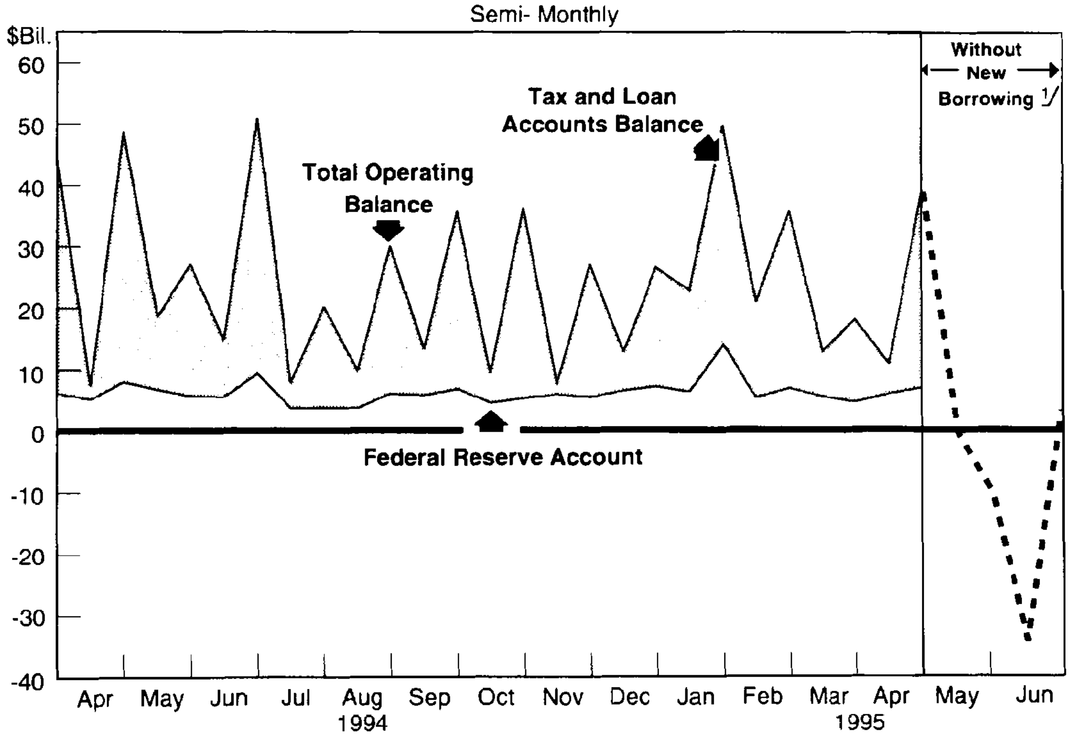
(Billions of Dollars)

Total		**25.8**
Done [1]		**-15.9**
Bills		
Regular weekly	-16.3	
52 week	2.3	
Cash management	-9.1	
Notes		
7 year note	-7.0	
2 year note	2.2	
5 year note	12.0	
To Be Done		**41.7**

[1] Issued or announced through April 28, 1995 .

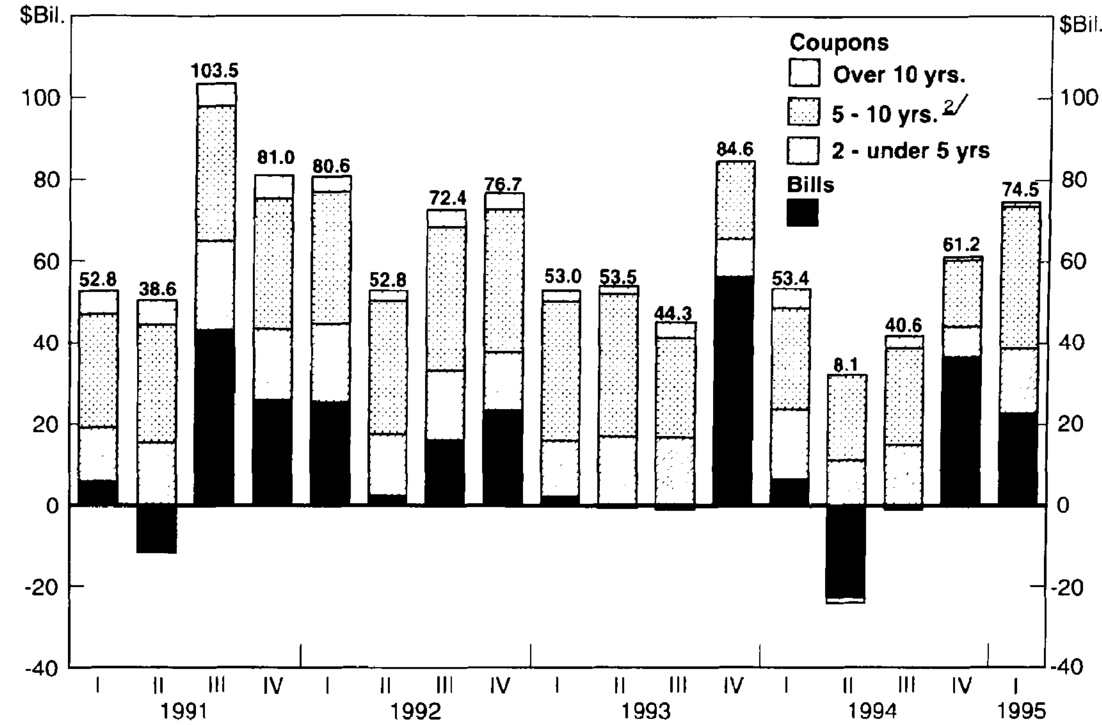
TREASURY OPERATING CASH BALANCE

Semi- Monthly



1/ Assumes refunding of maturing issues.

TREASURY NET MARKET BORROWING [1]



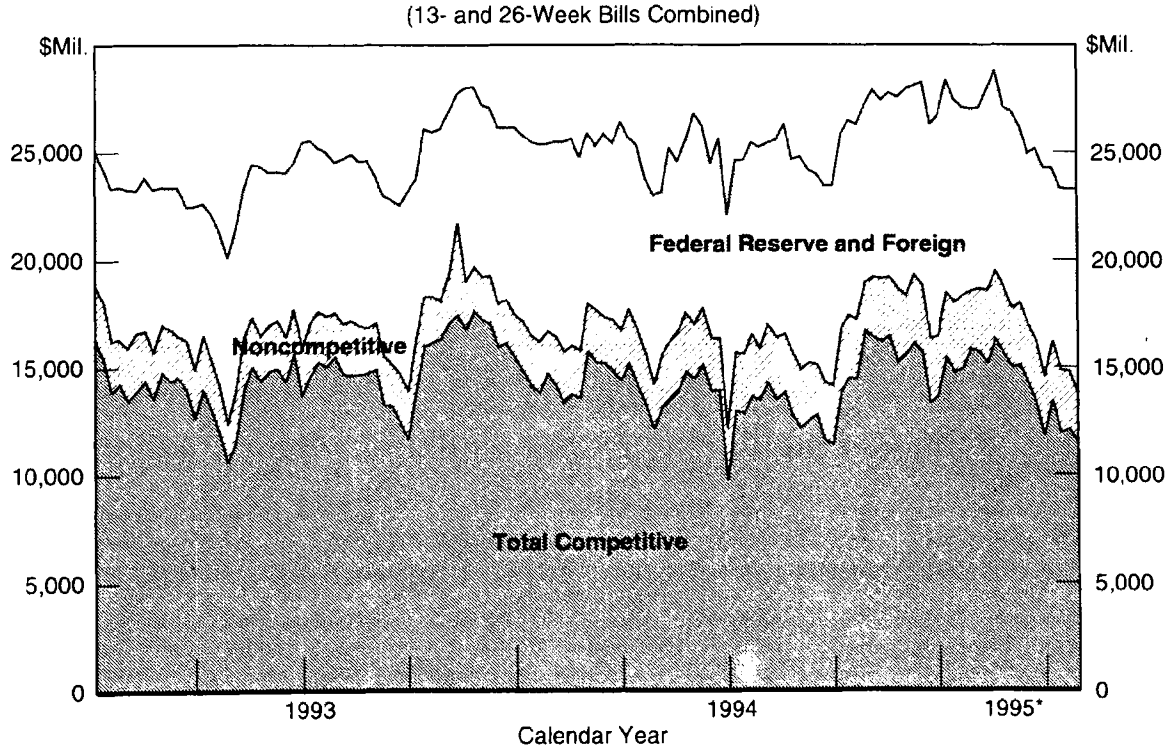
1/ Excludes Federal Reserve and Government Account Transactions.
2/ 7 year note discontinued after April 1993.

Department of the Treasury
Office of Market Finance

May 1, 1995-5

AWARDS IN WEEKLY BILL AUCTIONS

(13- and 26-Week Bills Combined)

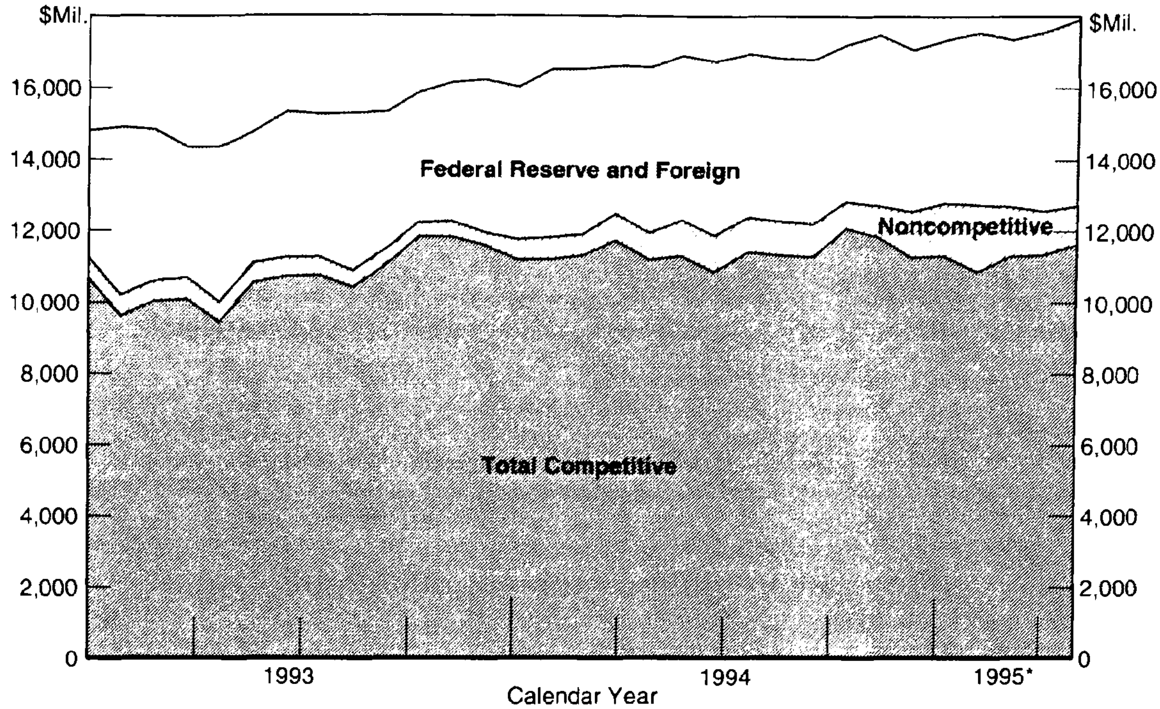


*Data through April 24, 1995 Auction.

Department of the Treasury
Office of Market Finance

May 1, 1995-6

AWARDS IN 52-WEEK BILL AUCTIONS

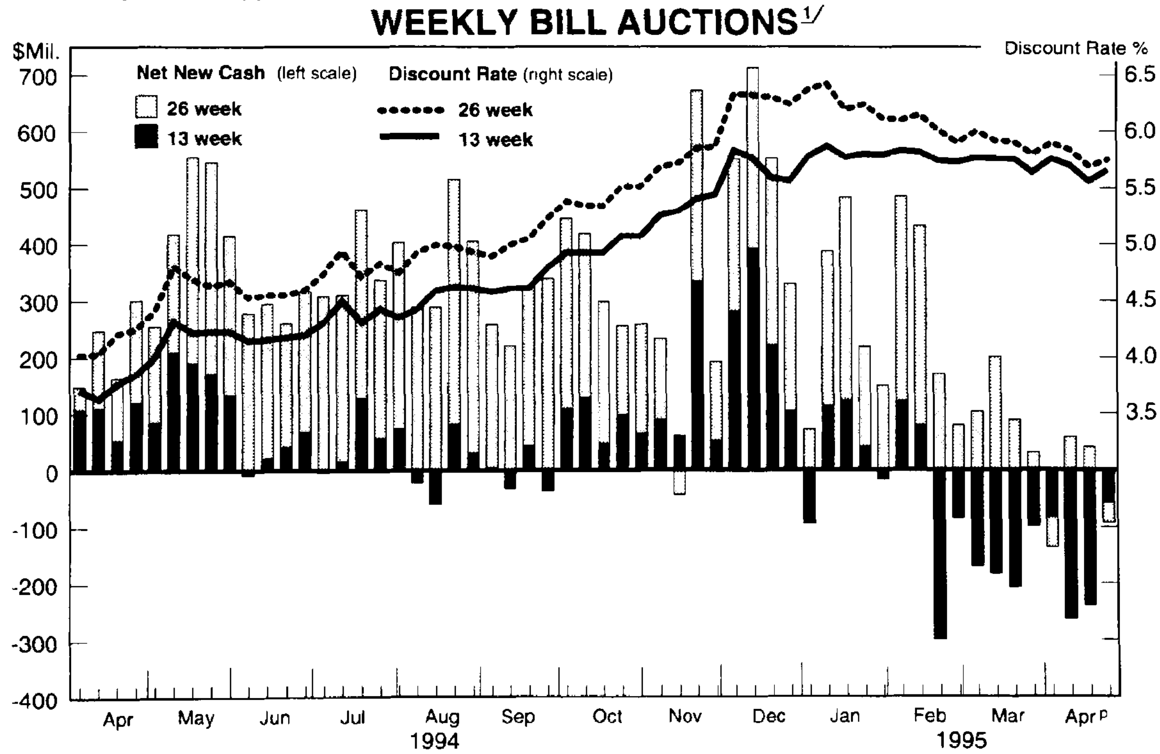


*Data through April 27, 1995 auction.

Department of the Treasury
Office of Market Finance

May 1 1995-7

NET NEW CASH FROM NONCOMPETITIVE TENDERS IN WEEKLY BILL AUCTIONS[1/]

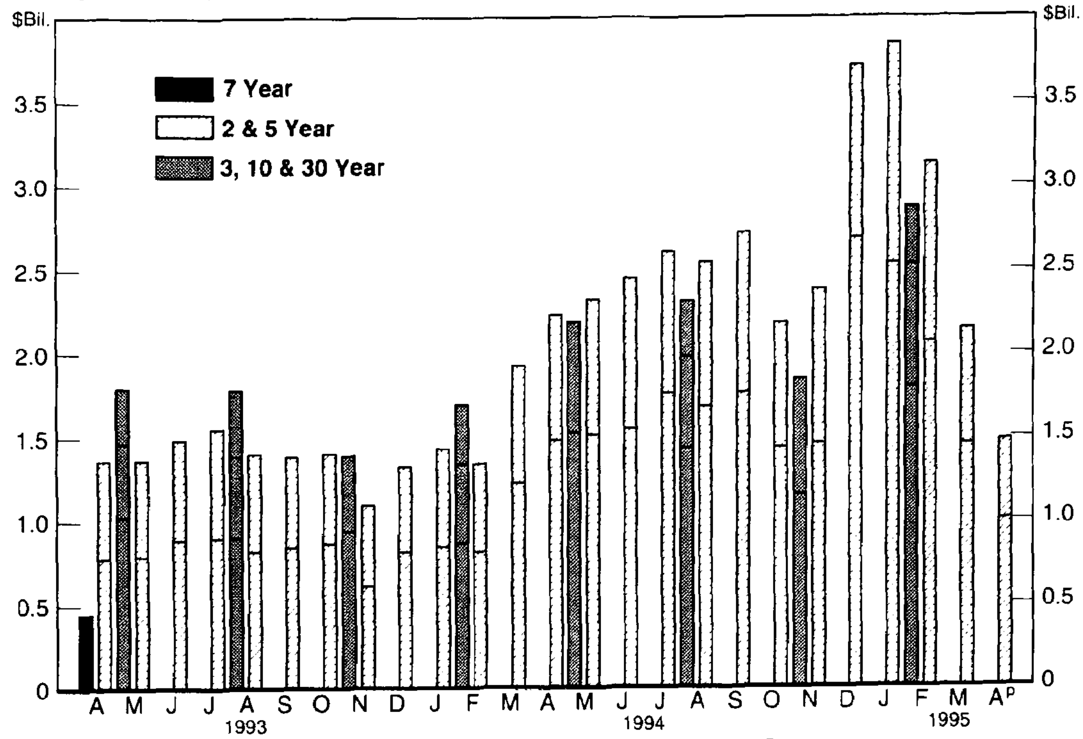


1/ Excludes noncompetitive tenders from foreign official accounts and the Federal Reserve account.
p Preliminary

Department of the Treasury
Office of Market Finance

May 1, 1995-8

NONCOMPETITIVE TENDERS IN TREASURY NOTES AND BONDS 1/



1/ Excludes foreign add-ons from noncompetitive tenders

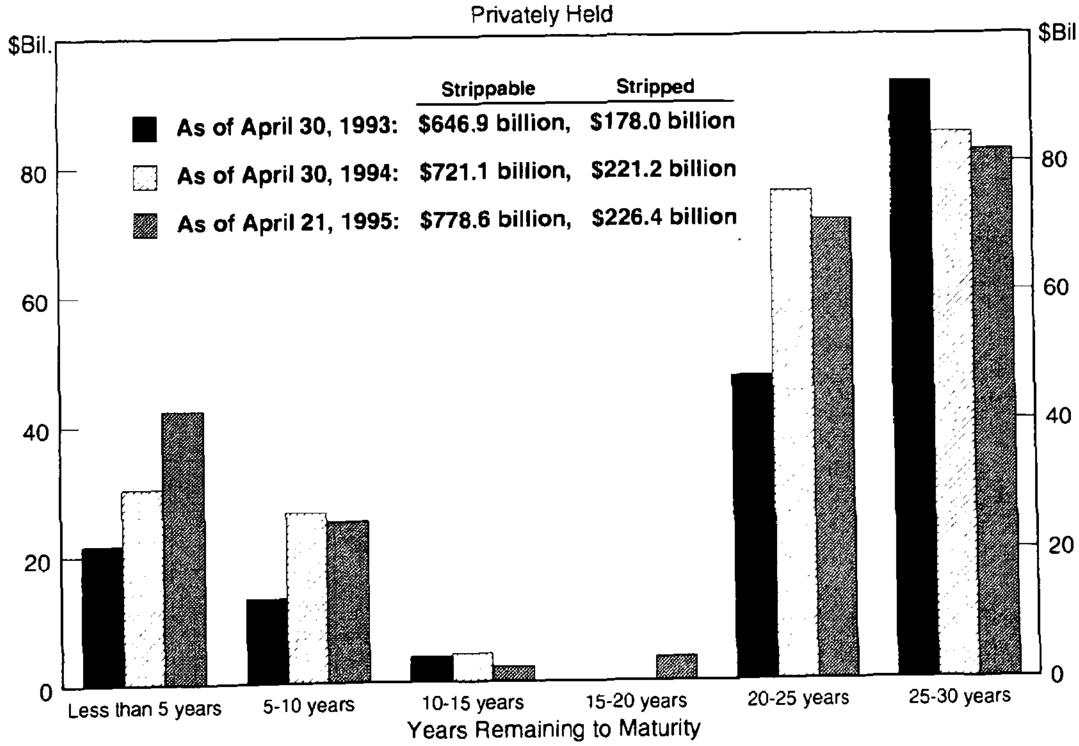
p Preliminary

Treasury increased the maximum noncompetitive award to any noncompetitive bidder to $5 million effective November 5, 1991.

Effective February 11, 1992, a noncompetitive bidder may not hold a position in WI trading, futures, or forward contracts, nor submit both competitive and noncompetitive bids for its own account.

SECURITIES HELD IN STRIPS FORM 1993-1995

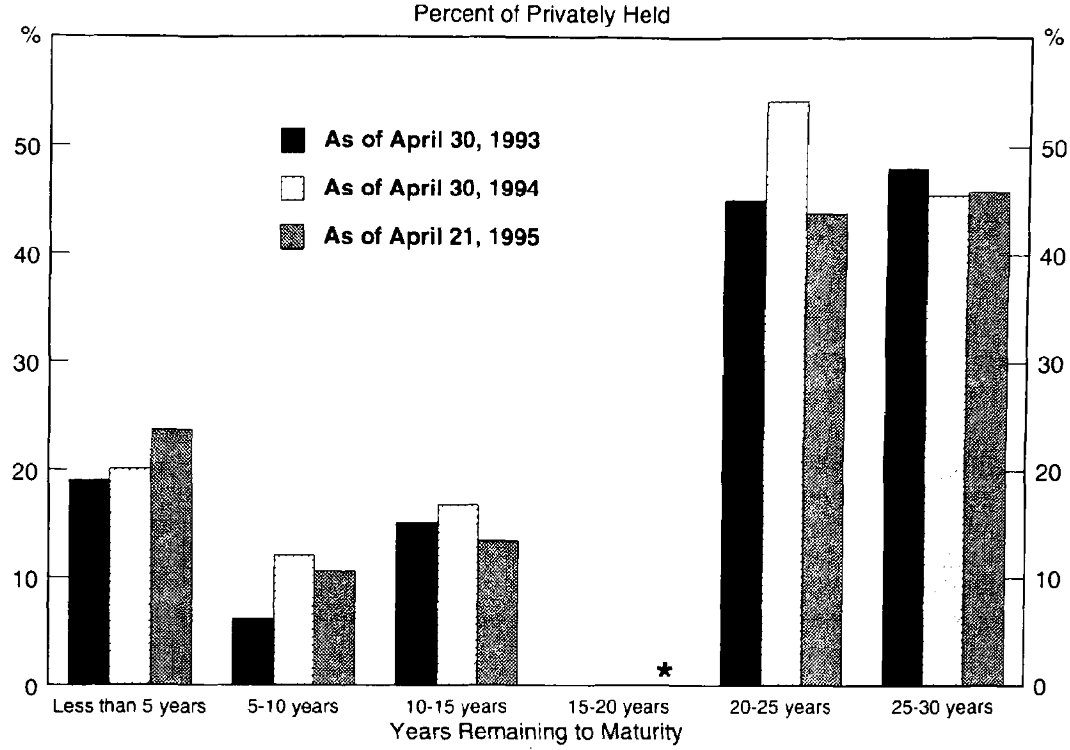
Privately Held



Note: The STRIPS program was established in February 1985. The 11 5/8% note of November 15, 1994, issued on November 15, 1984, was the first STRIPS-eligible security to mature.

SECURITIES HELD IN STRIPS FORM 1993-1995

Percent of Privately Held



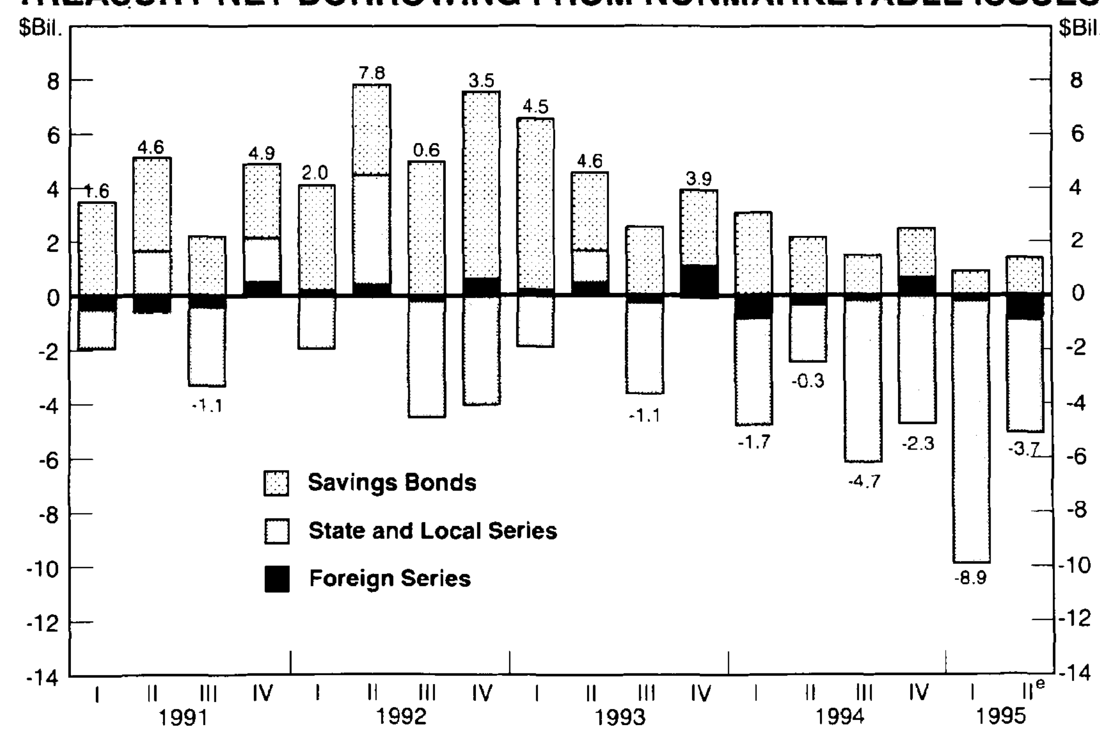
* The 11 3/4% bond of 11/15/09-14 had $4.9 billion (privately-held) available for stripping, of which 76% was held in stripped form.

Note: The STRIPS program was established in February 1985. The 11 5/8% note of November 15, 1994, issued on November 15, 1984, was the first STRIPS-eligible security to mature.

Department of the Treasury
Office of Market Finance

May 1, 1995-11

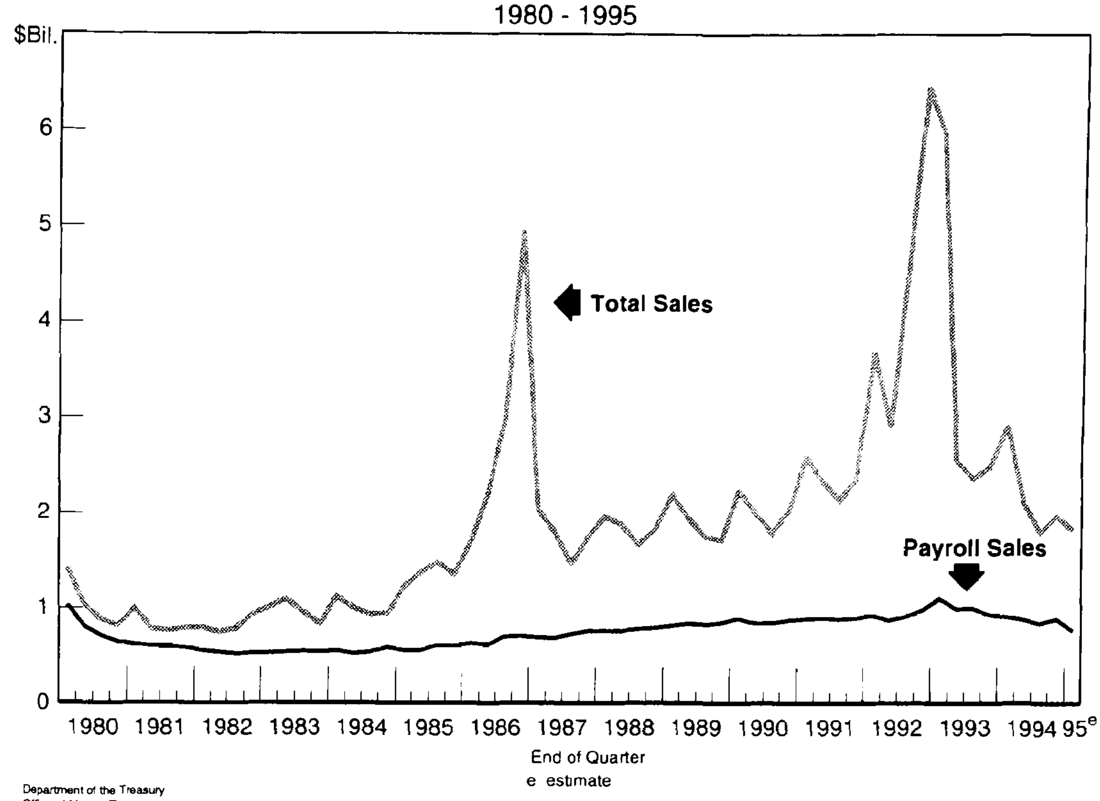
TREASURY NET BORROWING FROM NONMARKETABLE ISSUES



Department of the Treasury

SALES OF UNITED STATES SAVINGS BONDS

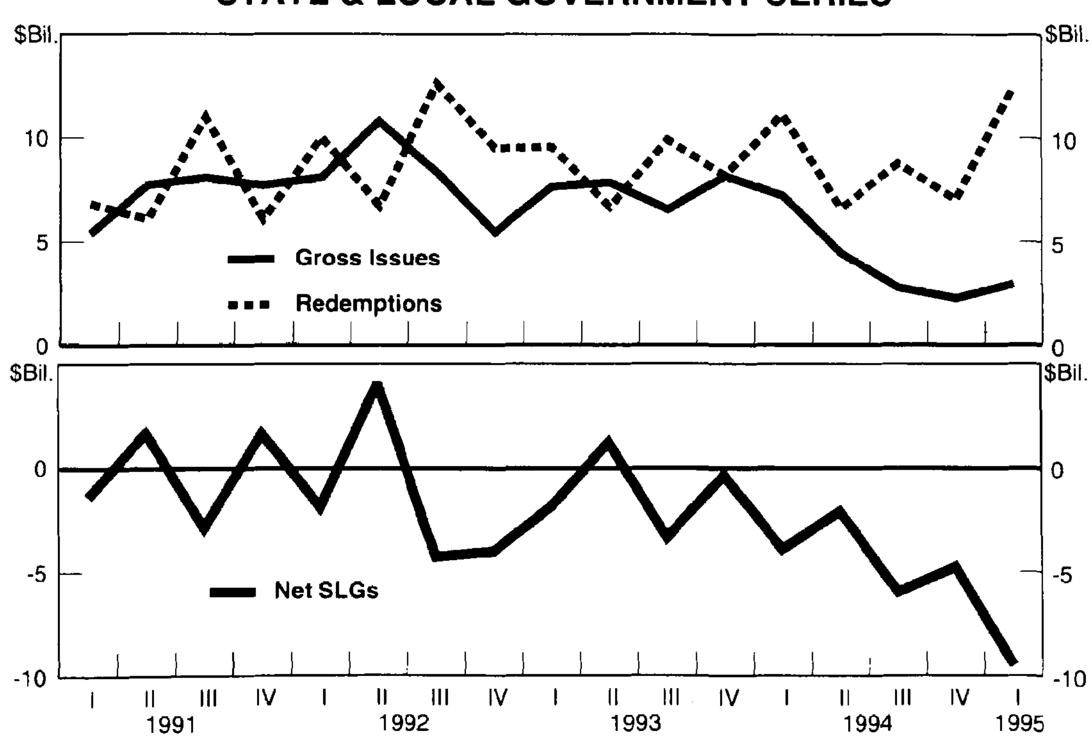
1980 - 1995



Department of the Treasury
Office of Market Finance

May 1, 1995-13

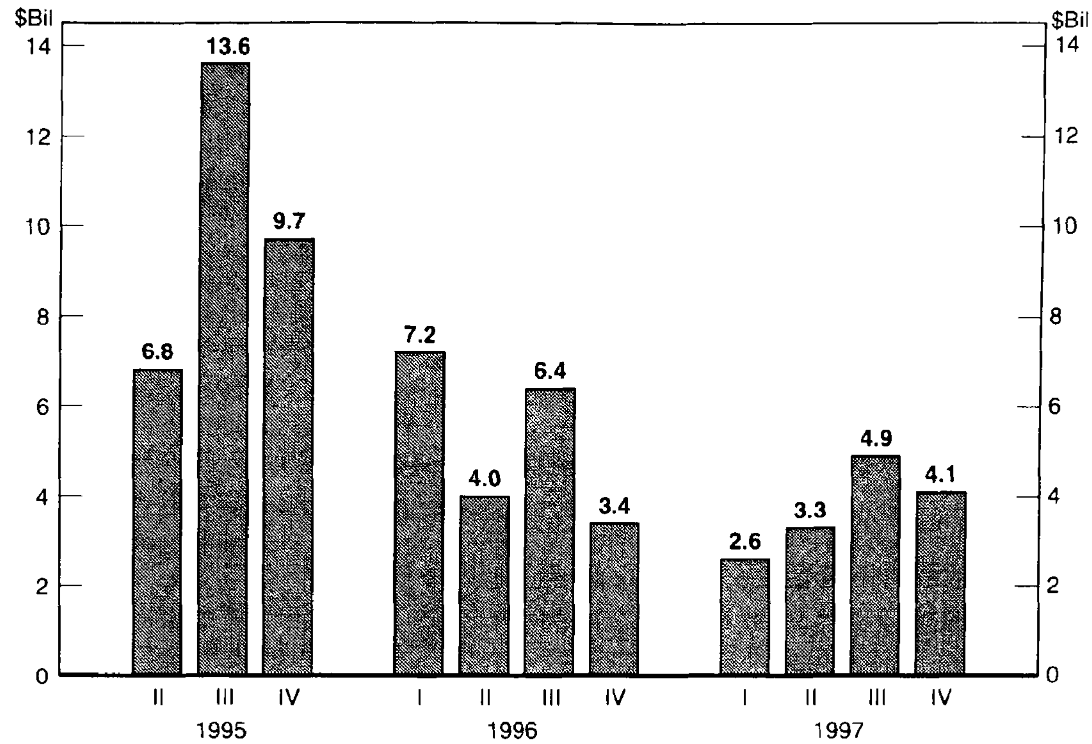
STATE & LOCAL GOVERNMENT SERIES



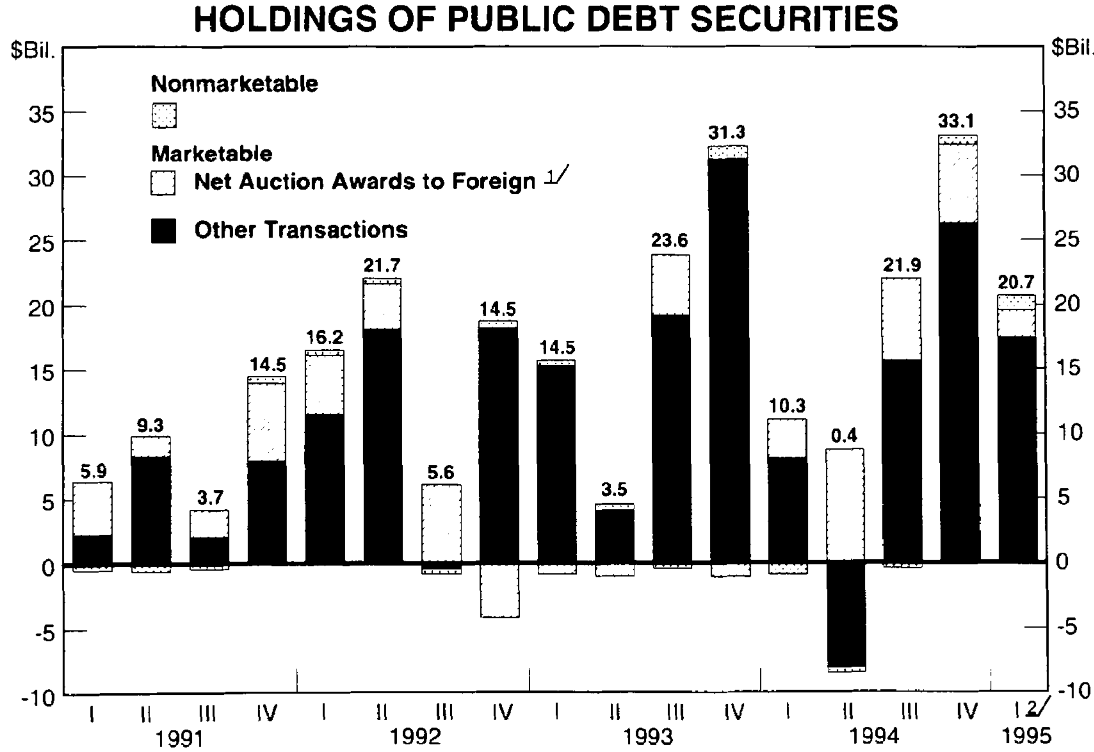
Department of the Treasury
Office of Market Finance

May 1, 1995-14

STATE AND LOCAL MATURITIES 1995-1997



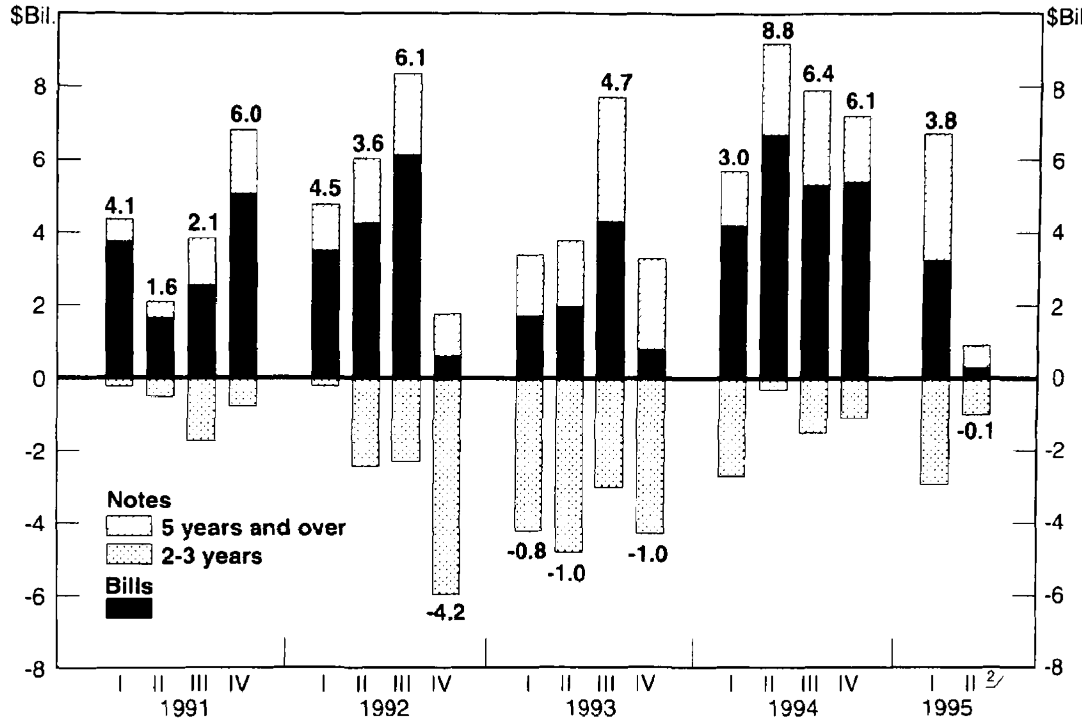
QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES



1/ Auction awards to foreign official purchasers netted against holdings of maturing securities.

2/ Data through February 28, 1995.

NET AWARDS TO FOREIGN OFFICIAL ACCOUNTS 1/



1/ Noncompetitive awards to foreign official accounts held in custody at the Federal Reserve in excess of foreign custody account holdings of maturing securities.

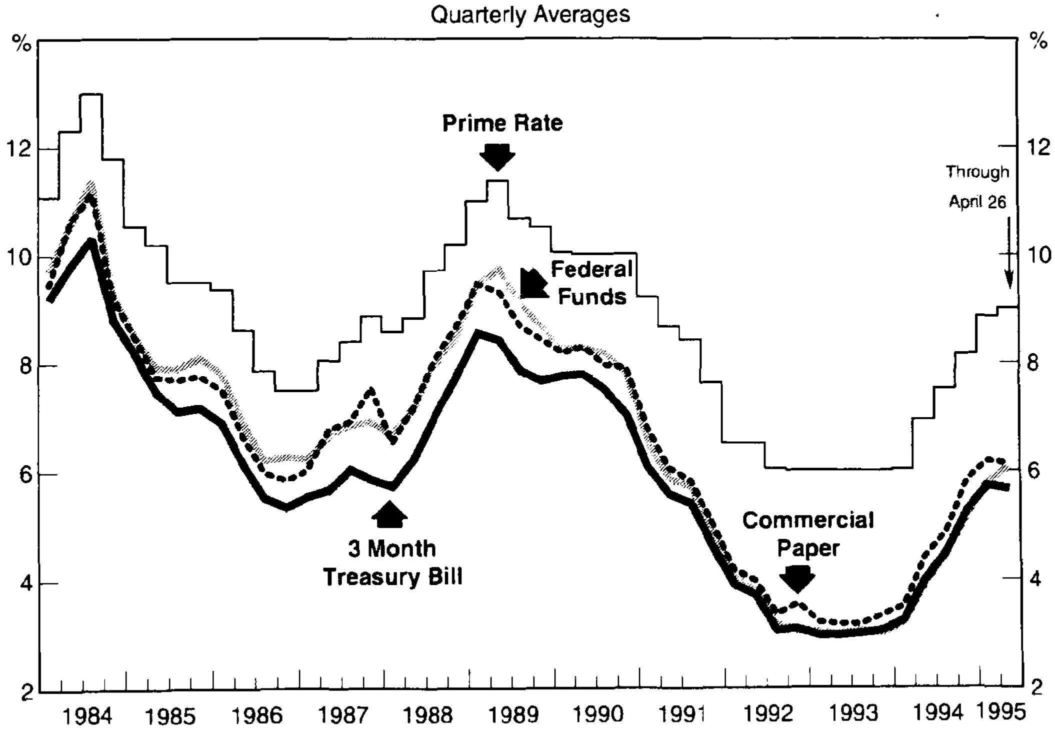
2/ Through April 28, 1995.

Department of the Treasury
Office of Market Finance

May 1, 1995-17

SHORT TERM INTEREST RATES

Quarterly Averages

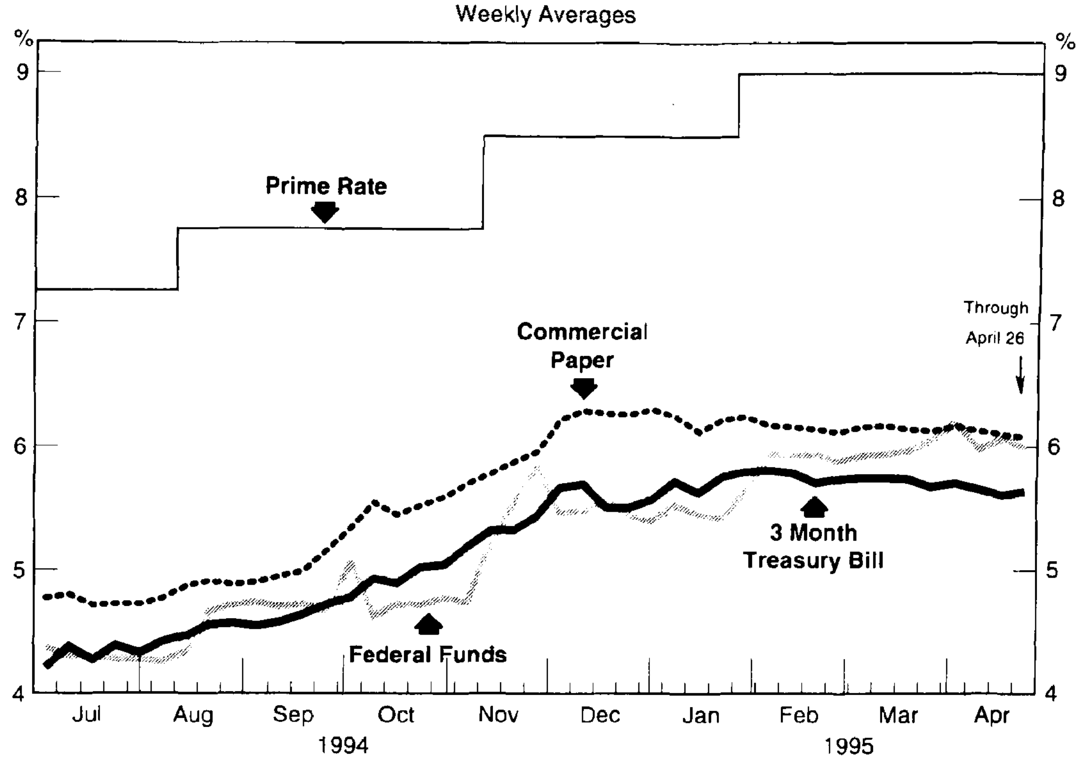


Department of the Treasury
Office of Market Finance

May 1, 1995-18

SHORT TERM INTEREST RATES

Weekly Averages

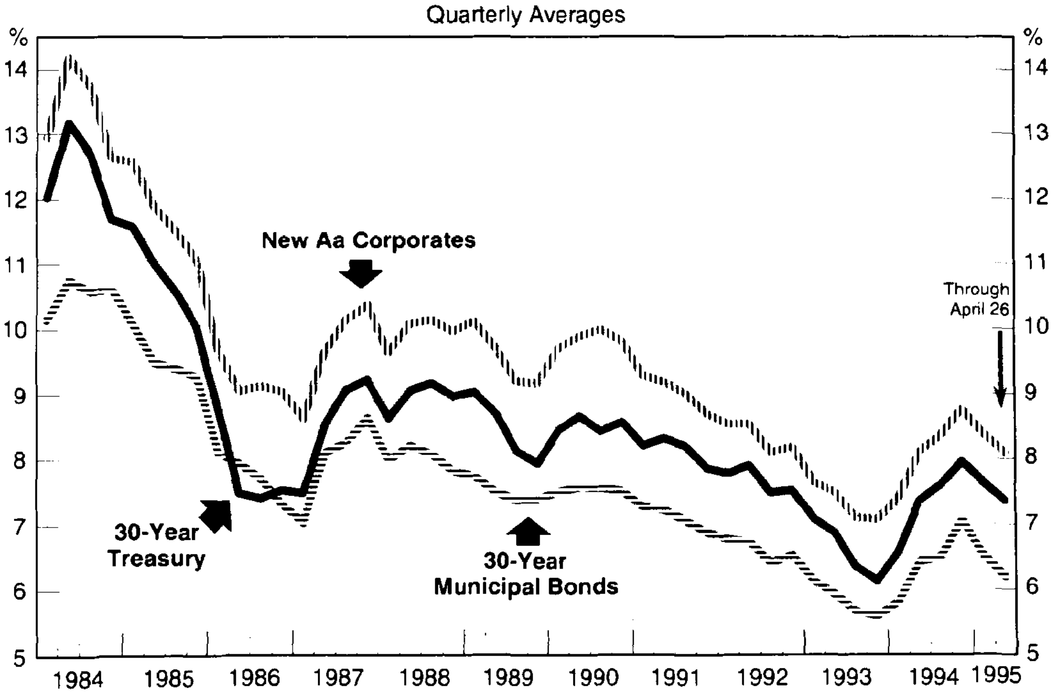


Department of the Treasury
Office of Market Finance

May 1, 1995-19

LONG TERM MARKET RATES

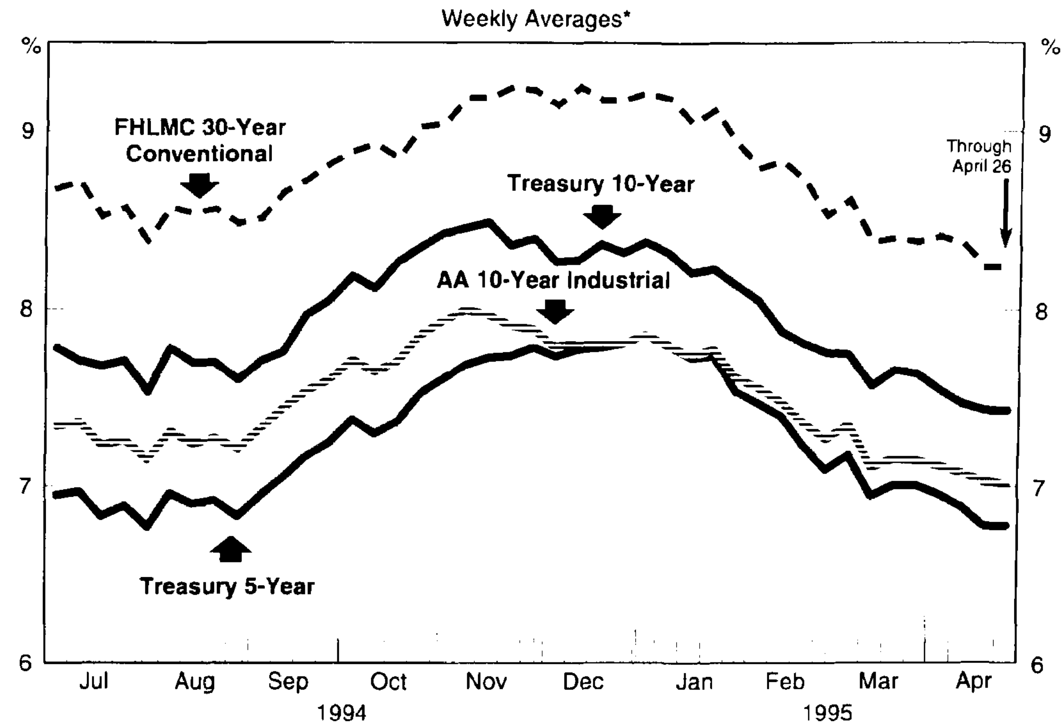
Quarterly Averages



Department of the Treasury
Office of Market Finance

May 2, 1995-20

INTERMEDIATE TERM INTEREST RATES

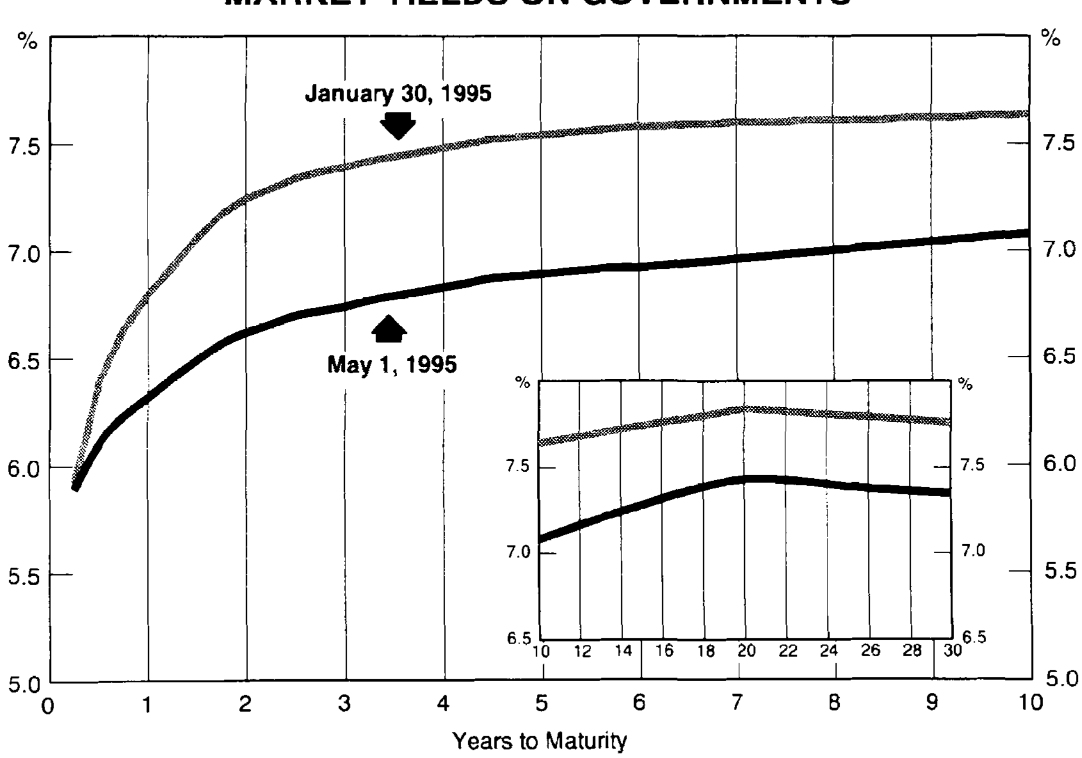


* Salomon 10-yr. AA Industrial is a Thursday rate.

Department of the Treasury
Office of Market Finance

May 1, 1995-21

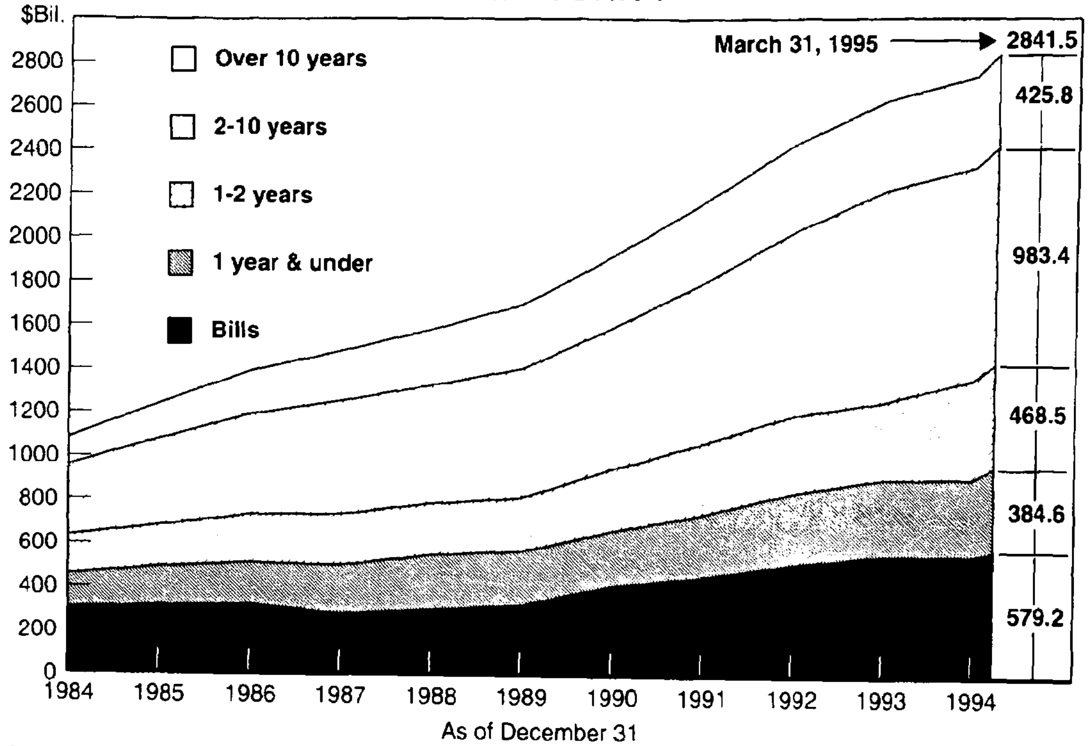
MARKET YIELDS ON GOVERNMENTS



Department of the Treasury
Office of Market Finance

May 1, 1995-22a

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY

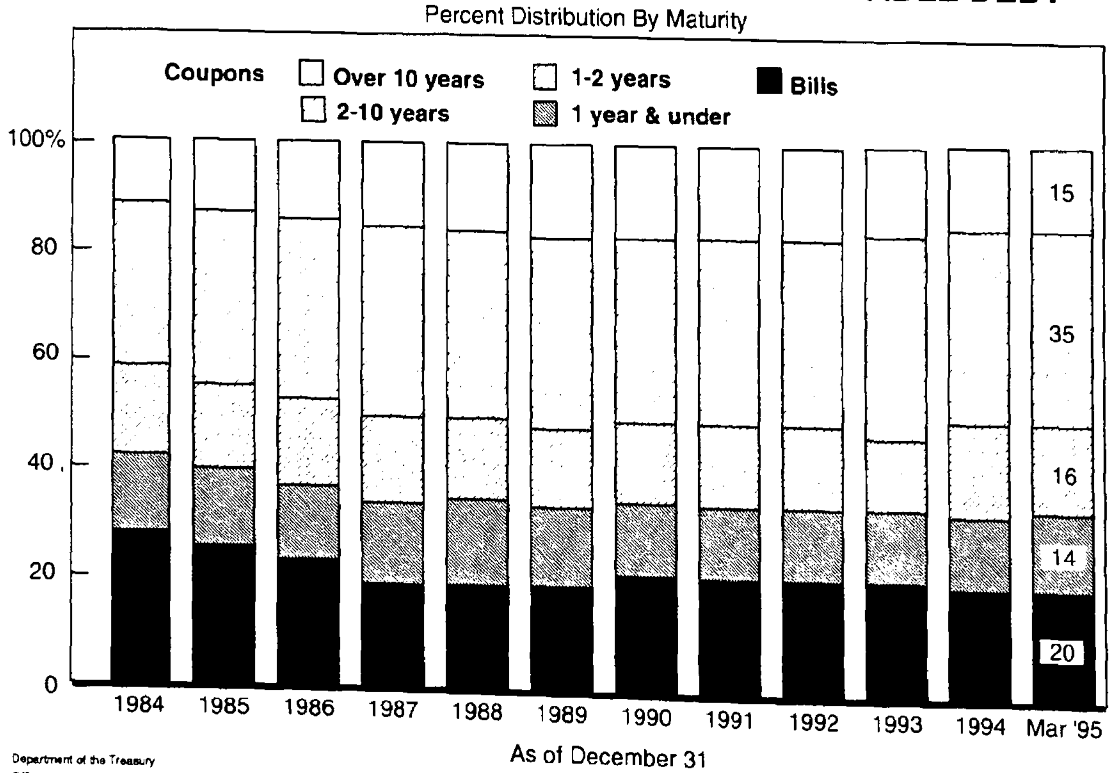


Department of the Treasury
Office of Market Finance

May 1, 1995-23

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT

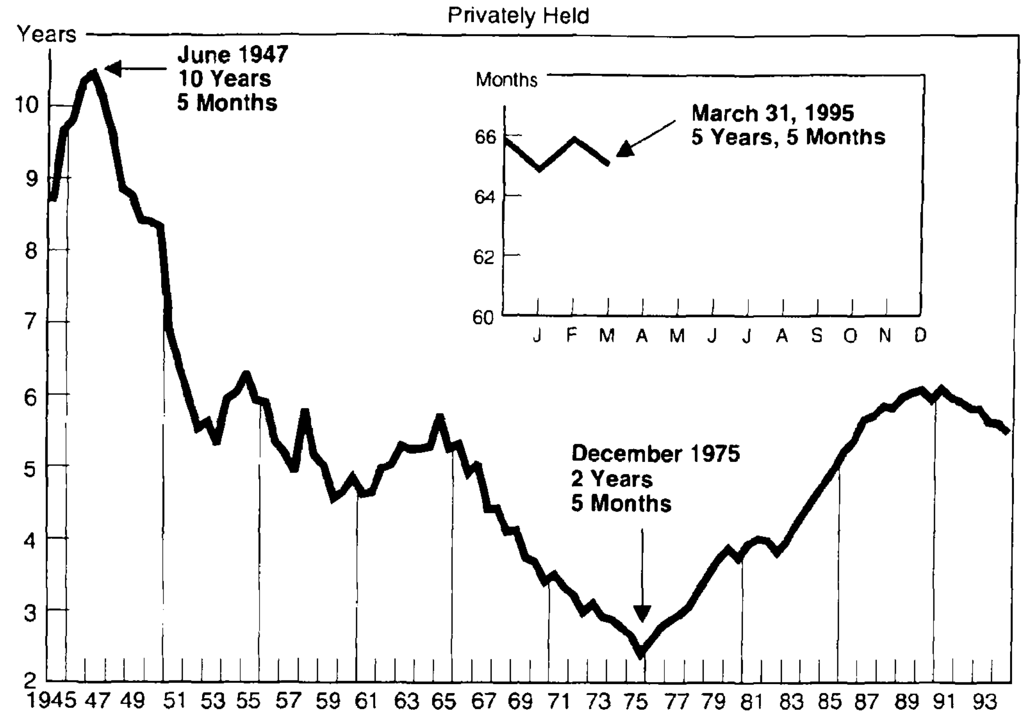
Percent Distribution By Maturity



Department of the Treasury
Office of Market Finance

May 1 1995-24

AVERAGE LENGTH OF THE MARKETABLE DEBT



MATURING COUPON ISSUES

May - September 1995

(in millions of dollars)

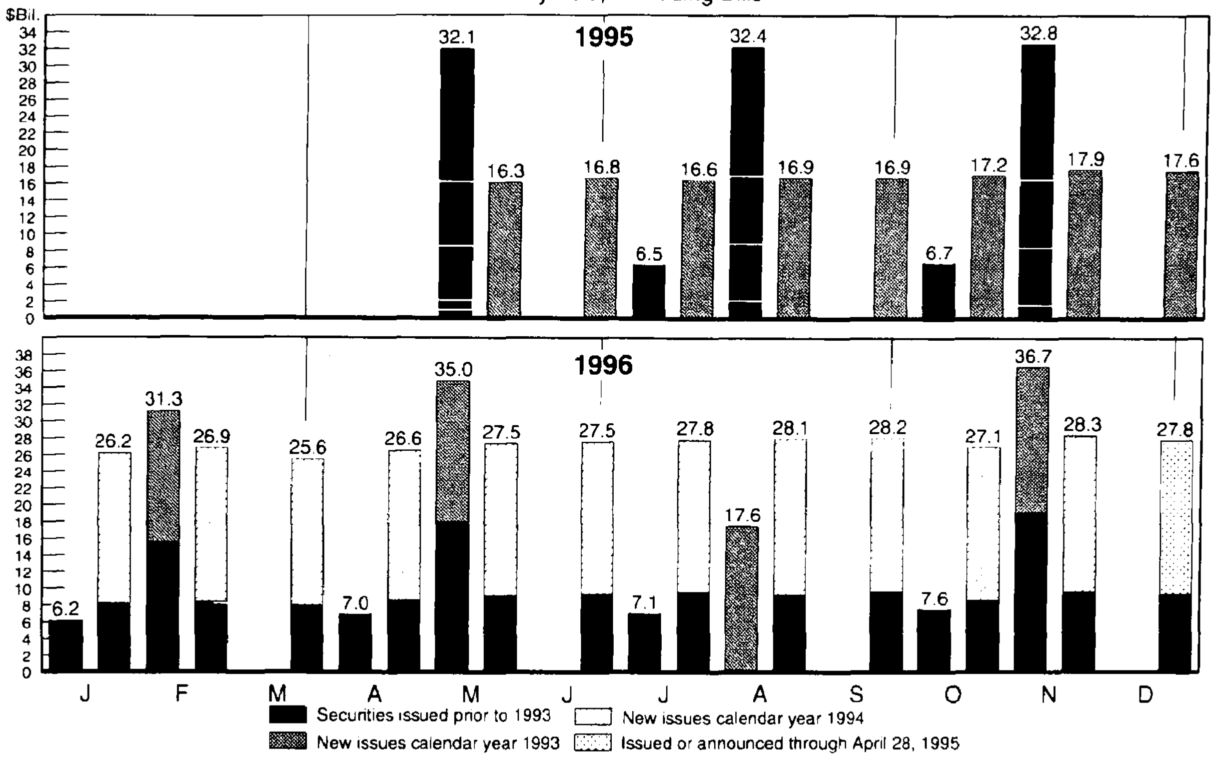
Maturing Coupons			March 31, 1995			
			Total	Held by		
				Federal Reserve & Government Accounts	Private Investors	Foreign 1/ Investors
5 7/8%	Note	5/15/95	19,152	3,829	15,323	999
8 1/2%	Note	5/15/95	8,293	273	8,020	286
11 1/4%	Note	5/15/95	7,127	798	6,329	55
12 5/8%	Bond	5/15/95	1,503	417	1,086	4
10 3/8%	Bond	5/15/95	1,504	126	1,378	201
4 1/8%	Note	5/31/95	17,527	1,227	16,300	2,275
4 1/8%	Note	6/30/95	18,164	1,392	16,772	1,934
8 7/8%	Note	7/15/95	6,805	300	6,505	415
4 1/4%	Note	7/31/95	17,183	562	16,621	1,650
8 3/8%	Bond	8/15/95 2/	4,612	2,219	2,393	46
10 1/2%	Note	8/15/95	7,956	1,097	6,859	437
8 1/2%	Note	8/15/95	8,877	866	8,011	953
4 5/8%	Note	8/15/95	18,038	2,911	15,127	922
3 7/8%	Note	8/31/95	17,577	725	16,852	2,592
3 7/8%	Note	9/30/95	17,904	961	16,943	2,206
Totals			172,222	17,703	154,519	14,975

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

2/ On April 11, Treasury called for redemption at par the 8 3/8% Bonds 1995-00, issued August 15, 1975.

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills

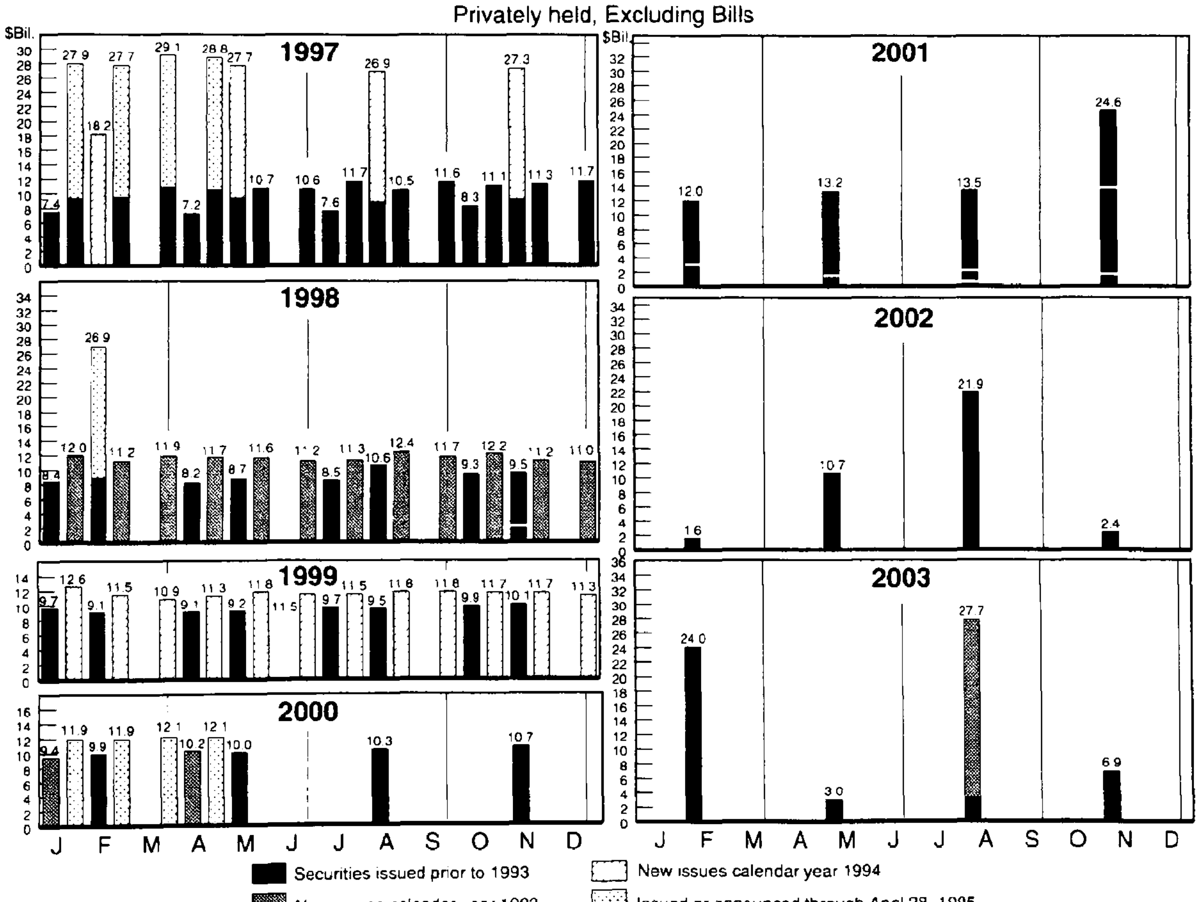


Department of the Treasury
Office of Market Finance

May 1, 1995-27

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills

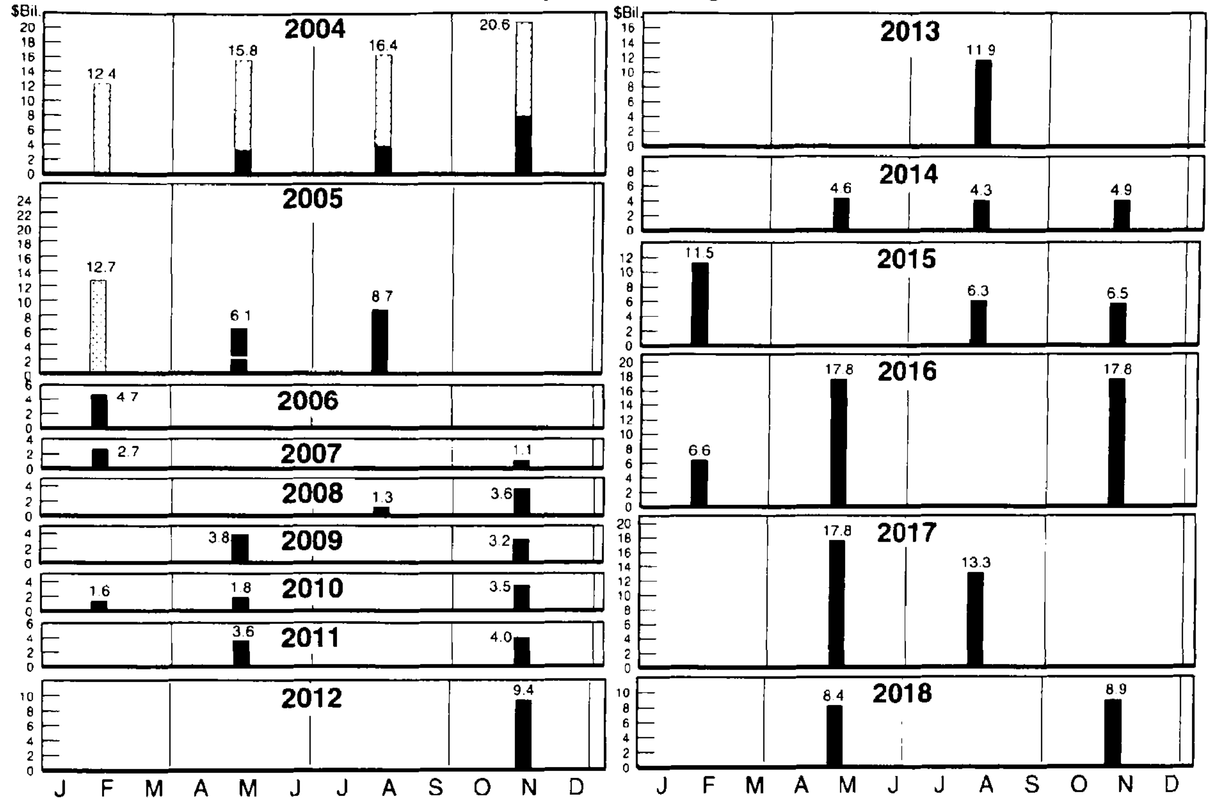


Department of the Treasury
Office of Market Finance

May 1, 1995-28

TREASURY MARKETABLE MATURITIES

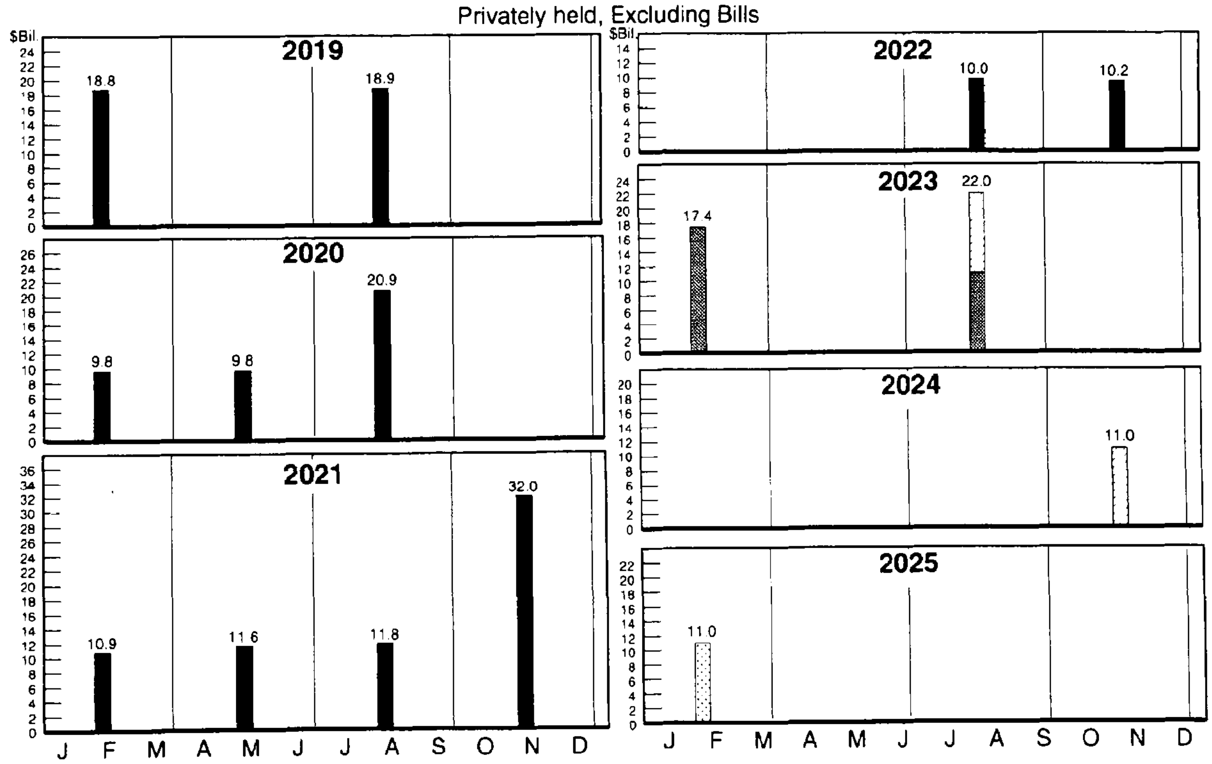
Privately held, Excluding Bills



Securities issued prior to 1993
New issues calendar year 1993
New issues calendar year 1994
Issued or announced through April 28, 1995

TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills



Securities issued prior to 1993
New issues calendar year 1993
New issues calendar year 1994
Issued or announced through April 28, 1995

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
May 1, 1995

Contact: Peter Hollenbach
(202) 219-3302

TREASURY ANNOUNCES MARKET-BASED SAVINGS BOND RATES FOR MAY - OCTOBER 1995

Treasury's Bureau of the Public Debt today announced the market-based rates for U.S. Savings Bonds for May through October 1995. The new short-term rate is the first to apply since Treasury announced that, beginning May 1, Series EE bonds would earn market-based rates right from the start.

SHORT-TERM SAVINGS BOND RATE 5.25 %

Series EE bonds issued on or after May 1, 1995, earn short-term rates for the first five years. The 5.25 percent short-term rate is 85 percent of the average of six-month Treasury security yields for the preceding three months. A new rate is announced each May 1 and November 1, and EE bonds issued on or after May 1, 1995, earn the short-term rates for semi-annual interest accrual periods beginning on or after each announcement date.

LONG-TERM SAVINGS BOND RATE 6.31%

The 6.31 percent long-term rate is 85 percent of the average of five-year Treasury security yields for the preceding six months. Series EE bonds issued on or after May 1, 1995, earn long-term rates from five years through 17 years. Since none of the bonds issued under the new rate structure have been outstanding for five years, the long-term rate in this announcement will not be used and is provided only for reference.

Series EE and E bonds and savings notes that have been outstanding for five years or longer and have not reached final maturity will continue to earn market-based variable investment yields. In general, the market-based variable rate investment yield is 85 percent of the average of the average five-year Treasury security yields for the applicable six-month periods.

Series E bonds issued May 1955 and prior have reached final maturity and no longer earn interest. Bonds issued from June 1955 through October 1955 stop earning interest June 1 through October 1, 1995, or forty years from the issue date.

Series H and HH bonds issued or entering an extended maturity period since March 1, 1993, pay interest semiannually at a fixed rate of 4 percent per annum.

The table on the reverse of this bulletin shows actual yields for Series EE bonds. The savings bond regulations, 31 CFR Part 351, contain detailed information.

o0o

PA-181
(RR-255)

REDEMPTION VALUES AND YIELDS FOR
$100 SERIES EE BONDS -- MAY 1995 THROUGH APRIL 1996

This table shows semiannual redemption values for $100 Series EE Bonds*. Values for other denominations are proportional to the values shown. For example, the value of a $50 bond is one-half the amount shown and the value of a $500 bond is five times the amount shown. The Earnings column shows the annual yield that the bonds will earn during the period indicated. The Yield From Issue Date is the bond's yield from its issue date to the date shown or date adjusted as shown in the footnotes. Additional information may be obtained from the Bureau of the Public Debt, 200 Third Street, Parkersburg, WV 26106-1328.

Series EE Bond	Value as of		Earnings		Value and Yield From Issue Date		
Issue Dates	Date**	Amount	Period begins**	Yield***	Date**	Amount	Yield
5/95 thru 10/95	5/1/95	50.00	5/1/95	5.28%	11/1/95	51.32	5.28%
11/94 thru 4/95	5/1/95	51.00	5/1/95	4.08%	11/1/95	52.04	4.04%
5/94 thru 10/94	5/1/95	52.04	5/1/95	4.00%	11/1/95	53.08	4.03%
11/93 thru 4/94	5/1/95	53.08	5/1/95	4.07%	11/1/95	54.16	4.04%
5/93 thru 10/93	5/1/95	54.16	5/1/95	3.99%	11/1/95	55.24	4.03%
3/93 thru 4/93	9/1/95	55.24	9/1/95	3.91%	3/1/96	56.32	4.01%
11/92 thru 2/93	5/1/95	56.32	5/1/95	5.97%	11/1/95	58.00	5.01%
5/92 thru 10/92	5/1/95	58.00	5/1/95	6.76%	11/1/95	59.96	5.26%
11/91 thru 4/92	5/1/95	59.96	5/1/95	7.20%	11/1/95	62.12	5.50%
5/91 thru 10/91	5/1/95	62.12	5/1/95	7.86%	11/1/95	64.56	5.76%
11/90 thru 4/91	5/1/95	64.56	5/1/95	8.18%	11/1/95	67.20	6.00%
5/90 thru 10/90	5/1/95	67.20	5/1/95	6.07%	11/1/95	69.24	6.01%
11/89 thru 4/90	5/1/95	69.24	5/1/95	6.01%	11/1/95	71.32	6.01%
5/89 thru 10/89	5/1/95	71.40	5/1/95	6.27%	11/1/95	73.64	6.05%
11/88 thru 4/89	5/1/95	73.44	5/1/95	9.59%	11/1/95	76.96	6.26%
5/88 thru 10/88	5/1/95	76.96	5/1/95	6.24%	11/1/95	79.36	6.26%
11/87 thru 4/88	5/1/95	79.36	5/1/95	6.25%	11/1/95	81.84	6.26%
5/87 thru 10/87	5/1/95	81.84	5/1/95	6.26%	11/1/95	84.40	6.26%
11/86 thru 4/87	5/1/95	84.40	5/1/95	6.26%	11/1/95	87.04	6.26%
5/86 thru 10/86	5/1/95	97.00	5/1/95	7.51%	11/1/95	100.64	7.50%
11/85 thru 4/86	5/1/95	100.64	5/1/95	7.55%	11/1/95	104.44	7.50%
5/85 thru 10/85	5/1/95	104.44	5/1/95	4.06%	11/1/95	106.56	7.34%
11/84 thru 4/85	5/1/95	106.56	5/1/95	3.98%	11/1/95	108.68	7.18%
5/84 thru 10/84	5/1/95	108.68	5/1/95	3.97%	11/1/95	110.84	7.04%
11/83 thru 4/84	5/1/95	110.84	5/1/95	5.05%	11/1/95	113.64	6.96%
5/83 thru 10/83	5/1/95	115.00	5/1/95	6.26%	11/1/95	118.60	7.03%
11/82 thru 4/83	5/1/95	121.36	5/1/95	6.20%	11/1/95	125.12	7.18%
5/82 thru 10/82	5/1/95	135.92	5/1/95	6.00%	11/1/95	140.00	7.77%
11/81 thru 4/82	5/1/95	140.00	5/1/95	6.00%	11/1/95	144.20	7.71%
5/81 thru 10/81	5/1/95	144.20	5/1/95	5.99%	11/1/95	148.52	7.65%
11/80 thru 4/81	5/1/95	152.12	5/1/95	6.00%	11/1/95	156.68	7.76%
5/80 thru 10/80	5/1/95	164.40	5/1/95	5.99%	11/1/95	169.32	8.03%
1/80 thru 4/80	7/1/95	167.64	7/1/95	6.01%	1/1/96	172.68	7.90%

* Monthly increases in value, applicable to some bonds issued prior to May 1995, are not shown in the table.

** The dates shown are for the first issue date of the range in the first column. Add one month for each later issue month. For example, a bond issued in 7/94 (two months after the first date in the range) would be worth the amount shown two months after the date listed. The six-month earning period would begin two months later than the date shown.

*** Yields and savings bond rates may not agree due to rounding and due to the methodology for computing market-based yields for bonds issued prior to May 1, 1995.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
May 1, 1995

Contact: Hamilton Dix
(202) 622-2960

CURRENCY BEARING SECRETARY RUBIN'S SIGNATURE TO BE INTRODUCED

Treasury Secretary Robert E. Rubin will introduce the new Series 1995 United States currency bearing his signature at 10 a.m, Friday, May 5, in the Visitors Center at the Bureau of Engraving and Printing, Washington, D.C.

Secretary Rubin will be joined by U.S. Treasurer Mary Ellen Withrow, whose signature also appears on the currency, and 25 fifth graders from Harrison Elementary School in the District of Columbia.

A tour of the facility to view production of the new currency will follow.

For nine years the Bureau's police officers have served as mentors for Harrison students and raised money to purchase educational materials such as computer software for science classes.

The series year of 1995 reflects the year Secretary Rubin took office. Treasurer Withrow was sworn into office March 1, 1994.

United States currency is printed in two places -- Washington, D.C. and Fort Worth, Texas. The two plants together print about 35 million notes each day with a face value of about $465 million.

Media should use the Visitors Center entrance on 15th Street, N.W. Cameras should be in place by 9:45 a.m.

All journalists must provide name and organization by 4 p.m. Thursday, May 4, to Dawn Haley, Bureau of Engraving and Printing Public Affairs (202-874-3913).

-30-

RR- 256

AUCTION RESULTS

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
May 1, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $12,409 million of 13-week bills to be issued May 4, 1995 and to mature August 3, 1995 were accepted today (CUSIP: 912794U36).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.71%	5.89%	98.557
High	5.74%	5.92%	98.549
Average	5.74%	5.92%	98.549

Tenders at the high discount rate were allotted 23%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$55,764,214	$12,409,307
Type		
Competitive	$50,499,946	$7,145,039
Noncompetitive	1,377,953	1,377,953
Subtotal, Public	$51,877,899	$8,522,992
Federal Reserve	3,355,115	3,355,115
Foreign Official Institutions	531,200	531,200
TOTALS	$55,764,214	$12,409,307

5.72 -- 98.554 5.73 -- 98.552

RR-257

AUCTION RESULTS

PUBLIC DEBT NEWS

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

FOR IMMEDIATE RELEASE
May 1, 1995

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $12,264 million of 26-week bills to be issued May 4, 1995 and to mature November 2, 1995 were accepted today (CUSIP: 912794V50).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.83%	6.11%	97.053
High	5.84%	6.12%	97.048
Average	5.84%	6.12%	97.048

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

TENDERS RECEIVED AND ACCEPTED (in thousands)

	Received	Accepted
TOTALS	$46,489,303	$12,263,503
Type		
Competitive	$39,073,760	$4,847,960
Noncompetitive	1,295,643	1,295,643
Subtotal, Public	$40,369,403	$6,143,603
Federal Reserve	3,200,000	3,200,000
Foreign Official Institutions	2,919,900	2,919,900
TOTALS	$46,489,303	$12,263,503

RR-258

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

Embargoed Until Delivery
Expected at 10:00 a.m. EST

Testimony of Under Secretary Lawrence H. Summers
Before The
Committee on Banking and Financial Services
Subcommittee on Domestic and
International Monetary Policy
U.S. House of Representatives
May 2, 1995

Mr. Chairman, Members of the Committee, I welcome the opportunity to testify before you this morning. We are requesting authorization for U.S. participation in the International Development Association, the Enhanced Structural Adjustment Facility and the Asian Development Bank.

Let me stress at the outset that this request is not about charity or foreign aid. It is about the way these institutions serve core United States economic and security interests.

RR - 259

Nearly every developing nation that has prospered and become a major U.S. export market -- South Korea, Indonesia, Thailand, Chile, and over a dozen more -- has seen its economy jump-started and bolstered by programs from at least one of these three institutions. These institutions have worked in nearly every important region where the United States has sought to anchor stability -- in Central America, in Southeast Asia, in Southern Africa, and now in Eastern Europe and the former Soviet Union. And whether it is reducing infant mortality by half, halting the spread of AIDS, or eradicating river blindness in Africa, these institutions are at the frontlines in meeting every major challenge we face.

Perhaps the greatest economic imperative facing us today is the need to support the historic shift to market-based economics around the world. This change has opened enormous new opportunities for U.S. exports to developing countries, doubling their purchases of U.S. exports over six years -- to $197 billion in 1993. In fact, developing countries have become our fastest growing export market, taking 40 percent of U.S. exports, and creating nearly 4 million U.S. jobs. A great deal of the credit for this development must go to the development banks. All three of the programs for which we are requesting authorization design their activities directly to encourage market-based reform.

The International Development Association

Let me turn first to the International Development Association, or IDA as it is known, the largest element of our request. We are asking for the authority to participate in the third and final year of the tenth replenishment of IDA. Our request is for $1,250 million.

IDA was established by President Eisenhower in 1960 as an affiliate of the World Bank. Its role was to make loans to the poorest countries on concessional terms. Now, in 1995, we need to ask whether this program remains in our own national interest. I believe it does, for three compelling reasons.

One, IDA provides the seed money for capitalism and free market reforms that develop important new markets for U.S. exports. In effect, IDA is helping to remake developing countries in the image of the United States and the other industrialized democracies. This type of reform does not come easily. There is no natural constituency for market-oriented capitalism in many of the poorest countries. IDA's support is essential in getting these nations to undertake reforms which will enable them to prosper, and can turn them into important United States trading partners.

India provides an excellent example. The World Bank and IDA have provided about $2.0 billion annually to India since 1991. That support has been conditioned on India's opening its market to U.S. and other goods and investment, and pursuing other economic reforms. A $500 million World Bank-IDA loan, conditioned on India's lowering its tariff barriers, helped to bring those barriers down from 400 percent to 65 percent. Since then, the United States has become India's largest foreign investor. Our exports to India jumped from $1.9 billion to $2.8 billion in just one year alone. Last year, Commerce Secretary Ron Brown announced additional contracts for U.S. firms amounting to more than $7 billion.

India's achievements are but one example of IDA's market-friendly impact. Almost all of the major emerging market success stories -- including South Korea, Indonesia, Thailand and Turkey -- were once IDA recipients. All of these countries are now major customers for U.S. exports and no longer require IDA assistance. In fact, IDA has 20 "graduates" which took $42 billion in U.S. exports in 1993 alone.

This pattern of IDA support for market reform followed by large increases in U.S. exports repeats itself again and again -- even in the poorest countries. Present IDA borrowers, for example, took $20 billion in U.S. exports in 1993, up from $14 billion in 1988. The economic benefits to the United States have been clear: IDA-backed reforms lead to higher U.S. exports, which produce more jobs in our domestic economy.

Second, the United States relies on IDA to advance our strategic and humanitarian interests. IDA helps lay the foundation for stability in key regions, as it is doing by supporting economic transition and democracy in parts of the former Soviet Union. IDA cements incipient peace processes, with programs such as emergency economic support for Haiti. And IDA responds quickly to natural disasters, through efforts such as earthquake reconstruction in Armenia or flood reconstruction in Pakistan. The scale of IDA's support for this kind of lending could only be replicated by our bilateral programs at much higher budgetary cost to the United States.

That brings me to the third reason IDA is so important. IDA is a very cost-effective way for us to assist the poorest countries. Over thirty countries contribute to IDA. The U.S. share of the funding has dropped dramatically -- from 42 percent to roughly 20 percent. Repayments on past loans now finance 18 percent of all new lending. This means that IDA is able to leverage $6 dollars for every dollar the United States contributes. That is a highly effective way for us to invest our scarce resources.

Important Reforms

Two years ago, this Committee authorized participation in the first two years of the tenth replenishment of IDA, leaving the third year unauthorized until certain reforms had been undertaken at the World Bank. I am pleased to report to you today that those important reforms are now in place.

Under U.S. leadership, the Bank has implemented a new policy which makes information about its operations available to the public. An independent inspection panel has been created to ensure full compliance with Bank policies in preparing and implementing projects. Further, the Bank is undertaking a whole series of internal reforms to improve the quality of its lending operations.

The Bank has put into place a rigorous set of policies on the environment. Environmental considerations are now at the heart of project development, not a peripheral consideration or afterthought. Finally, the Bank has responded to U.S. efforts to control administrative costs. The Bank will be cutting its administrative budget by 12 percent in real terms over the next two years. First class air travel has been eliminated and benefits have been capped.

These measures have already produced a fundamental shift in the Bank's culture and approach to development. We are very pleased with this progress. In our view, the reforms address the concerns that have been expressed by this Committee in the past.

Mr. Chairman, IDA is doing essential work. It is promoting some of our country's most basic values -- free markets, privatization, responsible governance, and economic reform. It provides us with direct economic benefits. And it responds well to U.S. leadership. For these reasons, we are requesting the support of this subcommittee for a full authorization of the third year of IDA-10.

Enhanced Structural Adjustment Facility

We are also requesting an authorization of $75 million for the Enhanced Structural Adjustment Facility, known as the ESAF. This IMF-administered facility provides concessional loans to the poorest countries -- more than two-thirds of which are in Sub-

Saharan Africa -- provided they undertake economic reforms to put them on a sustainable growth path.

Let me offer four specific points about the ESAF:

First, the ESAF has proven very effective in promoting market-oriented reforms essential to sustain growth and development. ESAF loans are on terms which the poorest countries can afford, but on conditions that ensure that the countries enact and follow through on the reforms to which they have agreed. The signs of progress are clear. Ghana has graduated from the ESAF. Uganda, Malawi, and Cote D'Ivoire are among the countries that have achieved significant improvements in growth, exports and inflation under ESAF programs.

Second, the U.S. pledge amounts to less than a nickel of every dollar that is contributed to ESAF. For every dollar we contribute, nineteen dollars come from other sources, including a significant portion from developing countries themselves. Ours is a modest contribution from the world's largest economy, and it provides us with a strong voice in the operation of the facility.

Third, our pledge to commit $100 million to the $2.1 billion subsidy account for the facility was quite modest. Still, it was a necessary catalyst for other countries' contributions. Our contribution was also designed to minimize pressures on the already overburdened foreign assistance account. Therefore, the $100 million will be spent over a 15-year period, with outlays to begin in FY97. The fact that the outlays do not begin until next year should not be taken as a reason to delay authorization of the full amount, however. It is important to authorize the full amount of our contribution to this highly effective program, to demonstrate our support for reforms in the poorest countries of the world.

Fourth, we have made substantial progress in fulfilling the request put forward by Congress last year in agreeing to partial authorization for the extended and expanded ESAF, that the IMF provide greater disclosure of its activities. The IMF now publishes much more information on countries. Moreover, at its April 26 meeting, the IMF's Interim Committee, in its communique, "emphasized that timely publication by members of comprehensive data would give greater transparency to (members') economic policies; it requested the Executive Directors to work toward the establishment of standards to guide members in the provision of data to the public, and to submit proposals for consideration by the Committee at its next meeting."

A review of countries that have recently enacted ESAF-backed reforms shows just how effective ESAF is at promoting market-based development, while opening markets for our products:

- **Ghana** has benefitted from both a series of ESAF arrangements and IDA loans. These have bolstered a decade of economic reforms that have given Ghana GDP growth of about 5 percent per year since 1983. Ghana's exchange and trade regimes have been liberalized, and social indicators are up. Ghana, in fact, graduated from the ESAF program in 1991.

- **Uganda**, now in its fourth year of ESAF reforms and a major recipient of IDA funding, has introduced a market-determined exchange system and liberalized prices and interest rates. Inflation has declined from 240 percent in the late 1980s to single digits today. The civil service and military have been reduced in size. Real GDP growth last year was 8 percent, and is expected to be at least as high this year.

- **Cote D'Ivoire** and other African Franc zone members agreed to devalue their currency by 50 percent in January 1994, with support from IDA lending and ESAF finance. The result for the Cote D'Ivoire has been a strong boost in the competitiveness of its goods, increased exports, and improved economic growth and inflation.

- **Malawi** has one of the longest sustained commitments to economic reform in Africa. Economic growth exceeded 11 percent in 1993, and the exchange rate is fully market-determined.

Despite the successes that ESAF programs have so clearly achieved, many nations continue to need backing for economic reform efforts -- especially in Sub-Saharan Africa.

We see continued U.S. participation in the ESAF as a vital element in meeting these challenges.

The Asian Development Bank

Finally, we are requesting authorization of $66.6 million for U.S. participation in the fourth general capital increase of the Asian Development Bank, or ADB.

The ADB has played a leading role in encouraging Asia's dynamic growth as a major U.S. market. U.S. exports to developing Asia have more than doubled since 1986, from $29.5 billion to $82.5 billion in 1993. In that time, U.S. exports to the Asian Bank's "graduates" -- South Korea, Singapore, Taiwan, Hong Kong and Fiji -- have increased even more rapidly, roughly tripling.

ADB lending benefits U.S. businesses and exporters in two ways. First, it makes possible the economic development which allows U.S. exports to soar. But even more directly, U.S. firms are major beneficiaries of Asian Development Bank procurement contracts. AT&T is providing telephone equipment in the Philippines through an ADB financed project. Offshore Pipelines of Houston is active in ADB-funded Indian work. ADB finance represents an important point of entry for U.S. firms.

The ADB is an extremely cost-effective way for us to accomplish these goals. That results from the ADB and other development banks' ability to lever the money we contribute many times over, supporting programs which are far larger than we could support alone. The Bank accomplishes that in three ways. First, it draws on money from other countries -- over $5 for every dollar we will contribute to this capital increase. Second, the ADB raises money on private capital markets. Third, the Bank has positive net income from its investments, so it can finance new projects using these funds and the flow of repayments on outstanding loans.

Because of the way we and other member countries subscribe to the ADB's regular loan windows, its activities costs us pennies to the dollar. We subscribe in two basic ways. First, we subscribe for paid-in capital -- meaning funds we and other member states must contribute up front. This amounts to only a very small fraction of the United States' and other member states' total subscription -- only 2 percent for this capital increase. Second, member states subscribe to callable capital, which provides the financial backing for the Bank to borrow in capital markets.

Because U.S. paid-in subscriptions are so small in relation to our callable capital subscription, our ADB participation requires very low budget outlays, relative to the support our subscription buys. For every dollar of U.S. paid-in capital provided since its inception, the Asian Bank has lent a $80.

Last year, we concluded negotiations on a capital increase for the Bank. The Bank's capital base was expanded to $48 billion, enabling it to resume lending activities while strengthening its balance sheet. The new capital will provide support for market-oriented reform, assist in the economic transition of the Asian Republics of the former Soviet Union, and help to create economic opportunities for the poor.

The United States succeeded in negotiating the lowest annual cost ever on payments to the Bank. Our payments average $11.1 million per year for an overall total of $66.6 million paid-in capital. At the same time, we kept parity with the Japanese as the largest shareholders of the Bank. Each U.S. taxpayer dollar invested in paid-in capital will allow the Bank to lend over $300, and catalyze another $90 in private/commercial financing.

Objectives Accomplished

In addition, we accomplished all our major objectives regarding Bank programming and organization. To cite just a few examples:

-- The Bank now has comprehensive policies on information disclosure and transparency, to allow for far better monitoring of its activities.

-- Comprehensive new policies have been adopted for energy, population, and forestry lending. The Bank is also establishing an independent inspection function to ensure these policies are being followed.

-- The Bank is developing policies on resettlement and protection of indigenous populations.

-- The Bank is implementing an action plan to improve project supervision and implementation. It is providing for more public participation in its projects and sharpening its country focus. This action plan has resulted in a major reorganization of the Bank.

-- The Bank is increasing its support for market-based development through new programs to catalyze private sector finance; by providing seed money for new enterprises; and devoting a greater portion of its lending to helping countries establish a market-friendly environment.

-- The Bank is further restraining administrative costs. First class travel has been eliminated. The Board of Directors adopted a 1995 budget with zero real growth, excluding one-time costs of an early retirement program for Bank staff.

Finally, the Bank will open an office in Washington later this year. The office will serve a range of constituents in the United States and Canada: businesses, financial institutions, consultants, the academic community which often provides consulting services to the Bank, and non-governmental organizations.

The deadline for subscribing to the capital increase is December 1995. If we do not subscribe, our shares could eventually be purchased by others and our voting power could be cut from 16 percent to 8 percent. We expect that such a loss would be permanent. Other members would inevitably perceive this as a withdrawal of the United States from the Asian region, and acquiescence to reduced influence in the ADB. Our firms would find it more difficult to expand into the Asian market in this environment. We would also find it more difficult to press our agenda for change in the institution. For these reasons, it is important that our participation in the ADB capital increase be fully authorized.

Conclusion

Continued support for these important international institutions is in our national interest. These institutions foster economic liberalization and policy reforms. In doing so, they open up vast new markets for United States goods and services, while anchoring political and social stability. And they do all that for pennies to the dollar, leveraging the money we provide by drawing on contributions from many other sources.

Mr. Chairman, these institutions have always had strong bipartisan support. That has been based on one simple fact -- their effectiveness in supporting core U.S. interests. I urge the members of this subcommittee to continue to provide such bipartisan support by fully authorizing the Administration's request. Thank you.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

STATEMENT OF EDWARD S. KNIGHT
GENERAL COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH,
NATURAL RESOURCES, AND REGULATORY AFFAIRS
OF THE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

May 2, 1995

Mr. Chairman and members of the Subcommittee, I am pleased to present the views of the Department of the Treasury on H.R. 994, the "Regulatory Sunset and Review Act of 1995."

H.R. 994 would provide for the automatic termination of each existing agency regulation at the end of 7 years, and each new regulation at the end of 3 years. A regulation would not terminate if

(1) the issuing agency solicits and considers public comment on whether the regulation should be continued or terminated in light of the 18 criteria specified in the bill, (2) the agency conducts an in-depth review of the regulation, (3) the agency submits to the President, OMB, and the Congress and publishes in the *Federal Register* a preliminary report of that review, (4) the agency considers comments to the preliminary report received from Congress and OMB, and (5) the agency submits to the Congress and publishes in the *Federal Register* a final report together with a notice extending the regulation, with or without modifications. Thereafter, each regulation would continue to terminate on a 7-year cycle unless the agency repeats this process.

As you know, on March 28, Sally Katzen, the Administrator of the Office of Information and Regulatory Affairs at OMB, appeared before the Subcommittee to present the Administration's views on H.R. 994. The Department of the Treasury is in full agreement with those views. Today, I would like to present you with a brief overview of the regulatory responsibilities of the Department of the Treasury and discuss how H.R. 994 could affect the Department and its regulatory programs.

Treasury regulations are issued by a number of offices and bureaus that have distinct and critical regulatory responsibilities:

The Internal Revenue Service (IRS) issues regulations to interpret and implement the Internal Revenue Code of 1986 and related tax statutes, and to collect about $1 trillion in taxes annually. The IRS accounts for about 50 percent of Treasury's informal rulemaking under the APA.

The Bureau of Alcohol, Tobacco, and Firearms (BATF) issues regulations to fulfill its statutory mandates to enforce the Federal laws relating to the manufacture, commerce and taxation of alcohol products, tobacco products, firearms and explosives.

The United States Customs Service issues regulations to administer the laws concerning the importation of merchandise into the United States, to collect over $25 billion in duties annually, and to enforce the laws prohibiting smuggling and trafficking in narcotics and other contraband.

The Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) issue regulations necessary to supervise and to ensure the safety and soundness of national banks and savings associations.

Regulations of the Bureau of the Public Debt establish the terms and conditions for the sale and redemption of savings bonds and marketable Treasury securities, protect the integrity, liquidity and efficiency of the government securities market and insure investor protection.

Regulations of the Financial Management Service (FMS) are designed to improve government financial management.

The Financial Crimes Enforcement Network (FinCEN) implements the anti-money laundering and related authorities of the Secretary under the Bank Secrecy Act.

The Office of Foreign Assets Control (OFAC) issues regulations to implement economic sanctions against foreign countries imposed pursuant to Presidential order or mandated by legislation. OFAC regulations currently implement unilateral or multilateral trade and financial sanctions against Cuba, Iran, Iraq, Libya, North Korea, Serbia, UNITA (Angola) and terrorist groups threatening the Middle East peace process.

Other components of the Department occasionally issue regulations. These include the United States Secret Service, the Bureau of Engraving and Printing, the Office of the General Counsel, and the offices of several assistant secretaries of the Treasury.

In fact, terrorism is one of several areas where Treasury's bureaus work in partnership towards a common policy goal. Our enforcement bureaus protect the most visible terrorist targets in the United States, enforce laws directed at the most common instruments of terror, protect against the smuggling of weapons of mass destruction, and enforce economic sanctions against countries and groups that promote terrorism.

We all agree that principles of good government and sound regulatory policy demand that agencies periodically review their existing regulations. We must all work to ensure that they are necessary and working as intended, reflect current statutory authority, and impose the least burden on the public consistent with legitimate regulatory objectives. These principles are embodied in the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), which requires agencies to conduct a review every 10 years of regulations that have a significant economic impact on a substantial number of small businesses, and the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*), which requires agencies to review each reporting and recordkeeping requirement - including those contained in regulations - not less frequently than every 3 years.

This Administration is committed to these principles even if they are not required by law. The President took the additional step in March of directing each agency to review its regulations to identify requirements that can be eliminated or modified to make them less burdensome, as well as statutory impediments to regulatory reform. Not only does Treasury strongly support this initiative, but regulatory review has been a practice at Treasury for many years. Let me review some recent history:

In 1994, the IRS completed revising its regulations concerning nondiscrimination requirements for pension plans. The resulting regulations are significantly shorter and simpler, and enabled the IRS to revoke over 80 revenue rulings based on the prior regulations.

Also in 1994, the IRS issued revised regulations relating to the definition of "activity" for purposes of the limitation on deducting losses from passive activities. The old regulations consisted of over 100 rules in about 40 pages in the *Code of Federal Regulations* (CFR); the new regulations contain about 15 rules in less than 2 pages.

In the past two years, the IRS has simplified 15 major tax forms. These changes have eliminated over 46 million hours of paperwork for more than 134 million taxpayers.

The Bureau of the Public Debt recently repealed two obsolete CFR parts.

The Office of the Comptroller of the Currency has been reviewing each of its 29 regulatory parts in the Code of Federal Regulations. When completed, this project will have simplified dozens of regulatory and paperwork requirements affecting both large and small financial institutions. A similar project is about to get underway at the Office of Thrift Supervision.

The Financial Crimes Enforcement Network, working closely with financial institutions, is engaged in a basic re-engineering of its regulations implementing anti-money laundering objectives of the Bank Secrecy Act. Reporting requirements are being eliminated or reduced for a wide range of banks and non-bank financial institutions. In addition, FinCEN recently withdrew two final rules and two proposed rules after determining that they were either unnecessary or imposed disproportionate burdens on banks or other financial institutions.

The Customs Service is implementing the Customs Modernization Act, which substantially revised the Tariff Act of 1930 to reflect the changes in trade, transportation, and communication and information technology that have occurred over the past 6 decades. As a result of this legislation, Customs estimates that about 90 percent of its regulations will be updated in the near term.

BATF is nearing completion of a recodification and revision of its regulations governing the tax credit on alcohol not used in alcoholic beverages. Among other things, the final regulation is expected to reduce the amount of documentation that must be submitted in support of a tax credit claim by 75 percent.

BATF has reduced reporting requirements for small brewers by over 70 percent, and for small wine producers by over 60 percent.

Regulatory review is but one component of Treasury's regulatory reform program. We are also actively engaged in implementing the President's other regulatory reform initiatives:

We have just completed a series of 26 outreach meetings across the country between our senior regulators and those subject to Treasury regulations. These meetings reconfirm Treasury's long-standing practice of developing partnerships with the regulated community. And in the coming months, we expect to begin developing more than 40 regulatory projects in partnership with our regulated public.

We are developing policies to expand our programs that waive or mitigate regulatory fines or penalties imposed on first time small business violators, and to focus regulatory enforcement and compliance personnel on results instead of process and red tape.

Also, we are working to reduce the frequency of regularly scheduled reporting requirements.

H.R. 994's impact on Treasury must be viewed from this background. We have concluded that although H.R. 994's underlying principle of periodic regulatory review is integral to sound regulatory policy, the approach taken is seriously flawed.

First, the scope of the bill is so broad as to encompass practically any agency activity - no matter what the significance or insignificance - that affects the public in some manner.

Second, Treasury will have to divert an enormous amount of resources in order to comply with the bill.

Third, the bill does not recognize the architecture of the Federal rulemaking process and is likely to have unintended and harmful consequences.

Finally, the ultimate potential consequence of the bill - a regulatory death penalty in the form of the automatic termination of agency regulations - is not in the best interests of the public or consistent with sound public policy.

Let me explain each of these points.

As defined in the bill, the term regulation means "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy, other than such a statement to carry out a routine administrative function of an agency." It is difficult to imagine what is not covered by this definition. This definition encompasses what most of us generally recognize as agency regulations: Those documents issued pursuant to the informal rulemaking procedures of the APA (or under an APA exemption) that are published in the *Federal Register* and codified in the *Code of Federal Regulations*. At Treasury, these regulations range from the very simple (such as a BATF regulation designating a particular geographic winegrape growing region as a viticultural area) to the very complex (such as an IRS regulation interpreting a complex provision of the Internal Revenue Code or an OCC or OTS regulation prescribing capital requirements for financial institutions).

But H.R. 994's definition of "regulation" goes well beyond APA rulemakings. Other Treasury "statements" that implement, interpret or prescribe law or policy include a wide range of agency activities such as legal opinions and legal briefs prepared in support of a civil or criminal enforcement action; IRS private letter rulings, revenue rulings and revenue procedures; rulings and similar documents issued by the Customs Service; internal guidance and enforcement manuals relied on by agency staff; agency enforcement actions; as well as licenses, permits and other agency authorizations to engage in a particular activity.

Under the bill, every agency internal legal opinion that ever interpreted the scope of a statute or analyzed the applicability of a statutory or regulatory requirement to a particular set of facts is within the definition of "regulation." Legal opinions form the very foundation of virtually all of the operations, functions and programs of Federal agencies. Similarly, the definition is so broad as to encompass pleadings, briefs and other documents prepared in the context of civil and criminal litigation.

Under this legislation, taxpayers and the IRS would be particularly affected. Each year, taxpayers request guidance from the IRS concerning the proper tax treatment of particular transactions. In just the last three years the IRS issued over 7,000 private letter rulings and technical advice memoranda that can be relied on by the requesting taxpayer, as well as over 500 revenue rulings and revenue procedures providing guidance on matters of interest to wide range of taxpayers. Each one of these rulings, which interprets how the tax law applies to a specific transaction or a category of transactions, is a regulation within the meaning of H.R. 994.

When an agency determines to take an enforcement action against a particular person, that action is necessarily predicated on an agency determination that there has been a violation of law or an agency regulation having the force of law. For example, a deficiency notice issued to a taxpayer by the IRS is generally based on a determination that a particular transaction was not entitled under law to the tax treatment claimed by the taxpayer. Under H.R. 994, such a deficiency notice would be a "regulation" because it is an agency statement that implements or interprets the law.

Like the IRS, the Customs Service receives requests for guidance. In response, Customs issues approximately 9,500 ruling letters annually that give the trade community guidance on issues relating to imported merchandise.

Under the Customs laws, a domestic interested party may file a petition requesting the Customs Service to reconsider the tariff classification of specific categories of imported merchandise. Customs responds to these petitions by publishing a notice in the *Federal Register* and soliciting public comment on what are often highly complex technical issues. After reviewing the public comments, Customs publishes a final ruling in response to the petition. Every existing Customs ruling on a domestic interested party petition is a "regulation" subject to the provisions of H.R. 994.

In determining whether to grant a license, permit or other authority, Federal agencies often must determine whether the applicant is entitled by law to receive the license, permit or other authority. In these cases, the issuance or denial of an application is a "regulation" because it constitutes an agency statement that interprets or implements law.

For example, the Federal Alcohol Administration Act provides that no label can be placed on a container of distilled spirits, wine or malt beverage unless the label is approved by BATF. When reviewing a request for a label approval, BATF determines whether the label complies with the law and BATF's implementing regulations. BATF has approved about 1.5 million labels, each of which would be a "regulation" subject to the procedures of H.R. 994.

Even the exemption in the bill for routine administrative functions provides agencies with little assurance that such actions will not become subject to the review required by the bill. Coupled with the explicit authorization of judicial review of agency compliance with the procedures required by the bill, agencies will be forced to review routine administrative actions to avoid the possibility that a judge somewhere will decide that a particular function is neither administrative nor routine.

Regardless of how simple or complex, or whether a serious question has ever been raised about its necessity or burdens, H.R. 994 would apply to all of the activities I have just described. This one-size-fits-all approach to regulatory review only serves to divert scarce agency resources away from the real regulatory priorities. We are focused - and we should keep our focus - on reviewing and revising those regulations that do impose significant costs or heavy regulatory burdens and those new regulations that are needed to provide the public with guidance on how to comply with the laws enacted by the Congress. For example:

> Although BATF label approvals do not expire, each of the 1.5 million existing approvals would terminate at the end of 7 years unless BATF followed the procedures prescribed by H.R. 994. Under the bill, BATF would be required to review an average of almost 215,000 existing label approvals every year. This would be in addition to processing the approximately 60,000 requests for new label approvals received annually, and reviewing each newly-granted label approval by the end of 3 years and thereafter on a 7-year cycle.
>
> Under the bill, each regulation that an agency ever issued in the past to eliminate an existing regulation or to repeal an existing regulatory requirement is itself an existing regulation subject to periodic review. The task of identifying each such regulation would be an undertaking of substantial proportions.

We seriously question whether diverting scarce staff resources to tasks such as these is a wise use of taxpayer money.

H.R. 994 does not recognize the architecture of the Federal rulemaking process and is likely to have unintended and harmful consequences. The bill fails to distinguish between regulations published in the *Federal Register* and regulations codified in the CFR. Other than perhaps the first time Treasury develops a regulation to implement a new statute or provision of law, a Treasury regulation published in the *Federal Register* rarely represents a complete regulatory program. The typical Treasury regulation appearing in the *Federal Register* is not a free-standing regulation; instead, it eliminates, amends or adds to one or more existing provisions of the CFR. These *Federal Register* documents are subsumed when they are codified in the CFR.

The CFR consists of volumes, chapters, subchapters, parts, subparts, sections, paragraphs, etc. Which of these is the equivalent of a "regulation" for purposes of the review required by H.R. 994?

In other words, where does a particular regulation begin and where does it end? If one section contains a cross-reference to a definition or a requirement in an otherwise unrelated section, would the cross-referenced section and the regulation in which it is embodied have to be reviewed at the same time as the cross-referencing section and the regulation in which it is embodied? Is an agency review invalid if a court determines that the agency should have included more (or fewer) CFR provisions within the review in order to more fully assess the impact of the "regulation" with respect to the 18 review criteria listed in H.R. 994?

Suppose a regulatory provision already codified in the CFR on the date of enactment of H.R. 994 is amended by a final rule published in the *Federal Register* a year after the date of enactment. Under the bill, the regulation as it existed in the CFR on the date of enactment must be reviewed within 7 years. However, the bill also requires that the final rule revising that regulation be reviewed within 3 years. This puts different provisions in the same component of the CFR on different review schedules, the practical effect of which is to compress H.R. 994's review cycle from 7 years to 3 years after a CFR component is revised.

Given the enormously broad scope of H.R. 994, we cannot assure you that we will have sufficient resources to complete all of our reviews within the prescribed time periods, that something will not be inadvertently overlooked, or that a court might not find fault with the procedures or substance of a particular review. If any one of these situations were to occur, the bill provides that the affected regulation would thereafter have no force or effect without any consideration of the consequences. While the automatic termination of regulations sound appealing, it is contrary to sound public policy and the best interests of the public. For example:

Terminating IRS regulations, revenue rulings and private letter rulings will remove the certainty taxpayers need to comply with the law. Even if a tax regulation terminates, the underlying provision of the tax code remains in effect. The absence of this kind of guidance — which informs IRS revenue agents as well as taxpayers — will result in individual revenue agents determining whether a particular taxpayer has complied with the law and will increase the likelihood that similarly situated taxpayers will be treated differently. What taxpayers need is certainty; H.R. 994 would remove the certainty provided by IRS regulations and rulings.

Terminating IRS deficiency notices would have disastrous implications for the administration of the tax code. It would provide a strong incentive for taxpayers to prolong disputes with the IRS or refuse to enter into voluntary agreements to keep a tax year "open" pending resolution of a dispute.

Treasury's Bureau of the Public Debt issues regulations establishing the terms and conditions of the sale and redemption of marketable Treasury securities and savings bonds. This includes the 30-year "benchmark" bond, intermediate term Treasury notes, and bills. These regulations govern the procedures for Treasury auctions and set out the contract between the Government and the investor. By raising the mere possibility that these regulations could terminate, H.R. 994 could raise questions about whether Treasury auctions will be disrupted and how the United States will meet its contractual commitments on the securities. This uncertainty could seriously impair the liquidity of the government securities market and could force the Federal Government to pay higher interest rates to compensate investors. Because many other interest rates are tied to Treasury borrowing rates, consumers may well be faced with higher rates on home mortgages and other loans.

Terminating private letter rulings issued by the Customs Service will remove the certainty demanded by the trade community for sound business planning.

FinCEN regulations implementing the Bank Secrecy Act are the core element of Treasury programs to fight money laundering and financial crime. The information derived from these regulations is utilized by Federal, State, local and international law enforcement organizations. Termination of these regulations would produce a gap through which drug dealers, weapons traffickers and terrorists could move funds with no fear of detection.

The Office of Foreign Assets Control (OFAC) issues regulations implementing economic sanctions against foreign countries or terrorist groups imposed in response to threats to the U.S. foreign policy, national security, or economy. These regulations constitute the direct exercise of the President's foreign policy powers. OFAC sanctions programs affect countries such as Cuba, Iran, Iraq, Libya, North Korea, and Serbia, and Middle East terrorist groups. Any termination of an OFAC regulation would seriously undermine the President's conduct of the foreign policy of the United States.

Terminating regulations issued by OCC or OTS that govern the safety and soundness of financial institutions will threaten the integrity of federally insured financial institutions and put Federal deposit insurance funds at risk.

More problematic is what could happen if a final rule that was published in the *Federal Register* and that revised an existing CFR provision terminates under the provisions of H.R. 994. For example, suppose the IRS issues a new regulation that revises an existing CFR provision to simplify regulatory burdens or to provide a more favorable tax treatment for certain transactions. What happens if, for some reason, that final rule ceases to have any force or effect by operation of H.R. 994? It is very likely that the more onerous pre-revision regulatory provisions spring back into force. The potential for uncertainty and confusion on the part of the public is real, particularly when highly technical or complex underlying statutory provisions implemented or interpreted by a regulation continue to have effect.

In closing, the Department of the Treasury strongly endorse the concept that agencies should review their regulations to eliminate unnecessary provisions and reduce paperwork and regulatory burdens whenever that can be accomplished consistent with law and sound regulatory policy. H.R. 994, however, is not the answer. It is too broad in scope. Its automatic termination provisions not only are unnecessary to accomplish its intended purpose, but are likely to have serious unintended consequences. Far more public benefit will result from allowing agencies and Departments like Treasury continue to focus on and revise specific regulatory provisions that raise the problems sought to be addressed by H.R. 994.

This concludes my formal statement. I would be glad to answer any questions you may have on how H.R. 994 would affect the Department of the Treasury.

STRIKING A BETTER BALANCE BETWEEN THE COSTS AND BENEFITS OF REGULATION

Testimony of the Honorable Richard S. Carnell
Assistant Secretary of the Treasury

On S. 650

Before the Subcommittee on Financial Institutions and Regulatory Relief
Committee on Banking, Housing, and Urban Affairs
United States Senate

May 2, 1995

RR-261

SUMMARY

The Administration has a strong commitment to reducing the costs and improving the quality of bank regulation. Over the past two years, we have taken numerous steps to achieve that objective (see Appendix B). We can and we should improve the regulatory environment for depository institutions. Accordingly, we support, as drafted or with some modification, a large portion of S. 650's provisions.

We welcome the opportunity to participate in the Subcommittee's efforts to identify and eliminate needless regulatory costs, consistent with our commitment to promote efficiency and competition, keep federally insured depository institutions safe and sound, and protect the interests of consumers.

Community Reinvestment Act

We have major concerns about provisions of the bill that would amend, or otherwise impair the operation of, the Community Reinvestment Act (CRA). We strongly oppose any weakening of the CRA, and urge the Subcommittee to keep the CRA outside the scope of the bill.

Two years ago, responding to complaints about how the CRA has been implemented over the years, the President called on the federal banking agencies to rewrite their CRA rules to stress performance, not paperwork. Last month, after one of the most comprehensive rulemaking proceedings in recent times, the agencies promulgated final regulations, culminating a lengthy process in which they sought and obtained the input of thousands of interested parties.

In the course of their rulemaking, the agencies considered and dealt effectively with the problems of the old CRA system. There is thus no need for statutory changes. The thoughtful, carefully balanced reforms adopted by the agencies fulfill both the promise of the statute and the President's request. They provide real incentives for depository institutions to serve all our communities, and a streamlined, straightforward process for assessing their success.

The new rules deserve a chance to work, and we believe they should be implemented as scheduled. To amend the CRA in any respect before the new rules' effectiveness can be evaluated would be counterproductive, and the Administration would firmly oppose it.

Banking laws have long required banks to obtain regulatory approval for such transactions as establishing branches, acquiring new institutions, and merging institutions. We believe the process for reviewing such transactions can and should be

streamlined. To preserve current opportunities for review of an institution's record of serving its community, we would: retain existing requirements to publish notice of the transactions in question; give interested persons at least 30 days to comment on an institution's CRA record; and specify that, for purposes of the CRA, institutions must follow these procedures for a full application if regulators receive a substantial CRA protest. This approach would provide a streamlined notice process in the overwhelming majority of cases, while maintaining the integrity of the CRA.

Fair Lending

The bill rightly seeks to encourage institutions to test themselves for discrimination. We want institutions to be able to self-test and to then take corrective action, and we support incentives toward those ends. We would be glad to work with the Subcommittee on appropriate language to encourage self-testing without hindering appropriate enforcement action.

Truth in Lending; RESPA

We support simplifying the Truth in Lending Act and the Real Estate Settlement Procedures Act (RESPA).

The Truth in Lending Act should not permit borrowers to avoid responsibility altogether because of truly technical violations by a lender, and we support appropriately drafted provisions to prevent them from doing so.

We support efforts to improve disclosures (e.g., about adjustable-rate mortgages and the transfer of loan servicing).

We oppose exempting second mortgages from the protections of RESPA.

Safety and Soundness Safeguards

We oppose permitting small banks and thrifts to go two years between examinations. Interest rates and local economic conditions can change dramatically during such a period, and capital can erode very rapidly. A two-year examination cycle would undercut the system of "prompt corrective action" enacted in 1991, under which FDIC-insured depository institutions face progressively more stringent supervisory safeguards as their capital declines. This system depends on timely and accurate measurement of capital, including the results of examinations.

We generally oppose permitting an institution's managers to serve on its audit committee. Such a committee is typically the principal point of contact between an institution's board of directors and the institution's own internal audit function. Internal auditors -- who are, of course, employees of the institution -- must be able to communicate their concerns and findings to the board without control by, or fear of reprisal from, the very management whose actions they may be reviewing.

Conclusion

We look forward to working with the Subcommittee to craft legislation that eliminates regulatory burdens while maintaining important and necessary public benefits.

STRIKING A BETTER BALANCE BETWEEN THE COSTS AND BENEFITS OF REGULATION

OUTLINE

STRIKING A BETTER BALANCE
BETWEEN THE COSTS AND BENEFITS
OF REGULATION

Testimony of the Honorable Richard S. Carnell
Assistant Secretary of the Treasury

On S. 650

Before the Subcommittee on Financial Institutions
and Regulatory Relief
Committee on Banking, Housing, and Urban Affairs
United States Senate

May 2, 1995

Mr. Chairman, Senator Bryan, Members of the Subcommittee. I am pleased to be here today to present the Administration's views on S. 650, the Economic Growth and Regulatory Paperwork Reduction Act of 1995.

I would like to commend you, Mr. Chairman, for holding this hearing and for the role you, Senator Mack, and others have played in keeping attention focused on improving the regulatory environment in which depository institutions operate. I also want to thank Senators Sarbanes and Bryan for their constructive support in these matters.

The Administration has a strong commitment to reducing the costs and improving the quality of bank regulation. Over the past two years, we have taken numerous steps to achieve that objective (some of which I summarize in appendix B). We can and we should improve the regulatory environment for depository institutions. Accordingly, we support, as drafted or with some modification, a large portion of S. 650's provisions.

I. THE NEED FOR A BALANCED APPROACH

Banking regulation serves many goals: maintaining a safe and sound financial system; protecting consumers; and assuring that communities' needs are served.

Congress enacted the provisions of existing law we are considering today in furtherance of such goals -- to remedy some specific abuse in the marketplace, to better protect taxpayers from the risks of bank failure, or to advance some particular public policy. For example, it passed the Truth in Lending Act, Truth in Savings Act, and Real Estate Settlement Procedures Act (RESPA) in response to complaints about the practices of certain institutions. It intended the Community Reinvestment Act, Home Mortgage Disclosure Act, and Bank Secrecy Act to advance well-defined policy objectives. And it sought, by limiting insider lending and requiring FDIC-insured institutions to undergo annual examinations and have independent audit committees, to assure that taxpayers need never again pick up the bill for bank failures.

Why then do many see these laws today as presenting such burdens as to warrant extensive amendment? There are a variety of answers, I submit:

First, in many cases the issues addressed by these laws have turned out, in the implementation, to be far more complex than anyone imagined. This complexity is generally reflected in the rules written by the agencies Congress has directed to carry out its mandate.

Second, when violations of these laws carry significant penalties, the industry itself has often sought considerable specificity and certainty about its obligations, which makes the rules more detailed and difficult.

Third, market participants find ways to avoid restrictive statutes, prompting the agencies to engage in repetitive loophole-plugging to shore up the statutes. This cycle of evasion and stringency makes regulation more burdensome, particularly for those careful about complying with the law.

In short, what we now see as burdens commonly result from the efforts of highly capable people of good conscience, in Congress and in the agencies, to serve the public interest.

For these reasons, it is appropriate and important to review the regulatory framework and eliminate undue burdens that have crept into the process. We welcome the opportunity to participate in this review. Indeed, this Administration has committed itself to removing unwarranted barriers to efficiency in both government and the private sector.

In the process of being vigilant about the emergence of costly burdens, it is essential that we maintain a balanced approach. While needless burdens surely ought to be lifted, we must also avoid impairing our ability to realize the original objectives of the laws we address. Particularly when we deal with laws meant to cure abuses, improve service, or protect taxpayers and consumers, we would disserve our public trust by acting incautiously in the name of relieving burdens.

We must continually have in mind the need to ensure safety and soundness, to promote more efficient and competitive service, and to protect the interests of consumers. This means that we must focus on more than just gross compliance costs, for if we do not keep firmly in mind the goals we started out to achieve, we will let these objectives become the victims of scores of small and isolated cuts.

II. S. 650, THE ECONOMIC GROWTH AND REGULATORY PAPERWORK REDUCTION ACT OF 1995

Against this background, let me turn to some of the specifics of S. 650. I note that Appendix A contains section-by-section comments on the bill.

A. COMMUNITY REINVESTMENT ACT

We have major concerns about provisions of S. 650 that would amend, or otherwise impair the operation of, the Community Reinvestment Act (CRA). We strongly oppose any weakening of the CRA, and urge the Subcommittee to keep CRA outside the scope of this bill.

The CRA is important to the Administration's objective of encouraging depository institutions to look in all communities for good business opportunities. As the President declared on April 19, 1995, "the CRA can create miracles in small towns and big cities from coast to coast -- miracles like mortgage or business loans for people who never thought they could own a house or business, multifamily housing loans, and commercial development loans in low- to moderate-income communities."

1. Amendments to CRA

Two years ago, responding to complaints about how the CRA has been implemented over the years, the President called on the federal banking agencies to rewrite their CRA rules to stress performance, not paperwork. Last month, after one of the most comprehensive rule-making proceedings in recent times, the agencies promulgated final regulations, culminating a lengthy process in which they sought and obtained the input of thousands of interested parties, including banks, savings institutions, customers, and community groups. The agencies received over 6,700 comments in 1993, and over 7,200 comments in 1994.

In the course of their rulemaking, the agencies considered and dealt effectively with the problems of the old CRA system. In other words, this extensive process has already addressed the very problems that also prompted current legislative proposals to amend the CRA. There is thus no need for statutory changes. The thoughtful, carefully balanced reforms adopted by the agencies fulfill both the promise of the statute and the President's request. They provide real incentives for depository institutions to serve all our communities, and a streamlined, straightforward process for assessing their success.

The banking industry itself has responded favorably to the new rules. For example, the American Bankers Association hailed the new rules as a "regulatory rightsizing of CRA" that was "long overdue" -- one that "slows the spiral of paperwork for paperwork's sake and restores some sanity to the process." The Independent Bankers Association of America declared that the new rules "should alleviate the paperwork nightmare of CRA for community banks and allow them to concentrate on what they do best -- reinvest in their communities." And just last week, joining a coalition of civic and community groups and mayors from around the country, such leading financial institutions as Chemical Bank, Bank of America, NationsBank, First National Bank of Chicago, American Savings Bank, and Home Savings of America, jointly praised the rulemaking effort, saying that the new rules strike "a balance between the banking industry's desire for reduced regulatory burden and the need for all American communities to have access to better information . . . . They represent a significant move in the right direction . . . Now, we urge that they be given a chance to work."

The right approach, after all of this thoughtful work by the regulatory agencies and the public, is for the regulators to implement the new regulation on schedule. To amend the CRA in any respect before the new rules' effectiveness can be evaluated would be counterproductive, and the Administration would firmly oppose it.

2. Procedural Changes Affecting CRA

Banking laws have long required banks to obtain regulatory approval for such transactions as establishing branches, acquiring new institutions, or merging institutions. We believe the process for reviewing such transactions can and should be streamlined. (Indeed, the OCC and OTS have already taken steps, within the limits of their current statutory authority, to expedite and simplify that process.)

Thus we support the objectives of sections 201 (acquisition of banks by bank holding companies), 202 (mergers of FDIC-insured depository institutions), 203 (Oakar transactions), and 204 (branch applications) of S. 650, which would revise the procedure for reviewing such transactions. Under sections 201 and 204, well-capitalized, well-managed institutions with satisfactory CRA records could generally give regulators notice before a transaction and then proceed with the transaction unless regulators acted within a specified time to require an application.

As currently drafted, these sections could insulate such transactions from effective CRA review -- review which current law specifically requires, and which has played an important role in assuring the CRA's effectiveness. No longer would persons concerned about an institution's record of meeting community needs receive notice of, or have a meaningful opportunity to comment on, a proposed transaction. These sections would thus, in effect, establish a safe harbor against CRA-based challenges -- in addition to the explicit safe harbor proposed in section 133. Just as we strongly oppose section 133, we would strongly oppose that result.

Our opposition to CRA safe harbors is in accord with the principles of the bill. In section 201, for example, institutions with satisfactory CAMEL ratings would not automatically receive approval for their transactions. The Federal Reserve would evaluate the transaction to confirm that other considerations do not warrant a more complete review despite the bank's rating. This same logic underlies our position on CRA review: a satisfactory CRA rating does not mean that an opportunity to consider other factors is unnecessary.

To reconcile our CRA-related concerns with the shared objective of streamlining the application process, we would preserve existing requirements to publish notice of the transactions in question; give interested persons at least 30 days to comment on an institution's CRA record; and specify that, for purposes of CRA, institutions must follow these procedures for a full application if regulators receive a substantial CRA protest. This approach would provide a streamlined notice process in the overwhelming majority of cases, while preserving the integrity of the CRA.

Section 201, which we have already discussed in the context of CRA, also raises a question about the proper role of the Antitrust Division of the Department of Justice in considering the competitive effects of bank acquisitions. As drafted, section 201 would allow an expedited 15-day prior notice process if certain preconditions were satisfied. Among these would be a requirement that the proposal complies with guidelines adopted by the Federal Reserve, in consultation with the Department of Justice, to "identify proposals that are not likely to have a significantly adverse effect on competition in any relevant financial services market."

We support this approach, with a slight modification. The Department of Justice has raised a procedural question about their ability to receive simultaneous notice of a transaction. Giving the Department simultaneous notice of the transaction would expedite the process if done in conjunction with an amendment to waive the typical 30-day post-approval waiting period contained in 12 U.S.C.1948 (b), except for those transactions where the Department has informed the Federal Reserve, within the 15-day period contained in this section, that the affect of this transaction may be substantially to lessen competition. This will enable the transactions to proceed expeditiously.

3. Small Business Lending Data

We also strongly oppose section 235, which would repeal the current requirement that depository institutions report information on their lending to small businesses and small farms. Such information is both useful and not otherwise available. For example, the Justice Department's Antitrust Division uses this data in dozens of bank merger cases each year in various local markets throughout the country. This data is the only readily available source of information on banks' small business lending, and is therefore of great importance in evaluating the anticompetitive effects of proposed mergers. The Small Business Administration also uses the data to rank the small business lending of all the nation's commercial banks.

B. Fair Lending

I think everyone would agree that discriminating against loan applicants based on such characteristics as race or sex is reprehensible. The Equal Credit Opportunity Act and the Fair Housing Act prohibit such discrimination, and this Administration is firmly committed to eliminating such discrimination. When such discrimination relates to home mortgage credit, it also contravenes the national policy of encouraging home ownership, which this Committee has had a major role in formulating and advancing.

Section 302 rightly seeks to encourage institutions to test themselves for discrimination. We want institutions to be able to self-test and to then take corrective action. We support incentives toward those ends. Section 302 as drafted is overly broad, so we, the Department of Justice, and HUD would be happy to work with the Subcommittee on appropriate language that encourages self-testing without hindering appropriate enforcement action.

We cannot, however, support section 236's proposed reduction in the number of institutions reporting under the Home Mortgage Disclosure Act, given the role these reports play in identifying discrimination. These reports can serve to alert an institution of possible discriminatory practices in its operations. They also assist the regulators in determining compliance with CRA and enforcing the fair lending laws.

While we recognize that this data must be handled carefully and used properly, it has real value.

C. Truth in Lending Act; RESPA

1. Coordinating RESPA and the Truth in Lending Act; Responsibility for Administering RESPA

The Truth in Lending Act establishes a way of calculating and disclosing the true cost of credit, i.e., the annual percentage rate (APR). The Truth in Lending Act's APR disclosures must be delivered within three days of loan application, or sooner if the loan is closed first. RESPA requires that lenders provide borrowers, within three days of loan application, with a Good Faith Estimate of all settlement costs associated with a closing on a purchase money mortgage loan. Typically, the Truth in Lending Act disclosures are provided separately but along with the Good Faith Estimate and other RESPA disclosures. Additional disclosure are also required under both statutes at the time of closing.

The Truth in Lending Act applies to most consumer credit transactions, including, for example, credit cards, car loans, and home mortgages. RESPA applies only to loans on residential real property. Both statutes apply to lenders, but RESPA provisions also apply to: real estate agents and brokers; title agents and underwriters; credit reporting companies; appraisers; attorneys; escrow or closing agents; and mortgage, casualty and homeowners insurers, etc.

This brief recitation suggests the compliance difficulties lenders have faced in dealing with these two laws. Action to harmonize the workings of the Truth in

Lending Act and RESPA is clearly appropriate. Eliminating duplicative and needlessly burdensome disclosures and unworkable requirements in the home mortgage lending process would reduce the cost of loan originations and relieve consumers from information overload.

Indeed, we believe that simplifying, consolidating, and coordinating *all* the disclosures required in the home purchase and finance process (including, for example, environmental disclosures) and eliminating needless requirements would best serve the interests of consumers and the industry. We further believe that this objective should be pursued through an interagency process rather than by giving a mandate to the Federal Reserve simply to make the disclosures uniform. The problem that creates the overlap is primarily statutory, not regulatory, and does not lend itself to creating minor exemptions from one provision or another. We suggest that the Federal Reserve, HUD, and Treasury be directed jointly to study the entire process as it relates to home finance and to develop recommendations for changes in all the relevant laws that would simplify and coordinate this process, to ensure that consumers receive the information and protection they need and to avoid needless burdens on lenders and other participants.

S. 650 also provides for the transfer of all RESPA responsibilities to the Federal Reserve. Recognizing that HUD is the only agency with comprehensive expertise on the full scope of housing-related matters, we should leave rulemaking authority under RESPA with HUD. In the meantime, we support the clarification that the financial regulatory agencies have concurrent jurisdiction with HUD in enforcing RESPA.

2. Specific Provisions

We agree on the value of simplifying the Truth in Lending Act and RESPA. We support most of the bill's amendments to those Acts, either as drafted or with modifications.

The Truth in Lending Act should not permit borrowers to avoid responsibility altogether because of truly technical violations. Accordingly, we support the objectives of sections 113, 114, 115, 116, 117, and 119. We are concerned, however, that some of these sections as drafted are overly broad. We would be glad to work with the Subcommittee to develop appropriate language.

We would support a modified version of section 103, under which the Federal Reserve may, by regulation, exempt transactions from the Truth in Lending Act if the Fed found that coverage by the Act did not benefit consumers by providing useful information or protection. Furthermore, the requirement that benefits be "measurable" is overly restrictive, and should be deleted.

We support the efforts to improve disclosures. Section 104 would simplify disclosure regarding the transfer of loan servicing. Section 112 simplifies disclosure of how interest rates on an adjustable-rate mortgage may change. The current regulatory requirement to provide a hypothetical example of how the annual percentage rate and minimum payment would have changed during the past 15 years is overly complex. But borrowers should be made clearly aware of how their monthly payments can increase (e.g., by including a worst-case scenario).

We oppose section 104's elimination of the RESPA protection for second mortgages, which Congress extended in 1992 "because of the unfortunate potential for fraud and abuse among the elderly and inner city homeowners."

We support section 118's clarification of assignees' Truth in Lending liability.

D. TRUTH IN SAVINGS ACT

Section 141 would largely repeal the Truth in Savings Act, retaining only those provisions of the Act that require banks to pay interest on the full investable balance at the disclosed rate. Although we agree that the Act warrants review, we do not support its repeal. We note that the costs of compliance have, to a significant degree, already been expended. We are concerned about repealing the Act's protections against fraudulent and misleading statements, and against advertising minimum balance accounts as free. We also see value in promoting clear and accurate disclosure of account terms, annual percentage yield and applicable fees and penalties.

A better approach may be to identify and improve the aspects of the Truth in Savings Act that cause problems, rather than repealing it. For example, institutions without automated systems to calculate interests rates do have difficulty complying with the Act, and appropriate exemptions could address these concerns. Any revisions to the Act should retain the regulator's authority to act against misleading statements.

F. SAFETY AND SOUNDNESS SAFEGUARDS

Several provisions of S. 650 directly affect the supervisory process and have significant implications for safety and soundness. With memories of massive bank and thrift failures still fresh in the public's memory, and with public confidence in bank supervision still being restored, we think it especially important to move with great caution in this area.

Three topics give us serious concern: the frequency of examinations, the independence of audit committees, and insider lending.

1. Annual Examinations

Current law generally requires an annual examination of every bank with assets of $250 million or more. Regulators can examine smaller banks on an 18-month cycle, depending on the institution's size and examination rating. Section 221 would expand these exceptions so that regulators could examine the overwhelming majority of FDIC-insured institutions only every two years.

We believe that two years is too long a period to forego examination of even small banks. In two years, the local economy or interest rates can change dramatically, or management could be replaced. To extend the annual examination exception to two years would work to contravene the objectives that Congress sought to achieve through the FDIC Improvement Act of 1991 (FDICIA).

In FDICIA Congress adopted "prompt corrective action" -- a new approach to supervision in which depository institutions face progressively more stringent supervisory safeguards as their capital declines. Two aspects of this new system are of critical importance: timely and accurate measurement of capital levels, and prompt intervention as capital falls.

The experience of the past decade has taught us that capital can erode with amazing speed when an institution comes under stress. Frequent bank examinations are crucial to maintaining the integrity of prompt corrective action. Two years is simply too long, in our view, for a bank of any size to go without examiner oversight, and permitting a two-year cycle for small banks would simply increase the exposure of the deposit insurance funds.

2. Independent Audit Committees

The importance of an effective independent audit function in depository institutions cannot, in our judgment, be overstated. It is an essential internal check and balance. Weakening this important safeguard, in the name of reducing burdens, would be misguided.

We are particularly concerned about a retreat from the current requirement that audit committees consist entirely of outside directors. To permit management directors to sit on the audit committee would, we believe, impair the committee's objectivity and independence, and we believe there is substantial experience to bear this out.

This is particularly important because the audit committee is typically the principal point of contact between an institution's board of directors and the institution's own internal audit function. Internal auditors -- who are, of course, employees of the institution -- must be able to communicate their concerns and findings to the board without control by, or fear of reprisal from, the very management whose actions they may be reviewing. Allowing management directors to sit on audit committees would compromise the effectiveness of this process.

While we support giving regulators some limited discretionary flexibility to grant hardship exemptions, under carefully defined circumstances, for only a limited number of positions on the audit committee, we oppose any change in the basic requirement.

3. Insider Lending

Ensuring not only a safe and sound, but also a fair, banking system demands that loans to bank insiders face special scrutiny and that insiders not receive preferential access to credit. Tracking loans to insiders helps protect against abuses. Section 212 would amend several of the tracking rules.

While we support certain of these proposed changes, we would not eliminate the requirement for reports of loans to officers by unaffiliated banks where the loans exceed the amount the officers could borrow at the employing banks. Nor would we eliminate reports to the board of directors regarding correspondent bank loans to executive officers and shareholders who control more than 10 percent of the bank's voting securities. In each of these cases the potential for conflicts of interest is great, and the required reports are an important safeguard.

F. Thrift Charter

Several sections of the bill relate specifically to thrift institutions. Section 303 would exempt from the QTL test savings associations at least 90 percent of whose customers consist of current or former military personnel, or related persons. We can accept this section.

We support amending the federal thrift charter to remove percentage-of-assets limits on credit card loans and education loans, and permit institutions to invest an additional 10 percent of their assets in small business loans, all as proposed in section 304.

Section 304 would also treat a savings association that meets the Internal Revenue Code's definition of "domestic building and loan association" as a qualified thrift lender (QTL) for purposes of the Home Owners Loan Act. We generally support this provision, but only for thrifts not controlled by commercial firms. We oppose using this bill as a vehicle for impairing the separation between banking and commerce. Accordingly, we believe that such thrifts should continue to comply with the QTL test.

Permitting thrifts to satisfy either the QTL test or the tax test gives many thrifts additional flexibility. We do not support going beyond that to let consumer, credit card, educational, or other loans satisfy the QTL test without limit as if they were residential mortgages. Such proposals -- which essentially amount to letting thrifts become consumer banks -- beg the question of whether there is still any need for a separate thrift charter.

A banking organization that owns both a bank and a savings association is both a bank holding company and a savings and loan holding company, and is regulated by both the Federal Reserve and the Office of Thrift Supervision. Section 205 would eliminate OTS regulation in such instances. We do not object to the proposal, but we want to ensure that the OTS retains its authority to address holding company matters unique to savings associations. We therefore believe the OTS and the Federal Reserve should be directed to work out necessary procedures for addressing these matters. For example, the Federal Reserve should be directed to cooperate with the OTS on enforcement matters, the OTS should receive access to inspection reports, and the OTS should have the authority to comment on applications for the acquisition of a new thrift. Examinations are already coordinated, so the OTS has that authority.

G. MISCELLANEOUS

There are several provisions of S. 650 that do not lend themselves to a more general classification. I would like to touch upon several of these.

We support sections 201, 202, 203, and 204, which streamline regulatory application procedures, with the modest changes discussed above to preserve the effectiveness of the CRA.

Section 206 would eliminate the per-branch capital rule for national and state member banks, which modern consolidated capital requirements render unnecessary. We support this section.

We also support section 207's elimination of branch application requirements for ATMs. ATMs differ qualitatively from brick and mortar buildings in the availability of services and in the competitive advantage they provide to a particular institution. The applications process should reflect this.

We support section 208, which would permit well-capitalized national and state member banks with satisfactory CAMEL ratings to invest up to 150 percent of their capital stock in bank premises without regulatory approval.

We believe section 210 goes too far by eliminating the requirement that institutions file a notice at least 30 days before hiring new directors or senior executive officers for newly chartered institutions, undercapitalized institutions, or institutions that have recently undergone a change in control. Eliminating this notice requirement would also eliminate the background check requirement. The quality of management is very important in these critical situations. However, we recognize that the regulators may know individuals being considered for management positions, making lengthy background checks unnecessary. We therefore believe regulators should continue to receive notice of changes in management, but have authority to waive the requirements for a background check.

Section 215 would amend the Foreign Bank Supervision Enhancement Act of 1991, which required the Federal Reserve Board to establish and implement standards for foreign bank entry into the U.S. and established the Federal Reserve as the primary Federal regulator for State-licensed offices of foreign banks covered by this section. We support the section's elimination of the duplicative examination procedures for foreign banks. We support the current moratorium on imposing examination fees on offices of foreign banks, as enacted in the Interstate Banking and Branching Act of 1994, and therefore oppose section 215's override of the underlying fee provision. In addition, we support alternative approaches (set forth in Appendix A) for reducing delays in reviewing and acting on such foreign bank applications. Finally, we oppose eliminating the Federal Reserve's authority to order the termination of a State-licensed foreign bank, branch or agency. It is crucial to have a Federal bank regulator cognizant of those entities' multi-State and international activities, with access to Federal intelligence on such entities' international operations and authority to assure their speedy termination should the public interest require.

We oppose using this bill as a vehicle for goals other than alleviating regulatory burden, such as restructuring the FDIC board (section 243) or permitting nonbank banks owned by commercial firms to increase their assets without limit, free from the 7 percent annual growth limit Congress imposed in 1987 when it reaffirmed the separation of banking and commerce (section 308).

III. CONCLUSION

We look forward to working with the Subcommittee and other Members of Congress as this bill works its way through the legislative process. Working together, we can eliminate regulatory burdens while maintaining important and necessary public benefits.

I would be happy to respond to any questions the Subcommittee may have.

APPENDIX A
SECTION-BY-SECTION COMMENTS ON S. 650

Sec. 101. Coordination of the Truth in Lending Act and the Real Estate Settlement Procedures Act (RESPA).

The Truth in Lending Act establishes a way of calculating and disclosing the true cost of credit, *e.g.*, the annual percentage rate (APR). The Truth in Lending Act's APR disclosures must be delivered within three days of loan application, or sooner if the loan is closed first. RESPA requires that lenders provide borrowers, within three days of a loan application, with a "good faith estimate" of *all* settlement costs associated with a closing a purchase money mortgage loan. Typically, the Truth in Lending Act disclosures are provided separately, but along with the good faith estimate and other RESPA disclosures. Additional disclosures are also required under both statutes at the time of closing.

The Truth in Lending Act applies to most consumer credit transactions, including, for example, credit cards, car loans, and home mortgages. RESPA applies only to loans on residential real property. Both statutes apply to all types of lenders, but other RESPA provisions also apply to other settlement service providers, including real estate agents and brokers, title agents and underwriters, credit reporting companies, appraisers, attorneys, escrow or closing agents, mortgage, casualty and homeowner insurers, and so on.

Section 101 directs the Federal Reserve to make the disclosures required under the Truth in Lending Act and RESPA consistent with each other and with other disclosure laws. It would prohibit the Federal Reserve from imposing any disclosure requirement unless the requirement would eliminate, modify, or simplify any disclosure required by the Truth in Lending Act or RESPA.

Eliminating the duplicative or overwhelming disclosures in the home mortgage finance origination process would reduce the cost of loan originations of lenders and simplify the mystifying blizzard of paper that the consumer receives.

However, the problem does not lie primarily in RESPA and the Truth in Lending Act regulations. The Truth in Lending Act specifies how to calculate and disclose the cost of credit for all credit transactions. Typically, this information is added to the "good faith estimate."

The Administration believes that simplification, consolidation, and coordination of timing of *all* of the disclosures required in the home purchase and finance process (including, for example, environmental disclosures) and the elimination of unnecessary requirements would be in the best interest of consumers and the industry. However, the manner in which this occurs requires important policy decisions.

We have concerns about granting this authority solely to the Federal Reserve, because it has no experience with RESPA. Instead, we suggest that the Federal Reserve, HUD, and the Treasury perform the coordination task. HUD and the Federal Reserve administer these respective statutes, and the Treasury can provide an objective and broadly-oriented perspective to this process. The three agencies would study the lending process as it relates to home finance and develop recommendations for changes in all the relevant laws that would simplify and coordinate this process, to ensure that consumers receive the information and protection they need and to relieve lenders and other participants of needless burdens.

Sec. 102. Elimination of redundant regulators.

The authority of HUD to administer RESPA would be transferred to the Federal Reserve under this section. Enforcement authority would be exercised by an institution's primary federal regulator in the case of banks, thrifts, and other regulated entities and the Federal Trade Commission when enforcement authority is not provided to another agency.

It is important that the agency charged with developing regulations under RESPA has knowledge and expertise concerning the home purchase and finance process and a mission that includes protection of the home-buying consumer. RESPA covers not only lenders, but also many other settlement service providers, including real estate agents and brokers, title agents and underwriters, credit reporting companies, appraisers, attorneys, escrow or closing agents, mortgage, casualty, and homeowner insurers, *etc.* HUD is the only agency with responsibilities and expertise that include the full panoply of the housing and housing-finance system. We should therefore leave rulemaking authority under RESPA with HUD after the Interagency Task Force referred to under section 101 has completed its work.

The system of enforcement set forth in section 102 would not work well for RESPA enforcement. First, there is a risk of dramatically different interpretations of the same statute by different enforcing agencies. Second, many RESPA violations concern two or more actors providing different settlement services who would be under the jurisdiction of different agencies under this enforcement scheme. Finally, much of the expertise and information used to develop informed regulations comes from complaints and other enforcement activity. This valuable input would be lost under this scheme.

Consequently, pending the conclusion of the analysis called for under section 101, the Administration supports clarifying in legislation that the bank regulatory agencies have concurrent enforcement authority along with HUD under RESPA.

Sec. 103. General exemption authority for loans.

This section would require the Federal Reserve to exempt any class of credit transactions from all or part of the Truth in Lending Act when the Board determines that coverage under the Act fails to "measurably" benefit consumers. The bill directs the Federal Reserve to base its determination on such factors as the amount of the loan, whether such disclosures complicate this type of transaction, the sophistication of the borrower, and the importance of credit to the borrower.

We can support this provision if the restrictive qualifier "measurable" is deleted. This will clarify that the goals of the Truth in Lending Act must not be undermined. It would also be consistent with Executive Order 12866, Regulatory Planning and Review. Such exemptions should be granted only by rule to ensure sufficient public comment and avoid ambiguity arising from the Federal Reserve's inaction in a particular case.

Sec. 104. Reductions in RESPA regulatory burdens.

Section 104 would require lenders to disclose to loan applicants whether loan servicing may be assigned, sold, or transferred. Neither historic information nor an applicant attestation would be required. It would also eliminate the application of RESPA to second mortgages.

We do not object to simplifying the servicing disclosure, although we do not believe the current requirement creates much of a burden. Last year, Congress eliminated the most burdensome provision of the statute, which required that the lender disclose the percentage of business over the last three years that it had sold, assigned, or transferred. All that remains is that they must: (1) disclose that the loan servicing may be assigned; (2) disclose that the lender has previously assigned servicing; and (3) if the lender does not engage in loan servicing at all, indicate the present intent to assign the servicing. This provision would go further, requiring only item (1).

We oppose removing the application of RESPA in the second mortgage context. In 1992, Congress amended RESPA to extend its provisions to subordinate liens, finding:

> The Subcommittee included second mortgages within RESPA because of the unfortunate potential for fraud and abuse among the elderly and inner city homeowners. The Subcommittee heard disturbing testimony . . . that indicated that some secondary mortgage lenders, home repair specialists and banks had allegedly taken advantage of elderly and minority homeowners by making loans with rates as high as 25% with balloon payments due in three to five years . . . The Subcommittee believes that some homeowners might have been spared foreclosure and bankruptcy if comprehensive RESPA disclosures had been required during the negotiation process and if the anti-kickback provisions had been in place.

HUD's rule implementing this provision only went into effect on August 9, 1994. Nothing has changed to eliminate the concern that Congress expressed only a few years ago.

Finally, section 104 would conform RESPA and the Truth in Lending Act exemptions for business loans. Currently, the two exemptions are identical, except that RESPA does not exempt individual financing 1-4 family properties for rental purposes. Although these purchasers are not unlike to individuals purchasing their own homes, we do not oppose this reconciliation of definitions.

Sec. 111. Exemption for certain borrowers.

This section would add a "sophisticated borrower" exemption to the Truth in Lending Act. Loans to consumers with an earned annual income of more than $200,000 or with net assets in excess of one million dollars would not be covered by Truth in Lending Act.

While we question the assumption that such consumers do not need the Act's protections, and while it appears that the need to confirm that borrowers meet the requirements of the exemption will likely add burdens for the industry, we have no objection to this proposal.

Sec. 112. Alternative disclosures for adjustable rate mortgages.

The Truth in Lending Act requires lenders providing open-end credit secured by the consumer's principal dwelling to disclose a hypothetical example of how the annual percentage rate and minimum periodic payment would have changed during the previous 15 years.

The bill would grant lenders of open-end credit transactions the option of providing the hypothetical example currently required, or stating that the monthly payment may increase or decrease with the annual percentage rate. A new requirement would grant lenders in a variable interest rate residential mortgage transaction that is not open-end credit the same disclosure alternative.

We support simplifying this disclosure requirement. But the simpler alternative proposed offers consumers no substantive information. We suggest requiring disclosure only of the highest payment possible under the terms of the loan, or some other characterization of a borrower's "worst case scenario."

Sec. 113. Treatment of certain charges.

The Truth in Lending Act defines "finance charge" to include fees paid to third parties, such as courier services that deliver documents necessary for closing. In a recent court case, a borrower was able to rescind an entire transaction because a lender included such third-party charges in the "amount financed," rather than as part of the finance charge.

This section would retroactively and specifically exclude from the Truth in Lending Act definition of finance charge fees and amounts imposed by third-party closing agents if the creditor does not expressly require the charge and does not retain the charge. In addition, this section would exclude from the "finance charge" certain taxes and fees for preparing documents in certain transactions.

We agree that lenders honestly attempting to comply with the Truth in Lending Act's rules may suffer unduly harsh penalties for merely technical violations. The language of this section, however, is overbroad. We are happy to work with the Subcommittee on appropriate language.

Sec. 114. Exemptions from rescission.

Under the Truth in Lending Act, consumers may rescind a transaction at any time within three days of closing for any reason, or for three years if material disclosures were not provided. This section would exclude refinancings, other than high cost refinancings, from those transactions subject to this right of rescission.

We believe consumers need to know the terms under which credit is being granted, whether the loan is a first mortgage or a refinancing. This especially applies when offers to refinance come from disreputable contractors who urge consumers to pay for services with new funds that become available through a refinancing. However, we can support this provision if applied only to those refinancings where the loan amount is not increased, except to cover transaction costs related to the new loan.

Sec. 115. Tolerances; basis of disclosures.

The Truth in Lending Act contains no tolerance for even small errors in disclosing the finance charge. This section would create a statutory tolerance for errors in the disclosed finance charge of up to $100 for transactions that are not open-end credit plans. It would also provide that a disclosure with respect to a portion of interest determined on a *per diem* basis and payable at closing would be considered accurate under the Truth in Lending Act if based on reasonably available information at the time.

We agree that the Truth in Lending Act should accommodate reasonable estimates and *bona fide* errors. Lenders, for example, cannot always disclose completely accurately the amount of interest due at closing when based on a daily charge, given the frequency with which closing dates change. However, a flat $100 tolerance may be too large on a small loan.

Sec. 116. Limitation on liability.

This section exempts lenders from civil, criminal, or administrative enforcement under the Truth in Lending Act and from the three-year rescission period for Truth in Lending Act violations for disclosures, such as: (1) taxes incurred as a precondition for recording a security interest; (2) third-party fees neither required nor retained by the lender; (3) fees for preparing settlement documents, such as deeds and appraisals; and (4) creditor-imposed delivery charges.

As with the other Truth in Lending Act amendments, we support the goal. However, we do not believe section 116's broad liability exemption best addresses the problems raised by the court case discussed under section 113. We are happy to work with the Subcommittee on appropriate language.

Sec. 117. Limitation on rescission period.

Section 135 of the Truth in Lending Act grants a right of rescission to a consumer in a credit transaction in which a security interest is retained or acquired in the consumer's principal dwelling. If required material disclosures are made to the consumer, the right to rescind expires three days after the transaction is consummated. If required material disclosures are not made, the right to rescind expires on the earlier of (1) three years after the date the transaction is consummated, or (2) upon the sale of the property.

The Truth in Lending Act would be amended by this section to expressly provide that the expiration of the right of rescission is absolute, and no consumer may assert rescission affirmatively or as a defense in any action brought under the Truth in Lending Act in any state or federal court. Any state law that is inconsistent with the limitations on the rescission right contained in the Truth in Lending would be overridden.

The proposal appears to address state court decisions that have permitted consumers to rescind transactions after the expiration of the three-year limitation period when rescission is raised as a defense in the nature of recoupment or as a counterclaim.

We support the goals of the provision, but the language should be clarified to ensure that the focus is on state court interpretations of federal law. As drafted, it may preempt state laws.

Sec. 118. Assignee liability.

Assignees may be liable for violations of the Truth in Lending Act when such violations are apparent. The Truth in Lending Act includes two non-exclusive examples of apparent violations: (1) when the disclosure can be determined to be inaccurate on the face of the disclosure statement; and (2) when a disclosure fails to use the terms required by Truth in Lending Act.

Section 118 would limit the liability of assignees under Truth in Lending Act (essentially defining apparent violation to only mean the two examples currently in the statute). Such modification seems appropriate since assignee liability to date has never been found on any other grounds. Furthermore, such standards are sufficiently broad to cover most, if not all, anticipated circumstances. We support this provision as written.

Sec. 119. Modification of waiver of right of rescission.

The Truth in Lending Act permits borrowers to rescind a consumer credit transaction in which the consumer's principal dwelling is retained or acquired as security during the three-day period following the transaction's consummation. Loan funds may not be disbursed until after such three-day period has expired. Borrowers may waive their right of rescission, and thereby obtain the loan funds immediately, only in the case of a *bona fide* personal financial emergency.

Section 119 would delete the *bona fide* personal financial emergency limitation on the Federal Reserve's authority to permit waivers of the rescission right.

We can support this section if Congress provides the Federal Reserve with appropriate guidance, which includes limiting its application to insured depository institutions. Insured depository institutions are closely regulated, so there is more opportunity to discover the type of unscrupulous behavior for which the protections of the Truth in Lending Act were designed.

Sec. 131. Expression of congressional intent.

This section would amend the purposes provisions of the Community Reinvestment Act (CRA) to state that the federal banking agencies shall not impose any recordkeeping or reporting requirements, unless they eliminate, streamline, or reduce burden.

We strongly oppose any amendments to CRA. The regulators have just released their final regulations. After a two-year rulemaking process, the new regulations completely overhauled the compliance process, and the passage of any new legislation now would simply serve to create new uncertainties.

Sec. 132. Small bank exemption.

Banks with total assets of $250 million or less would be exempt from CRA under this section.

We strongly oppose amendments to CRA for the reasons discussed under section 131. The new regulations recognizes that the costs of CRA compliance may be more burdensome for smaller banks. Consequently, the new rules apply a streamlined examination process to them and exempt them from data collection requirements, while retaining their ultimate obligation to serve their communities.

Sec. 133. Community input and conclusive rating.

An institution's compliance with CRA is reviewed through two processes. First, CRA compliance is reviewed through periodic examinations. Second, it is reviewed as part of the formal application process by the institution for a deposit facility.

Section 133 would provide that the rating received following an examination and completion of any request for reconsideration of a rating would be conclusive until the next examination. CRA protests to an application would not be permitted.

We strongly oppose amendments to CRA for the reasons discussed under section 131. Also, the process proposed is unwieldy. Community groups would have an incentive to appeal ratings, knowing that they would be precluded later. Moreover, CRA ratings should not be considered conclusive because circumstances can change, and change rapidly.

Sec. 134. Special purpose banks.

This section would create, for CRA purposes, a "special purpose bank" category, which would be defined as a bank that does not generally accept deposits of less than $100,000 from the public Regulators would be required to consider the nature of the business in which a special purpose bank is engaged in determining compliance with the CRA. The regulators also would be required to develop compliance standards that are consistent with the nature of these businesses.

We strongly oppose amendments to CRA for the reasons discussed under section 131. The new CRA rules already addresses this issue by providing for a tailored assessment process for limited purpose and wholesale banks. It also exempts specific special purpose banks from the rule altogether.

Sec. 135. Increased incentives to lending to low- and moderate-income communities.

This section would direct the regulators to "give positive consideration" in determining compliance with CRA to investments and loans that provide benefits to distressed communities located outside of an institution's service area.

We strongly oppose amendments to CRA for the reasons discussed under section 131. The new CRA rule addresses this concern. Under the new rules, retail institutions can get credit for community development lending and qualified investments outside their immediate assessment area, provided they benefits a broader statewide or regional area that includes their assessment area. For wholesale or limited purpose banks, as long as an institution has adequately severed the needs of its assessment area, qualified investments, community development service, and community development lending outside the institution's assessment area will receive full consideration.

Sec. 141. Payment of Interest Act.

This section would largely repeal the Truth in Savings Act, retaining only those provisions of the Act that require banks to pay interest on the full investable balance at the disclosed rate. Although we agree that the Act warrants review, we do not support its repeal. We note that the costs of compliance have, to a significant degree, already been expended. We are concerned about repealing the Act's protections against fraudulent and misleading statements, and against advertising minimum balance accounts as free. We also see value in promoting clear and accurate disclosure of account terms, annual percentage yield and applicable fees and penalties.

A better approach may be to identify and improve the aspects of the Truth in Savings Act that cause problems, rather than repealing it. For example, institutions without automated systems to calculate interests rates do have difficulty complying with the Act, and appropriate exemptions could address these concerns. Any revisions to the Act should retain the regulator's authority to act against misleading statements.

Sec. 201. Streamlining of prior approval requirement for certain acquisitions.

Current law requires all bank holding companies submit an application to, and obtain the approval of, the Federal Reserve before acquiring a bank.

This section would replace the application requirement with a 15-day notice requirement for certain bank holding companies. To be eligible to use this notice process a bank holding company must: (1) be well-capitalized; (2) be well-managed; (3) have a lead insured depository institution that is well-capitalized, have well capitalized insured depository institution subsidiaries that control at least 80 percent of the total risk-weighed assets of all the company's insured depository institution subsidiaries and have no undercapitalized insured depository institution subsidiaries; (4) have bank subsidiaries that all have at least a "satisfactory" CRA rating (except for institutions acquired within the previous 12 months); and (5) be limited in size. In addition, the acquisition must not be prohibited by interstate requirements and it must have no adverse affect on competition.

We support streamlining the acquisition process for bank holding companies. However, we strongly oppose section 201 as drafted because it insulates transactions from effective CRA review. Moreover, the exception for recently acquired banks with an acceptable CRA rating requirement creates a large loophole to reconcile.

To reconcile the CRA-related concerns with the shared objective of streamlining the applications process, we propose publishing a notice of such applications (*e.g.*, in a newspaper of general circulation). Consumer groups must be given sufficient time after publication to comment on the application (no less than 30 days). If a substantial CRA protest arises, the notice application process should be transformed into a full application process, but only with regard to the CRA issue. The regulators should be directed to define what constitutes a substantial CRA protest. If no such protest arises, the application would be deemed approved if all other relevant conditions of this section are satisfied. The section should clarify the rights of an institution that believes it has satisfied the requirements for the notice process, but the Federal Reserve does not agree.

Section 201 also has implications for the Justice Department's review of bank acquisitions. As drafted, the 15-day notice procedures in section 201 would be available if the proposed transaction satisfied guidelines, worked out between the Federal Reserve and the Department of Justice, under which it could be concluded that no significantly adverse effect on competition would be presented. Under present law, the Department has 30 days after a transaction is approved in which to decide whether to file an antitrust action against it. We suggest that section 201 be amended to require that the Attorney General be given simultaneous notice of a proposed acquisition, and to provide further that the 30-day waiting period is waived unless during the 15-day notice period, the Department notifies the Federal Reserve that it believes the effect of the transaction may be substantially to lessen competition.

Sec. 202. Elimination of certain filing and approval requirements for certain insured depository institutions.

This section would exclude mergers between subsidiary banks of the same bank holding company from the filing and approval requirements of the Bank Merger Act, if certain conditions are met, including a 10-day prior notice to the appropriate Federal banking agency. The Bank Holding Company Act would continue to apply to the mergers.

We support streamlining the approval process for these mergers. However, we believe that, consistent with the current operation of the Bank Holding Company Act, retaining the Bank Merger Act approval, which is done by the resulting appropriate federal regulator, rather than the Bank Holding Company Act approval, is appropriate. We further recognize that merging subsidiaries of the same holding company presents no competitive issues. We therefore recommend Congress eliminate the portions of the Bank Merger Act relating to competitive analysis of these mergers.

Sec. 203. Elimination of redundant approval requirement for Oakar transactions.

Certain transactions involving both a BIF-insured institution and a SAIF-insured institution are excluded from the moratorium on conversions, provided the transaction is approved under both the "Oakar Amendment," and the Bank Merger Act and certain conditions are met. This section would streamline the approval process.

We oppose the provision as drafted. Although we support eliminating unnecessary applications, we believe that, as drafted, this amendment creates ambiguity regarding the conditions imposed on these transactions, including the application of the Bank Merger Act, the prohibition against transferring deposits from SAIF to BIF insurance, and the ability of the regulator to consider what they deem appropriate. Consequently, this amendment should be recast in the affirmative to reaffirm the need to file a Bank Merger Act application and to maintain the condition that an Oakar transaction shall not be construed as authorizing transactions that result in a transfer of any deposit from one insurance fund to the other.

Sec. 204. Elimination of unnecessary branch application.

Bank branching applications would be eliminated for those institutions that are: (1) well-capitalized; (2) rated CAMEL 1 or 2; (3) have at least a "satisfactory" CRA rating; and (4) seek to operate in an area that satisfies all applicable geographic limitations.

We support streamlining the branch application process. However, we strongly oppose this provision as drafted because it also insulates the transactions from effective CRA review. We also note that with the advent of interstate branching, such applications may become very important. Therefore, the CRA procedures discussed under section 201 should apply equally in these cases

Sec. 205. Elimination of duplicative requirements imposed upon bank holding companies under the Home Owners' Loan Act.

A banking organization that owns both a bank and a savings association is both a bank holding company and a savings and loan holding company, and is regulated by both the Federal Reserve and the Office of Thrift Supervision (OTS). This provision would eliminate OTS regulation of the holding company in such instances.

We do not object to the proposal, but we want to ensure that the OTS retains its authority to address holding company matters unique to savings associations. We therefore believe the OTS and the Federal Reserve should be directed to work out necessary procedures for addressing these matters. For example, the Federal Reserve should be directed to cooperate with the OTS on enforcement matters, the OTS should be allowed access to inspection reports, and the OTS should have the authority to comment on applications for the acquisition of a new thrift. Examinations are already coordinated, so the OTS has that authority.

Sec. 206. Elimination of per branch capital requirement for national banks and State member banks.

Under this section, national and state member banks would no longer be required to maintain capital for their branches as if each branch was a separately chartered bank under this section.

We support this section. Recent laws requiring banks to maintain consolidated capital render this unnecessary and ensure that the bank as a whole has adequate capital for safety and soundness purposes.

Sec. 207. Elimination of branch application requirements for automatic teller machines.

We also support section 207's elimination of branch application requirements for ATMs. ATMs differ qualitatively from brick and mortar buildings in the availability of services. The applications process should recognize this.

Sec. 208. Elimination of requirement for approval of investments in bank premises for well capitalized and well managed banks.

Current law requires national and state member banks to obtain regulatory approval to invest in bank premises in an amount exceeding the bank's capital stock. This provision eliminates the prior approval requirement for well-capitalized institutions with a CAMEL 1 or 2 rating, provided the investment does not exceed 150 percent of the bank's capital stock.

We support this provision. Benefits should accrue to well-capitalized institutions as an incentive to maintain or attain that status. Moreover, this change raises no safety and soundness concerns because such investments are included in the call report and considered in examinations.

Sec. 209. Elimination of approval requirement for divestitures.

Current law requires a bank holding company to obtain the Federal Reserve's agreement that a subsidiary's sale truly changes the ownership of the subsidiary when an affiliate financed the sale or an officer or director interlock remains after the sale.

We support eliminating this approval requirement, given the ability of the Federal Reserve to prevent sham divestiture transactions under other authority.

Sec. 210. Elimination of unnecessary filing for officer and director appointments.

Current law requires depository institution holding companies to file with their regulators a notice at least 30 days prior to hiring new directors or senior executive officers: (1) if the institution has been chartered or has undergone a change in control within the past two years; or (2) if the institution does not comply with the applicable minimum capital requirements. In these instances, the new hires would have to undergo background checks.

Section 210 would eliminate the notice and background check requirements in the former case, but retain it in the latter case, provided the regulator affirmatively determines that notice is appropriate.

Institution managers are very important for newly chartered or undercapitalized institutions or those that have recently undergone a change in control. Notice of management changes should continue to be provided to the regulators. However, we would support granting the regulators the authority to waive the background check requirements in appropriate situations, such as when the individual is known to the regulator because of a prior position.

Sec. 211. Amendments to the Depository Institutions Management Interlocks Act.

Currently, banks or bank holding companies with more than $1 billion in assets may not have a management interlock or interlocking boards anywhere in the country with another bank or bank holding company with assets greater than $500 million. This provision would raise these thresholds to $2.5 billion and $1.5 billion, respectively. The provision would also grant regulators the authority to increase these amounts annually to reflect inflation or market changes. Finally, grandfathered interlocks would be permitted to serve indefinitely, and the exemptive authority of the regulators would be restored to its pre-1994 level.

We support these amendments as a proper balancing of the need to prevent an undue concentration of economic power among large institutions while permitting smaller institutions to draw on the limited pool of qualified managers and directors.

Sec. 212. Elimination or recordkeeping and reporting requirements for officers.

Section 212 amends several insider lender provisions. We have concerns about portions of the section.

First, this section would exempt company-wide benefits plans from the insider lending restrictions. We share the goal, but believe the section should identify the specific benefits to be provided to senior management. The statute should clarify that in order to be widely available, the benefits cannot be structured to benefit only senior management. The section also permits the Federal Reserve to exclude executive officers, directors, and principal shareholders of a bank holding company or nonbank affiliates from the prohibition on preferential terms being provided to senior executive officers. We do not support those exclusions.

Second, this section directs the Federal Reserve to prescribe the insider lending reports banks must complete and provides that an auditor has met its responsibility if the bank has completed the required reports. We do not support this change. Section 301 of the bill would eliminate the auditor's attestation requirement, which has been the focus of many of the complaints regarding auditors. Repeal of this section would eliminate the requirement for any auditor reports.

Third, this section would eliminate reports by banks of loans made to officers of unaffiliated banks exceeding the amount the officer could borrow at the employing bank and reports of new insider loans made in the previous quarter as a supplement to the call report. We oppose eliminating the former reporting requirement, because examiners need to review such loans because they could indicate a conflict of interest and should be monitored. We do not object to eliminating the call report supplement, although such data must still be maintained to ensure compliance with the restrictions on aggregate insider lending.

Fourth, this section repeals the regulators' authority to require reporting and public disclosure of insider lending. We oppose this provision because only the

Federal Reserve would retain similar authority under other provisions of law. We believe that all of the regulators should have this authority, rather than only one of them.

Finally, this section would eliminate reports to the board of directors regarding correspondent bank loans to executive officers and shareholders who control more than 10 percent of the bank's voting securities. We oppose eliminating information that is useful to both boards of directors and bank examiners.

Sec. 213. Abolition of Appraisal Subcommittee; transfer of functions.

A 1989 statute established a subcommittee within the Federal Financial Institutions Examination Council (FFIEC) to monitor states in establishing procedures for licensing and regulating real estate appraisers. This section would abolish the subcommittee. The FFIEC would continue to oversee the states and report to Congress.

We do not object to this provision. The states are in compliance with the Title XI requirements. There are, however, issues that continue to require mediating presence to ensure consistency (*e.g.*, ensuring consistency in state temporary practice policies). Consequently, the transfer back to the FFIEC of the subcommittee's authority, and the extent of such authority, should be clearly stated. Furthermore, the need for the continuation of such FFIEC oversight should be reviewed in three years in light of the progress of the states at that time.

Sec. 214. Branch closures.

The provision would eliminate the requirement that institutions provide notice to their customers when branches close as a result of (1) mergers, (2) relocations, or (3) emergency or assisted acquisitions. Also excluded from the notice requirement would be the closing of ATMs. The regulators would be granted the authority to issue additional exemptions. We support this provision, but would amend it to require regulations to define "local market area" by regulation to amend the exemption would apply only when service is not affected.

Sec. 215. Foreign banks.

Section 215 would substantially amend the Foreign Bank Supervision Enhancement Act of 1991 (FBSEA), enacted following the Banca Nazionale di Lavoro and BCCI scandals that highlighted certain inadequacies in the domestic and international supervision of foreign banks. FBSEA strengthened the Federal Reserve role in terminating, examining, and approving the establishment of U.S. branches and agencies of foreign banks.

Section 215 would eliminate the Federal Reserve's ability to "order" the termination of a state licensed foreign bank or branch, provided in FBSEA, and would allow the Federal Reserve only to "recommend" termination to the appropriate state bank supervisor. Thus, there would be no federal bank regulator able to terminate a state licensed office in a timely manner consistent with the public interest. The OCC fulfills this role for federal branches and agencies of foreign banks.

Section 215 would require the Federal Reserve to rely "to the maximum extent practicable" on the examination reports of the OCC or the appropriate state bank supervisor and would require the Federal Reserve to assure its exam schedules are comparable to those normally applicable to domestic banks. The Federal Reserve would continue to be able to conduct examinations of foreign bank branches, agencies, and affiliates in the U.S. where appropriate. The provision on examinations also permits the Federal Reserve to collect fees for examining foreign banks to the extent it collects similar fees from domestic banks. We support the present moratorium on the Federal Reserve's authority to impose fees for examining the branches and agencies and other offices of foreign banks, as provided in the Riegle-Neal Interstate Banking and Branching Efficiency Act, and therefore oppose the Section 215 provision on the collection of fees by the Federal Reserve.

Section 215 would impose a statutory 60-day deadline for the Federal Reserve to review and deny or approve a foreign bank application to establish a branch or agency. It also would restrict the Federal Reserve to evaluating foreign bank applications solely on the basis of whether "approval of any application would place at risk the safe and sound operation of the United States banking system." This would eliminate the current mandatory prudential requirement that all new branches and agencies of foreign banks be subject to comprehensive consolidated supervision by home country supervisors and would eliminate other reasonable statutory factors to be considered in evaluating foreign bank applications.

We oppose the provisions of Section 215 dealing with termination of foreign bank branches and agencies in the U.S. We support the two provisions dealing with eliminating duplicate examinations. In addition, we would support the effort to streamline review of foreign bank applications, with substantial modifications, to ensure a set of reasonable criteria for the review and approval of all foreign bank applications by a federal regulator and the imposition of practicable deadlines that take into account the unique problems regulators face in collecting and evaluating crucial information from foreign bank and government sources.

To assure a reasonable set of standards for review of all foreign bank applications, we propose to permit federal bank regulators to exempt certain banks from the current statutory requirement that they be subject to comprehensive consolidated supervision (CCS). The mandatory CCS standard for all foreign bank applicants has been a major source of delay in approving foreign bank applications. It imposes a standard that is more stringent than current minimum international standards agreed to by the Basle Committee on Banking Supervision and the practice in a number of countries that, nonetheless, may have well supervised and well run banks. The CCS standard as implemented does not permit the federal bank regulator to take into account an individual foreign bank's current record of sound and prudent operation, even if the bank already has U.S. operations.

Such exemptions would be conditioned upon the foreign bank's ability to demonstrate that it is not subject to a U.S. regulatory enforcement action, will make adequate financial resources available to support the proposed office, and is subject to substantial consolidated supervision and continues to make progress toward full CCS. We support retention of other statutory factors that may be considered in reviewing applications, such as financial resources and managerial competence, compliance with U.S. law, the consent of the home country to establishment of the U.S. office, and the provision of adequate assurances that the foreign bank will provide information on the worldwide activities of the bank as necessary to ensure compliance with federal law.

To encourage prompt review and action on all relevant foreign bank applications, we propose that following receipt of an application already approved by the OCC or an appropriate state bank supervisor, the Federal Reserve be subject to a statutory 60-day deadline for review and denial or approval of the application. The 60-day deadline would be subject to a 60-day extension upon Federal Reserve notice and explanation. To address the duplicate federal review process for relevant federal offices, we propose that the Federal Reserve "recommend" to the OCC the approval or denial of a foreign bank application to establish a federal branch or agency.

Sec. 221. Small bank exam cycle.

Current law requires annual examinations for banks with $250 million or more in assets and permits examinations every 18 months for CAMEL 1 banks with less than $250 million in assets and for CAMEL 2 banks with less than $100 million in assets. The regulators may increase the CAMEL 2 threshold to $175 million after September 1996.

This section would permit examinations every 24, rather than 18, months for CAMEL 1 institutions that are well-capitalized and have less than $250 million in assets and for CAMEL 2 institutions that are well capitalized and have less than $175 million in assets. It would also permit the regulators to raise the CAMEL 2 asset threshold to $250 million after September 1996.

We do not object to raising the asset thresholds because it allows the regulators to focus more closely on those larger institutions that require greater scrutiny without jeopardizing safety and soundness.

We oppose strongly extending the examination cycle to 24 months. The lesson of recent years is that the condition of a bank can deteriorate rapidly.

The FDIC Improvement Act of 1991 (FDICIA) adopted an entirely new approach to capital regulation, and a mandate for prompt corrective action, that was intended to guard against such consequences. Adopting this section contravenes the objections of Congress under FDICIA.

Sec. 222. Reimbursement for corporate records.

The Right to Financial Privacy Act requires the government to reimburse a financial institution for assembling and providing financial records relating to individuals. This section would extend the reimbursement authority to cover corporate customers.

We oppose this provision. It could cost the federal government at least $30 million a year, according to a Department of Justice report, and thus raises pay-go problems. In addition, this provision would establish an undesirable precedent of expanded government reimbursements to the private sector for supplying non-protected records to law enforcement, which could ultimately lead to greatly increased costs for the government. The Administration recognizes that government records requests can sometimes be burdensome; we do not make such requests lightly. The agencies that make the bulk of the requests for the kinds of records addressed by the section have procedures in place to ensure that records requests are necessary and are as limited in scope as possible.

Sec. 223. Required regulatory review of regulations.

The regulators and the Federal Financial Institutions Examination Council would be required under this section to review their regulations at least once every 10 years to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions. We support this provision.

Sec. 231. Prohibition on additional reporting under Community Reinvestment Act of 1977.

The CRA would be amended to limit the regulators' authority to issue additional recordkeeping requirements, unless they eliminate regulatory burden. This provision also prohibits the collection of loan data and does not allow any federal financial supervisory agency to make such information public.

We strongly oppose amending CRA for the reasons discussed under section 131.

Sec. 232. Exemption from community support requirements of the Federal Home Loan Bank Act for institutions meeting certain criteria.

Under current law, financial institutions that are members of the Federal Home Loan Bank System (FHLBank System) must meet community support requirements to ensure access to long-term advances. In some cases, these requirements overlap with those of the CRA.

The bill would exempt from these community support requirements institutions that have either been chartered for less than two years and have not received a rating from their primary regulator or that have a CRA rating of "satisfactory" or better. If a member does not qualify for the exemption, member's first time homebuyers record will be considered.

We oppose piecemeal amendments to the FHLBank System. We are preparing comprehensive legislation to reform the System and view such discrete and piecemeal amendments as counterproductive. The issues presented by this section will be addressed on comprehensive reform package.

Sec. 233. Recording requirements.

Current law requires financial institutions issuing a bank check, cashier's check, traveler's check, or money order to an individual in an amount of $3,000 or more for coin or currency to: (1) verify that the individual has a transaction account with the institution and record the method of verification; or (2) obtain identification from the individual and verify and record that information according to Treasury regulations. This section would eliminate the requirements that financial institutions (1) record the method of verifying that a purchaser has an account with the institution, and (2) obtain, verify, and record such information in accordance with Treasury regulations from a purchaser without an account with the institution.

We oppose this section because as drafted. The section eliminates the authority of banks to issue monetary instruments in amounts of $3,000 or more to non-account holders and non-banks to sell such instruments in excess of $3,000 to anyone. If such income-producing opportunities are to be retained, for enforcement purposes, the requirement for contemporaneous recordkeeping must be maintained. Because Treasury has withdrawn its controversial "$3,000 log" regulations, the maintenance of the barebones records now required by Treasury regulation should not be troublesome.

Sec. 234. Identification of nonbank financial institutions customers.

This section would repeal the requirement mandating that the Treasury issue regulations directing financial institutions to identify their nonbank financial institutions customers.

We support the repeal, provided that the Treasury retains the discretionary authority to register money transmitters under section 408 of the Riegle Community Development and Regulatory Improvement Act of 1994, and the authority to require the identification of foreign non-bank financial institutions customers.

Sec. 235. Repeal of commercial loan reporting requirements.

We strongly oppose the repeal of the current requirement that depository institutions report information on their lending to small business and small farms, contained in section 235. Such information is both useful and not otherwise available.

For example, the Justice Department uses the data for antitrust purposes when evaluating bank mergers and examining small business customers and the commercial loan middle market. This commercial loan data is the only practically available source of information on small business lending for many banks. As the banking industry consolidates and moves into interstate branching, this data will become even more valuable to the Justice Department.

The Small Business Administration also uses the data for ranking all 10,000 commercial banks with respect to their lending to small businesses. Both banks and small business have found this information useful. Small businesses can use the information in determining which banks to approach for loans. Banks can use the information for marketing.

Sec. 236. Increase in Home Mortgage Disclosure Act; disclosure exemption.

The Home Mortgage Disclosure Act (HMDA) requires financial institutions with $10 million or more in assets to compile and report data related to home mortgage loans.

Under this section: (1) the $10 million threshold would be increased to $50 million; (2) the Federal Reserve would receive the authority to exempt larger institutions from HMDA if the cost of complying outweighs the usefulness of the data; and (3) depository institutions will be in compliance with the public availability requirement if the information is kept at the home office and if the branch office provides notice that the information is available upon written request.

The effect of section 234 would be to reduce by one-third the number of companies covered by HMDA. Given the importance of HMDA data in determining compliance with CRA and its importance in fighting discrimination generally, we strongly oppose reducing the number of reporting institutions under HMDA. These reports also serve to alert an institution of possible discriminatory practices in their operations. While we recognize that this data must be handled carefully and used properly, its value should not be questioned. This Administration consistently favors disclosure over prescribed results. The HMDA approach bear this out.

Sec. 237. Elimination of stock loan reporting requirement.

This provision would eliminate the requirement the financial institutions and their affiliates report extensions of credit by the financial institutions and their affiliates that are in aggregate, secured directly or indirectly, by 25 percent or more of any class of shares of the same insured depository institution.

We support this provision. The change in control rules would apply if the institution had to take control of ownership collateral.

Sec. 241. National bank directors.

Under current rules, the directors of a national bank must be United States citizens, and a majority of them must live in the bank's state or within 100 miles of an office of the bank.

This section would grant the OCC the authority to waive the citizenship requirement for a minority of the directors and to waive the residency requirement altogether. We support this proposal.

Sec. 242. Paperwork reduction review.

The bill directs the regulators to review within six months regulations requiring depository institutions and credit unions to establish internal written policies and to eliminate any unnecessary requirements.

We oppose this provision as unnecessary. Section 223 already calls for a full review of regulations at least every 10 years, which would include these policies. Also, section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 directed the regulators to conduct a two-year regulatory review, which includes these policies. Moreover, the President's regulatory review directive includes these policies. Thus, the section is redundant with on-going efforts and could slow down rather than increase the pace of regulatory reform. Thus, the section is redundant with on-going efforts, and could slow down, rather than increase, the pace of regulatory reform. Finally, a six-month timeframe is too short for any such review.

Sec. 243. State bank representation on the Board of Directors of the FDIC.

This provision would add a sixth voting member to the FDIC's board of directors who must be a state bank supervisor or commissioner and would require that the Chair and Vice-Chair if the FDIC Board be appointed from among the four independent members of the board.

We oppose this section as unnecessary and inappropriate. In addition, it may be unconsitutional. In addition, it may be unconstitutional. It is unnecessary because the President already has the authority to appoint individuals who can represent state banks. It is inappropriate because it assumes FDIC board members represent the interests of the banking industry and its various segments, rather than the integrity of the deposit insurance funds. The United States stands behind the deposit insurance funds, which requires the FDIC, as a federal regulator of state banks, to represent that federal interest. Furthermore, this provision raises serious conflict of interest concerns because the FDIC is the federal regulator for state-chartered institutions. Finally, there is no evidence that state banks are disadvantaged by not having a state bank supervisor on the FDIC board.

Most importantly, section 243 impermissibly infringes upon the President's constitutional authority. By narrowly limiting the pool of candidates from which the President would be permitted to appoint the additional board member to those currently serving as a state bank commissioner. It is long-established that, in vesting the President with the power to appoint all principal federal officers, the Constitution requires that the President be afforded a sufficiently broad scope within which to exercise his judgment.

Moreover, because the section provides that the state bank commissioner must be removed automatically upon ceasing to hold the position of state bank commissioner, this provision effectively gives whatever state official that has the authority to remove the state bank commissioner from that post the practical authority to remove a federal officer. This, too, raises serious constitutional questions.

Finally, the bill would forbid the President from making successive appointments of state bank commissioners from the same state. Establishing qualifications for an office necessarily restrains the President's constitutional appointment power. Whatever authority Congress may have to enact reasonable and relevant qualifications as a prerequisite for appointment to a permit Congress, we do not believe that it extends so far as to permit Congress to adopt geographic requirements.

Sec. 301. Audit costs.

This section would amend the independent auditor requirements in several ways. First, it would eliminate the requirement that an independent auditor determine an institution's compliance with laws and regulations designated by the FDIC. We support this because this responsibility overlaps with that of the examiners. It is also impossible for an auditor to attest to an institution's compliance with all safety and soundness laws.

Second, this section would change the requirement that an institution's audit committee consist entirely of outside directors to requiring that a majority of its members be outside directors. We oppose weakening the current requirement as a general matter. The importance of an effective independent audit function cannot, in our judgment, be overstated. Experience shows that all-independent committees better protect the safety and soundness of institutions. Legislation that would weaken the effectiveness of this important safeguard would be seriously misguided, we would support, however, granting regulators discretionary authority to allow a minority of the members of the audit committee to be insiders where an institution has experienced hardship in getting a full complement of outsiders to serve.

Sec. 302. Incentives for self-testing.

Section 302 provides that reports or results of self-testing may not be used in enforcement actions. In addition, the Equal Credit Opportunity Act (ECOA) would be amended to provide that the existence of a self-test does not limit that ability of an agency to refer matters for enforcement to the proper agencies. This section is designed to encourage creditors to self-test for compliance with the ECOA and the Fair Housing Act.

We support the goals of section 302 but believe it is far too broad and would have the effect of protecting discriminating institutions which have no intention of correcting problems discovered during a self-test. We want institutions to be able to self-test and to then take corrective action without fearing an enforcement action. Current law has a chilling effect on this goal because it requires such tests to be referred for enforcement purpose in some cases, even if corrective action is being taken.

Although the provision attempts to remedy this problem, we believe its solution is far too broad and we cannot support it as drafted. For example, we believe that the term "self-test" should be defined. We do not want underlying data subject to the disclosure exemption because an institution looked at its files, called that a test, and claimed that the files were thereby privileged. To avoid this, self-tests could be defined as arranging for "testers" to pose as clients to ascertain how the lender's employees would treat clients. Also, such tests should be available if used as a defense, voluntary disclosure should be permitted, and any confidentiality should end upon an independent finding of a violation.

The Justice Department and HUD have been examining these issues closely. We recommend you solicit their views. We would all be happy to work with the Subcommittee on appropriate language to achieve the balance that encourages self-testing without unnecessarily hindering enforcement.

Sec. 303. Exemption for savings institutions serving military personnel.

This section would exempt from the restrictions imposed on savings associations that do not meet the qualified thrift lender (QTL) test those savings associations where at least 90 percent of their customer consists of active or former military personnel, or individuals related to military personnel.

We do not object to this provision.

Sec. 304. Qualified thrift investment amendments.

This section would permit a federal savings association to invest in credit card loans and education loans without imposing a limit as to a percentage of the associations assets. In addition, it would permit a federal savings association to have up to an additional 10 percent of its assets in small business loans. We support these provisions.

This section also provides that if a savings association qualifies as a domestic building and loan association, as defined in the Internal Revenue Code, the association will be a qualified thrift lender (QTL) under the Home Owners Loan Act. We support this provision, but only for thrifts not controlled by commercial firms. We oppose using this bill as a vehicle for impairing the separation between banking and commerce. Accordingly, we believe that such thrifts should continue to comply with the QTL test.

Permitting thrifts to satisfy either the QTL test or the tax test gives many thrifts additional flexibility. We do not support going beyond that to let consumer, credit card, educational, and other loans satisfy the QTL test without limit as if they were residential mortgages. Such proposals - when essentially account to letting thrifts become consumer banks -- begs the question of whether there is still any need for a separate thrift charter.

Sec. 305. Daylight overdrafts incurred by Federal home loan banks.

Generally, the Federal Reserve permits some level of overdrafts to its members without cost because members hold reserves with the Federal Reserve Banks that could ultimately cover such overdrafts. However, the Federal Home Loan Banks hold no such reserves. Section 305 would amend the Federal Reserve Act to provide that any Federal Reserve Board policy or regulation governing payment system risk or intra-day credit exempt the Federal Home Loan Banks or include net debit caps appropriate to the credit quality of each Federal Home Loan Bank and impose daylight overdraft fees calculated in the same manner as fees for other users.

We have not yet concluded our analysis of the issues presented by this section. However, we do not support piecemeal amendments to the Federal Home Loan Bank Act. In addition to the possible concerns of exposing the payment system to risk because of the lack of reserves, this provision raises the question of what is a proper function of the FHLBank System. Providing such overdraft protection permits the Banks to engage in other activities, such as correspondent banking.

While the provision of such services to small institutions that cannot otherwise obtain them may after careful analysis prove to be an appropriate function for the System, in granting such access we must ensure such access is not used by the

FHLBanks to generally expand their purpose beyond that of providing liquidity or as a means to substitute their credit for the poorer credit of their members.

We understand these problems. However, we do not support any amendments to the Federal Home Loan Bank Act. The Administration has been preparing a comprehensive legislative reform package. Discrete, individual amendments will not best serve needed reform of the FHLBank System.

Sec. 306. Application for membership in the Federal home loan bank system.

This section would amend section 4 of the Federal Home Loan Bank Act that provides for an institution to become a member of only, and secure advances only from, the Federal Home Loan Bank for the district in which the institution's principal place of business is located. If "demanded by convenience" and approved by the FHFB, an eligible institution may become a member of the adjoining district.

Section 306 would provide an application process for an institution to become a member and set criteria for a Federal Home Loan Bank to approve applications. A Federal Home Loan Bank would be required to approve an application in their district if the institution meet all the eligible requirements for membership. Membership in an adjacent district would be permitted if the FHFB determines it is necessary for the convenience of the member institution.

We have serious policy concerns about making membership automatic upon satisfying fixed criteria if it will undermine the ten-year lock-out provision in current law. Certain institutions which have left that FHLBank System are prohibited from rejoining for a ten-year period. This provision should not weaken the lock-out because it provides incentives for stability of the System. In any case, we do not support any amendments to the Federal Home Loan Bank Act for the reasons discussed under section 305. The Administration is drafting a comprehensive legislative reform package where this issue can be addressed.

Sec. 307. Authority for Federal home loan banks to select external auditors.

Section 307 provides that: (1) the FHLBanks shall contract annually with a single auditor for their annual audits; and (2) the Finance Board shall not participate in any FHLBank audit, or in the audit contracting process, except to establish requirements for the audit contracts and accounting standards to be used in connection with the audits.

With regard to audits, it is necessary to retain the provision requiring all the FHLBanks to use a single audit provider. Producing the combined System financial statements requires a consistent application of accounting principles and uniformity in disclosures. In areas where GAAP is subject to interpretation, different auditors could have different interpretations making a combined statement problematic. The Finance Board currently requires (and the FHLBanks have concurred) that the FHLBanks use a single auditor for individual FHLBank and System financial statements.

We also understand that there is some concern about permitting the Finance Board to set accounting standards. We agree that GAAP should be followed to the extent possible. However, some GAAP provisions are open to interpretation, and the Finance Board needs the authority to ensure consistent interpretation to make combined financial statements meaningful.

Although we understand these concerns, we do not support any piecemeal amendments to the Federal Home Loan Bank Act for the reasons discussed under section 305. Our comprehensive reform package will address this issue.

Sec. 308. Limited purpose bank growth cap relief.

Nonbank banks are prohibited by a 1987 statute from growing at an annual rate in excess of seven percent. This growth cap on limited purpose banks would be removed by this section.

Most companies that control FDIC-insured banks must comply with the Bank Holding Company Act, which generally does not permit them to affiliate with commercial firms. Nonbank banks, although FDIC-insured, escaped the Act's limits through a loophole that Congress closed in 1987 under the Competitive Equality Banking Act (CEBA). CEBA prohibited the creation of new nonbank banks and, among other things, limited their asset growth to seven percent annually.

In opting for grandfathering rather than strict conformity with the Act, Congress "placed considerable weight on the fact that . . . nonbank banks . . . are generally quite small." It sought to prevent what the legislative history described as "the abuse of grandfathered privileges that would occur if grandfathered companies changed the character of the institutions involved through aggressive asset growth." The asset growth restriction was designed to "help prevent existing nonbank banks from changing their basic character . . . ; from drastically eroding the separating of banking and commerce; and from increasing the potential for unfair competition . . . and other adverse effects." It also sought to "give the owners of nonbank banks an incentive to support, rather than obstruct, additional legislation."

Allowing unlimited asset growth by nonbank banks would disrupt the balance struck in CEBA. It would erode the bank Holding Company Act's separation of banking and commerce, allow nonbank banks to significantly increase their share of total bank assets, and increase the competitive advantages nonbank banks and their parent companies have over other FDIC-insured banks and regulated bank holding companies.

And this fundamental change in CEBA would occur through an isolated, amendment -- rather than, as CEBA contemplated, through comprehensive legislation, allowing "all banks or bank holding companies to compete on a more equal basis" with companies controlling nonbank banks.

This change would, moreover, provide a windfall to a limited group of companies that already have special privileges -- the two dozen firms with grandfather rights under CEBA.

We oppose this amendment. The issue of nonbank banks should be considered in the context of broader financial modernization legislation.

Sec. 311. Due process protections.

The this section requires a court to apply the Federal Rules of Civil Procedure Rule 65 standard of "irreparable and immediate harm" to requests by the FDIC when acting as receiver/conservator or by other conservators appointed by the OCC or OTS for the attachment of assets and for other injunctive relief. Additionally, the provision permits a banking agency in a permanent or temporary cease-and-desist proceeding to issue an order prohibiting a person from withdrawing, transferring, removing, dissipating, or disposing of any funds, assets or other property where injury, loss or damage to such property is irreparable and immediate. The Rule 65 standard of "irreparable and immediate harm" must also be applied to prejudgment attachment orders in termination of insurance proceedings or in any administrative or other civil action for money damages, restitution, or civil money penalties brought by a federal banking agency.

We oppose this provision as likely to hamper important enforcement actions, especially when one considers that certain courts have held the loss of money does not constitute irreparable harm. The authority is used infrequently, but is necessary in those limited cases to prevent the dissipation of assets. Moreover, as drafted, the "immediate and irreparable harm" standard would apply to final cease-and-desist orders, which does not make sense, because those orders are only issued after an impartial hearing by an administrative law judge.

Sec. 321. Liability for unauthorized use of credit cards.

The Truth in Lending Act limits to $50 a consumer's liability for unauthorized use of a credit card. This section would require cardholders whose statements show unauthorized uses to notify the issuer within 60 days of receiving the statement, in the absence of such extenuating circumstances as extended travel or hospitalization. Cardholders failing to notify the issuer could be liable for more than $50. The Electronic Fund Transfer Act already contains a similar notification requirement.

We believe it is reasonable to expect cardholders to examine their statements within 60 days, in the absence of extenuating circumstances. We accordingly support the thrust of this section, and encourage Congress to require issuers to clearly and conspicuously call cardholders' attention to this new requirement.

Sec. 322. Unauthorized electronic fund transfers.

The Electronic Fund Transfer Act limits to $50 a consumer's liability for unauthorized transfers. The provision would increase the maximum liability to $500 if the cardholder has "substantially contributed" to the transfer.

We support the objective of this section. We are concerned, however, about the breadth of the term "substantially contributed," and believe additional legislative and regulatory clarification would be in order. This section could, for example, require the Federal Reserve to prescribe regulations specifying what actions meet the "substantially contributed" standard (*e.g.*, writing one's personal identification number on the envelope in which one keeps an ATM card).

APPENDIX B:
THE ADMINISTRATION'S ACHIEVEMENTS IN REDUCING THE COSTS AND IMPROVING THE QUALITY OF REGULATION

The Administration has taken substantial steps to reduce regulatory costs and improve the quality of regulation. These actions may be grouped under the following headings: (1) the Credit Availability Program; (2) Bank Secrecy Act compliance; (3) reviewing, rethinking, and revising banking regulations; (4) refocused supervision; and (5) reduced administrative costs of supervision resulting from greater interagency cooperation.

A. Credit Availability Program

In March 1993, soon after taking office, the President took steps to address the need to create a better climate for bank lending. The Program addressed (1) real estate lending and appraisals; (2) appeals of examination decisions and complaint handling; and (3) examination processes and procedures.

The concern about appraisals was that in some cases costly formal appraisals may render otherwise sound loans uneconomical. Three significant changes resulted. First, the agencies increased from $100,000 to $250,000 the threshold level at or below which certified or licensed appraisals would not be required for a real estate-related transaction. They identified additional circumstances, particularly for small business lending, in which appraisals are not required. Finally, they permitted renewals and refinancings without an appraisal if there had been no deterioration in market conditions.

The agencies also revamped their appeals processes to ensure bankers had a fair and prompt review of examination disagreements. The OCC and OTS have each created an Office of the Ombudsman, which manages the appeals process. The OCC has also revamped its procedures for handling the nearly 15,000 general complaints it receives annually. For example, it has established a toll-free number and improved its complaint tracking system.

Third, the regulators have begun to coordinate many of their interactions with the industry. For example, they have determined that examinations will be conducted by the primary federal regulator. Moreover, the OCC and FDIC share examination schedules to better coordinate the supervision of holding companies with both national and state-chartered banks, and coordinate enforcement actions.

B. Streamlining Compliance with the Bank Secrecy Act

A key to our "partnership program" for improving the BSA process is Treasury's Bank Secrecy Advisory Group, composed of 30 representatives of financial institutions and federal and state regulatory and enforcement officials. Working with the Advisory Group, Treasury has eliminated the requirement that institutions record and retain for five years special records of all cash purchases of travelers checks, bank checks, and cashier's checks over $3,000 in cash. Proposed regulations that would have required mandatory electronic filing of currency transaction reports, and would have established a mandatory system to "aggregate" cash transactions, were withdrawn.

Treasury also streamlined the currency transaction report (CTR), a form long criticized as too cumbersome by bankers, by 30 percent. The new form should be introduced in October. Treasury finalized long-pending rules relating to casinos and to wire transfers in a way that responded to industry calls for burden reduction, and it plans such further actions as reducing the number of CTRs filed by banks by at least 30 percent (which amounts to three million forms per year). According to the American Bankers Association (ABA), the last reform could save banks more than $40 million. Overall, the ABA has applauded the Administration's reform efforts on the BSA; "The banking industry is very pleased at the direction of the Treasury's Bank Secrecy Act efforts. We appreciate the good faith efforts of this Administration to see to it that banks report and retain only information that helps curtail money laundering." (October 14, 1994 ABA Press Release)

C. A-to-Z Review of Regulations

The President has directed each agency to undertake a line-by-line review of their regulations with the goal of eliminating redundant unnecessary requirements, streamlining procedures, and rewriting the rules to be more easily understood.

The OCC has been conducting this type of review for nearly two years. To date, all of their regulations have been reviewed, three major parts have become or will soon become final, and 11 parts have been published for comment. The OTS is doing a similar review.

There are concrete examples of the burden-reducing benefits resulting from this intense review. The OCC and OTS reduced, by six times, the number of lending limit calculations institutions must perform, requiring quarterly, rather than daily, analyses. The OCC has also reduced some of its fees and its national bank assessment rate, which covers the costs of examination and supervision. For example, the fee for establishing a shared ATM will be reduced from $1,500 to zero, corporate application fees have been reduced by 50 percent, and the national bank assessment rate has been reduced by six percent. In addition, to these concrete examples, the OCC and the OTS are putting their rules in clearer language, and making the rules more user friendly, which should reduce the time and costs associated with interpreting and complying with rules.

D. REFOCUSED SUPERVISION

Our nation's thousands of depository institutions vary greatly in size, complexity, and financial strength. Yet regulations often ignore these differences by treating all institutions alike and relying on generally-applicable procedures. This provides institutions with little regulatory incentive to reduce risk or increase their capacity to manage risk. It also creates needless regulatory burden and costs when rules are inappropriate, irrelevant, or even counterproductive as applied in certain instances.

The OCC and OTS have been diligently working to make appropriate differentiations in their regulations. For example, both bureaus have streamlined the examinations process for smaller, well-capitalized, well-managed institutions. Materials requested for noncomplex small national bank examinations have been reduced by nearly 600 percent, from some 200 items (or more at the examiner's discretion) to 35 standardized items. Moreover, the streamlined nature of such examinations is evidenced from the OCC small bank examination handbook, which has been reduced from 1,216 pages to just over 30 pages. In addition, small, well-capitalized, well-managed savings associations need no longer automatically obtain a costly annual independent audit.

The difficulty of supervising a diverse banking industry has also led regulators to focus on eliminating and streamlining procedures. The Administration has worked to refocus supervision on results instead, and to thereby provide institutions with the incentive to perform well, rather than simply to avoid criticism or follow needless procedures. In this vein, the OCC's new examination guidelines emphasize operational results, such as default rates, rather than operational procedures, such as loan underwriting. Moreover, all of the banking agencies worked on the recently released final rules on the Community Reinvestment Act, which emphasizes results over process.

E. Reducing Administrative Overhead Costs

The Administration's efforts to reduce the expense of regulation have focused on both direct and indirect costs. By controlling a regulator's overhead costs, the cost of regulation declines when those savings are passed through in the form of reduced assessments: the OCC and OTS have done just that.

One of the primary means of reducing overhead has been an increase in jointly issued or coordinated regulations, such as the appraisal regulations and the real estate lending guidelines.

Another way in which overhead costs are being reduced has been through coordinated examinations. The banking agencies, the Securities and Exchange Commission (SEC), and the National Association of Securities Dealers (NASD) have agreed that the banking agencies and NASD will coordinate the examination of bank brokerage units. The OCC and SEC plan joint examinations of bank and bank-advised mutual funds. Finally, the regulators will use securities industry qualification tests for bank-employed brokers. Not only has this coordination indirectly reduced the cost of regulation, but it has also directly reduced the burden of multiple examinations.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
Text as prepared for delivery
May 2, 1995

REMARKS TO THE TREASURY BORROWING ADVISORY COMMITTEE OF THE PUBLIC SECURITIES ASSOCIATION BY ASSISTANT SECRETARY OF THE TREASURY ALICIA H. MUNNELL

I am delighted to have the opportunity to meet with you again this morning. Three months ago, the question was whether the economy could move to a sustainable long-run growth path without disrupting the expansion. Since the economy is operating more or less at capacity, maintaining last year's pace of activity simply was not possible without igniting inflationary pressures. On the other hand, engineering a soft landing is a tricky business. There is always the danger that an economic slowdown can cumulate and turn into a recession. They have done so in the past.

Beginning late last year, we started to see a string of softer statistics which continued into this year.

- Retail sales slowed abruptly in February signalling a pause in consumer spending.
- Housing sales and starts fell rather sharply in response to last year's interest rate increases.
- Auto and light truck sales eased down in January and February from their expansion high in December of last year.
- There were signs in the monthly numbers -- now confirmed -- of increased inventory accumulation, some of it possibly involuntary.

To be candid, for a while the list of negative statistics was a little longer than I thought necessary. So the nice performance of the economy in March was welcome news. We have seen some good numbers mixed in with the signs of deceleration. Retail sales bounced back in March. Housing is soft but may respond to lower interest rates. Orders for durable equipment have been strong throughout. With the exception of auto sales, there seems to be a firmer tone to some of our numbers.

(More)

RR-262

This better balance was evident in the first quarter's real GDP estimate last Friday. Real growth at a 2.8 percent annual rate was broadly in line with expectations and fully consistent with a continued recovery. Friday's report suggests that it will indeed be possible to achieve a smooth transition from last year's 4 percent real growth to something closer to 2-1/2 percent this year.

Some might be a little concerned about the composition of first-quarter growth. Real final sales (GDP less inventory investment) fell sharply from a 5.7 percent annual rate of increase in the fourth quarter to 1.8 percent in the first. An increased rate of inventory accumulation--equivalent to 1 percentage point at an annual rate--boosted growth in the first quarter, but may imply the need for some downward production adjustments in the period ahead.

Interestingly, this pattern is not unlike what we saw last year. The burst of spending in the fourth quarter of 1993 -- when real final sales increased at a 6.4 percent annual rate -- was even stronger than that experienced at the end of last year. This was followed by two successive quarters in 1994 during which real final sales averaged less than 2 percent annual rate and growth was sustained by an inventory buildup. By the middle of last year, gloomy forecasts were a dime a dozen. Yet, the economy grew strongly in the second half of the year, absorbing the seeming excess of inventories without difficulty.

Of course, things are a little different this year than last. The Fed has made several moves to tighten and the full effects of this tightening may not yet have been fully felt. On the other hand, lower long-term rates have led to a slight decline in mortgage rates and this may offset some of that impact. Similarly, my best guess is that the inventory situation may prove this year, as it did last, to be a subsidiary theme rather than a dominating consideration.

More fundamentally, this economy is robust. It is powered by the twin engines of job creation and investment and these engines provide the greatest reason for optimism.

One engine is powering a jobs machine that has created 6.3 million jobs since January, 1993. Even in the first quarter, payroll employment rose by more than 700,000 -- nearly 240,000 per month. Since Federal government employment is declining, almost all the jobs (93 percent) are in the private sector, with state and local governments accounting for the remainder of job growth. Of course, the soft landing now apparently in process will eventually necessitate some moderation in the rate of employment gains.

But even at that more moderate pace, we should continue to enjoy a reinforcing sequence of more jobs, more income, more purchasing power, and more consumer spending. This spending in turn will lead to more jobs in the future. Consumers cut back in the first quarter after a burst of spending late last year, but consumer confidence is high and the outlook is bright, so long as the job machine keeps running smoothly.

The other engine is powering an investment machine. This machine has raised producers durable equipment in real terms to a postwar record as a share of national output. This level of investment has generated its own reinforcing sequence of increased capacity, enhanced productivity, and slow growth in costs per unit of output. Investment in structures has also begun to pick up recently and the investment engine seems to be hitting on all cylinders.

Good inflation performance is another major reason for optimism. The fixed-weighted GDP price index is still staying close to a 3 percent annual rate of increase-- edging up only to a 3.1 percent annual rate in the first quarter. A very subdued pace of growth in employment costs is an underlying factor. Frankly, this has come as something of a surprise with the economy entering its fifth year of expansion and the unemployment rate less than 6 percent for seven straight months. Many economists would have predicted much more inflationary pressure than has, in fact, emerged.

The employment cost index rose by 2.9 percent in nominal terms over the past 12 months-- the smallest increase in the history of the series dating back to the early 1980's. This record small increase in compensation costs results from:

-- relatively stable growth in nominal wages and salaries near 3 percent for almost 3 years, and
-- benefit costs that have slowed dramatically from growth of roughly 7 percent annually from 1988 through 1990 to less than 3 percent over the latest 12 months.

In short, the economic outlook is very favorable. Inflation remains in a stable range. The economy has made a necessary downshift toward cruising speed with the job and investment engines running smoothly. While the full transition to steady growth has not yet been made, the progress during the first quarter was very encouraging.

-30-

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

ADV 3:15 P.M. EDT
Text as prepared for delivery
May 2, 1995

REMARKS OF TREASURY SECRETARY ROBERT E. RUBIN SOCIETY OF AMERICAN BUSINESS EDITORS AND WRITERS.

Before I get started, I thought it would be useful for context to focus for just one moment on the current state of our economy, which is healthier in terms of the current conditions that at any time that I can remember: steady growth, low inflation, the lowest unemployment rate in decades, falling deficits and a falling deficit-to-GDP ratio, outdated programs being terminated and a process that will lead to having the federal civilian workforce at the lowest level since JFK was president.

Many measures have been taken aimed at preparing our economy for the future. Having said that, there is much more to be done, both domestically and internationally, and my opinion of the critical need for that preparation was reinforced in the past three weeks by meetings I have held with finance ministers of the world's major economies -- developed and developing countries.

I started those three weeks with a meeting in Bali with the 17 other APEC Finance Ministers, including Japan's and China's; then visited India, after which I stopped briefly in Egypt and Ireland; and then I finally returned to Washington to chair the G-7 Finance Ministers and to attend the IMF and World Bank Interim Committee meetings.

After that intense immersion in the global economy, two closely related ideas remain absolutely clear to me. First, we must frame all of our economic decisions with the understanding that the global economy is changing with great rapidity. Those changes, such as the rise of once impoverished nations into vigorous economic competitors and huge potential markets, the speed and overpowering size of the global capital market flows, and the interconnectedness of all our economies, all deeply affect -- as problems and opportunities -- the ability of our country to achieve rising living standards for all Americans.

RR-263

(MORE)

And second, as a result, we must vigorously pursue a forward looking domestic and international economic strategy that positions the country effectively for the new global economy, if we are to be economically successful in the years and decades ahead.

It is these two ideas that drove the President's economic strategy from the beginning of this Administration. Speaking for myself, I developed a similar view from my immersion in the trading and investment banking businesses as they truly globalized beginning in the early 1980s. It was an eye-opening experience that cast light on the competitive effects in the global economy of our deteriorating public school system, our ever increasing inner city problems, and our massive fiscal and current account deficits, and so on.

As an aside, even after being immersed in the global economy for roughly 15 years, some examples of the enormity of the changes that I heard in the past three weeks were striking.

In India, I heard about a major American financial services firm that is working on having much of its back office processing done in India -- which has computer software capability second only to the United States -- using the new methodologies of communication to the tie together the front office and back office as effectively as once occurred through locating both in the same building.

And a senior government official of one large non-Latin American country of vital interest to the United States told me of how -- during the Mexican currency crisis in December -- capital flows to his country dried up temporarily, until our intended intervention gave the markets some breathing time to adjust and sort matters out.

The global economy is real, and the American economy, though the largest member, is inextricably an integral part of the global economy and will be highly sensitive to events and circumstances elsewhere.

For the President, his economic vision has been clear from the very beginning: a broad based strategy to create and now sustain recovery, to position the economy for the long term, and to increase the incomes of working Americans. Every budget the President has submitted, and every economic measure he has advanced, has been directed toward these purposes.

When the President took office, the immediate objective was to start, and then sustain economic recovery, The critical initial step was our powerful multi-year deficit reduction program enacted in 1993. There is no question in my mind that that program was the principal factor in bringing interest rates down in 1993, and those lower rates drove the recovery. Though rates have now come back up -- a rise that reflects growth -- long term rates are still lower with 3% growth and 5.5% unemployment than they were at the end of the prior Administration with 1-1/2% growth and 7% unemployment.

The key is that real and significant deficit reduction has largely taken the deficit premium out of long term rates, an artificial impediment to growth, so that the real rates can rise and fall with growth -- which is how the system should work -- and thus provide the private sector with the interest rate framework it needs for long-term growth.

To focus further in on the fiscal deficit, when we got here, the federal deficit was 4.9% of GDP. This fiscal year we project the percentage will be down to 2.7%. And the budget the President has submitted would bring the deficit-to-GDP ratio down to 2.1% by the year 2000 and to 1.6% by 2005. We haven't seen numbers like that in over two decades.

Moreover, among all the G-7 countries, counting deficits at all levels, state, local, federal, we are tied with Japan at 2% for having the lowest deficit to GDP ratio.

One more word about deficits: Although the federal budget is in deficit, with the deficit reduction accomplished in the past two years and carried forward in the President's 1996 budget submission, the money we raise is more than sufficient to pay for the cost of operating the Government.

This year government spending excluding interest payments is projected at $1.3 trillion, but revenues are forecast at $1.35 billion -- a surplus of $50 billion. That surplus, plus our entire deficit are going to pay the interest on the national debt, the vast majority of which was incurred in the 1980s and early 90s. I believe -- and believed then -- that the fiscal policy of that period was one of the great policy failures of American economic history, and we are now paying the price.

We must continue working toward a balanced budget, but with practical and sensible weighing of the trade-offs of the economic effects of specific cuts, as in education, for example, versus the economic effects of the related deficit reduction, and not simply arbitrary dates and arbitrary cuts. The President's budget carries forward fiscal discipline by adding $81 billion of additional deficit reduction to the more than $500 billion in deficit reduction put n place in 1993. And, as he has so often said, the next major step must be getting federal health care costs under control, because that is the major driver in the deficit, but within the context of thoughtful health care reforms to avoid cost shifting and other distortions.

At the same time, while we continue down a thoughtful path of fiscal discipline, we must have a vigorous and sufficient program of investment in the areas essential to future productivity and competitiveness, especially in education, training and the problems of the inner cities.

When you look at the amazing economic story of Asia -- the many countries at our APEC conference that twenty years ago were impoverished and today are growing rapidly and have vastly increased living standards -- education is a key common denominator. These countries, including the highly education oriented nations of China and India, will be our competition in the decades ahead, and we must be sure that our work force is prepared and ready.

And that's why budgeting cannot be arbitrary, but must be a thoughtful process of weighing tradeoffs.

For example, you can look at a great many programs -- Head Start, Job Corps, the Women, Infants and Children program, Goals 2000, School to Work, the President's proposal skills initiative and proposed education tax deductions -- as social programs. Or, you can view them as I do, and more importantly, the way the President does, from a very pragmatic, hard headed business point of view, as crucial long term investment in the better educated and more productive work force that is absolutely critical to future economic growth and to establishing an economy which works for all working Americans.

I want to focus for just a moment on this issue of the incomes of working Americans. This isn't some catchy political phrase but rather is a serious national problem. In the 1950s, 60s and through the mid-70s, all quintiles grew at roughly the same rates; since then, the upper 40 percent have prospered, and the bottom 60 percent have had falling real incomes. That is a terrible threat to our social fabric, undermines support for forward looking economic policies like free trade and flexible labor markets, and is at odds with the traditional American view that the economy should work for everyone who works.

The tax provisions of the budget we submitted are aimed at promoting economic growth and reversing the income trend I mentioned. They include a credit for families with young children, so those families have more money to invest in their children; a deduction for education costs, so Americans will be more willing to invest in themselves; and changes in the Individual Retirement Account law that will encourage savings. As an aside, I don't have time to focus on savings today, but what is striking and troubling is how low our private savings rate is compared to virtually every other functioning economy in the world, developed or developing.

More generally, as to tax cuts, we made our judgments based on four criteria that can be applied to any tax cut proposal: how substantial is the economic effect, both absolutely and relative to the economic benefits of the program spending foregone to pay for the tax cut; how does it affect tax fairness; and is it fully paid for with no budget gimmicks?

Now, lets turn briefly to the international side of economic strategy:

Before my trip to the APEC meeting I was thinking that 20 years ago, or even 10 years ago, the capitals where a Treasury Secretary needed to pay close attention because of the potential to affect our economy, could just about be listed on one hand -- London, Paris, Bonn, Tokyo. Today, that list is almost indefinite: New Delhi, Beijing, Moscow, Jakarta, Johannesburg, Hong Kong, Singapore, Buenos Aires, Mexico City, and so on. This is why I went to Asia, India, Egypt and Ireland, and that's why I'll be in Moscow and Kiev next week with the President.

To the extent that Russia and the Ukraine transform their economies to successful market-based systems, we have new avenues for trade in goods and services, as well as enhanced national security, and if we invest in assisting that transformation, it is money well spent.

What is true in the former Soviet Union is equally true around the world. Our national economic interest requires that we engage with the global economy to expand market opening around the world, to promote growth and economic reform in developing countries, and to provide leadership when problems like Mexico's occur and threaten systemic effects and our national interests.

There are those who would turn our backs on the global economy and on global engagement, but that neo-economic isolationism is directly contrary to our national economic interest.

Developing countries, to expand on that point, buy 40% of our exports. Our contributions to the World Bank and other multi-lateral development banks are an excellent investment in promoting the growth and reform that will increase our export opportunities. This money is highly leveraged, and the returns -- when viewed as a long term investment -- are significant.

In all my meetings with finance ministers, it was clear that in today's world only the United States can provide the necessary leadership when trouble develops in the global economy. But, it is also clear that the response must be multilateral, as when the IMF contributed so heavily to dealing with Mexico. And that is why we are focusing on providing the international financial institutions with a mission and capabilities as modern as the global financial market and the global economy. Towards that end, we are providing energy and leadership with regard to the Halifax G-7 leaders meeting, which itself will be one step in an on-going process.

Before I take your questions I have two things I want to say in closing.

I believe as you write about business and economic issues, though obviously the specifics of the matter at hand will dominate, you can provide another and deeper dimension by relating back to this context; how does each matter at hand relate to preparing the American economy for success in the rapidly changing global economy. That is the standard to which we should be held, and to which others should be held -- does what we propose prepare the American economy for success?

I believe this administration has a program to make this nation more productive and more competitive, and to bring the benefits of global engagement to the American worker. It is a program that takes the long view, that is fully paid for, and which has, as I mentioned at the outset, already paid enormous dividends in terms of restoring our economic health.

And second, whether we like it or not, the United States is no longer a largely autonomous economic giant, but is now, though still the largest economy in the world, an integral part of the global economy. The opportunities in this global economy are enormous, but there are also problems. Our future prosperity depends on fully engaging within the global economy, leading where that is needed, and on preparing ourselves domestically to be productive and competitive.

Thank you.

-30-

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE UPON DELIVERY
Expected at 10:30 a.m. EDT
May 4, 1995

STATEMENT OF TREASURY SECRETARY ROBERT E. RUBIN
BEFORE THE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FOREIGN OPERATIONS
EXPORT FINANCING AND RELATED PROGRAMS
U.S. SENATE

Mr. Chairman. Members of the Committee. I am pleased to present the Administration's FY 1996 appropriations request for the multilateral development banks. Our request of $2.3 billion includes $1.9 billion in regularly scheduled payments and just over $400 million for the payment of arrears.

In addition, there is $25 million for the enhanced structural adjustment facility of the International Monetary Fund; $56 million for the North American Development Bank; and $42 million for debt restructuring and buy-backs. Details of these programs are set out in a separate table at the end of my written statement.

Almost 60 percent of our request for the development banks is for the U.S. contribution to IDA 10, an agreement negotiated under President Bush in 1992. In fact, 88 percent of this year's request is to fulfill pledges made under the Reagan and Bush Administrations. Our administration is fully committed to meeting all of those obligations. (Chart 1)

Meeting those obligations is important. U.S. participation in the development banks serves U.S. political and security interests. It helps to increase U.S. exports and creates U.S. jobs. This request is not about charity or foreign aid.

We live in an increasingly interconnected world of more than 5.5 billion people. Because of the development banks, a great many of these people are increasing their incomes and becoming better customers for the goods and services we produce.

RR-264

Let me begin by emphasizing the stake that our country has in the multilateral development banks. These institutions are at the heart of the international economic system. The United States took the lead in creating that system just after the end of World War II. The banks have always had broad bipartisan support and have served our national interests well for more than 50 years.

This year proposals have been made to greatly reduce or even eliminate U.S. participation in the development banks. Some people say we should not proceed with negotiations for the next replenishment of IDA, the International Development Association. Those proposals are directly contrary to our national self-interest. It would be a grave mistake to turn our backs on the banks or walk away from our international obligations.

Cost-Effective Internationalism

This request is not a request for straight-line funding on a business as usual basis. We understand there is a new budgetary environment; that calls are being made for cuts in many other programs. We also know that the request for the development banks is cost-effective, that it responds to the need for substantial savings in budget authority this year and in coming years.

Over the past two years Treasury negotiated a 50 percent reduction in the annual costs of U.S. contributions to the Inter-American Bank, and cut back on the annual costs of our contribution to the Asian Bank. We will continue these cost-cutting measures in future negotiations, including those for IDA 11.

Moreover, the money we contribute to the development banks is very highly leveraged. The banks are cost-effective internationalism. First, they are able to draw in contributions from other countries -- four dollars for each dollar we contribute -- mostly from Europe and Japan. Second, they raise nearly all their funds for regular lending -- non-concessional lending -- from private capital markets. That lowers the budgetary cost of our participation in the banks by substantial amounts every year. (Chart 2)

This ability to get results at a much lower cost is a unique advantage of our participation in the development banks. We are able to multiply scarce budgetary resources and remain engaged internationally -- pursuing our objectives and acting effectively in our own national interest.

Our Stake in the International Economic System

With the world's largest economy, the United States has an enormous stake in maintaining the stability of the international economic and financial system. Our own economic health and vitality, as well as our prospects for future growth, are intertwined with those of other nations. We need an international system that functions effectively and allows for continued growth of international trade and investment.

All of the multilateral development banks have a part in strengthening the international economic system. Their policy reform loans increase global growth by lowering trade and investment barriers in developing countries. Their economic advice and market-building loans help Eastern Europe and the Former Soviet Union to become full-fledged participants in international trade.

At the beginning of the year, strong backing from the IMF enabled the President to react swiftly and decisively in providing support to the Mexican peso. The World Bank has also been a key player in Mexico -- nearly $9 billion in active loans and an additional $4.5 billion in the pipeline.

The World Bank responded very quickly in providing advice to Mexico's banking supervisors. This is a good example of how these institutions help countries cope with problems that stretch their capabilities in this area.

I discussed the future role of the institutions with my G-7 counterparts in Washington last week, and the heads of state will be paying close attention to this issue at the Halifax summit. We are working to assure more effective coordination between the IMF and the development banks and equip them with the tools they need to respond to new problems.

Supporting Foreign Policy and National Security

Let me focus in a little more closely on how the MDBs promote our national interests. The MDBs are exceedingly valuable assets in the conduct of U.S. foreign and national security policy. Their ability to mobilize financial resources -- to react rapidly when there is need -- gives us greater scope than we would have on our own to take action in times of international crisis.

The banks also help us respond to natural disasters and other emergencies through relief efforts. IDA is providing support following earthquakes in India and Armenia and flooding in Pakistan. Rwanda, Burundi, and Haiti are receiving emergency assistance from IDA to reopen primary schools and fund emergency health care.

Through the multilateral development banks, we have promoted our interests in areas vital to our national security interests. For example, Russia is receiving substantial assistance in putting its economy on a market basis, and the banks are undertaking new projects in other countries in the region: privatizing state-owned corporations in Ukraine and lending money to small entrepreneurs in Georgia and Belarus.

At the end of 1994, the World Bank and the European Bank had lent more than $24 billion in Central and Eastern Europe and the former Soviet Union. Some $18 billion in additional projects are in the pipeline and should be committed over the next three years. (Chart 3)

The World Bank has taken the lead in providing financial support for the Middle East peace process. Last year it began an emergency assistance program for Gaza and the West Bank and is following up this year with a loan that focuses on health and education problems. Support is also going to Egypt and Jordan.

Economic Benefits to the U.S.

The MDBs provide substantial benefits to the U.S. economy. Caterpillar of Peoria, Illinois estimates that it gets $250 million each year from contracts funded through the MDBs. These contracts help the economy in Illinois and have a ripple effect elsewhere through sub-contractors and suppliers.

Other U.S. corporations also get major contracts from the MDBs. AT&T is providing telephone equipment in the Philippines. McDermott International of New Orleans is doing electric power work in China with turbines supplied by Westinghouse. Offshore Pipelines of Houston is active in India.

Small and medium-sized firms also benefit. Morrison Textile Machinery Corp. employs 135 people in Fort Lawn, S.C. It is providing equipment for industrial projects in India funded through the World Bank and IDA. M&W Pump Corp. employs 200 people in Deerfield Beach, Fla. It is providing fluid pumps and motors for development bank-funded projects in Latin America and Asia.

Engineering and consulting firms write feasibility studies, prepare final designs, and oversee implementation of projects. Their work often leads to large-scale contracts for U.S. firms downstream.

Developing countries are our most rapidly expanding export market, going from $91 billion in 1987 to $197 billion in 1993. That's 40 percent of our total exports. Those exports to developing countries sustain nearly four million jobs and benefit our whole economy. We know that a great deal of the credit for this increase must go to the multilateral development banks for their work in economic reform.

The most important commercial benefits we get from the MDBs come from the work they do in creating more open and market-oriented economies in developing countries. Nothing is more important than promoting the private sector in these economies. This is where 85 percent of the world's people live.

Most of the world's economic growth is taking place in developing countries. Asian economies will grow by 7 percent this year, and Latin American economies by 4-5 percent. A great deal of the impetus for greater growth in our own economy will come from developing countries.

The MDBs contribute to creating market-oriented economies by encouraging lowering tariffs, liberalizing investment regimes, reorganizing the financial sector, changing the tax system, providing incentives for investment, and creating a new legal and regulatory framework to spark private initiative.

The Importance of IDA

In particular, I would like to emphasize our economic interests in supporting IDA. IDA plays an extremely important role in promoting growth in the poorer countries, those with the least capacity to fund public and private investment, and IDA promotes the private sector. In the mid-1980s, it was given a new job: engineering economic reforms that emphasize market mechanisms and the private sector. IDA provides seed money for capitalism and free market reform, which does not come easily. It takes time and is a difficult and painful process. Developing countries have too little natural constituency for international capitalism and free markets. It must be built from the bottom up and against strong resistance from the status quo. IDA support is essential in getting poorer countries through that process.

This is a large part of what IDA does today. It helps remake developing countries in the image of the United States and the other industrialized democracies. One of it's biggest success stories is India, which also shows how these programs have benefitted the United States.

Under IDA lending, beginning in 1991, India cut its tariffs and liberalized investment rules. Since then, the U.S. has become India's largest foreign investor. Our exports jumped from $1.9 billion to $2.8 billion in one year and Secretary Brown recently announced new contracts for U.S firms of more than $7 billion.

We're also seeing change in the economies of sub-Saharan African countries, which are now experiencing higher rates of growth under IDA economic reform programs.
IDA has 20 graduates, including big emerging export markets for the United States like Korea, Indonesia, Thailand, and Turkey. In 1993, these 20 countries took $42 billion in U.S. exports and current IDA borrowers took an additional $20 billion.

IDA sets the stage for engagement by our bilateral export agencies like Eximbank, OPIC and TDA. What IDA and the other development banks do is an essential complement and support to our export agencies. All of the banks are used by U.S. firms to establish a toehold in new and emerging markets.

The development banks also promote the export of U.S. values: our commitment to democracy and political freedom, capitalism and free markets, privatization and economic reform, and a greater commitment to protection of the environment. All of the development banks are focussed on promoting good governance and public participation.

I want to add just a personal note here. I was in India two weeks ago and saw first-hand a watershed preservation project supported by the World Bank and IDA. I met people who were poor almost beyond description. But they told me their living standards are being increased because this project is allowing them to increase livestock production, and to capture and use sparse rainfall that used to run off and be wasted. Women told me how they are gaining more control over their lives and their families' futures because their circumstances are improving and they are having a say in how the project operates. Men told me how farming has become more productive. I saw soil that wasn't going to be washed away in the monsoons, and a rising water table in an area that's almost a desert. And it all came from simple low-cost soil conservation techniques the villagers were applying themselves.

Mr. Chairman -- development works. It improves lives in developing countries, and as those lives improve, it will have a direct impact on our economy, on the jobs and living standards of Americans. It is, simply put, money well spent.

Protecting the Environment

Let me turn now to a new binational financial institution that we are jointly establishing with Mexico -- the North American Development Bank or NADBANK. For decades, communities along both sides of the border with Mexico have been plagued by the problems of raw sewage dumped in boundary waters, unsafe drinking water, and inadequate municipal waste disposal.

These are international problems which have had a strong impact on U.S. citizens. As part of NAFTA, the United States and Mexico have agreed to address these problems through the creation of NADBANK and its sister institution, the Border Environment Cooperation Commission or BECC.

When NADBANK is fully capitalized, each dollar in U.S. contributions will result in at least $10 in new financing for border environmental infrastructure projects and community adjustment programs that will provide significant benefits to U.S. citizens and firms. NADBANK, which has its top management in place, will be ready in the coming months to look at projects along with the BECC. Its U.S. community adjustment window will soon be up and running too.

Along with our request for funds for the development banks, we are requesting $42 million to reduce debts owed to the U.S. Government. Joining other creditor countries in providing up to two-thirds debt reduction for the poorest countries, particularly in Sub-Saharan Africa, we are seeking to help those whose debt is worth very little but which continues to weigh heavily on them. Building on the Summit of the Americas, we are also proposing a buy-back and swap program for lower income countries in this hemisphere which will generate local resources for the environment and child development.

Another of our requests is for the Global Environment Facility or GEF, which is enlisting developing countries in the job of protecting the global environment. We cannot do this by ourselves. The GEF targets ozone depletion, pollution of international waterways and protection of biological diversity, and is low-cost insurance against the possibility of global warming.

Improving Performance/Reducing Arrears

We have also been working very successfully to make the MDBs more effective at what they do: improving project quality; adopting open information policies; making their operations more transparent; establishing independent inspection panels; improving their poverty programs; and strengthening their environmental performance. (Chart 4)

The development banks have greatly increased their lending for health, education and nutrition. Their work in the area of education for young women is particularly important. It results in smaller and healthier families and in higher family incomes. The World Bank has also become the largest lender for programs to combat AIDS. More than 17 million people have been infected with the HIV virus and the number is expected to reach 29 million by the year 2000.

On the administrative side, the banks are making their managers more accountable, cutting back on budgets and reducing travel costs. These actions have been taken as a result of U.S. initiatives. They demonstrate how responsive the banks have been to our interests and concerns.

And that is a critical point. We have enormous influence in the MDBs -- I can attest to that from my own experience working with the MDBs as Secretary of the Treasury -- and that enormous influence is critical in helping keep the MDBs working in the directions I've already described. But that influence is at risk, if do not meet our existing commitments and continue to contribute fairly to future replenishments.

Yet following FY 1995 rescissions, we are now around $900 million behind in meeting our commitments to the banks. We are the world's largest economy and the only nation that has such arrears. (Chart 5)

Mr. Chairman, I cannot emphasize too strongly how important these institutions are to our national interests. They are the most cost-effective way I know to assist economic growth and economic, political and social reform. At our urging, the institutions are changing their culture and adapting to evolving challenges. And with this request, we are following through on the international commitments made by prior administrations, obligations we are expected to keep, and it is in our interest to keep.

Thank you.

-30-

Table: The Elements of the Request

The Administration's request includes the following:

- $28.2 million for paid-in capital to the World Bank (IBRD). This will clear U.S. arrears to the 1988 general capital increase, which is currently supporting about $17 billion in annual lending to about 78 eligible countries.

- $1,386.2 million to the International Development Association (IDA). Of this, $1,250 million is for the third and final installment of the U.S. contribution to the tenth IDA replenishment. The remainder would clear $118.2 million in arrears.

- $67.6 million to the International Finance Corporation (IFC). This includes $47.5 million for the fifth and final installment to the IFC 1991 general capital increase, and $20 million for payments due in prior years. This will support IFC's projected $2.8 billion in loan and equity investments in private sector projects which could total investments of $18 billion. For every dollar the IFC invests for its own account, other lenders and investors invest about $5.4.

- $110 million to the Global Environment Facility (GEF): $100 million for the second installment of the U.S. contribution to the restructured facility to provide financing to developing countries for projects which will benefit the global environment, and $10 million for the shortfall in appropriations from the FY95 request.

- $26 million for the Inter-American Development Bank (IDB): $25.6 million for the second installment of the U.S. contribution to eighth replenishment of the IDB, and $0.3 million to clear arrears.

- $20.8 million for the Fund for Special Operations (FSO): $20.5 million for the second installment of the U.S. contribution to eighth replenishment, and $0.3 million to clear arrears.

- $100 million for the Multilateral Investment Fund (MIF) for the fourth scheduled installment of the U.S. contribution, which will assist Latin American and Caribbean countries in securing necessary investment reforms to stimulate both domestic and foreign investment in the region.

- $13.2 million for paid-in capital to the Asian Development Bank (ADB) for the first of six installments to the fourth general capital increase.

- $304.5 million to the Asian Development Fund (ADF): $170 million for the fourth and final installment to the fifth replenishment, and $134.5 million to clear arrears.

- $127 million to the African Development Fund (AFDF) for a seventh replenishment.

-- $81.9 million to the European Bank for Reconstruction and Development (EBRD) to clear arrears.

- $56.3 million to the North American Development Bank (NADBANK) for the second installment of the U.S. payment to the NADBANK's capitalization.

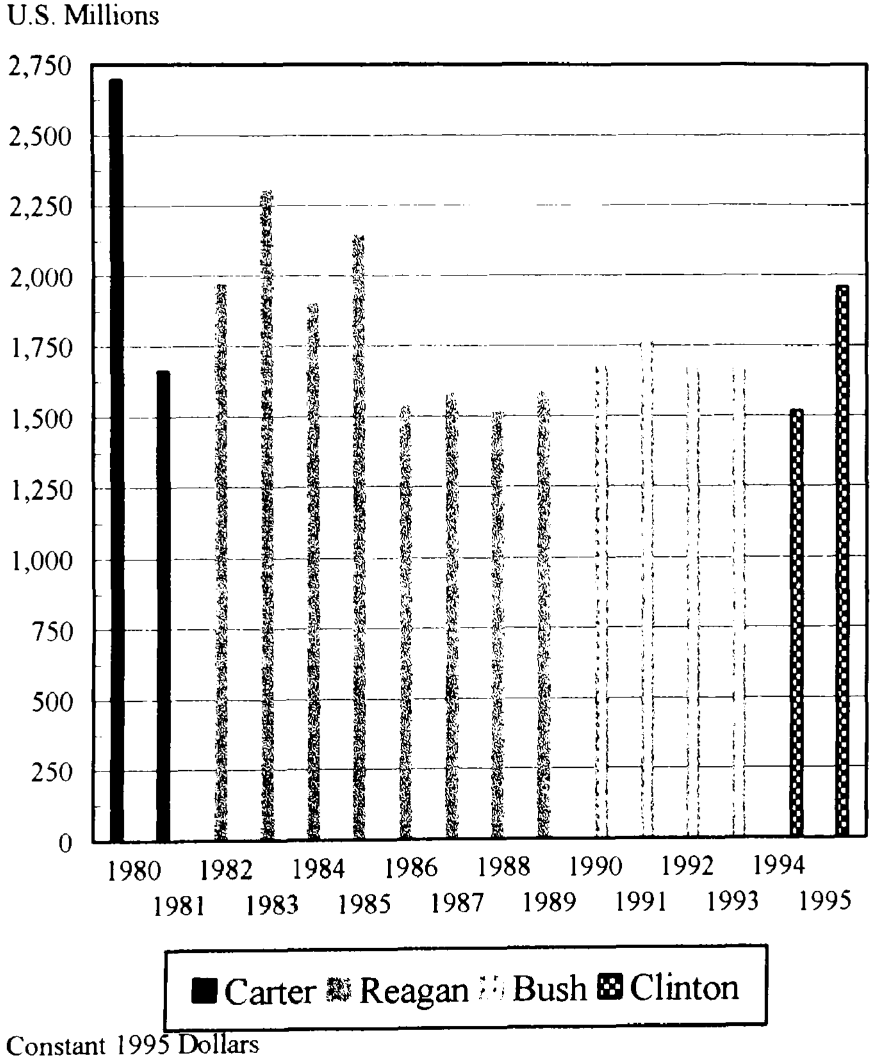
-- $27 million to continue a multilateral program for Debt Restructuring for the heavily indebted, poorest countries that have a sustained record of economic reform.

-- $15 million for a pilot buyback and swap program for environmental and child development programs in Latin America.

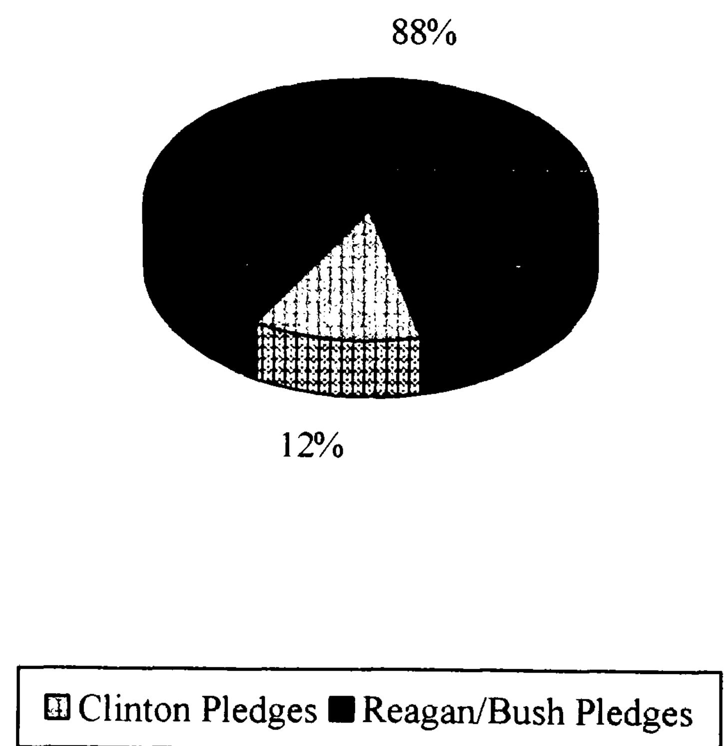
Chart 1

U.S. Support for the MDBs has been Bipartisan

Appropriations for the MDBs



The Bulk of the President's FY 96 Request
is to Fulfill Reagan & Bush Administration Pledges



Composition of FY 96 Request

Chart 3

The MDBs are Globally Active

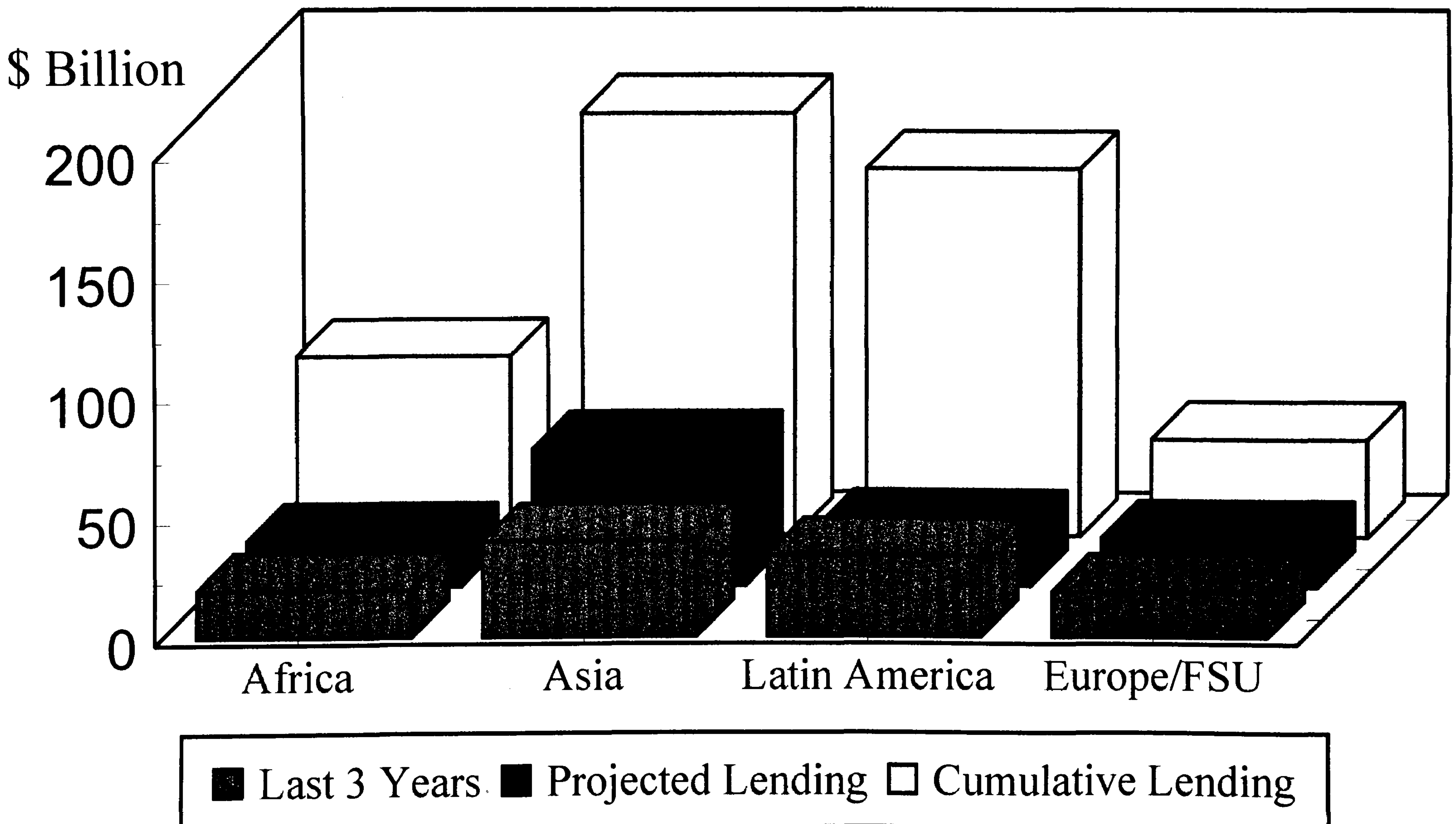


Chart 4

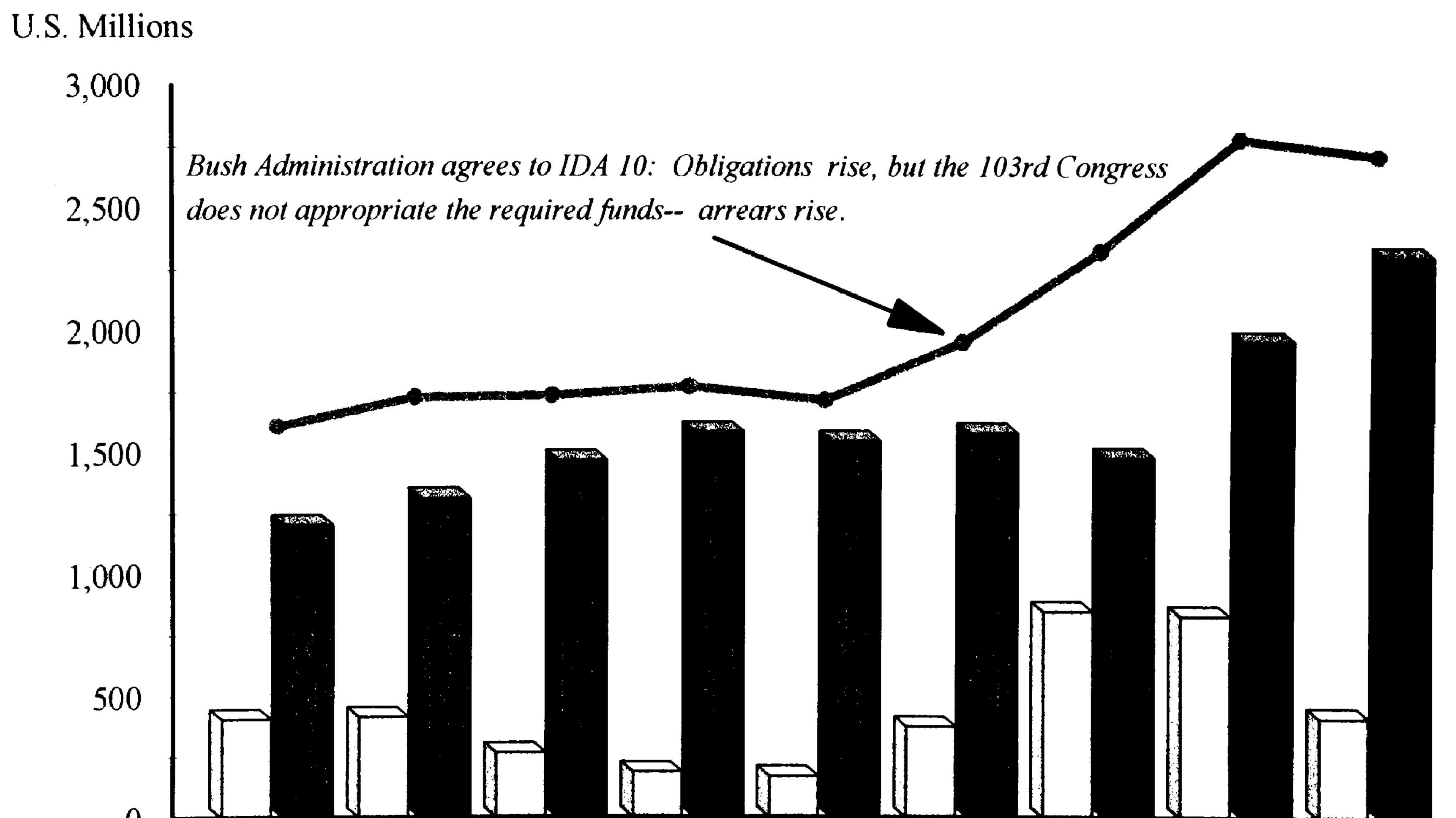
Recent Contributions have Generated Major Reforms

The Clinton Administration has:

- Cut administrative costs
- Strengthened role of private sector
- Increased access to information
- Enhanced protection of the environment
- Increased lending to health, education & nutrition

Chart 5

Arrears in the Multilateral Development Banks



	1988	1989	1990	1991	1992	1993	1994	1995	1996
Outstanding Arrears	405.0	414.7	268.3	187.5	168.6	373.7	846.9	825.2	409.6
Appropriations	1,205.6	1,314.6	1,469.2	1,586.3	1,548.9	1,583.4	1,479.9	1,959.1	2,303.9
Payments Due	1,610.6	1,729.3	1,737.5	1,773.8	1,717.5	1,957.1	2,326.8	2,784.3	2,713.5

GUARANTEE AGREEMENT

Dated as of February 21, 1995

among

The United States Department of the Treasury,

and

The Government of the United Mexican States

TABLE OF CONTENTS

AGREEMENT

This Agreement, dated as of February 21, 1995 (the "Guarantee Agreement"), is a commercial agreement among the UNITED STATES DEPARTMENT OF THE TREASURY (the "Treasury Department") and the GOVERNMENT OF THE UNITED MEXICAN STATES, acting through the Ministry of Finance and Public Credit ("Mexico")(together, the "Members").

WHEREAS, monetary and financial cooperation between the United States of America and Mexico is an important factor in carrying out the objectives of the International Monetary Fund, of which both countries are members, consistent with their obligations, as members, on orderly exchange arrangements and a stable system of exchange rates; and

WHEREAS, stabilization arrangements have been in effect between the two countries since 1941, and have proved beneficial to the financial relationship between the two countries; and

WHEREAS, the Members entered into the U.S.- Mexico Framework Agreement for Mexican Economic Stabilization on February 21, 1995, which provides for (i) Mexico to make and use medium-term purchases under the Medium-Term Exchange Stabilization Agreement, dated February 21, 1995 among the Treasury Department and Mexico, with the Federal Reserve Bank of New York ("FRBNY") acting as fiscal agent for the Treasury Department (the "Medium-Term Agreement") and (ii) Mexico to issue debt securities which will be guaranteed by the Treasury Department under this Guarantee Agreement, utilizing the United States Treasury Exchange Stabilization Fund; and

WHEREAS, the Members have entered into the North American Framework Agreement, dated April 26, 1994, among Mexico, the Banco de Mexico (the "Bank"), the Treasury Department, the FRBNY acting at the direction of the Federal Open Market Committee, and the Bank of Canada, as amended from time to time, (the "NAFA"), the Exchange Stabilization Agreement, dated April 26, 1994, as amended, and the Temporary Exchange Stabilization Agreement, dated January 4, 1995, as amended, to provide short-term swap facilities; and

WHEREAS, the Treasury Department and Mexico have entered into the Medium-Term Agreement; and

WHEREAS, the Treasury Department, the FRBNY, Mexico, the Bank, acting on its own account and as fiscal agent of Mexico, Petróleos Mexicanos, P.M.I. Comercio Internacional S.A. de C.V.

and P.M.I. Trading Limited have entered into the Oil Proceeds Facility Agreement (the "Oil Agreement") dated as of February 21, 1995 providing for certain proceeds of Mexican oil sales to be available as an assured source of repayment for any amounts that the Treasury Department (i) may pay under the Securities Guarantees (as defined below) provided hereunder, (ii) has provided Mexico under the Medium-Term Agreement or the NAFA, and (iii) may claim against the Bank or Mexico as a result of the assignment to the Treasury Department of certain claims in respect of short-term swaps provided by the FRBNY, acting at the direction of the Federal Open Market Committee, against the Bank or Mexico.

NOW THEREFORE, in order to further such objectives and in consideration of the mutual covenants contained herein, it is agreed as follows:

ARTICLE I

DEFINITIONS

"Basic Fee" shall have the meaning set forth in Section 5.01 of this Guarantee Agreement.

"Business Day" shall mean a day on which the Treasury Department and the Federal Reserve Bank of New York are both open for business.

"Calculated Guarantee Amount" shall mean, as calculated by the Treasury Department at the time of the delivery of any Request for Issuance of Guarantees relating to a proposed issue of Debt Securities, the sum of (i) the present value, as of the proposed Settlement Date specified in such Request, of the portion of the principal and interest payments on the Debt Securities proposed to be issued that is to be guaranteed pursuant to a Securities Guarantee issued by the Treasury Department under this Guarantee Agreement and (ii) the present value, that was calculated as of the respective Settlement Date of each other issue of Debt Securities then outstanding, of the portion of the principal and interest payments on such outstanding Debt Securities that is covered by Securities Guarantees that have been issued by the Treasury Department under this Guarantee Agreement. The present values referred to in clauses (i) and (ii) above shall be determined by discounting each payment by the applicable United States Government Risk-Free Rate from the date on which such payment is due.

"Contract of Guarantee" shall mean the Mexican Securities Guarantee Standard Terms and Conditions and a legend endorsed on each Debt Security incorporating such Mexican Securities Guarantee Standard Terms and Conditions.

"Debt Securities" shall mean the debt securities denominated in United States dollars to be issued by, and subject to the full faith and credit of, Mexico to investors and guaranteed by the Treasury Department pursuant to this Guarantee Agreement.

"Defease" shall mean, with respect to the guaranteed portion of any Debt Securities, (i) the irrevocable deposit with the applicable Fiscal Agent, in trust, or (ii) the irrevocable deposit with the Treasury Department or the FRBNY, as fiscal agent for the United States, in trust, of Government Securities in an amount sufficient, together with the earnings thereon, or cash equal to the present value to pay the portion of the amounts due or to become due on such Debt Securities subject to a Securities Guarantee. Such present value is to be determined by the Treasury Department.

"ESF" shall mean the United States Treasury Exchange Stabilization Fund.

"1995 Framework Agreement" shall mean the U.S.- Mexico Framework Agreement for Mexican Economic Stabilization dated the date hereof, among the Treasury Department, Mexico and the Bank.

"Fiscal Agent" shall mean, with respect to any issue of Debt Securities, the fiscal agent under the Fiscal Agency Agreement with respect thereto.

"Fiscal Agency Agreement" shall mean, with respect to any issue of Debt Securities, the fiscal agency agreement among the United Mexican States, the Treasury Department and the FRBNY or another financial institution appointed as fiscal agent by Mexico with the consent of the Treasury Department.

"FRBNY" shall mean the Federal Reserve Bank of New York.

"Government Agency" shall mean any ministry, department, authority or statutory corporation of, or any corporation or other entity (including a trust) owned or controlled directly or indirectly by, Mexico or any of the foregoing (including, without limitation, the Bank).

"Government Securities" shall mean any security or other debt obligation which is issued by or guaranteed by the United States of America or any other agency or instrumentality of the United States of America, the obligations of which are backed by the full faith and credit of the United States of America.

"Medium-Term Agreement" shall have the meaning set forth in the Recitals hereof.

"Mexican Securities Guarantee Standard Terms and Conditions" shall mean the Mexican Securities Guarantee Standard Terms and Conditions to be promulgated by the Treasury Department.

"NAFA" shall have the meaning set forth in the Recitals hereof.

"Offering Document" shall mean any offering circular, prospectus or similar document used in connection with the offer or sale of any Debt Securities and any amendments or supplements thereto.

"Oil Agreement" shall mean the Oil Proceeds Facility Agreement, dated February 21, 1995, among the Treasury Department, the FRBNY, Mexico, the Bank, acting on its own account and as fiscal agent of Mexico, Petróleos Mexicanos, P.M.I. Comercio Internacional S.A. de C.V., P.M.I. Trading Limited.

"Outstanding Medium-Term Swap Amount" shall mean at any date the aggregate principal amount outstanding of United States Dollars sold to Mexico by the Treasury Department under the Medium-Term Agreement.

"Outstanding NAFA Swap Amount" shall mean at any date the aggregate principal amount of outstanding drawings made by Mexico or Banco de Mexico from the U.S. Monetary Authorities under the NAFA.

"Premium" shall have the meaning set forth in Section 5.02 of this Guarantee Agreement.

"Request for Issuance of Guarantees" shall mean a Certificate and Request for Issuance of Securities Guarantees signed by an authorized signatory and delivered in accordance with Sections 3.02B and 6.01B.

"Securities Agreements" shall mean, with respect to any issue of Debt Securities, collectively this Guarantee Agreement, the applicable Fiscal Agency Agreement and the applicable Underwriting Agreement (if any).

"Securities Guarantees" shall mean the guarantees of the Debt Securities issued by the Treasury Department pursuant to this Guarantee Agreement.

"Total Outstanding Amount" shall mean at any time the sum of the Outstanding NAFA Swap Amount, the Outstanding Medium-Term Amount and the Calculated Guarantee Amount.

"Underwriting Agreement" shall mean, with respect to any issue of Debt Securities, the agreement pursuant to which such Debt Securities are sold by Mexico to investors, or to underwriters, agents or dealers, as principal or agent, for their own account or for resale to investors, and, in the case of Debt Securities sold pursuant to an auction, tender offer or exchange offer, the agreement, if any, between Mexico and any agent of Mexico therefor.

"United States Government Risk-Free Rate" shall mean the interest rate for the appropriate maturity as reported in "Interest Rates for the Credit Reform Act" as determined by the Treasury Department.

"U.S. Monetary Authorities" shall have the meaning ascribed to such term in the NAFA.

ARTICLE II

COMMITMENT

Section 2.01. Guaranteed Debt Securities.

A. Subject to the terms and conditions set forth in the 1995 Framework Agreement, this Guarantee Agreement, and in any Contract of Guarantee, the Treasury Department, through the ESF, will guarantee the payment of all or part of the principal of, interest on, or principal of and interest on, Debt Securities; provided that the Calculated Guarantee Amount, when added to the Outstanding NAFA Swap Amount and the Outstanding Medium-Term Swap Amount, will not exceed twenty billion United States Dollars (U.S. $20,000,000,000).

B. The Treasury Department will issue the Securities Guarantees through the ESF.

C. The Debt Securities shall be issued by Mexico in such amounts, and at such times, as may be requested by Mexico and approved by the Treasury Department.

D. The terms and conditions of the Debt Securities and of the Securities Agreements shall be approved by the Treasury Department. Each Debt Security shall be issued in registered form and not in bearer form, and no Securities Guarantee may be issued in respect of payments of principal or interest due more than 10 years after the date of issuance of the Debt Securities. The Treasury Department may require that Debt Securities be subject to redemption.

ARTICLE III

COMMITMENT CONDITIONS

Section 3.01. Conditions Precedent to the Initial Issuance of Securities Guarantees. The Treasury Department shall be under no obligation to issue any Securities Guarantees hereunder (i) if the Treasury Department has made a determination pursuant to Article VI of the 1995 Framework Agreement, or (ii) until Mexico shall have obtained all authorizations and approvals required for it to issue Debt Securities, and (iii) until Mexico has satisfied the following additional conditions or the Treasury Department has waived such conditions in writing:

A. Mexico shall have delivered to the Treasury Department a legal opinion, substantially in the form to be agreed to by the Members hereto and to be set forth as an exhibit to this Guarantee Agreement, of the Fiscal Attorney of Mexico acting as counsel to the Ministry of Finance and Public Credit of Mexico; and

B. Mexico shall have delivered to the Treasury Department, a legal opinion, substantially in the form to be agreed to by the Members hereto and to be set forth as an exhibit to this Guarantee Agreement, of the New York counsel for Mexico;

Section 3.02. Conditions Precedent to the Issuance of Each Securities Guarantee. The Treasury Department shall be under no obligation to issue any Securities Guarantees under Section 2.01 of this Guarantee Agreement (i) if the Treasury Department has made a determination pursuant to Article VI of the 1995 Framework Agreement, or (ii) until Mexico complies with the condition set forth in paragraph 2 of Article V of the 1995 Framework Agreement, and (iii) until Mexico has satisfied the following additional conditions or the Treasury Department has waived such conditions in writing with respect to each issuance of a Securities Guarantee:

A. at the time of, and after giving effect to, the proposed issuance of such Securities Guarantee, the Total Outstanding Amount shall not exceed twenty billion United States Dollars (U.S. $20,000,000,000).

B. Mexico shall have delivered to the Treasury Department and the FRBNY an executed Request for Issuance of Guarantees with respect to such Securities Guarantee not less than 16 Business Days prior to the Settlement Date proposed in such Request, after having engaged in previous consultations with the Treasury Department, which Request for Issuance of Guarantees may be amended with the consent of the Treasury Department and shall have been accepted by the Treasury Department by affixing an authorized signature to such document;

C. Mexico shall have paid the Basic Fee applicable to such Securities Guarantee as provided in Article V of this Guarantee Agreement;

D. there shall have been consultation and agreement among the Treasury Department and Mexico, that the issuance of such Securities Guarantee is consistent with the terms and conditions of the 1995 Framework Agreement, including that the use of proceeds of the Debt Securities to which such Securities Guarantee will apply complies with such terms and conditions, and that adequate and assured sources of repayment exist for any amount of such Debt Securities to be guaranteed by the Treasury Department;

E. copies of each of the applicable Fiscal Agency Agreement and the applicable Underwriting Agreement (if any), which shall have been approved by the Treasury Department, shall have been duly executed and delivered to the Treasury Department and each such agreement shall be in full force and effect;

F. Mexico shall have delivered to the Treasury Department a legal opinion, substantially in the form to be agreed to by the Members hereto and to be set forth as an exhibit to this Guarantee Agreement, of the Fiscal Attorney of Mexico, acting as counsel to the Ministry of Finance and Public Credit of Mexico;

G. Mexico shall have delivered to the Treasury Department a legal opinion, substantially in the form to be agreed to by the Members hereto and to be set forth as an exhibit to this Guarantee Agreement, of New York counsel for Mexico;

H. Mexico shall have delivered to the Treasury Department a certificate signed by the Minister of Finance, or an authorized delegee in form and substance satisfactory to the Treasury Department, stating that (i) the representations and warranties made by Mexico in the Securities Agreements shall be true and correct on and as of the date of issuance of the applicable Debt Securities, (ii) Mexico shall have observed or performed all of the covenants, conditions, and agreements contained in this Guarantee Agreement, the Securities Agreements and the Oil Agreement to be observed or performed by it on or before the date of issuance of the applicable Debt Securities; and (iii) since the date of the Offering Document, no change in fact or circumstance has occurred that might have a material adverse effect on the ability of Mexico to perform its obligations under this Guarantee Agreement, the outstanding Debt Securities or those being issued, the Securities Agreements or the Oil Agreement;

I. Mexico shall have delivered to the Treasury Department all documents required by the terms of the Securities Agreements to satisfy any and all conditions precedent contained therein and such conditions shall have been satisfied or waived as provided therein; and

J. Mexico shall have delivered to the Treasury Department such other certificates, opinions, and assurances, in form and substance satisfactory to the Treasury Department, as the Treasury Department may reasonably request, including, without limitation, opinions of counsel concerning compliance as to form, if applicable, and the absence of material misstatement or omission from any Offering Document.

ARTICLE IV

COVENANTS

Mexico covenants and agrees that, so long as the Treasury Department shall be obligated to issue Securities Guarantees hereunder and so long as any Securities Guarantee shall be outstanding and until the payment in full of all amounts owed to the Treasury Department hereunder and the performance of all other obligations of Mexico hereunder, Mexico will duly perform and observe each and all of the covenants and agreements hereinafter set forth.

Section 4.01. Use of Proceeds from Debt Securities. Mexico agrees that the proceeds from the issuance of any Debt Securities shall be used only (i) to assist Mexico in stabilizing its exchange and financial markets by providing resources to be used in such a manner as to facilitate the redemption, refinancing or restructuring of Mexico's short-term debt obligations and such other purposes consistent with the obligations of the United States and Mexico, as members of the International Monetary Fund, on orderly exchange arrangements and a stable system of exchange rates; and (ii) in accordance with the purposes set forth in the Request for Issuance of Guarantees relating to such Debt Securities.

Section 4.02. Payment of Amounts Due on Debt Securities. Mexico shall duly and punctually pay the principal of, and interest on, the Debt Securities in accordance with the terms of such Debt Securities and the Securities Agreements.

Section 4.03. Delivery of Offering Document. Mexico shall deliver to the Treasury Department drafts of any Offering Document a reasonable time before the first use thereof and shall use no Offering Document to which the Treasury Department shall reasonably object.

Section 4.04. Material Change of Law, Act, Fact or Circumstance. In the event there is any change in law, act or other change of fact or circumstance as a result of which Mexico is not able to make the warranties in, or to perform its obligations under, this Guarantee Agreement, the Debt Securities, the Securities Agreements, the 1995 Framework Agreement or the Oil Agreement, Mexico shall inform the Treasury Department of such change in law, act or other change of fact or circumstance promptly after such change in law, act or other change of fact or circumstance and of the steps that Mexico plans to take in response to remedy its inability to make such warranties or perform its obligations hereunder.

Section 4.05. Information; Consultation; Annual Budget. Mexico agrees that it will:

A. furnish to the Treasury Department the information required under the 1995 Framework Agreement;

B. furnish, or cause to be furnished, to the Treasury Department such information relating to the Debt Securities, the Securities Guarantees and the Securities Agreements as the Treasury Department shall reasonably request;

C. afford authorized representatives of the Treasury Department opportunity during reasonable business hours to discuss with officials of Mexico, the Debt Securities, the Securities Guarantees, and the Securities Agreements; and

D. include in its Federal Budget for each fiscal year amounts sufficient to pay all principal, interest and other amounts due during such year on all Debt Securities and all amounts payable to the Treasury Department hereunder.

Section 4.06. Certain Notices. Immediately upon obtaining actual knowledge thereof, Mexico shall deliver to the Treasury Department written notice of (i) any representation or warranty made in this Guarantee Agreement, any Underwriting Agreement, or the Oil Agreement, or in any certificate delivered pursuant to such documents, that shall prove to have been incorrect or untrue in any material respect when made, and (ii) any failure by Mexico or any Government Agency to observe, perform or fulfill any covenant, condition or agreement contained in this Guarantee Agreement, any Fiscal Agency Agreement, any Underwriting Agreement or the Oil Agreement on the part of Mexico to be observed, performed or fulfilled.

ARTICLE V

FEES

Section 5.01. Assessment of Basic Fee. Upon the issuance of any Securities Guarantee pursuant to Section 2.01 of this Guarantee Agreement, Mexico shall pay to the Treasury Department the basic fee in United States Dollars assessed by the Treasury Department (the "Basic Fee"), calculated in accordance with

Section 5.02 of this Guarantee Agreement.

Section 5.02. Calculation of Amount of Basic Fee. The amount of the Basic Fee shall be determined by the Treasury Department and shall be equal to the difference between:

(i) the present value as of the date of issuance of the portion of the principal and interest payments on the Debt Securities to be guaranteed pursuant to a Securities Guarantee to be issued by the Treasury Department under this Guarantee Agreement, discounted at a rate equal to the appropriate United States Government Risk-Free Rate at the time of issuance of such Debt Securities, and

(ii) the present value as of the date of issuance of the portion of the principal and interest payments on the Debt Securities to be guaranteed pursuant to a Securities Guarantee to be issued by the Treasury Department under this Guarantee Agreement, discounted at a rate equal to the sum of (x) the appropriate United States Government Risk-Free Rate at the time of issuance of such Debt Securities and (y) the Premium, as defined below.

The Premium, with respect to any Securities Guarantee, shall be the greater of (x) the risk premium that would be set, in accordance with the Interagency Credit Risk Assessment System on a loan from the United States to Mexico, having the same term as the Securities Guarantees and (y) 225 basis points, if, upon issuance of such Securities Guarantee pursuant to Section 2.01 of this Guarantee Agreement, the Total Outstanding Amount is $5,000,000,000 or less; 275 basis points, if, upon issuance of such Securities Guarantee pursuant to Section 2.01 of this Guarantee Agreement, the Total Outstanding Amount is greater than $5,000,000,000, but less than $10,000,000,000; 325 basis points, if, upon issuance of such Securities Guarantee pursuant to Section 2.01 of this Guarantee Agreement, the Total Outstanding Amount is equal to or greater than $10,000,000,000 and less than $15,000,000,000, or 375 basis points, if, upon issuance of such Securities Guarantee pursuant to Section 2.01 of this Guarantee Agreement, the Total Outstanding Amount is equal to $15,000,000,000 or in excess thereof.

Section 5.03. Means of Payment of Basic Fee. The Basic Fee shall be payable by electronic funds transfer at FRBNY when required to be paid pursuant to Section 5.01 of this Guarantee Agreement by specifying "for credit to the account of the Treasury in the name of "U.S. Department of the Treasury -- Mexican Securities Guarantee Fees."

ARTICLE VI

DISBURSEMENT AND INVESTMENT OF PROCEEDS

Section 6.01. Use of Proceeds.

A. The net proceeds of each issuance of Debt Securities shall be used in accordance with the purposes set forth in Article I of the 1995 Framework Agreement and consistently with the most recent Financial Plan (as defined in the 1995 Framework Agreement) delivered by Mexico pursuant thereto.

B. Each Request for Issuance of Guarantees delivered pursuant to Section 3.02B hereof shall state:

(i) the proposed date on which the terms of the Debt Securities will be determined (the "Pricing Date") and the proposed date on which such Debt Securities will be issued (the "Settlement Date"), which shall be a Business Day;

(ii) an outline of the proposed terms (including, but not limited to, the aggregate principal amount, purchase price, interest rate and maturity) of such Debt Securities, or a description of the method by which such terms will be determined;

(iii) an outline of the procedure for the sale of such Debt Securities, including the procedures for underwriters or agent selection (if any);

(iv) the approximate dollar amount of the net proceeds of the issuance of such Debt Securities;

(v) that Mexico has separately furnished to the Treasury Department, prior to the date of such Request for Issuance of Guarantees, the information required pursuant to paragraph 2 of Article V of the 1995 Framework Agreement;

(vi) the intended use or uses of the net proceeds of the issuance of the Debt Securities, and the approximate date or dates on which each portion of such net proceeds is anticipated to be so used; and,

(vii) whether Mexico intends to invest all or any of such net proceeds in accordance with Section 6.02 herein.

C. In the event that the Treasury Department shall approve a proposed issuance of Debt Securities requested pursuant to a Request for Issuance of Guarantees, (i) the Treasury Department shall forward to Mexico and the FRBNY, not later than six Business Days prior to the proposed date of issuance of such Debt

Securities, a copy of such Request for Issuance of Guarantees countersigned on behalf of the Treasury Department by an authorized signatory and (ii) Mexico shall send to the Treasury Department and the FRBNY, in a form acceptable to the FRBNY and the Treasury Department, not later than three Business Days prior to the date of issuance of such Debt Securities a notice stating:

(i) the actual Settlement Date, which shall be not more than ten Business Days after the proposed Settlement Date specified in the related Request for Issuance of Guarantees;

(ii) the terms (including, but not limited to, the aggregate principal amount, purchase price, interest rate and maturity) of such Debt Securities, which terms may not, without the written consent of the Treasury Department, be inconsistent in any material respect with the terms or method of determining such terms set forth in the related Request for Issuance of Guarantees;

(iii) the net proceeds of the issuance of such Debt Securities;

(iv) if different from the information furnished in the related Request for Issuance of Guarantees, the intended use or uses of the net proceeds of the issuance of the Debt Securities;

(v) if different from the information furnished in the related Request for Issuance of Guarantees, the approximate date or dates on which each portion of such net proceeds will be used; and,

(vi) whether Mexico intends to invest all or any of such net proceeds in accordance with Section 6.02 herein.

In the event that the information set forth in the notice delivered by Mexico pursuant to this Section 6.01C shall vary in material respects from the information contained in the related Request for Issuance of Guarantees, then the Treasury Department shall not be obligated to issue the Securities Guarantees contemplated by such notice unless it shall approve such variations by countersigning such notice with an authorized signature.

Section 6.02. Investment of Proceeds. In the event that Mexico does not intend promptly to apply the full amount of the net proceeds of the issuance of any Debt Securities for the purposes set forth in the applicable Request for Issuance of Guarantees, then all or any portion of such net proceeds may be invested or reinvested by the FRBNY, at the written direction of Mexico pursuant to procedures separately agreed with the FRBNY.

It shall be the sole responsibility of Mexico to ensure that any investments made pursuant to this Section 6.02 are liquidated as necessary to meet Mexico's requirements for the use of such net proceeds, and the FRBNY shall have no responsibility in this regard.

At maturity or upon early liquidation of any investments provided for herein, the proceeds of such investments shall, until disbursed in accordance with Section 6.03, be deposited into, and held by Mexico in an account of the Bank, acting as fiscal agent of Mexico, at the FRBNY, and such proceeds may be withdrawn by Mexico from time to time, upon notice to the FRBNY, for purposes not materially inconsistent with the use of such proceeds contained in the related Request for Issuance of Guarantees. Mexico may, with the consent of the Treasury Department change the use of proceeds specified in the Request for Issuance of Debt to another purpose consistent with its Financial Plan.

Section 6.03. Disbursement of Proceeds. In the event that all or any portion of the net proceeds of any issuance of Debt Securities is invested in accordance with Section 6.02, no less frequently than once each week after the Settlement Date for such Debt Securities, Mexico shall provide the Treasury Department with a statement executed by an authorized official stating:

(i) the amount of such net proceeds to be applied during the following calendar week, and the purposes for which such net proceeds shall be applied during such week;

(ii) the amount of such net proceeds applied on each day during the preceding calendar week, and the purposes for which such net proceeds were applied on each such day; and

(iii) the changes in use of the proceeds previously specified in a Request for Issuance of Guarantee.

ARTICLE VII

REIMBURSEMENT OBLIGATION, SUBROGATION AND INDEMNIFICATION

Section 7.01. Reimbursement Obligation. Mexico covenants and agrees that it shall immediately reimburse the Treasury Department in United States Dollars in the United States for any amounts paid by the Treasury Department pursuant to any Securities Guarantee and for any costs incurred directly or indirectly in connection with making payments on any Securities Guarantee. The obligation of Mexico to reimburse the Treasury Department pursuant to this Section 7.01 shall be backed by the full faith and credit of Mexico and shall be absolute, unconditional and irrevocable and shall not be subject to any right of set-off, counterclaim, recoupment, defense, abatement, deferment or reduction, whether with respect to the investors in the Debt Securities, the Treasury Department or any other person.

Section 7.02. Subrogation. In the event that the Treasury Department makes any payment under any Securities Guarantee, the Treasury Department shall, by operation of this Guarantee Agreement and any applicable laws as may exist, be subrogated to all of the rights and remedies of the respective holders of the applicable Debt Securities who received such payment against Mexico.

Section 7.03. Indemnification. Mexico shall indemnify, save and hold harmless the Treasury Department and any of its agents, officers or employees at all times during the term of and after termination of this Guarantee Agreement from and against:

A. any and all liabilities, claims, charges, judgments, damages, losses, expenses or payments asserted against, imposed on, or incurred or made by the Treasury Department or any agent, officer or employee (other than those resulting from the gross negligence or willful misconduct of the Treasury Department or of any such agent, officer or employee of the Treasury Department or the inaccuracy or alleged inaccuracy of the Treasury Department's representation in Section 11.02 herein) that may hereafter arise out of the Treasury Department having guaranteed the Debt Securities;

B. any and all liabilities, claims, charges, judgments, damages, losses, expenses or payments asserted against, imposed on, or incurred or made by the Treasury Department or any such agent, officer or employee that may hereafter arise out of Mexico's performance under this Guarantee Agreement, the Debt Securities, any Securities Agreement, or Contract of Guarantee in which the Treasury Department or any such agent, officer or employee is joined as a party sought to be held liable, including all liabilities, claims, charges, judgments, damages, losses, expenses or payments in connection with any misstatement or alleged misstatement or omission or alleged omission in any Offering Document; and

C. any and all liabilities, damages, losses or deficiencies resulting from any misrepresentation, breach of warranty or breach of any agreement on the part of Mexico with respect to this Guarantee Agreement, the Debt Securities, any Securities Agreement, or Contract of Guarantee.

ARTICLE VIII

LATE PAYMENT CHARGES

Section 8.01. Late Payment Charges. In the event that (i) payment of any amount is not made when and as due under this Guarantee Agreement, and (ii) there remains an amount due and payable hereunder by Mexico to the Treasury Department (any such amount being an "Overdue Amount"), the amount payable shall thereafter be that Overdue Amount plus, to the extent permitted by law, interest thereon (that interest being the "Late Charge") computed in accordance with this Section 8.01. The Late Charge shall accrue from the date the payment was due (the "Due Date") to the actual date on which payment is made. The Late Charge shall be computed on the basis of (x) actual days elapsed from (but not including) the Due Date to the actual date on which payment is made, and (y) the number of days occurring in the one-year period beginning on the Due Date. The Late Charge shall accrue at a rate (the "Late Charge Rate") established by the Treasury Department equal to 500 basis points over the average investment rate for 91-day (13-week) United States Treasury bills auctioned immediately preceding the Due Date. The initial Late Charge Rate shall be in effect until either the actual date of payment or that date which is 91 days after the Due Date, whichever occurs first. If the Overdue Amount and the amount of accrued Late Charge are not paid on or before that date which is 91 days after the Due Date, then an amount equal to the amount of accrued Late Charge shall be added to the Overdue Amount, and the amount then payable shall be the sum of the Overdue Amount and the amount of the accrued Late Charge (the sum being the "New Overdue Amount"), plus a Late Charge to be then determined in accordance with the principles of the second preceding sentence (but using the investment rate from the auction of 91-day (13-week) United States Treasury bills immediately preceding that date rather than such auction preceding the Due Date). For so long as any Overdue Amount, or, if applicable, any New Overdue Amount, remains unpaid, the Late Charge Rate shall be redetermined in accordance with the principles of the third preceding sentence at 91-day intervals from the scheduled date of payment (using the investment rate from the most recently auctioned 91-day (13-week) United States Treasury bills), and shall be applied to the Overdue Amount, or if applicable, the New Overdue Amount, and all amounts of accrued Late Charge to the actual date of payment. The obligation of Mexico to pay any Late Charge pursuant to this Section 8.01 shall be backed by the full faith and credit of Mexico and shall be absolute, unconditional and irrevocable and shall not be subject to any right of set-off, counterclaim, recoupment, defense, abatement, deferment or reduction, whether with respect to the investors in the Debt Securities, the Treasury Department or any other person.

ARTICLE IX

REMEDIES

Section 9.01. Remedies. If the Treasury Department determines that an event specified in paragraph 1 of Article VII of the 1995 Framework Agreement shall have occurred and be continuing, then, in each and every such event, the Treasury Department may, upon notice to Mexico, require Mexico either to (i) Defease the guaranteed portion of any or all of the outstanding Debt Securities or (ii) redeem any or all of such Debt Securities as may be redeemed pursuant to the terms and conditions of such Debt Securities (or, if permitted by the terms of such Debt Securities, the guaranteed portion thereof).

Section 9.02. Rebate. In the event of any redemption or defeasance pursuant to Section 9.01, the Basic Fee relating to such redeemed or defeased Debt Securities shall be recalculated on the basis of those principal and interest payments guaranteed by the Treasury Department until the date of redemption or defeasance and the difference shall be refunded to Mexico provided Mexico has paid to the Treasury Department all amounts payable under this Agreement, including costs.

Section 9.03 No Waiver; Cumulative Remedies. No failure, delay, or refrainment by the Treasury Department in the exercise of any right or remedy accruing to the Treasury Department under this Guarantee Agreement, any Securities Agreement or any Contract of Guarantee shall operate as a waiver by the Treasury Department of such right, power or remedy thereof, nor shall any single or partial exercise of any such right, power or remedy preclude any other or further exercise thereof or the exercise of any other right, power or remedy. The rights, powers and remedies provided herein are cumulative and not exclusive of any rights, powers or remedies provided by law.

ARTICLE X

REDEMPTION; DEFEASANCE

Section 10.01. Redemption/Defeasance.

A. Upon its determination, after consultation with Mexico, that Mexico has well-established access to funds on reasonable market terms, the Treasury Department may require Mexico to secure resources in the international markets and apply such resources:

(i) to repurchase pesos for dollars under any or all of the Medium-Term Swaps, Treasury Short-Term Swaps or other short-term swaps with Treasury Backing; and/or

(ii) either to (I) defease the guaranteed portion of any or all debt securities for which Securities Guarantees have been issued or (II) redeem any such debt securities that are subject to early redemption (or, if permitted by the terms of such debt securities, the guaranteed portion thereof);

unless Mexico is unable, using its best efforts, to identify replacement resources (in addition to funds needed to be raised in the market pursuant to the Financial Plan) on reasonable market terms with maturities at least as long as the remaining maturities of the Primary Resources being replaced within 90 days following notification by the Treasury Department to Mexico of its intention to require such prepayment.

B. If an event described in paragraph (13)(b) of Annex A of the Framework Agreement shall have occurred, and if the consultation contemplated by such paragraph does not result in agreement between Mexico and the Treasury Department as to a substitute assured source of repayment or other solution satisfactory to the Treasury Department, then the Treasury Department, if such event is continuing may require Mexico upon not less than 7 days notice thereof:

(i) to repurchase pesos for dollars under any or all of the Medium-Term Swaps, Treasury Short-Term Swaps or other short-term swaps with Treasury Backing; and

(ii) either to (I) defease the guaranteed portion of any or all debt securities for which Securities Guarantees have been issued or (II) redeem any such debt securities that are subject to early redemption (or, if permitted by the terms of such debt securities, the guaranteed portion thereof).

C. In addition, Mexico may at any time redeem or defease any or all of the outstanding Debt Securities as may be redeemed pursuant to the terms and conditions of such Debt Securities.

Section 10.02. Rebate of Basic Fee. In the event of any redemption or defeasance pursuant to Section 10.01, the Basic Fee relating to such redeemed or defeased Debt Securities shall be recalculated on the basis of those principal and interest payments guaranteed by the Treasury Department until the date of redemption or defeasance and the difference shall be refunded to Mexico.

ARTICLE XI

MISCELLANEOUS

Section 11.01. Communications. All communications shall be in English, unless the Parties otherwise agree in writing. Any notice, request, document or other communication submitted by any Party under this Guarantee Agreement shall be in writing, by mail, telecopier, tested telex or personal delivery, shall refer to the applicable Mexico/Treasury Department Securities Guarantee number, and shall be deemed duly given or sent when delivered to such Party at the following addresses:

To Mexico
Mail Address: Director General of Public Credit
Ministry of Finance and Public Credit
Insurgentes Sur 826, Piso 9
Colonia del Valle
Mexico, D.F. 03100, Mexico
Telephone: 525-682-2799
Facsimile: 525-543-3446

Copy To:

To Department of the Treasury
Mail Address: Office of the Assistant Secretary for International Affairs
U.S. Department of the Treasury
Room 3430
Washington, D.C. 20220
Telephone: (202) 622-0417
(202) 622-0060

Copy To:

To the Federal Reserve Bank of New York
Mail Address:
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045
Telephone: (212) 720-5222
Facsimile: (212) 720-7621

These addresses may be changed by a Party upon written notice to all other Parties.

Section 11.02. Representation. Each of the Treasury Department and Mexico warrants that it has full power and authority to enter into and perform its obligations under this Guarantee Agreement (Except for any authorizations and approvals required by Mexico in connection with the issuance of Debt

Securities), and has taken and will take all necessary or other actions to authorize the performance of the terms and conditions of this Guarantee Agreement.

Section 11.03. Amendments. This Guarantee Agreement may be amended by the mutual agreement of the parties hereto; provided, however, that no provision of this Guarantee Agreement may be amended, modified, supplemented, waived, discharged or terminated orally but only by an instrument in writing.

Section 11.04. Term of Commitment to Issue Securities Guarantees. This commitment by the Treasury Department to issue Securities Guarantees under this Guarantee Agreement (but not the Securities Guarantees themselves) shall expire on February 21, 1996, unless extended pursuant to paragraph 8 of Article III of the 1995 Framework Agreement. This commitment by the Treasury Department to issue Securities Guarantees under this Guarantee Agreement may also be terminated at any time by mutual agreement of the Parties.

Section 11.05. Expenses. All out of pocket expenses reasonably incurred in connection with complying with this Guarantee Agreement shall be for the account of Mexico.

Section 11.06. Survival of Covenants. All covenants, agreements and warranties made herein shall survive the execution and delivery of this Guarantee Agreement and shall remain in full force and effect until repayment in full of the guaranteed portion of the Debt Securities and of all amounts owed to the Treasury Department pursuant to this Guarantee Agreement.

Section 11.07. Governing Law; Submission to Jurisdiction; This Guarantee Agreement shall be governed by and construed in accordance with the laws of the State of New York, to the extent not inconsistent with Federal law of the United States. Mexico hereby irrevocably submits for all purposes of or in connection with this Guarantee Agreement to the exclusive jurisdiction of the United States District Court located in the Borough of Manhattan in New York City. The United States hereby irrevocably submits for all purposes of or in connection with this Guarantee Agreement to the exclusive jurisdiction of the Federal courts of the United States. Mexico and the United States each hereby irrevocably waive, to the fullest extent, the defense of an inconvenient forum to the maintenance of an action or proceeding brought pursuant to this Section 11.08. In light of the fact that the Financing Arrangements, including this Agreement, constitute commercial activities, and in accordance with normal practices, Mexico waives immunity from (i) attachment in aid of execution, (ii) execution, or (iii) attachment prior to the entry of judgment, for all purposes of Title 28 United States Code Sections 1610 and 1611 in respect of their obligations under the Financing Arrangements, including this Agreement.

Section 11.08. Service of Process. Mexico hereby irrevocably appoints the person for the time being and from time to time acting as or discharging the function of the Consul General of Mexico in New York, New York (the "Process Agent"), with an office, on the date hereof, at 8 East 41st Street, New York, New York, 10017, United States, as its agent to receive on behalf of Mexico and its property, service of copies of the summons and complaint and any other process which may be served in any such action or proceeding brought in a Federal court sitting in New York City. Such service may be made by mailing or delivering a copy of such process to Mexico in care of the Process Agent at the address specified above for such Process Agent, and Mexico hereby irrevocably authorizes and directs such Process Agent to accept such service on its behalf.

Section 11.09. Counterparts. This Guarantee Agreement may be executed in separate counterparts, each of which when so executed and delivered shall be an original, but all of which together shall constitute but one and the same instrument.

ARTICLE XII

ENTRY INTO FORCE

This Guarantee Agreement may be executed in counterparts and shall enter into force on the date of the last signature hereto.

IN WITNESS WHEREOF, this Guarantee Agreement is signed and executed by the authorized representatives of Mexico and the Treasury Department.

DONE at Washington, this 21st day of February, 1995, in duplicate.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA	FOR THE GOVERNMENT OF THE UNITED ~~MEXICAN STATES~~
Department of the Treasury	Ministry of Finance ~~and~~ Public Credit

MEDIUM-TERM EXCHANGE STABILIZATION AGREEMENT

This Medium-Term Exchange Stabilization Agreement ("Medium-Term Agreement"), dated as of February 21, 1995, is between the United States Department of the Treasury (the "Treasury") and the Government of the United Mexican States, acting through the Ministry of Finance and Public Credit ("Mexico") (together, "Parties"), with the Banco de Mexico acting as fiscal agent for Mexico (the "Bank").

WHEREAS, monetary and financial cooperation between the United States of America and Mexico is an important factor in carrying out the objectives of the International Monetary Fund, of which both countries are members, consistent with their obligations, as members, on orderly exchange arrangements and a stable system of exchange rates;

WHEREAS, stabilization arrangements have been in effect between the two countries since 1941, and have proved beneficial to the financial relationship between the two countries;

WHEREAS, the Parties have entered into the North American Framework Agreement, dated April 26, 1994, among the Government of the United Mexican States, the Bank, the Treasury, the Federal Reserve Bank of New York acting at the direction of the Federal Open Market Committee, and the Bank of Canada, as amended from time to time (the "NAFA"), the Exchange Stabilization Agreement, dated April 26, 1994, as amended from time to time (the "ESA"), and the Temporary Exchange Stabilization Agreement, dated January 4, 1995, as amended from time to time (the "TESA"), to provide short-term swap facilities;

WHEREAS, the Parties and the Bank have entered into a U.S.-Mexico Framework Agreement for Mexican Economic Stabilization (the "1995 Framework Agreement"), dated as of February 21, 1995, which provides for Mexico's ability to (x) make and use medium-term purchases under this Medium-Term Agreement and (y) issue debt securities to be guaranteed by the Exchange Stabilization Fund of the Treasury (the "ESF") under the terms and conditions set forth in the Guarantee Agreement between the Treasury and Mexico, dated as of February 21, 1995 (the "Guarantee Agreement");

WHEREAS, the Parties have entered into the Oil Proceeds Facility Agreement, dated as of February 21, 1995, among Mexico, the Bank, Petroleos Mexicanos, P.M.I. Comercio Internacional S.A. de C.V., P.M.I. Trading Limited, the Treasury, and the Federal Reserve Bank of New York (the "Oil Proceeds Facility Agreement");

WHEREAS, the Parties have entered into the Guarantee Agreement;

NOW, THEREFORE, in order to further such objectives and in consideration of the mutual covenants contained herein and in the 1995 Framework Agreement, the Parties agree as follows:

1. <u>Commitments by the Parties to Purchase and Repurchase Currency</u>.

Subject to the terms and conditions of this Medium-Term Agreement and the 1995 Framework Agreement, the Treasury, through the ESF, and Mexico agree to purchase and subsequently repurchase Mexican pesos and U.S. dollars. The purchases and the subsequent repurchases under this Medium-Term Agreement shall be referred to, collectively, as "Medium-Term Swap Transactions" and, individually, as a "Medium-Term Swap Transaction." The Parties agree that Medium-Term Swap Transactions shall be commercial transactions.

2. <u>Terms of NAFA, ESA, and TESA Are Not Applicable</u>.

Except as otherwise provided in the 1995 Framework Agreement, Medium-Term Swap Transactions are not subject to the terms and conditions for any drawing pursuant to the NAFA, the ESA, and the TESA. Any Medium-Term Swap Transaction will be governed solely by the terms of this Medium-Term Agreement and the 1995 Framework Agreement.

3. <u>Conditions to the Treasury Commitment</u>.

The Treasury shall be under no obligation to sell any U.S. dollars to Mexico under this Medium-Term Agreement unless and until it determines that the following conditions precedent have been satisfied in connection with each request by Mexico to purchase U.S. dollars.

(a) **<u>Maximum Commitment Amount</u>.** At the time of such request by Mexico to purchase U.S. dollars, the amount of U.S. dollars which Mexico requests to purchase under this Medium-Term Agreement, when added to the sum of (x) the aggregate amount of U.S. dollars purchased by Mexico under this Medium-Term Agreement that are outstanding at the time of such request, (y) the Outstanding NAFA Swap Amount (as such term is defined in the Guarantee Agreement), and (z) the Calculated Guarantee Amount (as such term is defined in the Guarantee Agreement) (the sum of (y) and (z) being the "Other Facilities Amount"), shall not exceed in the aggregate twenty billion U.S. dollars (U.S.$20,000,000,000).

(b) **<u>Advance Notice Requirement</u>.** Mexico shall, through the Bank, provide notice of such request to purchase U.S. dollars to the Treasury and by authenticated telecommunication to the Federal Reserve Bank of New York, acting as Fiscal Agent for the Treasury (the "FRBNY"), in a form acceptable to each, no later than seven FRBNY Business Days (an "FRBNY Business Day" being any day on which the FRBNY is open for business) in advance of the proposed purchase date, which specifies:

(i) the date that Mexico proposes for Mexico's purchase of U.S. dollars from the Treasury and the Treasury's related purchase of Mexican pesos from Mexico, which date shall be an FRBNY Business Day and a Mexico City Business Day (a "Mexico City Business Day" being any day on which the Bank is open for business);

(ii) the amount of U.S. dollars that Mexico requests to purchase;

(iii) the date or dates on which Mexico proposes that the Treasury repurchase from Mexico all or any installment of the U.S. dollars sold to Mexico and that Mexico repurchase from the Treasury all or any installment of the Mexican pesos sold the Treasury, each of which dates shall be (A) a Calendar Quarter Date (a "Calendar Quarter Date" being March 31, June 30, September 30, and December 31 of each year, or, if such date is not an FRBNY Business Day and a Mexico City Business Day, the first day thereafter that is both an FRBNY Business Day and a Mexico City Business Day), and (B) not later than five years from the proposed purchase date;

(iv) if Mexico's repurchase is to occur in two or more installments (collectively, "Installments" and, individually, an "Installment"), the U.S. dollar amount of each Installment;

(v) whether Mexico will invest all or any portion of the purchased U.S. dollars in a Treasury Certificate (as such term is defined in paragraph 5(b) below) and, if so, the amount of such investment;

(vi) whether Mexico proposes to redeem all or any part of the Treasury Certificate on or before the maturity of the Treasury Certificate, and, if so, a schedule of the date and amount of each such early redemption of the Treasury Certificate; and

(vii) that Mexico has separately furnished to the Treasury, prior to the date of such request, the information required to be submitted in advance of any such purchase, as set forth in paragraph 2 of Article V of the 1995 Framework Agreement.

(c) **Consultation and Agreement**. The Parties shall have consulted and agreed on whether such purchase is consistent with, and the Treasury shall have been satisfied that such purchase is consistent with, the terms and conditions of the 1995 Framework Agreement and the Financial Plan (as such term is defined in the 1995 Framework Agreement) in effect at such time.

(d) **Agreement and Notice by the Treasury.** The FRBNY must receive, no later than two FRBNY Business Days in advance of the Value Date (as such term is defined below), an instruction from the Treasury, in an authenticated telecommunication in a form acceptable to the FRBNY, that sets forth Treasury's and Mexico's agreement to these terms:

(i) the agreed-upon date (the "Value Date") for Mexico's purchase of U.S. dollars and the Treasury's related purchase of Mexican pesos;

(ii) the amount of U.S. dollars to be purchased;

(iii) the date or dates (collectively, the "Maturity Dates" and, individually, a "Maturity Date") on which the Treasury will repurchase all or any Installment of the U.S. dollars sold to Mexico and Mexico will repurchase all or any Installment of the related Mexican pesos sold to the Treasury, and, if the repurchase is to occur in Installments, the amount, in U.S. dollars, of each Installment; and

(iv) the amount of U.S. dollars to be invested in a Treasury Certificate, and the schedule specifying the dates and amounts of any early redemptions of the Treasury Certificate.

Each Maturity Date shall be a Calendar Quarter Date. The Treasury shall be under no obligation to send such authenticated telecommunication to the FRBNY unless and until the Treasury determines that the conditions precedent set forth in paragraphs 3(a) through (c) above and in the 1995 Framework Agreement, including those in Article V, have been met.

4. **Exchange Rate Determinations.**

The U.S. dollar/Mexican peso exchange rate (the "Exchange Rate") that shall apply to (i) each purchase of U.S. dollars and Mexican pesos under this Medium-Term Agreement, (ii) each payment of accrued interest on each Mexico Certificate (as such term is defined in paragraph 6(b) below), and (iii) each repurchase of Mexican pesos under this Medium-Term Agreement, shall be determined as provided in this paragraph. The Exchange Rate for any Exchange Rate Determination Date (as such term is defined below) shall be determined jointly by the FRBNY and the Bank by reference to rates of that date (the "Reference Date") which is both at least two FRBNY Business Days and two Mexico City Business Days before, and closest to, that Exchange Rate

Determination Date. The Exchange Rate determination shall be based on three quotations of the U.S. dollar/Mexican peso exchange rate, obtained on the Reference Date for the Exchange Rate Determination Date by FRBNY and the Bank from banks acting in the Mexico City foreign exchange market. With respect to each Medium-Term Swap Transaction, the Treasury shall request the FRBNY, and Mexico shall request the Bank, to determine jointly the Exchange Rate as of the Value Date of such Medium-Term Swap Transaction. Thereafter, and so long as such Medium-Term Swap Transaction remains outstanding, the Treasury shall request the FRBNY, and Mexico shall request the Bank, to determine jointly a new Exchange Rate for such Medium-Term Swap Transaction for each succeeding Calendar Quarter Date (each Value Date and Calendar Quarter Date being an "Exchange Rate Determination Date"). The Exchange Rate determined for a given Exchange Rate Determination Date shall apply from that date until the following Calendar Quarter Date.

5. **Application of U.S. Dollars Purchased by Mexico**.

The following provisions shall apply to each purchase of U.S. dollars by Mexico made in accordance with paragraph 3.

(a) **Deposit of U.S. Dollars**. The Treasury shall instruct the FRBNY to credit, on the Value Date, the amount of U.S. dollars purchased by Mexico to the account at the FRBNY in the name of "Banco de Mexico as Fiscal Agent for Mexico -- Medium-Term Funds Account" (the "Bank's MTF Account").

(b) **Investment of U.S. Dollars in Treasury Certificates of Indebtedness**. To the extent that U.S. dollars credited to the Bank's MTF Account are not required immediately for use in accordance with Article V of the 1995 Framework Agreement, and subject to the Treasury's prior consent in the authenticated telecommunication referred to in paragraph 3(d) above, Mexico shall cause the Bank to authorize the FRBNY to debit the Bank's MTF Account by the amount not so required and invest this amount in a non-transferable United States Treasury Certificate of Indebtedness (the "Treasury Certificate"), which the Treasury, through the FRBNY, is prepared to issue to Mexico, at par, to mature on a date which is no later than 91 days after the Value Date of the related U.S. dollar purchase. The Treasury Certificate will be held in the securities custody account at the FRBNY in the name of "Banco de Mexico as Fiscal Agent for Mexico -- Medium-Term Custody Account" (the "Bank's MTC Account").

(c) **Early Redemptions of Treasury Certificates**. The Treasury Certificate may be redeemed, in whole or in part, prior to its maturity, upon two FRBNY Business Days' prior notice from the Bank to the FRBNY by authenticated telecommunication and the Treasury, at par plus accrued interest, provided that (x) Mexico shall have delivered to the Treasury, through the Bank, a schedule specifying the dates and amounts of all early redemptions of the Treasury Certificate, as provided in paragraph 3(b)(vi) above, and (y) the Treasury shall have notified the FRBNY, by authenticated telecommunication, of its consent to the early redemption requested. Mexico shall notify the Treasury, by authenticated telecommunication from the Bank to the FRBNY, of any proposed change in the date or amount of any scheduled early redemption at least two FRBNY Business Days in advance of such change.

(d) **Interest Payable to Mexico on Treasury Certificates.** Each Treasury Certificate will bear interest at a rate (the "Treasury Certificate Interest Rate") which is equal to either (x) the average investment rate for 91-day (13-week) United States Treasury bills auctioned immediately preceding the date of issuance of the Treasury Certificate, or (y) if such average investment rate, stated in terms of percentage carried to two decimal places, is not a multiple of 0.05, then that rate which is the next higher multiple of 0.05. Interest will be computed on the basis of (x) the actual number of days elapsed from (but not including) the date of issuance of the Treasury Certificate to (and including) the actual date on which the Treasury Certificate is redeemed, and (y) the number of days occurring in the one-year period beginning on the date of issuance of the Treasury Certificate.

6. **Application of Mexican Pesos Purchased by the Treasury.**

(a) **Initial Deposit of Mexican Pesos.** Using the Exchange Rate determined under paragraph 4 above, Mexico shall instruct the Bank to credit, on the Value Date of each Medium-Term Swap Transaction, the amount of Mexican pesos purchased by the Treasury in exchange for the amount of U.S. dollars purchased by Mexico under such Medium-Term Swap Transaction (the "Base Peso Purchase") to an account on the books of the Bank in the name of "Federal Reserve Bank of New York as Fiscal Agent of the United States, Special Account No. 3" ("Treasury's Special Account No. 3") in accordance with instructions delivered by the FRBNY to the Bank by authenticated telecommunication.

(b) **Investment of Mexican Pesos in Mexico Certificate of Deposit.** Immediately upon crediting the Treasury's Special Account No. 3 with the amount of Base Peso Purchase in accordance with paragraph 6(a) above, the Bank shall debit such account in the amount of such Base Peso Purchase and invest such amount in a non-transferable Mexico Certificate of Indebtedness (the "Mexico Certificate") which Mexico, through the Bank, shall issue to the Treasury, at par, to mature on any date on or before the Maturity Date of the U.S. dollar purchase. The Bank shall promptly confirm such investment to the FRBNY by authenticated telecommunication. If the U.S. dollar purchase is to be repaid in Installments, Mexico shall issue through the Bank a Mexico Certificate for each Installment, at par, to mature on or before the Maturity Date of that Installment. The Mexico Certificate shall be held in a securities custody account in the name of "Federal Reserve Bank of New York as Fiscal Agent of the Treasury -- Mexico Custody Account" at the Bank (the "Treasury's Custody Account").

(c) Early Redemptions of Mexico Certificates. The Treasury may redeem any Mexico Certificate (the par value of which will be adjusted from time to time under paragraph 6(f) below) or withdraw any amount of pesos deposited in the Treasury's Special Account No. 3 (the amount of which will be adjusted from time to time under paragraph 6(f) below), in whole or in part, at any time, upon two Mexico City Business Days' prior notice, by authenticated telecommunication from the FRBNY to the Bank. In the event of such withdrawal, Mexico agrees to pay the Treasury, on the withdrawal date, the unpaid and accrued interest on the amount of Mexican pesos being withdrawn, in U.S. dollars in the amount determined pursuant to paragraphs 6(d) and 6(e) below.

(d) Interest Payable to the Treasury on Mexico Certificates. Each Mexico Certificate shall earn interest at a rate calculated as provided in this paragraph 6(d), which rate is intended to be at least sufficient to cover the current U.S. Government credit risk cost for Mexico. This rate (the "Mexico Certificate Interest Rate") shall be calculated by the Treasury on the Value Date and, thereafter, on the last day of the preceding Interest Period (as such term is defined below) for each Mexico Certificate outstanding and shall equal the sum of the following components:

(i) a rate per annum, which shall equal either (x) the average investment rate (the "Yield") for 91-day (13-week) United States Treasury bills auctioned on the auction date immediately preceding the first day of such Interest Period or (y) if such Yield, stated in terms of percentage carried to two decimal places, is not a multiple of 0.05, then that rate which is the next higher multiple of 0.05; and

(ii) a spread (the "Credit Risk Premium"), determined as of the Value Date of such Base Peso Purchase, and remaining fixed until the last Maturity Date for such Base Peso Purchase, which spread shall be computed by the Treasury and shall equal the greater of:

(A) the appropriate credit risk premium which would be set, in accordance with the Interagency Credit Risk Assessment System ("ICRAS") on a loan from the United States to Mexico, having the same Maturity Date(s) as the related U.S. dollar purchase, and with accrued interest payable every Interest Payment Date, as defined below; or

(B) the sum, in U.S. dollars, of (x) the aggregate amount of all outstanding Medium-Term Swap Transaction purchases of U.S. dollars as of the Value Date of such Base Peso Purchase, and (y) the Other Facilities' Amount outstanding (the sum of (x) and (y) being the "Total Outstanding Amount"), which spread shall be computed by the Treasury as follows:

(1) 225 basis points if the Total Outstanding Amount is less than or equal to U.S.$5 billion;

(2) 275 basis points if the Total Outstanding Amount is greater than U.S.$5 billion and less that or equal to U.S.$10 billion;

(3) 325 basis points if the Total Outstanding Amount is greater than U.S.$10 billion and less than or equal to U.S.$15 billion; or

(4) 375 basis points if the Total Outstanding Amount is greater than U.S.$15 billion.

Interest will be computed on the basis of (x) the actual number of days elapse from (but not including) the Value Date of the related Base Peso Purchase to (and including) the actual date on which the Mexico Certificate is redeemed, and (y) the number of days occurring in the one-year period beginning on the Value Date of the related Base Peso Purchase. For so long as each Mexico Certificate shall remain outstanding, a new Mexico Certificate Interest Rate for such Mexico Certificate shall be redetermined and reset by the Treasury on the last day of the preceding Interest Period in accordance with the principles of this paragraph 6(d). Thereupon, the Treasury shall notify the FRBNY of the new Mexico Certificate Interest Rate, and the FRBNY shall promptly notify the Bank, by authenticated telecommunication, of such new Mexico Certificate Interest Rate. As used herein, "Interest Period" means, for each Base Peso Purchase, (x) initially the period from (but not including) the Value Date of such Base Peso Purchase to (and including) the first Calendar Quarter Date to occur after such Value Date and (y) thereafter, the period from (but not including) the last day of the preceding Interest Period to (and including) the first Calendar Quarter Date to occur thereafter. As used herein, "Interest Payment Date" means the last day of each Interest Period.

(e) Payment of Quarterly Interest in U.S. Dollars.

(i) Time of Payment. Interest accrued in any Interest Period on the amount of each Base Peso Purchase that is represented by a Mexico Certificate held in the Treasury's Custody Account shall be payable on each Interest Payment Date. On each Interest Payment Date, Mexico shall convert the amount of accrued and unpaid interest on the Mexico Certificate at the rate of exchange referred to in paragraph 6(e)(ii) below and transfer the resulting U.S. dollars (the "Interest Amount") to the FRBNY for credit to the account on the books of the FRBNY in the name of "Treasury's Special Funds Account No. 1" (the "Treasury Account").

(ii) Exchange Rate for Interest Payments. The Treasury will bear no exchange rate risk for any unpaid and accrued interest on any outstanding Medium-Term Swap Transaction. On each Interest Payment Date, Mexico shall use the Exchange Rate determined under paragraph 4 above for the immediately preceding Exchange Rate Determination Date to calculate the U.S. dollar amount of interest accrued and unpaid with respect to the Interest Period ending on such Interest Payment Date or part thereof.

(f) Maintenance of Value. Mexico shall maintain the value of pesos that remain on deposit in the Secretary's Special Account No. 3, or are represented by any Mexico Certificate in the Treasury's Custody Account, relative to the U.S. dollar in the following manner. On each Exchange Rate Determination Date, (i) the Bank shall, acting on behalf of Mexico, credit or, upon instruction by the FRBNY in an authenticated telecommunication debit, as the case may be, the Treasury's Special Account No. 3 using the Exchange Rate calculated for that date, and (ii) Mexico shall, through the Bank, adjust the par value of each Mexico Certificate in the Treasury's Custody Account, so that the United States dollar value of such peso deposit(s) and Mexico Certificate(s), as calculated on that date using the Exchange Rate for that date, is the same as the United States dollar value of such peso deposit(s) and Mexico Certificate(s) calculated on the same Exchange Rate Determination Date using the Exchange Rate for the preceding Exchange Rate Determination Date. Mexico and the Treasury will separately agree on Mexico's obligation to maintain the value of such peso deposit(s) and Mexico Certificate(s) in the event of withdrawals or redemptions by the Treasury on dates other than an Exchange Rate Determination Dates. Until such agreement is reached, the Treasury agrees that it will withdraw such peso deposit(s), or request redemption of Mexico Certificate(s) for value, on dates that are Exchange Rate Determination Date.

7. **Obligation of the Parties To Repurchase Said Currencies and Pay Accrued Interest**.

(a) **Obligation to Repurchase**. On or before the Maturity Date for each U.S. dollar purchase or Installment, the Treasury and Mexico shall repurchase and repay, respectively, the U.S. dollars and Mexican pesos that correspond to such purchase or Installment.

(b) **Applicable Exchange Rate**. The Treasury will bear no exchange rate risk for any purchase which has not been repaid. Mexico agrees to pay the Treasury in U.S. dollars the full amount of any Installment or U.S. dollar purchase outstanding on the Maturity Date of such Installment or U.S. dollar purchase. On the Maturity Date of such Installment or U.S. dollar purchase, the Treasury shall resell to Mexico the amount of the Base Peso Purchase that corresponds to such Installment or U.S. dollar purchase, calculated at the Exchange Rate for the Exchange Rate Determination Date immediately preceding the Maturity Date of such Installment or U.S. dollar purchase.

(c) **Payment of Accrued Interest**. In addition to the obligation to repurchase Mexican pesos sold to the Treasury, Mexico shall pay, on the Maturity Date for each U.S. dollar purchase or Installment, all accrued and unpaid interest on the Mexican pesos being repurchased as provided in paragraphs 6(d) and 6(e) above.

8. **Nonpayments**.

(a) **Redemption of Treasury Certificates**. With respect to any outstanding purchase of U.S. dollars, in the event that Mexico has not, by 1:00 p.m. (New York time) (x) on any Interest Payment Date, paid the Interest Amount due on that Interest Payment Date in accordance with paragraph 6(e), or (y) on the Maturity Date of any U.S. dollar purchase or any Installment, repaid in full the amount of that purchase or Installment then due, and paid all accrued and unpaid interest thereon, in accordance with paragraph 7 (each Interest Payment Date and the Maturity Date being a "Due Date"), Mexico hereby irrevocably authorizes and instructs the FRBNY to redeem, on such Due Date, any Treasury Certificate that was purchased with the U.S. dollar proceeds of that outstanding purchase or Installment, and to transfer all of the proceeds of such redemption to the Treasury Account to, first, pay any Interest Amount then due, and, second, repay the U.S. dollar purchase or Installment outstanding then due.

(b) **Redemption of Other Treasury Certificates**. Thereafter, in the event that Mexico still has due and unpaid obligations to pay interest or other amounts to the Treasury under this Medium-Term Agreement, Mexico hereby irrevocably authorizes and instructs the FRBNY to redeem in advance of maturity any other Treasury Certificates and to transfer all of the proceeds of such redemption to the Treasury Account until the Treasury receives payment in full of all obligations due to it under this Medium-Term Agreement, including any late payment charges determined under paragraph 8(c) below.

(c) __Late Payment Charges__. Thereafter, in the event that Mexico still has due and unpaid obligations to pay interest or other amounts to the Treasury under this Medium-Term Agreement (any such remaining amount in the aggregate being then an "Overdue Amount"), the amount payable shall be that Overdue Amount plus, to the extent permitted by law, interest thereon (that interest being the "Late Charge") computed in accordance with this paragraph. The Late Charge for an Overdue Amount shall accrue from the Due Date of the Overdue Amount to the actual date on which payment is made. The Late Charge shall be computed on the basis of (x) actual number of days elapsed from (but not including) the Due Date of the Overdue Amount to (and including) the actual date on which payment is made, and (y) the number of days occurring in the one-year period beginning on the Due Date of the Overdue Amount. The Late Charge shall accrue at a rate (the "Late Charge Rate") equal to 500 basis points over the average investment rate for 91-day (13-week) United States Treasury bills auctioned immediately preceding the Due Date. The initial Late Charge Rate shall be in effect until either the actual date of payment or the next Interest Payment Date, whichever occurs first. If the Overdue Amount and the amount of accrued Late Charge are not paid on or before the next Interest Payment Date, then an amount equal to the amount of accrued Late Charge shall be added to the Overdue Amount, and the amount then payable shall be the sum of the Overdue Amount and the amount of the accrued Late Charge (the sum being the "New Overdue Amount"), plus a new Late Charge on the New Overdue Amount accruing at a new Late Charge Rate to be then determined in accordance with the principles of the second preceding sentence (but using the investment rate from the auction immediately preceding such Interest Payment Date rather than the auction preceding the Due Date). For so long as any Overdue Amount, or, if applicable, any New Overdue Amount, remains unpaid, the Late Charge Rate shall be redetermined in accordance with the principles of the third preceding sentence on each succeeding Interest Payment Date (using the investment rate from the auction immediately preceding such Interest Payment Date), and shall be applied to the Overdue Amount, or if applicable, the New Overdue Amount, and all amounts of accrued Late Charge to the actual date of payment. Any funds received from Mexico after the Due Date shall be applied first to the payment of any accrued and unpaid Late Charge and then to the payment of any Overdue Amount or, if applicable, the New Overdue Amount.

9. **Authority of the FRBNY.**

In carrying out its functions as provided in this Medium-Term Agreement, the FRBNY shall have the authority to interpret and act under (x) the terms of this Medium-Term Agreement, and, if applicable, the 1995 Framework Agreement, (y) any irrevocable authorizations and instructions received by it hereunder, and (z) any notifications or other communications that the parties hereto shall send or transmit to the FRBNY, in such manner as the FRBNY, in its sole judgement, deems reasonable. In making any calculations of the purchases and repayments provided for under this Medium-Term Agreement, the FRBNY shall have the authority to make rounding adjustments to any amounts. Except for reimbursement of FRBNY's costs and expenses, no compensation shall be due from Mexico for services rendered by the FRBNY under the authorizations and instructions in this Medium-Term Agreement. In carrying out its functions under this Medium-Term Agreement, the FRBNY shall be liable only for its failure to exercise reasonable care.

10 **Warranties.**

(a) **Authority.** Each of the Treasury and Mexico warrants that it has full power and authority to enter into and perform its obligations under this Medium-Term Agreement and has taken and will take all necessary actions to authorize the performance of the terms and conditions of this Medium-Term Agreement.

(b) **Covenant to Inform.** In the event there is any change in law, act or other change of fact or circumstance as a result of which Mexico is not able to make the warranties in, or perform its obligations under, this Medium-Term Agreement or the 1995 Framework Agreement, Mexico shall inform the Treasury of such change in law, act, or other change of fact or circumstance and the steps that Mexico plans to take in response.

11. **Indemnity.**

Mexico hereby indemnifies and hold harmless the Treasury and the FRBNY and any of their agents, directors, officers, or employees (each such indemnified person, an "Indemnified Party") from and against any and all liabilities, obligations, losses, damages, penalties, judgments, costs, expenses or disbursements of any kind whatsoever that may be imposed on or incurred by, or asserted against, such Indemnified Party in any way relating to or arising out of this Medium-Term Agreement, or any action taken or omitted to be taken by such Indemnified Party in connection with this Medium-Term Agreement (including, without limitation, any action taken or omitted to be taken before the effective date of this Medium-Term Agreement by such Indemnified Party in preparation for acting hereunder); provided that Mexico shall not be liable for any portion of any such amount resulting from gross negligence or willful misconduct of such Indemnified Party.

12. **Governing Law and Submission to Jurisdiction**.

This Medium-Term Agreement shall be governed by and construed in accordance with the law of the State of New York, to the extent not inconsistent with the federal law of the United States. Mexico hereby irrevocably submits for all purposes of or in connection with this Guarantee Agreement to the exclusive jurisdiction of the United States District Court located in the Borough of Manhattan in New York City. The United States hereby irrevocably submits for all purposes of or in connection with this Guarantee Agreement to the exclusive jurisdiction of the Federal courts of the United States. Mexico and the United States each hereby irrevocably waive, to the fullest extent, the defense of an inconvenient forum to the maintenance of an action or proceeding brought pursuant to this paragraph.

In light of the fact that Medium-Term Swap Transactions hereunder constitute commercial activities, and in accordance with normal practices, Mexico waives immunity from (i) attachment in aid of execution, (ii) execution, or (iii) attachment prior to the entry of judgment, for all purposes of Title 28 United States Code Sections 1610 and 1611 in respect of its obligations under this Medium-Term Agreement.

13. **Service of Process**.

Mexico hereby irrevocably appoints the person for the time being and from time to time acting as or discharging the function of the Consul General of Mexico in New York, New York (the "Process Agent"), with an office, on the date hereof, at 8 East 41st Street, New York, New York, 10017, United States, as its agent to receive on behalf of each of them and its property, service of copies of the summons and complaint and any other process which may be served in any such action or proceeding brought in a Federal court sitting in New York City. Such service may be made by mailing or delivering a copy of such process to Mexico in care of the Process Agent at the address specified above for such Process Agent, and Mexico hereby irrevocably authorizes and directs such Process Agent to accept such service of its behalf.

14. **No Waiver and Cumulative Remedies**.

No failure, delay, or refrainment by the Treasury in the exercise of any right or remedy accruing to the Treasury under this Medium-Term Agreement shall operate as a waiver by the Treasury of such right, power, or remedy thereof, nor shall any single or partial exercise of any other right, power, or remedy. The rights, powers, and remedies provided herein are cumulative, and not exclusive of any rights, powers, or remedies provided by law.

15. Communications.

All communications shall be in English, unless the Parties otherwise agree in writing. Any notice, request, document or other communication submitted by one Party to the other Party under this Medium-Term Agreement shall be in writing, by mail, telecopier, tested telex or personal delivery, shall refer to this Medium-Term Agreement, and shall be deemed fully given or sent when delivered to such Party.

The channel of communications for the Treasury for all communications under this Medium-Term Agreement shall be:

Office of the Assistant Secretary
for International Affairs
U.S. Department of the Treasury
Room 3430
Washington, D.C. 20220
Telephone: (202) 622-0060
Facsimile: (202) 622-0417.

The channel of communication for Mexico under this Medium-Term Agreement shall be the same as in the 1995 Framework Agreement.

The channel of communication for the Bank under this Medium-Term Agreement shall be the same as in the 1995 Framework Agreement, and also by SWIFT: BDEMMXMM.

The channel of communication for the FRBNY for all communications under this Medium-Term Agreement shall be:

Federal Reserve Bank of New York
Central Bank Services
33 Liberty Street
New York, New York 10045
Telephone: (212) 720-5222
Facsimile: (212) 720-7621
SWIFT: FRNYUS33.

16. Amendments.

This Medium-Term Agreement may be amended by the mutual agreement of the Parties hereto; provided, however, that no provision of this Medium-Term Agreement may be amended, modified, supplemented, waived, discharged or terminated orally but only in writing.

17. **Termination**.

The commitment of the Treasury to sell U.S. dollars under this Medium-Term Agreement will terminate on a date which is one year after the effective date of the 1995 Framework Agreement, provided that such commitment may be extended for an additional six-month period in accordance with Article III(7) of the 1995 Framework Agreement. In any event, the terms and conditions of this Medium-Term Agreement will continue to apply until all amounts owed to the Treasury under this Medium-Term Agreement have been repaid in full.

18. **Survival of Covenants**.

All covenants, agreements and warranties made herein shall survive the execution and delivery of this Medium-Term Agreement and shall remain in full force and effect until repayment in full of all amounts owed to the Treasury pursuant to this Medium-Term Agreement.

19. **Counterparts**.

This Medium-Term Agreement may be executed in counterparts and shall enter into force on the date of the last signature hereto.

IN WITNESS WHEREOF, the undersigned, being duly authorized, have signed this Medium-Term Agreement.

DONE at Washington, this 21st day of February, 1995, in duplicate.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA	FOR THE GOVERNMENT OF THE UNITED MEXICAN STATES
Department of the Treasury	Ministry of Finance and Public Credit

U.S. - MEXICO FRAMEWORK AGREEMENT
FOR MEXICAN ECONOMIC STABILIZATION

WHEREAS, Mexico has achieved a remarkable economic transformation over the last several years on the basis of an effective stabilization program and far-reaching structural reforms; and

WHEREAS, these policies and reforms resulted in a correction in fiscal imbalances, a rationalization in the role of the state in the economy, a significant decrease in inflation, and a greater integration of Mexico into the global economy; and

WHEREAS, there was a sharp increase in Mexico's external current account deficit and, until recently, a significant real appreciation of the peso; and

WHEREAS, in 1994, investors' concerns about the sustainability of the current account deficit began to increase, against the background of adverse political events in Mexico, competition for foreign investment in other emerging markets, and higher interest rates abroad; and

WHEREAS, in 1994, as part of its efforts to maintain and attract foreign investment, Mexico substituted short-term indebtedness denominated in foreign currency for short-term local currency denominated debt; and

WHEREAS, investors' increasing concerns put further pressures on Mexico's foreign exchange and financial markets and precipitated the present financial crisis, which has had repercussions in other emerging markets in Latin America and elsewhere; and

WHEREAS, it is in the interest of the people of the United States and Mexico to restore financial stability to Mexico; and

WHEREAS, the international community and international institutions, particularly the International Monetary Fund ("IMF"), have recognized the gravity and potential global impact of Mexico's financial crisis and have committed to take extraordinary measures to restore financial stability to Mexico; and

WHEREAS, monetary and financial cooperation between the United States and Mexico is an important factor in carrying out the objectives of the IMF, of which both countries are members, consistent with their obligations, as members, on orderly exchange arrangements and a stable system of exchange rates, and

WHEREAS, stabilization arrangements have been in effect between the two countries since 1941, and have proved beneficial to the financial relationship between the two countries;

NOW, THEREFORE, the Parties, as described in Article II, agree as follows:

I
Purpose

The purpose of this agreement ("Agreement") is to assist Mexico in stabilizing its exchange and financial markets by providing resources to be used in such manner as to facilitate the redemption, refinancing or restructuring of Mexico's short-term debt obligations, and such other purposes consistent with the obligations of the United States and Mexico, as members of the IMF, on orderly exchange arrangements and a stable system of exchange rates.

II
Parties

This Agreement sets forth the mutual understandings of the Government of the United States of America ("United States"), acting through the United States Department of the Treasury ("Treasury Department"), and the Government of the United Mexican States ("Mexico"), acting through the Ministry of Finance and Public Credit, and the Banco de Mexico.

III
Availability and Use of Resources

1. Subject to the terms and conditions contained in this Agreement and the Financing Agreements referred to in Article VI, the United States shall make available to Mexico and the Banco de Mexico, or furnish for their benefit, resources (valued in accordance with such Financing Agreements) in the amount of not more than $20,000,000,000.

2. These resources shall be in the form of:

(i) medium-term swap transactions ("Medium-Term Swaps") provided through the Exchange Stabilization Fund ("ESF") at the Treasury Department;

(ii) securities guarantees ("Securities Guarantees") provided through the ESF;

(iii) backing by the Treasury Department for short-term swap transactions in an amount not to exceed $6,000,000,000 that have been or will be provided under the North American Framework Agreement of April 26, 1994, as amended from time to time ("NAFA"), by the Federal Reserve Bank of New York, acting at the direction of the Federal Open Market Committee ("FRBNY"), under which the rights and obligations of the FRBNY related to such short-term swap transactions may be assigned to the Treasury Department under certain circumstances ("Treasury Backing"); and

(iv) short-term swap transactions that have been or will be provided by the Treasury Department under the NAFA ("Treasury Short-Term Swaps").

3. The following shall be referred to herein collectively as the "Primary Resources:"

(i) the Medium-Term Swaps;

(ii) the Securities Guarantees;

(iii) the Treasury Backing with respect to short-term swaps not already outstanding on the date of entry into force of this Agreement; and

(iv) the Treasury Short-Term Swaps not already outstanding on the date of entry into force of this Agreement.

4. The Medium-Term Swaps shall be made available pursuant to a medium-term exchange stabilization agreement ("Medium-Term Agreement"), which shall not be inconsistent with this Agreement. The Medium-Term Agreement shall provide that:

(i) maturities for the Medium-Term Swaps shall be up to 5 years; and

(ii) the Medium-Term Swaps shall be payable prior to maturity as provided herein and in the Medium-Term Agreement.

5. The Securities Guarantees shall be made available pursuant to a guarantee agreement ("Guarantee Agreement"), which shall not be inconsistent with this Agreement. The Guarantee Agreement shall provide that:

(i) no Securities Guarantees may be issued in respect of payments of principal or interest due more than 10 years after issuance of the guaranteed debt securities; and

(ii) the debt securities for which Securities Guarantees are issued may be structured to allow for redemption prior to maturity under specified circumstances as provided herein and in the Guarantee Agreement.

6. The Treasury Backing shall be made available pursuant to the terms of a separate agreement between the Treasury Department and FRBNY ("Backing Agreement"). It is understood that, pursuant to the Backing Agreement and the NAFA, the FRBNY may enter into further short-term swap transactions with the Banco de Mexico that are subject to the Backing Agreement only with the written consent of the Treasury Department.

7. The Medium-Term Swaps may be entered into during the period that begins on the first date on which both this Agreement and the Medium-Term Agreement have entered into force and ends on the first anniversary of the date of entry into force of this Agreement ("Swaps Implementation Period"). If Mexico so requests, and with the written agreement of the Treasury Department, the Swaps Implementation Period may be extended for one additional six-month period.

8. The Securities Guarantees may be entered into during the period that begins on the first date on which both this Agreement and the Guarantee Agreement have entered into force and ends on the first anniversary of the date of entry into force of this Agreement ("Guarantee Implementation Period"). If Mexico so requests, and with the written agreement of the Treasury Department, the Guarantee Implementation Period may be extended for one additional six-month period.

9. The interest rates on the Medium-Term Swaps and the fees charged for the Securities Guarantees shall be designed to compensate the ESF for the risk of providing such Medium-Term Swaps and issuing such Securities Guarantees, and to provide an incentive to Mexico to rely on private capital markets for its financing needs.

10. The use of Primary Resources made available to or furnished for the benefit of Mexico or the Banco de Mexico shall be consistent with the purpose of this Agreement as set forth in Article I.

IV
Assured Sources of Repayment

1. No Primary Resources shall be provided to Mexico or the Banco de Mexico, directly or indirectly, unless the Treasury Department determines that:

(i) the resources of Mexico, including proceeds from the sale of Mexican oil and oil products to customers outside of Mexico as described in Annex A hereto, afford adequate, assured sources of repayment with respect to such Primary Resources; and

(ii) all instructions and other documents to be given or delivered pursuant to Annex A have been given or delivered within the time periods provided therein.

2. Mexico shall furnish, or cause to be furnished, all information reasonably requested by the Treasury Department in order that the Treasury Department might make the determinations required under this article. At the request of the Treasury Department, Mexico shall, at its expense, provide the Treasury Department with confirmation by independent public accountants that the information furnished to the Treasury Department is not inconsistent with the books and records of PEMEX and its subsidiaries.

V
Financial Plan

1. Mexico has made available to the Treasury Department a copy of its comprehensive and detailed financial plan ("Financial Plan") that includes, inter alia, a description of the intended uses of Primary Resources to be made available pursuant to this Agreement, and how such uses relate to the use of other funds to be made available to Mexico or the Banco de Mexico by other entities, and the Treasury Department has advised Mexico of its concurrence with the Financial Plan.

2. Prior to each request for Primary Resources by Mexico or the Banco de Mexico, Mexico shall submit to the Treasury Department a written description of Mexico's financial developments as they relate to the Financial Plan, the intended use or uses to which the Primary Resources will be put, and how such use or uses are consistent with the Financial Plan.

3. Mexico shall update its Financial Plan at least annually, as long as any Primary Resources are outstanding.

4. Mexico shall notify the Treasury Department in writing of any intended material changes in the Financial Plan.

VI
Conditionality

1. No Primary Resources shall be provided to Mexico or the Banco de Mexico directly or indirectly if the Treasury Department determines that Mexico's and the Banco de Mexico's economic policies are not in accordance with the Letter of Intent and Memorandum of Economic Policies (attached hereto as Annex B) relating to the stand-by credit for Mexico approved by the IMF on February 1, 1995 ("IMF Program"), or any other economic policies subsequently required under the IMF Program. In making such determinations, the Treasury Department shall take into consideration the IMF's reviews of the implementation of Mexico's economic objectives and policies.

2. No Primary Resources shall be provided to Mexico or the Banco de Mexico directly or indirectly if the Treasury Department determines that Mexico has failed in any material respect to implement the economic policies announced by Mexico on February 21, 1995, a summary of which is attached hereto as Annex C.

3. No Primary Resources shall be provided to Mexico or the Banco de Mexico directly or indirectly if the Treasury Department determines, following each request for Primary Resources and prior to the provision of such Primary Resources, that:

(i) Mexico or the Banco de Mexico has taken actions that are materially inconsistent with the Financial Plan;

(ii) Mexico's Financial Plan is materially inconsistent with prevailing conditions;

(iii) the intended use or uses of the Primary Resources are inconsistent with Mexico's Financial Plan;

(iv) the Treasury Department does not concur with any material changes made by Mexico to its Financial Plan; or

(v) Mexico or the Banco de Mexico has failed in material respects to comply with its obligations under Article IX.

4. No Primary Resources shall be provided to Mexico or the Banco de Mexico directly or indirectly if Mexico or the Banco de Mexico fails to make any payment when due, and has not remedied such failure within 7 days after notice thereof from the Treasury Department to Mexico or the Banco de Mexico, under the Medium-Term Agreement, the Guarantee Agreement, the NAFA, the Exchange Stabilization Agreement of April 26, 1994, as amended from time to time, or the Temporary Exchange Stabilization Agreement of January 4, 1995, as amended from time to time (collectively, "Financing Agreements").

VII
Acceleration, Early Redemption, Defeasance

1. If at any time the Treasury Department determines that:

(i) Mexico or the Banco de Mexico has failed to comply in any material respect with the agreement set forth in Annex A and has not remedied such failure within 30 days after notice thereof from the Treasury Department to Mexico; or

(ii) Mexico or the Banco de Mexico has failed to comply in any material respect with Article IX and has not remedied such failure within 60 days after notice thereof from the Treasury Department to Mexico or the Banco de Mexico; or

(iii) Mexico or the Banco de Mexico has used any Primary Resources provided under the Financing Agreements in a manner materially inconsistent with the purpose of this Agreement as set forth in Article I; or

(iv) Mexico or the Banco de Mexico has failed to make any payment when due under any of the Financing Agreements, and has not remedied such failure within 7 days after notice thereof from the Treasury Department to Mexico; or

(v) Mexico or the Banco de Mexico has failed in any material respect to follow the economic policies incorporated in the IMF Program, or any economic policies subsequently incorporated in the IMF Program and:

(A) such event shall have continued without cure for a period of 90 days after notice thereof from the Treasury Department to Mexico, and the Treasury Department shall have determined and so advised Mexico in writing that the continuance of such event may constitute grounds for acceleration; and

(B) such event shall have continued without cure for an additional period of 180 days, and the Treasury Department shall have determined and so advised Mexico in writing that in its reasonable judgment, the occurence and continuance of such event materially impairs the ability of Mexico to service on a timely basis the Medium-Term Swaps and the debt securities for which Securities Guarantees have been issued; or

(vi) Mexico or the Banco de Mexico has taken actions materially inconsistent with its Financial Plan and:

(A) such event shall have continued without cure for a period of 90 days after notice thereof from the Treasury Department to Mexico, and the Treasury Department shall have determined and so advised Mexico in writing that the continuance of such event may constitute grounds for acceleration; and

(B) such event shall have continued without cure for an additional period of 180 days, and the Treasury Department shall have determined and so advised Mexico in writing that in its reasonable judgment, the occurence and continuance of such event materially impairs the ability of Mexico to service on a timely basis the Medium-Term Swaps and the debt securities for which Securities Guarantees have been issued; or

(vii) Mexico or the Banco de Mexico has failed to implement the policies described in Annex C hereto and:

(A) such event shall have continued without cure for a period of 90 days after notice thereof from the Treasury Department to Mexico, and the Treasury Department shall have determined and so advised Mexico in writing that the continuance of such event may constitute grounds for acceleration; and

(B) such event shall have continued without cure for an additional period of 180 days, and the Treasury Department shall have determined and so advised Mexico in writing that in its reasonable judgment, the occurence and continuance of such event materially impairs the ability of Mexico to service on a timely basis the Medium-Term Swaps and the debt securities for which Securities Guarantees have been issued;

the Treasury Department may, upon notice to Mexico or the Banco de Mexico (in addition to the exercise of any other remedies set forth in the Financing Agreements):

(a) declare any or all obligations of Mexico or the Banco de Mexico to repurchase pesos for dollars under any or all of the Medium-Term Swaps, Treasury Short-Term Swaps or other short-term swaps with Treasury Backing immediately due and payable, whereupon the entire unpaid amount of such repurchase obligations, and all other amounts payable with respect to such obligations, shall become and forthwith be payable, without demand or further notice of any kind, all of which are expressly waived by Mexico and the Banco de Mexico; and

(b) require Mexico either to (I) defease the guaranteed portion of any or all debt securities for which Securities Guarantees have been issued or (II) redeem any such debt securities that are subject to early redemption (or, if permitted by the terms of such debt securities, the guaranteed portion thereof), whereupon Mexico shall, without demand or further notice of any kind, all of which are expressly waived by Mexico, either (at Mexico's option) defease the guaranteed portion of such debt securities or redeem such debt securities;

provided, however, that in the case of an event described in clause (iii) above, the remedies set forth in this paragraph 1 shall apply only to the Primary Resources applied inconsistently with Article I.

2. After any such declaration or requirement, if all amounts then due with respect to any or all obligations of Mexico or the Banco de Mexico under any or all of the Financing Agreements are paid (other than amounts due solely because of such declaration) and all other defaults with respect to such obligations are cured, the Treasury Department may annul and rescind such declaration or requirement.

3. In the event of an acceleration, early redemption, or defeasance pursuant to paragraph 1 above, the Treasury Department shall have the right to distribute, in such manner and in such order of priority as it deems appropriate, funds received by the Treasury Department pursuant to any Financing Agreement or the agreement set forth in Annex A for payment of the obligations of Mexico or the Banco de Mexico under any or all of the Financing Agreements.

VIII
Prepayment

1. Mexico or the Banco de Mexico may at any time prepay any or all of its obligations under any or all of the Financing Agreements.

2. Upon its determination, after consultation with Mexico, that Mexico has well-established access to funds on reasonable market terms, the Treasury Department may require Mexico or the Banco de Mexico to secure resources in the international markets and apply such resources:

(i) to repurchase pesos for dollars under any or all of the Medium-Term Swaps, Treasury Short-Term Swaps or other short-term swaps with Treasury Backing; and/or

(ii) either to (I) defease the guaranteed portion of any or all debt securities for which Securities Guarantees have been issued or (II) redeem any such debt securities that are subject to early redemption (or, if permitted by the terms of such debt securities, the guaranteed portion thereof);

unless Mexico or the Banco de Mexico is unable, using its best efforts, to identify replacement resources (in addition to funds needed to be raised in the market pursuant to the Financial Plan) on reasonable market terms with maturities at least as long as the remaining maturities of the Primary Resources being replaced within 90 days following notification by the Treasury Department to Mexico of its intention to require such prepayment.

3. If an event described in paragraph (12)(b) of Annex A shall have occurred, and if the consultation contemplated by such paragraph does not result in agreement between Mexico and the Treasury Department as to a substitute assured source of repayment or other solution satisfactory to the Treasury Department, then the Treasury Department, if such event is continuing may require Mexico or the Banco de Mexico, as applicable, upon not less than 7 days' notice thereof:

(i) to repurchase pesos for dollars under any or all of the Medium-Term Swaps, Treasury Short-Term Swaps or other short-term swaps with Treasury Backing; and

(ii) either to (I) defease the guaranteed portion of any or all debt securities for which Securities Guarantees have been issued or (II) redeem any such debt securities that are subject to early redemption (or, if permitted by the terms of such debt securities, the guaranteed portion thereof).

IX
Access to Monetary Data and Other Information

Mexico and the Banco de Mexico shall provide to the Treasury Department all information reasonably requested by the Treasury Department that the Treasury Department deems necessary to review the Financial Plan referred to in Article V and to make the determinations referred to in Articles VI and VII. This information shall include, but shall not be limited to, information that Mexico has announced it will make available publicly as described Annex D hereto.

X
Consultations

1. The Parties shall consult with one another concerning the interpretation or implementation of this Agreement or any of the Financing Agreements at any time upon the request of any Party.

2. The Parties shall engage in periodic consultations with respect to Mexico's intended changes in the Financial Plan, and, as contemplated by the North American Free Trade Agreement, with respect to monetary, fiscal, and structural policies.

XI
Power and Authority

Each Party warrants that it has full power and authority to enter into and perform its obligations under this Agreement and has taken all necessary actions to authorize its performance.

XII
Channel of Communication

1. The channel of communication for the Treasury Department for all communications under this Agreement shall be:

Office of the Assistant Secretary
for International Affairs
U.S. Department of the Treasury
Room 3430
Washington, D.C. 20220
Telephone: (202) 622-0060
Facsimile: (202) 622-0417

2. The channel of communication for Mexico for all communications under this Agreement shall be:

Director General of Public Credit
Ministry of Finance and Public Credit
Insurgentes Sur 826, Piso 9
Colonia del Valle
Mexico, D.F. 03100, Mexico
Telephone: 525-682-2799
Facsimile: 525-543-3446

3. The channel of communication for the Banco de Mexico for all communications under this Agreement shall be:

Director General of Central Banking Operations
Banco de Mexico
Avenida 5 de Mayo, No. 6, Piso 1
Mexico, D.F. 06059, Mexico
Telephone: 525-227-8821
Facsimile: 525-227-8803

XIII
Amendment

This Agreement may be amended by the consent of all Parties in writing, including consent by authenticated telecommunication.

XIV
No Waiver; Cumulative Remedies

No failure, delay, or refrainment by the Treasury Department in the exercise of any right or remedy accruing to the Treasury Department under this Agreement shall operate as a waiver by the Treasury Department of such right, power or remedy, nor shall any single or partial exercise of any other right, power or remedy. The rights, powers and remedies provided herein are cumulative and not exclusive of any rights, powers or remedies provided by law.

XV
Governing Law; Submission to Jurisdiction

This Agreement shall be governed by and construed in accordance with the laws of the State of New York, to the extent not inconsistent with the federal law of the United States. Mexico and the Banco de Mexico hereby irrevocably submit for all purposes of or in connection with this Agreement to the exclusive jurisdiction of the United States District Court located in the Borough of Manhattan in New York City. The United States hereby irrevocably submits for all purposes of or in connection with this Agreement to the exclusive jurisdiction of the Federal courts of the United States. Mexico, the Banco de Mexico and the United States hereby irrevocably waive, to the fullest extent, the defense of an inconvenient forum to the maintenance of an action or proceeding brought pursuant to this paragraph.

XVI
Commercial Activities

The obligations to be performed by the parties under this Agreement, the Medium-Term Agreement, and the Guarantee Agreement, and the Treasury Short-Term Swaps and other short-term swaps with Treasury Backing, shall constitute commercial activities within the meaning of 28 U.S.C. 1602 et seq.

XVII
Service of Process

Mexico and the Banco de Mexico hereby irrevocably appoint the person for the time being and from time to time acting as or discharging the function of the Consul General of Mexico in New York, New York ("Process Agent"), with an office, on the date hereof, at 8 East 41st Street, New York, New York, 10017, United States, as their agent to receive on behalf of Mexico and the Banco de Mexico and their property, service of copies of the summons and complaint and any other process which may be served in any such action or proceeding brought in a Federal court sitting in New York City. Such service may be made by mailing or delivering a copy of such process, in the case of Mexico, to Mexico, and, in the case of the Banco de Mexico, to the Banco de Mexico, in care of the Process Agent at the address specified above for such Process Agent, and Mexico and the Banco de Mexico hereby irrevocably authorize and direct such Process Agent to accept such service on their behalf.

XVIII
Entry into Force

This Agreement may be executed in counterparts and shall enter into force on the date of the last signature hereto.

IN WITNESS WHEREOF, the undersigned, being duly authorized, have signed this Agreement.

DONE at Washington, this 21st day of February, 1995, in triplicate.

FOR THE GOVERNMENT OF THE
UNITED STATES OF AMERICA

Department of the Treasury

FOR THE GOVERNMENT OF THE
UNITED MEXICAN STATES

Ministry of Finance and
Public Credit

FOR THE BANCO DE MEXICO

ANNEX A

OIL PROCEEDS FACILITY AGREEMENT

(1) Introduction

(a) Parties and Purpose. This Oil Proceeds Facility Agreement (the "Agreement"), dated as of February 21, 1995, sets forth the rights and obligations of (i) the Government of the United Mexican States, acting through the Ministry of Finance and Public Credit (the "Government"), (ii) the Banco de Mexico, acting on its own account and as fiscal agent of the Government (the "Banco de Mexico")(the Government and the Banco de Mexico shall be collectively referred to as "Mexico"), (iii) Petróleos Mexicanos, (iv) P.M.I. Comercio Internacional S.A. de C.V. ("PMI"), (v) P.M.I. Trading Limited ("PMI Trading") (Petróleos Mexicanos, PMI, PMI Trading, and any other subsidiary of Petroleos Mexicanos subsequently added as a party hereto being collectively referred to as "PEMEX" and individually as a "PEMEX Entity"), (vi) the United States Department of the Treasury (the "Treasury"), and (vii) the Federal Reserve Bank of New York (the "FRBNY") as to the use of proceeds from the Export of crude oil and Oil Derivatives, other than Excluded Exports (as such terms are defined in subparagraph 12(a) below) by PEMEX, and other certain sources, as a source of repayment for support by (A) the United States Monetary Authorities under the North American Framework Agreement, dated April 26, 1994, and as amended from time to time (the "NAFA"), and (B) the Treasury under the U.S.-

Mexico Framework Agreement for Mexican Economic Stabilization, dated as of February 21, 1995 (the "Framework"), the Medium-Term Agreement and the Guarantee Agreement (as each such term is defined in the Framework). The NAFA (with respect to the U.S. Monetary Authorities) and the Separate Agreements of the U.S. Monetary Authorities, as such terms are defined in the NAFA, the Framework, the Medium-Term Agreement, and the Guarantee Agreement are referred to collectively as the "Financing Arrangements" and individually as a "Financing Arrangement."

(b) Defined Terms; Schedules. Unless otherwise defined herein, terms used herein have the same meaning as they do in the appropriate Financing Arrangement. The schedules referred to in this Agreement shall be agreed to by the parties and attached hereto.

(c) January 16 MOU. This Agreement will supersede the terms and conditions of the Memorandum of Understanding (the "MOU"), dated January 16, 1995, among the Banco de Mexico, the Treasury, the FRBNY and the Bank of Canada, which MOU shall be terminated by its parties on the Effective Date of this Agreement.

(d) Obligations Backed by this Agreement. Mexico agrees that this Agreement will remain in place until all of its payment obligations under the Financing Arrangements have been fully satisfied or, if the Treasury, the FRBNY and Mexico enter into an agreement described in paragraph 17 below, until all of the Government's obligations under the Financing Arrangements and any

Other Financing Agreements referred to in paragraph 17 below have been fully satisfied.

(2) Implementation of Oil Proceeds Arrangements

(a) Conditions for Effectiveness. The following conditions shall be satisfied by either Mexico or PEMEX, as set forth below, on or prior to the Effective Date, as defined in paragraph 22 below.

(i) Legal Opinions and Instructions. Mexico and PEMEX shall obtain, and shall provide to the Treasury and the FRBNY, copies of the legal opinions and other documents as required by the Treasury, substantially in the form set out in Schedules A through F.

(ii) Banco de Mexico Account. Mexico shall complete all the necessary arrangements to provide for the transfer by PEMEX to the account of the Banco de Mexico (acting on its own account and as fiscal agent of the Government) at the FRBNY established for purposes of this Agreement (the "Special Funds Account") of proceeds from the Export of crude oil and Oil Derivatives (other than Excluded Exports (as such term is defined in subparagraph 12(a) below) and amounts payable to third parties under Specified Agreements, as defined in subparagraph 2(b)(v) below), the amounts so transferred and credited to the Special Funds Account becoming part of the property held by the Banco de

Mexico on its own account and as fiscal agent of the Government, with no PEMEX Entity having any rights to the funds in the Special Funds Account. Such funds will be transferred over Fedwire to the FRBNY by Swiss Bank Corporation, New York Branch ("SBC") for credit to the Special Funds Account. Upon advice of credit to the Special Funds Account from the FRBNY, the Banco de Mexico will credit a corresponding amount to the account of PEMEX or the respective PEMEX Entity on the books of the Banco de Mexico. Such arrangements are consistent with the regulatory practice of the Banco de Mexico.

(iii) <u>PEMEX Customer Instructions.</u> PEMEX shall, with respect to all Exports (other than Excluded Exports) by PEMEX of crude oil or Oil Derivatives pursuant to long-term contracts under which payments are to be made directly from the respective customer to PEMEX, irrevocably instruct, substantially in the form of Schedules K-1 or K-2,

(A) all existing customers of each PEMEX Entity (collectively "Buyers") to make all payments for the delivery or purchase of crude oil or Oil Derivatives due to that PEMEX Entity to an account of that PEMEX Entity at SBC; and

(B) the parties listed in Schedule G to make all payments due to any PEMEX Entity under the agreements described in Schedule H (the "Existing Agreements"), net of amounts payable to other parties under the Existing Agreements (the other parties' amounts, together with amounts payable to other parties under the Specified Agreements, as defined in subparagraph 2(b)(v) below, being the "Specified Payments") to an account of a PEMEX Entity at SBC (all payments referred to in subparagraph 2(a)(iii)(A) above, subparagraphs 2(b)(i), 2(b)(ii), and 2(b)(iv) below, and this subparagraph 2(a)(iii)(B) net of the Specified Payments being defined as the "Payments"); and

(iv) PEMEX SBC Instructions. PEMEX shall:

(A) execute and deliver to SBC letters of instructions, in the form of Schedules I-1, I-2 and I-3, whereby each PEMEX Entity unconditionally and irrevocably authorizes and directs SBC, beginning on the first FRBNY Business Day (any day the FRBNY is open for business shall be a "FRBNY Business Day") after the Effective Date, to credit to the FRBNY for credit to the Special Funds Account at the FRBNY, promptly, but in any event within one FRBNY Business Day of receipt by SBC, all Payments, until receipt of the release from the FRBNY referred to in subparagraph (f) below; and

(B) deliver to the Treasury and the FRBNY the irrevocable written consent of the SBC to the foregoing instructions of each PEMEX Entity, substantially in the form of Schedule J, and an opinion from in-house counsel of SBC in a form satisfactory to the Treasury.

(b) Continuing Obligations.

(i) New Customers. For so long as this Agreement is in effect, payments from export sales of crude oil and Oil Derivatives, other than Excluded Exports, to new customers of PEMEX after the Effective Date (the "New Buyers") will be subject to the terms of this Agreement, and PEMEX shall irrevocably instruct New Buyers to make payments in accordance with subparagraph 2(a)(iii) above;

(ii) Letter of Credit Contracts. In the event that payments under any of the long-term contracts referred to above are to be made pursuant to a letter of credit, PEMEX shall irrevocably instruct, substantially in the form of Schedule K-3, the bank confirming such letter of credit to make all payments due to each PEMEX Entity pursuant to such letter of credit in respect of such long-term contract to an account of a PEMEX Entity at SBC;

(iii) Acknowledgments. PEMEX shall take all steps necessary to ensure that each instruction is acknowledged, in the case of existing Buyers with long-term contracts, within three months after the Effective Date, in the case of confirming letter of credit banks, within one month of the receipt of the instructions, and, in the case of New Buyers, within three months after entering into a long-term contract with any PEMEX Entity. In the case of existing Buyers under long-term contracts, at the option of the Treasury, an additional three months may be extended for PEMEX to secure such acknowledgments. Copies of all acknowledged instructions shall be furnished to the FRBNY;

(iv) Other Instructions. With respect to all Exports by PEMEX of crude oil and Oil Derivatives (other than Excluded Exports) that are not made pursuant to long-term contracts,

(A) in the event that payment is to be made directly from the respective Buyer to PEMEX, PEMEX shall irrevocably instruct such Buyer to make payment for the delivery or purchase of such crude oil or Oil Derivatives to an account of a PEMEX Entity at SBC, or

(B) in the event that payment for such sale is to be made pursuant to a letter of credit, PEMEX shall irrevocably instruct, substantially in the form of Schedule K-3, the bank confirming such letter of credit to make all payments due pursuant to such letter of credit to an account of a PEMEX Entity at SBC; and

(v) Liens. PEMEX shall not sell or otherwise dispose of or create or permit or suffer to be created or exist any lien, pledge, mortgage, charge or other encumbrance or security interest whatsoever with respect to its rights to receive Payments nor to enter into any other arrangements, including sales of receivables or other rights to receive payments, with respect to such Payments which gives any person an interest therein other than as contemplated (A) by the Existing Agreements or (B) other agreements approved in advance by the Treasury, including agreements which either replace or refinance the Existing Agreements on terms that are substantially similar to those of the Existing Agreements (collectively, the "Specified Agreements"); and,

(vi) Notices. PEMEX shall notify the FRBNY of (A) any sale of receivables under the Purchase and Sale Agreement referred to in Paragraph 1 of Schedule H, (B) any payment by the Ministry of International Trade and Industry of Japan under the insurance policy referred to in Paragraph 2 of Schedule H, (C) any set-off by The Bank of Toyko, Ltd. in connection with the agreement referred to in paragraph 4 of Schedule H or (D) any comparable event under the Specified Agreements.

(c) Government Support. The Government will take whatever actions, and provide any other support, necessary to facilitate the performance of the Banco de Mexico or any PEMEX Entity under this Agreement.

(d) Absence of Liens on Special Funds Account. Mexico agrees that it will not sell or otherwise dispose of or create or permit or suffer to be created or exist any lien, pledge, mortgage, charge or other encumbrance or security interest whatsoever on any funds credited to the Special Funds Account, nor enter into any other arrangements with respect to such funds which give any person an interest therein, other than the arrangements specified in this Agreement.

(e) Use of Funds in the Special Funds Account and Other Accounts. The Banco de Mexico, acting on its own account and as fiscal agent of the Government, irrevocably authorizes and instructs the FRBNY to use the funds deposited in the Special Funds Account to repay all amounts due and payable under the Financing Arrangements. The FRBNY shall hold any amounts standing to the credit of the Special Funds Account for the benefit of the Treasury to the extent that any amounts payable under the Financing Arrangements are not paid when due. Any amount standing to the credit of the Special Funds Account may be withdrawn from time to time by the Banco de Mexico, acting on its own account or as fiscal agent of the Government, when and to the extent that there are no amounts due and unpaid under the Financing Arrangements.

In the event that the FRBNY receives an authenticated telecommunication from the Treasury, notifying it that Mexico failed to make any payment under any Financing Arrangement or under any Other Financing Agreement as defined in paragraph 17(a), then:

(i) the Banco de Mexico hereby irrevocably authorizes the FRBNY immediately to debit any account of the Banco de Mexico, including any fiscal agency account and any special funds account held by the Banco de Mexico on its own account and as fiscal agent for the Government, other than a collateral pledge account of the Government or of the Banco de Mexico, with the FRBNY, and, if necessary, to liquidate investments, other than collateral pledge investments, which the FRBNY holds for the Government or the Banco de Mexico, and to transfer all proceeds of such debit or liquidation to "Treasury's Special Funds Accounts No.1" on the books of the FRBNY (the "Treasury Account") and as additional funds or investments are received by the FRBNY from any source for the Banco de Mexico on its own account or as fiscal agent for the Government, to continue to debit such accounts and liquidate such investments and to transfer all proceeds of such debit or liquidation to the Treasury Account; and

(ii) the Government hereby irrevocably authorizes and instructs the FRBNY immediately to debit any account of the Government, including any account held by the Banco de Mexico as fiscal agent of the Government, other than a collateral pledge account of the Government, with the FRBNY and, if necessary, to liquidate investments, other than collateral pledge investments, which the FRBNY holds for the Government, and to transfer all proceeds of such debit or liquidation to the Treasury Account and as additional funds or investments are received by the FRBNY from any source for the Government or the Banco de Mexico as fiscal agent of the Government, to continue to debit such accounts and liquidate such investments and to transfer all proceeds of such debit or liquidation to the Treasury Account until the FRBNY receives a notice from the Treasury by authenticated telecommunication that the Treasury has received payment in full of all obligations due to it under the applicable Financing Arrangement(s), including any late payment charges determined under the applicable Financing Arrangement(s). The Treasury shall apply the amounts credited by the FRBNY to the Treasury Account under this subparagraph 2(e) to reduce any such payments due and unpaid by Mexico under the applicable Financing Arrangement(s), following the order of priority for payment and repayment as set forth in such Financing Arrangement(s). The FRBNY shall promptly inform the Banco de Mexico of any debits to the account of the Banco de Mexico or the Government on the books of the FRBNY pursuant to this subparagraph 2(e).

(f) Final Release. Upon satisfaction in full of all payment obligations, including accrued and unpaid interest thereon, under the Financing Arrangements, and subject to paragraphs 4 and 17 below, the Treasury shall give written confirmation to that effect to the FRBNY which shall (i) promptly release SBC from its obligations undertaken in accordance with Schedules I-1, I-2 and I-3, and deliver to the Banco de Mexico and to PEMEX through the Banco de Mexico a copy of such confirmation to the FRBNY, and (ii) transfer any funds remaining in the Special Funds Account as directed by the Banco de Mexico and close the Special Funds Account. Upon receipt of the confirmation referred to in the preceding sentence, PEMEX may revoke the instructions delivered by it under subparagraphs 2(a) and 2(b) above.

(3) Implementation Arrangements

(a) FRBNY Efforts. The FRBNY will use its best endeavors to assist Mexico in the implementation of the arrangements under paragraph 2 above for the benefit of the Treasury. The FRBNY shall, to the extent feasible, (i) set-off against the Special Funds Account and any other account of the Banco de Mexico, including any fiscal agency accounts, with the FRBNY, other than a collateral pledge account of the Government or the Banco de Mexico, any amounts due and unpaid by the Banco de Mexico under any Financing Arrangement, and (ii) set-off against the Special Funds Account and any other account of the Government, including any fiscal agency account held by the Banco de Mexico, with the FRBNY, other than a collateral pledge account of the Government, any amounts due and unpaid by the Government under any Financing Arrangement. If the FRBNY has exercised any right of set-off under this subparagraph 3(a), the FRBNY shall promptly inform the Banco de Mexico, by authenticated telecommunication, of such set-off and the amount set-off. Notwithstanding anything to the contrary in this Agreement, the FRBNY shall not assume any liability whatsoever to the Treasury for, nor bear any risk in connection with, the establishment or proper implementation of the arrangements described under subparagraph 2(e) above or the exercise of set-off rights under this paragraph 3. Moreover, the Treasury agrees to indemnify the FRBNY for all and any loss or damage, costs, or expenses, including attorneys' fees and expenses of litigation, it may incur as a result of the application of such arrangements, including any set-off under this paragraph 3.

(b) Assignment of Claims. In order to carry out its duties under subparagraph (a) of this paragraph, the FRBNY may request, at any time beginning on the Effective Date, the assignment to the FRBNY of any of the then-outstanding claims of the Treasury under the Financing Arrangements. If at any time beginning on the Effective Date any sum is due and unpaid to the Treasury, the Treasury shall have the right to assign its claims or a portion thereof arising under the Financing Arrangements to the FRBNY. Any such assignment shall be required to occur simultaneously with the exercise of the right of set-off described in subparagraph (a) of this paragraph. Any claims so assigned to the FRBNY shall be free from any pledge, encumbrance, or other similar right in favor of third parties, and the FRBNY shall have the right to decline to accept the assignment of any particular claim if, in its reasonable judgment, it believes such rights do or may exist. Upon acceptance of such an assignment from the Treasury, the FRBNY shall immediately set-off the amount of the claim assigned under the Financing Arrangements against any funds in any account specified in subparagraph (a) above. To the extent that assignment of any claim does not result in payment in full of such claim, the FRBNY shall promptly re-assign the unsatisfied part of any such assigned claim back to the Treasury, and the Treasury shall accept such reassignment. Immediately upon exercising a right of set-off, the FRBNY shall credit the Treasury's account on the books of the FRBNY in the amount to which it is entitled by virtue of its assignment of its claim to the FRBNY. The Treasury shall apply the amounts so credited to the Treasury Account to reduce any such payments due and unpaid by Mexico under the applicable Financing Arrangement(s), following the order of priority for payment and repayment as set forth in such Financing Arrangement(s).

(4) <u>FRBNY's Authority to Take Additional Steps</u>

In carrying out its duties in connection with the arrangements referred to in paragraphs 2 and 3 above, the FRBNY may, in its sole discretion, take such steps as it considers reasonable and appropriate in the circumstances to protect the interests of the Treasury.

(5) Authority

Each party to this Agreement individually warrants that it has full power and authority to enter into and perform its obligations under this Agreement, and has taken all necessary actions to authorize the performance of the terms and conditions thereof.

(6) Rules Applicable to the FRBNY

In carrying out its functions under this Agreement, the FRBNY shall have the authority to interpret and act under the irrevocable authorizations and instructions received by it hereunder and any notifications or other communications that the parties hereto shall send or transmit to the FRBNY, in such manner as the FRBNY, in its sole judgment, deems reasonable. In making any calculations of the payments provided for under this Agreement or the Financing Arrangements, the FRBNY shall have the authority to make rounding adjustments to any amounts. Except for reimbursement of FRBNY costs and expenses by the Banco de Mexico, which costs and expenses shall be paid by debit to the general account of the Banco de Mexico on the books of the FRBNY, no compensation shall be due from the Government or the Banco de Mexico for services rendered by the FRBNY under the authorizations and instructions in this Agreement. In carrying out its functions under this Agreement, the FRBNY shall be liable only for failure to exercise reasonable care, unless otherwise provided herein.

(7) Information for FRBNY

The FRBNY may require any party to provide it with any information necessary to make calculations or payments under this Agreement. The FRBNY shall, promptly on receipt thereof, provide the Treasury with a copy of each of the schedules received by it under this Agreement.

(8) Legal Action

(a) Mexico Notice. Mexico hereby covenants to give prompt written notice to the Treasury of all litigation or administrative or arbitration proceedings of or before any court or governmental authority or agency or tribunal against the Government, the Banco de Mexico, acting on its own account or as fiscal agent of the Government, or any of their respective assets, which would or might have a material adverse effect on the economic or financial conditions of Mexico.

(b) PEMEX Notice. PEMEX hereby covenants to give prompt notice in writing to the Treasury of all litigation or administrative or arbitration proceedings of or before any court or governmental authority or agency or tribunal against PEMEX, or any of its respective assets, which would or might have a material adverse effect on the financial conditions of PEMEX.

(c) Litigation Affecting the Financing Arrangements: Mexico. Mexico hereby covenants to give prompt notice in writing to the Treasury of any litigation or administrative or arbitration proceedings of or before any court or governmental authority or agency or tribunal to enjoin or restrain the execution or performance by Mexico of this Agreement or the Financing Arrangements, or in any manner to question, repeal, revoke, or rescind, in whole or in part, the laws and proceedings under which this Agreement or the Financing Arrangements have been or are to be executed, performed, or enforced.

(d) Litigation Affecting the Financing Arrangements: PEMEX. PEMEX hereby covenants to give prompt notice in writing to the Treasury of any litigation or administrative or arbitration proceedings of or before any court or governmental authority or agency or tribunal to enjoin or restrain the execution or performance by any PEMEX Entity of this Agreement, or in any manner to question, repeal, revoke, or rescind, in whole or in part, the laws and proceedings under which this Agreement has been or is to be executed, performed, or enforced.

(e) Avoidance of Litigation: Mexico. Mexico agrees to undertake no legal actions or proceedings which could (i) in any manner question, repeal, revoke, or rescind, in whole or in part, the laws and proceedings under which this Agreement or the Financing Arrangements have been or are to be executed, performed, or enforced, or (ii) enjoin or restrain the execution or performance by any PEMEX Entity of its obligations under this Agreement or (iii) in any manner impair or interfere with the reasonable exercise by Treasury or the FRBNY of their respective rights under this Agreement or the Financing Arrangements.

(f) Avoidance of Litigation: PEMEX. PEMEX agrees to undertake no legal actions or proceedings which could (i) in any manner question, repeal, revoke, or rescind in whole or in part the laws and proceedings under which this Agreement has been or is to be executed, performed, or enforced, or (ii) enjoin or restrain the execution or performance by any PEMEX Entity of its obligations under this Agreement, or (iii) in any manner impair or interfere with the reasonable exercise by Treasury or the FRBNY of their respective rights under this Agreement or the Financing Arrangements.

(g) Indemnity by Mexico. Mexico shall indemnify, save, and hold harmless the Treasury and the FRBNY and any of their agents, directors, officers, or employees (each such indemnified person, an "Indemnified Party") at all times during the term of and after termination of this Agreement from and against any and all liabilities, claims, charges, judgments, damages, losses, expenses, or payments asserted against, imposed on, or incurred or made by the Treasury or any Indemnified Party in any way relating to or arising out of this Agreement, or any action taken or omitted to be taken by such Indemnified Party in connection with this Agreement (other than those resulting from the gross negligence or willful misconduct of the Treasury and the FRBNY, of any such agent, director, officer or employee).

(9) Duties and Covenants of PEMEX

(a) Each PEMEX Entity. Each PEMEX Entity shall follow its customary standards, policies, and procedures in extending credit to any of the Buyers and shall make diligent efforts to collect all Payments as they become due. In addition, each PEMEX Entity shall take all steps necessary to enforce the payment instructions and acknowledgments delivered pursuant to subparagraphs 2(a) and 2(b) above. In the case of every shipment to any of the Buyers under long-term contracts, the relevant PEMEX Entity shall send out an invoice before the date on which payment is due according to the terms of the contract. In the event that any Payment or potential payment is made otherwise than to one of the PEMEX Entity accounts at SBC, such PEMEX Entity shall remit such Payment immediately to SBC.

(b) Attachment of SBC Account. In the event of legal action against a PEMEX Entity or against an SBC account to which payments are to be made, PEMEX will make all efforts to take such steps as the Treasury may reasonably request to protect the Payments.

(10) Statements, Reports, and Notices

Pursuant to the information-sharing provisions in the Framework, PEMEX hereby agrees that, so long as this Agreement shall remain in effect or any payment obligation of Mexico or PEMEX remains outstanding under the Financing Arrangements:

(a) Audited Financial Statements. PEMEX will deliver to the Treasury as soon as available, and in any case within 180 days after the end of each fiscal year of PEMEX, consolidated financial statements for such fiscal year of Petróleos Mexicanos and its subsidiaries, including therein its annual audited consolidated balance sheet and the related consolidated statements of income, changes in equity, and changes in financial position, together with consolidating schedules, in each case prepared in accordance with Mexican Generally Accepted Accounting Principles (GAAP), consistently applied (except as otherwise discussed in the notes to such statements), in each case certified by independent public accountants of recognized standing;

(b) Accompanying Documents. Concurrent with the delivery of the financial statements referred to in subparagraph 10(a) above:

(i) Accountants' Statement. PEMEX will furnish to the Treasury a letter from the independent public accountants of PEMEX reporting on such financial statements stating that in making the examination necessary to express their opinion on such financial statements no knowledge was obtained of the occurrence of an event described in subparagraph 12(b) below; and (ii) Certificate of Financial Officer. PEMEX will furnish to the Treasury a certificate of a senior financial officer of Petróleos Mexicanos, stating that, to the best of such officer's knowledge, after due inquiry, each PEMEX Entity has during the relevant period observed or performed in all material respects all of its covenants and other agreements, and satisfied in all material respects every condition contained in this Agreement, and that such officer has no knowledge of (a) any failure by PEMEX to pay any debt under any foreign financing agreement, (b) any failure by PEMEX to perform or observe in any material respect any provision of this Agreement, (c) the commencement of liquidation or bankruptcy proceedings by PMI or PMI Trading or involuntary bankruptcy proceedings affecting PMI or PMI Trading, and (d) the occurrence of an event described in subparagraph 12(b) below, except as specified in such certificate;

(c) Reconciliation. PEMEX will furnish to the Treasury as soon as available, but no later than 180 days after the end of each fiscal year of Petróleos Mexicanos, information necessary to reconcile the income and equity items in the financial statements delivered in accordance with subparagraph (a) of this paragraph 10 with the amounts for such items under U.S. GAAP;

(d) <u>SEC Reports</u>. PEMEX will furnish to the Treasury, promptly after the filing thereof, copies of all periodic and other reports filed by PEMEX with the United States Securities and Exchange Commission, and the delivery of such reports to the Treasury shall satisfy any separate requirement to furnish the same materials provided elsewhere in this paragraph 10;

(e) <u>Notice</u>. PEMEX will promptly furnish to the Treasury, after any executive officer of PEMEX obtains knowledge of (i) failure by PEMEX to pay any debt under any foreign financing agreement, (ii) failure by PEMEX to perform or observe in any material respect any provision of this Agreement, (iii) the commencement of liquidation or bankruptcy proceedings by PMI or PMI Trading or involuntary bankruptcy proceedings affecting PMI or PMI Trading, and (iv) the occurrence of an event described in subparagraph 12(b) below, a written notice signed by such officer describing such failure or event and the steps that PEMEX proposes to take in connection therewith;

(f) <u>Quarterly Statements</u>. No later than one month after the end of each calendar quarter, PMI shall furnish to the Treasury a statement setting forth (i) projections of the volumes of crude oil and Oil Derivatives Exports for the next quarter, and the values in dollars of such crude oil and Oil Derivatives Exports, using prices prevailing at the time of such certificate, (ii) volumes of crude oil and Oil Derivatives exported during the calendar quarter most recently ended and the values of such Exports, (iii) the amount of Payments received during the calendar quarter most recently ended with respect to such Exports plus payments received with respect to Excluded Exports, and (iv) a statement that the person furnishing such certificate has reviewed or caused to be reviewed the records of PMI and PMI Trading with respect to Payments payable during the calendar quarter most recently ended, and that no errors or irregularities were detected with respect to the collection of such Payments and that such collections were conducted in compliance with this Agreement, such statement to be certified by the president or chief financial officer of PMI or PMI Trading as being true and correct; and

(g) Additional Information. PEMEX will promptly furnish to the Treasury, and will use reasonable efforts to facilitate Treasury's obtaining, such information as the Treasury determines to be reasonably necessary to confirm that PEMEX has observed or performed its covenants and agreements contained in this Agreement, or such further information regarding its ability to perform its obligations under this Agreement. At the request of the Treasury, PEMEX shall, at its expense, (i) provide the Treasury with confirmation by independent public auditors (who may, absent a specific request by the Treasury setting forth the reasons therefor, be the independent public accountants of PEMEX reporting on the financial statements most recently delivered pursuant to subparagraph (a) of this paragraph 10) that the information furnished to the Treasury is not inconsistent with the books and records of PEMEX and (ii) provide such independent public accountants an opportunity to review all invoices with respect to all Exports of crude oil and Oil Derivatives by PEMEX occurring within the two years preceding the date of such request.

(11) Treasury Costs

Mexico agrees to reimburse the Treasury promptly for any out-of-pocket fees and expenses reasonably incurred by the Treasury in connection with this Agreement.

(12) Proceeds Covered and Threshhold Levels

(a) Exports. Mexico agrees that all Proceeds from exports of crude oil and Oil Derivatives by PEMEX (other than Excluded Exports described below) will be subject to the terms of this Agreement. An "Export" for purposes of this Agreement means any conveyance (which does not include shipment of crude oil for storage purposes) of crude oil or Oil Derivatives by PEMEX or by any other subsidiary of any PEMEX Entity that may now or in the future export oil or Oil Derivatives, from Mexico (including locations outside of Mexico where crude oil may be stored on PEMEX's behalf) to points outside of the borders of Mexico. "Oil Derivatives" means (i) natural gas, (ii) products derived from the processing or refining of crude oil or natural gas, including, but not limited to, gasoline, jet fuel, diesel and fuel oil, and (iii) to the extent manufactured and exported by an entity controlled by the Government, petrochemicals. "Excluded

Exports" means, during any calendar year, (i) Exports of natural gas, except to the extent that the dollar value of such Exports during such calendar year exceeds $75 million, (ii) Exports of crude oil and Oil Derivatives, to the extent that the value of such Excluded Exports during any calendar year does not exceed 4% of the total value of all Exports of crude oil and Oil Derivatives by PEMEX during such calendar year, and (iii) those crude oil or Oil Derivatives Exports as mutually agreed between the Treasury and Mexico.

(b) Threshhold Levels. Mexico agrees to notify and consult promptly with the Treasury in the event that:

(i) during any twelve-month period ending at the end of any calendar quarter occurring during the first five years following the Effective Date (A) the volume of crude oil Exports is less than 85% and (B) the dollar value of the total amount of crude oil Exports and Oil Derivatives Exports is less than 80% of, respectively, the volume and dollar value of crude oil Exports during the twelve-month period ending at the end of the corresponding calendar quarter in 1994, such base 1994 volumes and dollar values for such calendar quarters being provided to the Treasury as soon as practicable, or,

(ii) during any twelve-month period ending at the end of any calendar quarter occurring after the fifth anniversary of the Effective Date (A) the volume of crude oil Exports is less than 75% and (B) the dollar value of the total amount of crude oil Exports and Oil Derivatives Exports is less than 75% of, respectively, the volume and dollar value of crude oil Exports during the twelve-month period ending at the end of the corresponding calendar quarter in 1994;

(c) Mandatory Prepayment. If the consultation provided pursuant to the subparagraph 12(b) immediately above does not result in agreement between Mexico and Treasury as to a substitute assured source of repayment or other solution satisfactory to the Treasury, the provisions of paragraph 3 of Article VIII of the Framework will apply.

(13) Crude Oil and Oil Derivatives Exports

PEMEX will not export Mexican crude oil or Oil Derivatives directly or indirectly other than through a PEMEX Entity.

(14) Successors and Assigns; Additional Parties

This Agreement shall apply to and bind the parties hereto and their successors and assigns. Neither this Agreement nor any interest herein nor any obligation hereunder shall be assigned or transferred (whether by operation of law or otherwise) without the prior written consent of the Treasury.

PEMEX shall cause any of its subsidiaries who shall in the future export crude oil or Oil Derivatives and who are not now a party to this Agreement to become a party hereto promptly upon such subsidiary's beginning to export such crude oil or Oil Derivatives.

(15) Insurance

PEMEX shall maintain adequate insurance for the businesses in which all PEMEX Entities are engaged and for the properties which they own or operate. The Treasury shall have the right to inspect any and all applicable certificates or other evidence of insurance.

(16) Disputes

The parties agree that they will in good faith negotiate to resolve through mutual consultation any dispute arising out of or in connection with this Agreement.

(17) Use of Proceeds to Pay Claims Under Other Financing Agreements

(a) Other Foreign Participants. Subject to prior agreement between the Treasury, the FRBNY, and Mexico, after debit or set-off against any funds in the Special Funds Account, such funds may be distributed to other countries, central banks, and international financial institutions, such as the Bank for International Settlements (each such country, central bank or institution being a "Foreign Participant") which enter into financing agreements with the Government or the Banco de Mexico ("Other Financing Agreements").

(b) Claims Payment. Upon (a) receipt by the FRBNY from a Foreign Participant of the agreements, representations and indemnities comparable to those made or extended pursuant to paragraph 3 above in a form satisfactory to the FRBNY, and agreement by the Foreign Participant to provide any notices the FRBNY may reasonably require (the "Foreign Undertaking"), and (b) subsequent notice by the FRBNY to the Treasury and the Banco de Mexico that it has received the Foreign Undertaking, claims of the Foreign Participant under the Other Financing Agreement shall be treated in the same fashion as those of the Treasury above, provided that the Foreign Participant, the Treasury, and the Banco de Mexico may separately agree as to the order and priority of payment of their claims from any set-off amounts from the Special Funds Account.

(18) Governing Law and Jurisdiction

(a) New York Law and Waiver of Immunity. The Agreement shall be governed by and construed in accordance with the law of the State of New York, to the extent not inconsistent with the Federal law of the United States. Each of Mexico and PEMEX hereby irrevocably submits for all purposes of or in connection with this Agreement to the exclusive jurisdiction of the United States District Court located in the Borough of Manhattan in New York City. The United States hereby irrevocably submits for all purposes or in connection with this Agreement to the exclusive jurisdiction of the Federal courts of the United States. Each of

Mexico, PEMEX, and the United States hereby irrevocably waives, to the fullest extent, the defense of an inconvenient forum to the maintenance of an action or proceeding brought pursuant to this paragraph.

In light of the fact that the Financing Arrangements constitute commercial activities, and in accordance with normal practices, the Government, the Banco de Mexico and each PEMEX Entity waive immunity from (i) attachment in aid of execution, (ii) execution, or (iii) attachment prior to the entry of judgment, for all purposes of Title 28 United States Code Sections 1610 and 1611 in respect of their obligations under the Financing Arrangements.

(b) Service of Process. Mexico and PEMEX each hereby irrevocably appoints the person for the time being and from time to time acting as or discharging the function of the Consul General of Mexico in New York, New York (the "Process Agent"), with an office, on the date hereof, at 8 East 41st Street, New York, New York 10017, United States, as its agent to receive on its behalf or service of copies of the summons and complaint and any other process which may be served in any such action or proceeding brought in the Federal District Court sitting in the Borough of Manhattan in New York City. Such service may be made by mailing or delivering a copy of such process to Mexico or PEMEX in care of the Process Agent at the address specified above for such Process Agent, and each of Mexico and PEMEX hereby irrevocably authorizes and directs such Process Agent to accept such service on its behalf.

(19) Rights and Remedies Cumulative.

No right or remedy herein conferred upon or reserved to the Treasury is intended to be exclusive of any other right or remedy, and every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy given hereunder or now or hereafter existing at law or in equity or otherwise. The assertion or employment of any right or remedy hereunder, or otherwise, shall not prevent the concurrent assertion or employment of any other appropriate right or remedy.

(20) Amendment

This Agreement may be amended by the consent in writing, including consent by authorized telecommunication, of all the parties to the Agreement.

(21) Channel of Communications

(a) The channel of communications for the Treasury Department for all communications under this Agreement shall be:

Office of the Assistant Secretary
for International Affairs
U.S. Department of the Treasury
Room 3430
Washington, D.C. 20220

Telephone: (202) 622-0060

Facsimile: (202) 622-0417

(b) The channel of communication for the Banco de Mexico and the Government shall be the same as in the Framework.

(c) The channel of communication for PEMEX for all communications under this Agreement shall be:

Chief Financial Officer
Petróleos Mexicanos
Avenida Marina Nacional 329
Torre Ejecutiva Piso 31
Mexico, D.F., Mexico 11311
Telephone: (525) 726-1386
Facsimile: (525) 545-5247

(d) The channel of communication for the FRBNY for all communications under this Agreement shall be:

Federal Reserve Bank of New York
Central Bank Services
33 Liberty Street
New York, New York 10045
Telephone: (212) 720-5222

Facsimile: (212) 720-7621

(22) Entry into Effect

(a) Effective Date. This Agreement shall take effect on the date (the "Effective Date") when (i) all the parties hereto have properly executed this Agreement, (ii) the MOU has been terminated, and (iii) the conditions set forth in paragraph 2(a) above have been met, at which time the FRBNY shall promptly give notice to the Banco de Mexico that the Agreement has taken effect.

(b) Execution. This Agreement may be executed by separate parties in separate counterparts, each of which when so executed shall be deemed to be an original and all of which taken together shall constitute but one and the same Agreement.

IN WITNESS WHEREOF, the undersigned, being duly authorized, have signed this Agreement.

DONE at Washington, this 21st day of February, 1995, in quadruplicate.

FOR THE GOVERNMENT OF THE UNITED STATES	FOR THE GOVERNMENT OF THE UNITED MEXICAN STATES
Department of the Treasury	Ministry of Finance and Public Credit

FOR THE BANCO DE MEXICO, ON ITS OWN BEHALF AND AS FISCAL AGENT OF THE GOVERNMENT OF THE UNITED MEXICAN STATES

FOR PETROLEOS MEXICANOS

FOR PMI COMERCIO INTERNACIONAL

FOR PMI TRADING LIMITED

FOR THE FEDERAL RESERVE BANK OF NEW YORK

Mexico D.F., Mexico
January 26 , 1995

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus:

1. The attached Memorandum of Economic Policies outlines the program that the Government of Mexico and the Bank of Mexico intend to implement during 1995 to address the fundamental causes of the current financial crisis, to minimize its inflationary consequences and to quickly return the economy to a path of sustainable growth with low inflation. In support of this program, Mexico hereby requests an 18-month stand-by arrangement from the International Monetary Fund in an amount equivalent to SDR 5,259 million or 300 percent of Mexico's quota. The program provides for three reviews to be completed before the end of July 1995, November 1995, and May 1996. The reviews will focus, in particular, on the progress achieved in stabilizing the exchange and financial markets, price developments, and the evolution of the public finances. The second review also will focus on the 1996 budget and the establishment of performance criteria for March and June 1996.

2. We strongly believe that the pursuit of the policies set forth in this letter, combined with the large support from the international financial community, will soon re-establish market confidence in Mexico's macroeconomic policies. We recognize that the provision of substantial financing from the Fund and the frontloading of such financing requires an appeal to exceptional circumstances. Accordingly, in the event the situation stabilizes soon, as we expect it will, Mexico would forego some of the subsequent purchases and, if reserves permit, would make early repurchases from the Fund. Should the aforementioned policies, however, not rapidly stabilize the situation, Mexico would stand ready to strengthen further its policies.

3. The Government and the Bank of Mexico believe that the policies set forth in this letter are adequate to achieve the objectives of their program, but will take further measures that may become appropriate for this purpose. During the period of the stand-by arrangement, Mexico will consult with the Managing Director of the Fund on the adoption of any measures that may be appropriate, at the initiative of either the Government and the Bank of Mexico or the Managing Director. It also will provide the Fund with such information as the Fund requests on the progress made in policy implementation and the achievement of the program's objectives.

4. Moreover, after the period of the arrangement and while Mexico has outstanding purchases in the upper credit tranches, the Government and the Bank of Mexico will consult with the Fund from time to time, at the initiative of the Government and the Bank of Mexico or whenever the Managing Director requests consultation, on Mexico's balance of payments policies.

Sincerely yours,

/s/
Guillermo Ortiz Martínez
Secretary of Finance and
Public Credit of Mexico

/s/
Miguel Mancera Aguayo
Governor
Bank of Mexico

Attachment: Memorandum of Economic Policies

Mexico--Memorandum of Economic Policies

1. Over the past several years, Mexico has been implementing far-reaching macroeconomic and structural reforms which have succeeded in raising the living standards of the population and fostering conditions for sustainable economic growth. In recent years, however, the improvement in economic performance has been accompanied by a decline in private savings and a steady rise in the external current account deficit even as the public finances remained strong. While export growth, particularly of manufactures, has been remarkable, there has been a sharp increase in imports induced by buoyant private capital inflows, the real appreciation of the currency, the increase in real incomes, and trade liberalization.

2. In early 1994, adverse political events, coupled with rising interest rates in the United States and investors' concerns about the sustainability of the exchange rate regime and of the external current account deficit, began to create pressures in financial and foreign exchange markets. To contain these pressures the authorities increased interest rates and the use of dollar-indexed bonds (Tesobonos), exercised greater exchange rate flexibility within the exchange rate band, and made use of international reserves. However, these actions calmed the markets only through early November. By the middle of the month, renewed market pressures and political events produced a sharp decline in international reserves which culminated in an exchange crisis that led to the floating of the new peso on December 22.

3. The change in the exchange regime did not restore confidence. Foreign investors in the Mexican market began to sell their holdings of new peso-denominated instruments as well as Tesobonos. Moreover, in the context of a run against the new peso, concerns developed over Mexico's ability to amortize short-term foreign liabilities that were falling due. Under normal circumstances, these liabilities would have been rolled over, but, given the market uncertainties, the Government began to experience difficulties in placing new securities while foreign exchange liabilities of some commercial banks were being called. Foreign short-term

liabilities falling due in 1995 include Tesobonos held by foreigners in an amount close to US$17 billion and foreign currency liabilities of local commercial banks amounting to US$18 billion. The latter are largely certificates of deposit, interbank loans, commercial paper and Eurobonds issued by commercial banks. By end-December, the new peso had depreciated by 44 percent in local currency terms and treasury bill rates reached over 30 percent.

4. On January 3, 1995, the Government, the Bank of Mexico, and the labor, farm, and business sectors signed the Agreement of Unity to Overcome the Economic Emergency. This agreement provides a comprehensive strategy for stabilizing the financial and exchange markets, restoring investors' confidence, and returning the economy to a path of sustained growth with low inflation. The strategy involves a strengthening of Mexico's economic policies, to be supported by a sizable pool of external resources that would be available for stabilizing the exchange market in the face of pressures derived from the inability to roll-over dollar-denominated obligations. The authorities believe that these two elements--adjustment and financing--taken together will restore private sector confidence and encourage the roll-over of a large part of the maturing liabilities, reducing the need to draw on these resources

5. The economic program seeks to achieve a reduction of the external current account deficit by more than one-half to about US$14 billion (4.3 percent of GDP, a level sustainable over the medium term), and to contain the inflationary effects of the recent sharp depreciation. Regarding the latter, the aim would be to lower inflation from a cumulative 7-8 percent in the first quarter of 1995, to a cumulative 3 percent in the last quarter of the year. On this basis, the twelve-month rate of inflation in 1995 would be around 19 percent. The reduction of domestic demand can be expected to result in a decline in economic activity in the first half of the year, but real GDP is expected to recover strongly in the second half bringing the growth rate for 1995 as a whole to around 1.5 percent.

6. The program's objectives are to be achieved through a wage-price policy aimed at containing the inflationary effects of the devaluation as established in the context of the above-mentioned Agreement, fiscal strengthening, and credit

restraint, including a sharp curtailment of credit expansion by the development banks and trust funds. In addition, the Government plans to deepen its already extensive privatization program with a view to increasing the efficiency of domestic production and strengthening the ability of domestic producers to compete in world markets.

7. To underpin the program and to ensure orderly conditions in foreign exchange markets, the authorities are completing the assembly of an Exchange Stabilization Fund in an amount of US$18 billion to support the new peso as needed, especially in light of the potential amortization of foreign currency debt obligations. The Exchange Stabilization Fund includes resources from the United States and Canada under the North American Financial Agreement, from monetary authorities of several countries coordinated by the Bank of International Settlements (BIS), and from private commercial banks. Also, the World Bank and the Inter-American Development Bank are accelerating disbursements on existing loans to Mexico. Furthermore, on January 12, the U.S. Government announced its intention to provide Mexico with guarantees on the issuance of Mexican debt in international financial markets for up to US$40 billion. This support will give the Mexican Government the opportunity to improve the structure of its debt, while curtailing its interest costs.

8. In order to help minimize the inflationary impact of the exchange rate adjustment, wage policy under the Agreement provides for an increase in minimum and public sector wages of 7 percent, and an additional 3 percent through an income tax credit for workers with incomes of up to twice the minimum wage. Contractual wage negotiations also will adhere to these guidelines and, in addition, will include productivity bonuses freely negotiated between labor and business.

9. The Government is committed to carrying out a realistic public sector pricing policy so as to avoid distortions. However, in current conditions it has become necessary to have an orderly and gradual correction in these prices. Accordingly, public sector prices will be adjusted on a monthly basis by somewhat less than the projected rate of inflation. The limited price adjustments will generate a revenue loss, but this is being compensated by other fiscal measures. The Government intends to take action in due course to correct price distortions that may result. Private businesses have been requested to make an extraordinary effort to contain price

increases to the extent possible by reducing profit margins and, on a temporary basis, the Government has intensified the surveillance of prices of the 35 items in the basic consumption basket.

10. The Bank of Mexico will pursue its main objective, namely, the stability of the purchasing power of the currency, by establishing a limit to the growth of its net domestic credit for 1995. According to the commitments on wages, prices and government expenditures, subscribed under the Agreement to Overcome the Economic Emergency, and on the basis of an expected average exchange rate of NMex$4.50 per U.S. dollar, the inflation rate for this year should not exceed 19 percent for the December/December period. To attain this objective, the Bank of Mexico has established a limit of 10,000 million new pesos on the expansion of its net domestic credit in 1995. This amount is equivalent to 17.5 percent of currency issue at end-1994 and is consistent with an expected increase in money velocity of circulation. Should the Bank consider that, in light of developments, the credit expansion required to meet its inflation target is less than the stated ceiling, it will reduce the growth of its net domestic credit accordingly. Monetary control will be exercised through open market operations and by adjusting the interest rate charged to commercial banks for resources to meet clearing deficiencies. In accordance with the new Bank of Mexico Act, which went into effect in April 1994, the Bank of Mexico will no longer extend credit to development banks and trust funds.

11. Existing regulations on banks' foreign currency exposure, borrowing abroad and portfolio provisioning limited the direct impact of the sharp increase in interest rates and the depreciation of the new peso on the financial situation of commercial banks. While banks did not experience significant foreign exchange losses, some of them might soon face net capital shortages resulting from the higher new peso value of their foreign-currency denominated loan portfolio. In current circumstances, non-performing loans may increase thus requiring commercial banks to raise their reserves. In early January, the Savings Protection Fund (FOBAPROA) established a program to acquire subordinated debt issued by banks unable to obtain sufficient additional capital on a timely basis. If deemed necessary, the Bank of Mexico will grant credit to FOBAPROA for this purpose within its net domestic credit target.

12. In 1994 the rapid expansion of credit by the development banks (equivalent to about 4.4 percent of GDP) contributed to demand pressures. The 1995 program provides for a reduction in the rate of credit expansion by these banks by more than one-half (to 2.1 percent of GDP). The development banks and trust funds will continue to provide net financing to priority sectors including exports and agriculture.

13. The Government has tightened fiscal policy to achieve an overall public sector surplus for 1995 of 0.5 percent of GDP compared with overall balance in 1994. Within the overall fiscal plan, the program provides for a very strong fiscal effort in the first half of the year to produce a primary surplus of 4.4 percent of GDP and an overall surplus of 1.6 percent of GDP on an annual basis. This is to be achieved through the containment of non-interest expenditures which, in real terms, would be about 9 percent lower than in the corresponding period of 1994. In addition, the Government is prepared to introduce contingency measures in the second half of the year if the evolution of key economic parameters is not consistent with the attainment of the objectives of the program.

14. The 1995 budget provides for a reduction in government revenue of about 0.8 percentage points of GDP (compared with 1994), mainly reflecting direct and indirect revenue losses from the less than full adjustment of public sector prices. Government expenditure is to be reduced by 1.3 percent of GDP after taking into account higher interest payments of about 0.2 percent of GDP. The public sector current expenditures are projected to decline by 0.8 percentage points of GDP and capital expenditures will be cut by 0.5 percentage points of GDP by postponing new projects. The Government, however, will seek to preserve as much as possible the level of expenditure on social programs, in order to protect the poorer segments of the Mexican population.

15. The authorities are firmly committed to avoiding any measures that would limit exchange market convertibility. During the early weeks of 1995, there was a degree of over-shooting in the exchange market triggered by uncertainty and a lack of confidence. In this connection, under the existing floating exchange rate regime,

sound monetary and fiscal policies under the program, together with the support provided by the Exchange Stabilization Fund and the loan guarantee program being worked out by the U.S. Government, are expected to restore confidence in the new peso permitting a recovery in the exchange rate. The Bank of Mexico plans to remove regulatory obstacles to help provide investors with hedging opportunities (without government intervention) in the context of the existing exchange rate regime. Drawings on Exchange Stabilization Fund resources will be limited to counteract foreign exchange market pressures deriving from the difficulties in rolling over Tesobonos and banks' foreign liabilities. The Exchange Stabilization Fund is not envisaged as a substitute for conventional balance of payments financing or to take the place of appropriate policy adjustments.

16. The targeted reduction in the external current account deficit (from 8.0 percent of GDP in 1994 to 4.3 percent of GDP in 1995) reflects an expected surge in manufacturing exports and a decline of 7 percent in the value of imports (excluding those of in-bond industries). The deficit of around US$14 billion is expected to be covered by public sector borrowing (US$5 billion), direct foreign investment (US$8 billion) and other private flows (US$1 billion). The program assumes no change in net international reserves in 1995.

17. The Government of Mexico has decided to accelerate structural reforms in the transportation, telecommunications and banking sectors. These are crucial for increasing efficiency and productivity in the Mexican economy. Accordingly, the Executive has proposed to Congress constitutional amendments to allow private investment in railroad and satellite communications. Also, the Government will open up telecommunications to local and foreign competition, allow for privatization of electricity generation facilities, and has proposed legislation to permit greater foreign participation in the banking system than envisaged under the NAFTA arrangements. Steps to privatize other state facilities currently underway (including ports, airports, and petrochemical plants) will be accelerated. In this context, the authorities are committed to undertake privatization and concession operations that are estimated to yield about US$6 billion in 1995, and an additional US$6-8 billion in the following two years.

18. While all sectors of the Mexican society will share the burden of the sharp adjustment that must take place, the Government has taken specific steps to ensure that the poorest segments of the population are protected. As noted above, the decline in real income for workers earning less than twice the minimum wage will be contained through the use of an income tax credit; the slowdown in the rate of credit expansion by the development banks has been designed so as not to curtail credit availability to the agricultural sector, and the planned reduction in public spending will keep virtually untouched the level of real resources channeled to social programs. The Government acknowledges the urgent need to reduce poverty and improve the living standards of the Mexican population and stands by its commitment to increase substantially expenditures on social programs once financial stability is restored.

19. With the aid of debt restructuring operations, and through the use of privatization proceeds, total gross public debt (excluding the Bank of Mexico) declined from about 90 percent of GDP at end-1986 to about 35 percent of GDP at end-1994. The large-scale substitution of dollar-indexed debt (Tesobonos) for new peso-denominated treasury bills (Cetes) during 1994 complicated debt management and contributed to the present exchange-market problems. The Government will continue to exercise prudence in contracting new external debt and will seek to extend the maturities and improve the terms of outstanding short-term debt.

20. On the basis of the strategy outlined above, the economy should stabilize sufficiently during the year to permit the full restoration of private sector confidence and resumption of capital inflows. With continued strong growth in exports and the expected recovery in investment, a resumption in real GDP growth to around 4 percent would be feasible in 1996. To strengthen the basis for this recovery and to help reduce annual inflation to single digits, the Government and the Bank of Mexico are committed to the continued pursuit of prudent financial policies, including the maintenance of a fiscal surplus in 1996. In order to finance an increase in public sector investment and social sector spending, revenue consolidation efforts will be strengthened through further improvements in tax administration and new revenue measures. Such measures would take into consideration the need to increase private savings so as to achieve an external current account deficit in the range of 3.0-3.5

percent of GDP. The specific policies to be introduced in 1996 would be discussed in the context of the budget exercise.

21. Early in 1995, a Fiscal Advisory Commission will be created to advise the Government on matters of tax policy and administration. The Commission will have the basic purposes of analyzing the tax system and proposing modifications in order to strengthen fiscal federalism, simplify administrative procedures, improve legal safeguards, and increase the equity of the system. The proposals will be designed to increase tax fairness and the enforcement of tax obligations, as well as to strengthen tax revenues. The proposals will be ready before the opening of the congressional session in September 1995, so as to allow the Federal Government to include actions in the budget for 1996. Efforts will continue in 1996 to rationalize current expenditures in the public sector.

22. To sum up, Mexico is facing a short term financial crisis set off by the devaluation of the new peso. The Government's program contains steps to stabilize financial markets as well as measures to ensure that the devaluation succeeds in reducing the external imbalance and to reinforce the already solid fundamentals of the Mexican economy. The Government is confident that market stabilization will be quickly achieved and that Mexico will soon resume the path of strong non-inflationary economic growth with a steady improvement in welfare and social justice for all Mexicans.

Annex C: Economic Policy Memorandum

1. This memorandum describes the economic policy actions that the Government of Mexico and the Bank of Mexico intend to take in 1995 to address the present financial crisis. In support of these actions, Mexico hereby requests from the United States Government the activation of the US$20 billion emergency support package as detailed in the U.S.-Mexico Framework Agreement.

2. The economic policies of the Government of Mexico for 1995 have been described in detail in the Memorandum of Economic Policies presented to the IMF in our request for a stand-by arrangement. These include policies of fiscal strengthening, credit restraint, a deepening of privatization, and debt restructuring. We believe that our comprehensive economic program provides the basis for overcoming the present financial crisis. We reiterate our commitment to implement the policy steps described in that memorandum and to fulfill all the commitments we have undertaken with the IMF in connection with the stand-by arrangement.

3. In light of the severity and persistence of the present financial crisis, we have become convinced of the need for certain additional policy steps, described below, to bolster our 1995 economic program and to bring about more stable financial and exchange markets. We believe that these policy steps, implemented in conjunction with the activation of the support embodied in the U.S.-Mexico Framework Agreement and the other substantial external financial assistance, will provide the basis for stabilization, the full restoration of confidence, and the resumption of capital inflows sufficient to permit an orderly and timely fulfillment of all of Mexico's debt service obligations.

4. Our most immediate objective is to create economic and financial conditions that would stabilize the currency. We aim to strengthen the peso, which has become substantially undervalued, and reverse the capital outflows that have led to a depletion of the international reserves of the Bank of Mexico. Once the immediate price increases brought about by the recent peso depreciation have passed, we aim to bring inflation down to low levels. We consider stabilization the key to returning the economy quickly to a path of sustainable growth. Monetary and credit policy will bear much of the weight of achieving this objective. The principal objective of the Bank of Mexico, as stated in the law which establishes its full independence as an institution, is to procure the stability of the purchasing power of the peso.

5. Monetary policy will be directed at the overriding objectives

of reducing inflation, strengthening the peso, and encouraging the restoration of normal, spontaneous capital inflows. To anchor this policy firmly, the Bank of Mexico has adopted an upper limit for net domestic credit expansion of NP10 billion for all of 1995. These credit operations will raise base money by significantly less than the rate of inflation, and will lead to a decline in the real stock of base money backed by domestic credit. Any further rise in base money would come about only as a result of an accumulation of central bank net international reserves. The Bank of Mexico is committed to a forceful tightening of credit policy in response to any further net capital outflows.

6. The uncertainties regarding Mexico's financial system that have prevailed in recent months have complicated the management of money and credit policy. Now, with the activation of the U.S.-Mexico Framework Agreement, there is a good prospect for a reduction of these pressures. The Bank of Mexico has tightened monetary conditions to guarantee the substantially positive real interest rates that are essential to a successful stabilization. As stabilization takes hold and confidence is restored, interest rates should decline.

7. The financial crisis has placed strains on the banking sector. Restoring financial stability and confidence is essential to easing those strains. In the meantime, the Government and the Bank of Mexico are implementing actions to cope both with liquidity and solvency problems in the banking sector. Liquidity problems will be handled without relaxing the credit program established by the Bank of Mexico, and will be supported by the funds available under the U.S.-Mexico Framework Agreement. Solvency problems will be handled using the procedures established under law for the operations of the Savings Protection Fund (FOBAPROA). The Government is determined to protect depositors, but will take actions in a timely, forceful, and open manner, including interventions, to deal effectively and efficiently with cases of insolvency. To cover the fiscal costs that could arise from such actions, the Government will adopt appropriate fiscal measures. In addition, we intend to request assistance from the World Bank and other experts in strengthening our supervisory procedures.

8. The Mexican financial authorities believe that the peso has been substantially undervalued at the levels prevailing in the exchange market in recent trading sessions. A fundamental objective of monetary policy is to assure that the peso appreciates from the levels of its recent trading range. The funds available to Mexico from the IMF and other international authorities will be available for intervention to prevent inappropriate fluctuations. Any use of these funds will trigger a quick adjustment of credit and interest rate policies to reverse rapidly the intervention and any

accompanying credit expansion. In addition, we intend to improve the functioning of the foreign exchange market, including the development of futures and forward foreign exchange markets.

9. We set a goal, announced in the context of our IMF stand-by arrangement, to achieve a public sector surplus for 1995 of 0.5 percent of GDP, compared with a deficit of 0.3 percent in 1994, and to cut development bank lending in comparison with 1994. To that end, non-interest expenditures will be reduced by 1.3 percent of GDP. In order to strengthen our economic program, we committed to introduce additional measures if necessary.

10. The Mexican Congress has approved legislation that will enable the Government to accelerate structural reforms in the transportation, telecommunications, and banking sectors. These are crucial to improve the efficiency and productivity of the economy as a whole. The Government will open up telecommunications to local and foreign competition, allow for privatization of electricity generation facilities, and will permit greater foreign participation in the banking system than envisaged under the NAFTA. In this context, the Government is committed to undertake privatization and concession operations that are estimated to yield US$12-14 billion in the next three years.

11. The Government and the Bank of Mexico believe that their policies must be transparent in order to be effective. To that end, the Bank of Mexico will begin new weekly and monthly publications that present financial data on a timely basis, including money and credit aggregates and international reserves (see Annex B). The data will also be made available on Internet in the near future. The Ministry of Finance will begin a new publication presenting key fiscal data on a more timely basis, including the evolution of public sector expenditures, revenue, and debt. The data to be published will provide a clear basis for an analysis of the conduct of economic policy.

12. To underpin the economic program, ensure orderly debt service on public debt, and support orderly conditions in foreign exchange markets, the Mexican authorities have requested and received substantial support from the international financial community. Under the U.S.-Mexico Framework Agreement, US$20 billion will be available for short-term and medium-term swaps and for long-term guarantees with maturities of up to 10 years. The utilization of the guarantees will follow consideration by the Mexican Congress. Further support has been committed by the IMF and the international financial community. The Government will make every effort to access private capital markets as early and as fully as possible as

it goes ahead with the process of improving the maturity structure of its debt. The U.S. support will facilitate this process of enlarging Mexico's access to the markets. The Government aims to continue to make tenders for outstanding Tesobonos. The external finance will also be available to support orderly foreign exchange market conditions. With the policies described above and the large-scale external financial support, the Government and Bank of Mexico are confident their economic objectives can be achieved.

Annex D: Public Availability of Government and Bank of Mexico Statistical Information

Consistent with its commitment to the transparent disclosure of information on a timely basis, including data on its operations and monetary statistics, the Governing Board of the Bank of Mexico recently announced the following decision:

1. The Bank of Mexico, as of mid-March 1995, will publish a summary balance sheet based on gross assets and liabilities on a weekly basis (with a reporting lag of two to three days) substantially in the form set forth below:

ASSETS	LIABILITIES
International Assets	International Liabilities **/ International financial institutions Foreign financial authorities Other liabilities
Credit to Government	
Credit to Financial Intermediaries	
Holdings of Government Securities */	Monetary Base Bills and coins in circulation Bank deposits
Other	Government Deposits in Current Account
	Other

*/ Net of Government deposits for monetary regulation.

**/ Off-balance sheet items will be included as a memorandum item on a quarterly basis.

2. The Bank of Mexico will continue its policy of publishing its balance sheet on a monthly basis in the Mexican press.

3. The Bank of Mexico will expand its new practice of releasing key monthly data to include data on government securities in circulation and operations of FOBAPROA. These data will be released a few days after the end of the month.

4. At present, the Bank of Mexico releases preliminary monthly monetary statistics with an approximate lag of 25 days. Every effort will be made to shorten this lag to two weeks by June 1995.

5. The Bank of Mexico will present changes in net foreign assets, the monetary base, and net domestic assets according to IMF methodology on a quarterly basis with a reporting lag of one week.

6. At the same time, efforts are being made to shorten reporting lags for key data series contained in the Bank of Mexico's Government's monthly publication Indicadores Economicos. That publication includes final information on broad monetary aggregates, fiscal revenues and expenditures, public sector borrowing operations, operations of development banks, and trade and balance of payments statistics. Subscribers to this publication have access to the information on computer diskettes. In addition, the information will be made available on INTERNET in the near future.

7. By March 10th, the Bank of Mexico will announce a timetable setting forth regularly scheduled dates and times at which specified information will be released throughout the year.

8. The Ministry of Finance and Public Credit will publish preliminary data on fiscal revenues and expenditures, public sector borrowing operations, and operations of developmenmt banks with a 45-day lag.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR IMMEDIATE RELEASE
May 3, 1995

REMARKS BY DARCY BRADBURY
DEPUTY ASSISTANT SECRETARY (FEDERAL FINANCE)
TREASURY QUARTERLY REFUNDING PRESS CONFERENCE

Today, we are announcing the terms of the regular Treasury May midquarter refunding. I will also discuss Treasury financing requirements for the balance of the current calendar quarter and our estimated cash needs for the July-September 1995 quarter.

1. We are offering $30.0 billion of notes to refund $32.1 billion of privately held notes and bonds maturing on May 15.

The securities are:

-- First, a 3-year note in the amount of $17.5 billion, maturing on May 15, 1998. This note is scheduled to be auctioned on a yield basis at 1:00 p.m. Eastern time on Tuesday, May 9, 1995. The minimum purchase amount will be $5,000 and purchases above $5,000 may be made in multiples of $1,000.

-- Second, a 10-year note in the amount of $12.5 billion, maturing on May 15, 2005. This note is scheduled to be auctioned on a yield basis at 1:00 p.m. Eastern time on

RR-265

Wednesday, May 10. The minimum purchase amount will be $1,000.

2. We are also announcing a $17 billion 38-day cash management bill, which will be issued on May 15 and mature on June 22, 1995. This bill is scheduled to be auctioned on a discount rate basis at 1:00 p.m. Eastern time on Thursday, May 11. Noncompetitive tenders will be accepted up to $1 million. The minimum purchase amount will be $10,000 and purchases above $10,000 must be in multiples of $1,000.

3. As announced on Monday, May 1, 1995, we estimate a net market borrowing need of $25.8 billion for the April-June 1995 quarter. The estimate assumes a $45 billion cash balance at the end of June. Including the notes in this refunding, we have paid down $19.7 billion of cash from the sale of marketable securities. This was accomplished as follows:

-- raised $2.2 billion from the 2-year note that settled May 1;

-- raised $12.1 billion from the 5-year note that settled May 1;

-- raised $2.3 billion from the 52-week bills;

-- paid down $18.1 in the regular weekly bills, including those announced yesterday, May 2;

-- paid down $9.1 billion in cash management bills which matured April 20;

-- paid down $7.0 billion in the 7-year note that matured April 15; and

-- will pay down $2.1 billion in the notes announced for the refunding today.

4. The Treasury will need to raise $45.5 billion in market borrowing during the rest of the April-June quarter. We have taken into account the fact that the $17 billion cash management bill to be issued on May 15 will mature on June 22, before the end of the quarter. The financing remaining to be done before the end of June can be accomplished through regular sales of 13-, 26-, and 52-week bills and 2-year and 5-year notes. Additional cash management bill financing may be needed to bridge the seasonal low-point in the balance in June.

5. We estimate Treasury net market borrowing needs to be in the range of $40 to $45 billion for the July-September 1995 quarter, assuming a $30 billion cash balance on September 30. The estimate does not include cash to be raised in the September 2- and 5-year notes, which will be issued on October 2.

6. With this May refunding and the increases of $.5 billion each in the 2- and 5-year note offerings in April, the Treasury has begun to increase coupon offerings to reflect greater financing needs in future months. These increases are the first increases in the 2-year notes since July 1994, in 5-

year notes since January 1993, and in 3- and 10-year notes since August 1993.

7. The Treasury is reviewing a draft study evaluating the results to date of the single-price auction technique. We expect to have a paper for public comment within the next couple of months.

Treasury's use of the single-price auction method began with the 2- and 5-year note auctions in September 1992. The stated purpose was to determine whether the single-price auction technique broadens participation and reduces concentration of securities on original issue, and whether it reduces the Treasury's financing costs by encouraging more aggressive bidding by participants.

8. We will accept noncompetitive tenders up to $5 million for each of the notes announced today. The 10-year note is eligible for conversion to STRIPS (Separate Trading of Registered Interest and Principal of Securities) and, accordingly, may be divided into separate interest and principal components.

9. The August midquarter refunding press conference will be Wednesday, August 2, 1995.

**REPORT TO THE SECRETARY OF THE TREASURY
FROM THE
TREASURY BORROWING ADVISORY COMMITTEE
OF THE
PUBLIC SECURITIES ASSOCIATION**

MAY 3, 1995

Dear Mr. Secretary:

Since the Committee's last meeting with the Treasury in February 1995, the pace of economic activity has moderated. Price increases for final goods are still subdued, although inflationary pressures in raw materials and intermediate goods continue to intensify. After raising the Federal funds rate 0.5% to 6.0% early in February, the Federal Reserve has made no further changes in monetary policy.

During the last three months, yields on Treasury securities have declined. The drop was only a few basis points on short-term bills but ranged between 60 to 70 basis points for maturities from two to ten years; the yield on 30-year bonds fell less, with a drop of approximately 40 basis points The present shape of the yield curve and forward prices for various fixed-income instruments indicate market participants expect modest further increases in interest rates in the coming months.

Within this context, to refund the $32.1 billion of notes and bonds maturing on May 15, 1995 that are privately held and to raise additional cash of $18.9 billion, the Committee recommends that the Treasury auction $51.0 billion of the following securities:

- $18.0 billion 3-year notes due May 15, 1998;

- $13.0 billion 10-year notes due May 15, 2005;

- $10.0 billion cash management bills due June 22, 1995; and,

- $10.0 billion cash management bills due September 21, 1995.

Of the 18 Committee members present for the meeting, 17 favored the issuance of $18.0 billion 3-year notes and $13.0 billion 10-year notes. The recommended increase of $1.0 billion for both offerings from the levels in the last refunding was based on the absence of a 30-year bond in this quarterly cycle and the belief that, because of the substantial diminution of the cash raising potential from the issuance of 5-year notes beginning in 1996, the Treasury should continue the gradual building of the sizes of its coupon offerings. The vote of the Committee on the sizes and maturities of the cash management bills was unanimous.

In considering whether to recommend issuing a new 10-year note or reopening the 7 1/2% note due February 15, 2005, Committee members observed that the tightness of the outstanding issue in the repurchase agreement market was neither unusual nor acute. Also, the three point premium in the current market price of the outstanding issue materially exceeds the premiums of previously reopened issues. Without compelling reason to recommend a break with existing precedents, the Committee voted 15 to 3 in favor of a new issue.

With the aim of achieving a cash balance of $45 billion on June 30, the Committee unanimously recommends that for the remainder of the quarter the Treasury meet its borrowing requirement in the following manner:

- Two 5-year notes totaling $11.5 billion each, to raise $23 billion of new cash;
- Two 2-year notes totaling $17.75 billion each, to raise $2.4 billion of new cash;
- Two 1-year bills totaling $17.25 billion each, to raise $1.8 billion of new cash;
- Weekly issuance of 3- and 6-month bills through the remainder of the quarter, to raise $1.1 billion of new cash; and,
- The paydown on June 22 of $10.0 billion of cash management bills issued in conjunction with the May refunding.

Including the $18.9 billion raised in the mid-quarter refunding as well as anticipated foreign add-ons of $4.5 billion, the proposed financing schedule will raise a total of $41.7 billion. This amount, after subtracting the net paydown of $15.9 billion to date in the quarter, will accomplish the total net borrowing requirement of $25.8 billion. In addition, an intra-quarter cash management bill maturing on June 22 of approximately $17.0 billion will be needed to cover the cash low point in early June.

For the July-September quarter, the Treasury estimates a net borrowing requirement in the range of $40 to $45 billion with a cash balance of $30 billion at the end of September. To accomplish the anticipated net borrowing requirement, the Committee recommends the following provisional financing schedule:

Auctions		Size ($billions)	Raising ($billions)
Refunding:	3-year note	18.5	
	10-year note	13.5	
	30-year bond	12.0	
	Subtotal	44.0	14.0
Other:	5-year notes	2 x 12.0	24.0
	2-year notes	2 x 18.25	3.0
	1-year bills	3 x 18.25	4.2
	3- and 6-month bills	13 x 27.4	12.7
	Cash management bill (September maturity)		(10.0)
	Estimated foreign add-ons		4.5
	Subtotal		38.4
Less:	Redemption of 7-year notes		(6.8)
	Bonds called for redemption on August 15, 1995		(2.3)
	Subtotal		(9.1)
	Total Net Market Borrowing		43.3

The Committee also notes the likely need for the issuance of intra-quarter cash management bills to cover cash low points during the quarter.

In the discussion of alternative ways of meeting the marketable financing requirement through the remainder of the fiscal year, some members of the Committee raised the possibility of the Treasury issuing foreign currency denominated debt. In particular, these members expressed the view that the combination of the current exchange rate for the US dollar and the Japanese yen and the differential in current interest rates between the two debt markets offers an opportunity to obtain funding on terms which they judge will likely prove attractive. The discussion touched on a number of points in connection with issuing debt denominated in foreign currencies, including past experiences of the Treasury, practical considerations associated with the actual issuance, debt management policy objectives to be served, and potential market reactions. While the Committee makes no recommendation on this matter, several members expressed the view that the issuance of debt denominated in Japanese yen warrants consideration by the Treasury at this time, preferably in the context of broader public policy considerations.

The Committee's discussion of whether the Treasury should issue inflation-indexed debt was wide-ranging. The proposal, it was noted, has been raised numerous times over the years and has had sufficient merit to attract a number of thoughtful and respected proponents. The Committee welcomed the opportunity to offer its views on subject.

From the debt management standpoint, all Committee members agreed that the foremost criterion for judging any borrowing initiative by the Treasury should be the potential contribution to raising substantial amounts of funds on favorable terms. The Committee's deliberations focused on this objective and not on other possible policy objectives, however worthy, such as providing a more direct gauge of inflation expectations than is now available or discouraging the government from pursuing inflationary policies.

The Committee recognized that there are conceptually sound reasons for believing that the issuance of inflation-indexed debt could lower the cost of borrowing over the longer term. Academic research often cites the existence of some inflation risk premium in the yields on conventional debt that the Treasury might capture through the issuance of inflation-indexed debt. By issuing both conventional and inflation-indexed securities, the Treasury might be able to segment to its advantage the market for its debt. The magnitude of any potential saving is uncertain, however, and could be offset in some degree by the comparatively low level of liquidity that typifies inflation-indexed securities in other countries and the consequent negative effect the illiquidity would have on the price of the securities.

The recent and prospective substantial growth in self-directed retirement plans, which to date have evidenced a strong preference for safe, conservative investments, may offer the potential of significant demand for inflation-indexed securities, either in marketable or savings bond forms. The uniqueness of the instrument would mean, however, a major educational effort would likely be needed before the market reached meaningful proportions.

Defined benefit pension plans might also be a source of demand for inflation-indexed securities. An asset class with an assured real return together, in all likelihood, with low correlations with other standard asset classes is virtually certain to permit attainment of a higher level of "portfolio optimality" and hence be an attractive investment to defined benefit plans.

While there is an intriguing case, which necessarily is largely conjectural, for there being a reasonable long-term potential for the Treasury in issuing inflation-indexed securities, there are considerable short-term problems to developing the product. To begin, recent debate about the accuracy of the Consumer Price Index has to a degree politicized the issue and brings to the fore concerns about the integrity of the price index to be used for the inflation adjustment. More important, there is a need to pace the process of innovation in debt management techniques; in the view of the Committee, other initiatives--for

MINUTES OF THE MEETING OF THE TREASURY BORROWING ADVISORY COMMITTEE OF THE PUBLIC SECURITIES ASSOCIATION MAY 2 AND 3, 1995

May 2

The Committee convened at 11:45 a.m. at the Treasury Department for the portion of the meeting that was open to the public. Members present were Chairman Francis, Vice Chairman Kelly, Messrs. Ahearn, Bennett, Capra, and Corzine, Ms. Kenworthy, and Messrs. Lakefield, McKnew, Napoli, and Pike, Ms. Recktenwald, and Messrs. Roberts, Rosenberg, Sites, Stark, Thieke, and Wardlaw. The Federal Register announcement of the meeting and a list of Committee members are attached.

Deputy Assistant Secretary for Federal Finance Darcy Bradbury welcomed the Committee and the public to the meeting. Assistant Secretary for Economic Policy Alicia Munnell gave a summary of the current state of the U.S. economy. Jill Ouseley, Director of the Office of Market Finance, presented an informational briefing updating Treasury borrowing estimates and statistical information on recent Treasury borrowing and market interest rates. The borrowing estimates and other information in chart form had been released to the public on May 1, 1995.

The public meeting ended at 12:25 p.m.

The Committee reconvened in closed session at the Madison Hotel at 1:45 p.m. The members listed above, Ms. Bradbury, Mr. Norman Carleton, Director of the Office of Federal Finance Policy Analysis, and Ms. Ouseley were present. Ms. Bradbury gave the Committee its Charge, which is also attached. The Committee first discussed the size of the Treasury cash balance at the end of June. By consensus, a $45 billion balance was recommended. The Committee then turned to the May midquarter refunding, discussing the need to increase the sizes of Treasury coupon issues in order to raise cash needed by the Treasury in the refunding and beyond. A draft proforma that had been prepared by a member of the Committee (attached) was used during the discussion.

The Committee voted 17-to-1 to recommend increasing the 3- and 10-year notes by $1.0 billion each from the levels of the February refunding to $18.0 billion for the 3-year notes and $13.0 billion for the 10-year notes. The vote to recommend a new 10-year rather than to reopen the 7-1/2% note of 2/15/05 was 15-to-3. The consensus was that the Treasury should also issue cash management bills to settle with the refunding issues on May 15. The bills would be a $10.0 billion issue to mature on June 22, 1995 and a $10.0 billion issue to mature on September 21, 1995. The Committee recommended by consensus that the Treasury leave the 2- and 5-year notes at their April levels in the May and June offerings and that the 52-week bill remain at $17.75 billion during the rest of the quarter.

For the July-September quarter, the Committee consensus was that the $30 billion end-of-quarter balance recommended by the Treasury is appropriate. The Committee's preliminary consensus recommendation was that the Treasury increase the sizes of the coupon issues and 52-week bills by $.5 billion each from the sizes in the April-June quarter and increase the 30-year bond by $1.0 billion from the level in the February refunding to $12.0 billion. Two members wanted to recommend an increase of $.5 billion, rather than $1.0 billion in the August 1995 bond. Regular weekly bills would be adjusted appropriately.

Alternative borrowing instruments

Looking forward to 1996, when the 5-year notes which have been offered monthly since January 1991 begin to mature, the Treasury requested in its Charge that the Committee consider whether to recommend that the Treasury issue inflation-indexed debt securities to augment the current regular offerings of Treasury securities.

Japanese yen-denominated debt. Several Committee members suggested that the Treasury consider issuing yen-denominated as soon as possible to raise funds at reduced cost. They suggested that the yen market is an attractive source of funding currently and that other borrowers are taking advantage of financing opportunities in yen.

No recommendation was made on this proposal. Several members were concerned that any foreign denominated currency issuance by the Treasury be undertaken only in the context of achieving broader economic policy objectives.

Inflation-indexed debt. Charts and tables (attached) were reviewed to frame the discussion on indexed securities. Potential demand for inflation-indexed debt was seen from defined contribution retirement plans, which tend to invest conservatively in shorter term instruments, and defined benefit retirement plans, which tend to prefer conservative longer term assets. The potential buyers were not viewed as likely to want to trade their securities, and therefore there was a concern that the market for inflation-indexed securities would be illiquid. In this connection, several members thought an inflation-indexed nonmarketable savings bond would be appropriate.

The discussion then turned to whether the Treasury could sell enough inflation-indexed debt to make mounting a sales effort worthwhile at this time. The consensus was that now is not the time to introduce this new instrument for several reasons relating to: questions that have been raised recently about the accuracy of the consumer price index to measure inflation; the prospect that other debt management innovations, such as floating rate notes, would gain greater market acceptance now; and the Treasury's need to do more market research and to educate the public about inflation-indexed instruments before mounting a sales effort. The Committee did not address the specific terms that the Treasury might offer on inflation-indexed debt.

The meeting adjourned at 4:40 p.m.

May 3, 1995

The Committee reconvened at 8:30 a.m. at the Treasury in closed session. All members were present who attended the May 2 meeting except Messrs. Corzine and Napoli and Ms. Recktenwald. The Chairman presented the Committee report (copy attached) to Deputy Secretary Frank N. Newman and Deputy Assistant Secretary Bradbury.

A discussion followed the reading of the Committee report.

-- Several Committee members believed that it is appropriate now to signal gradual, continuing increases the sizes of coupon issues in the future.

-- Regarding the statutory debt limit, members suggested that the Treasury provide technical briefings on the potential disruptions in Treasury's regular borrowing and the securities markets as a result of a debt limit impasse for Congress members and their staffs who will be working on the issue this summer.

The meeting adjourned at 9:00 a.m.

Jill K. Ouseley
Jill K. Ouseley, Director
Office of Market Finance
Domestic Finance
May 3, 1995

Attachments

Certified by: Stephen C. Francis
Stephen C. Francis, Chairman
Treasury Borrowing Advisory Committee
of the Public Securities Association
May 3, 1995

incorporated essentially all minor a d major changes in the IAEA standard with negligible variations. All nat s with major nuclear programs invo ed with significant commercial transportation of nuclear materia incorporate the IAEA standards to their transportation regulations n some cases the IAEA regulations are opted by reference.

At the present time, both RS A and the Nuclear Regulatory Comm sion are revising the domestic transpc ation regulations to incorporate m t of the provisions of the 1985 IAEA egulations, as amended in 1990. It is e ected that the U.S. regulations in the ture will adopt provisions that will b in the 1996 IAEA regulations.

A few of the expected c anges between the 1985 and 19 6 IAEA regulations involve:

—A higher performance Type C package for large quantities of materials transported by air.
—Exclusive use of the nternational System of Units (SI Units) in the regulations and on abels and shipping documen s.
—International Com nission on Radiological Prot ction standards (ICRP 60/61) im cts on radiation protection progr ms and limitations on quantities a classification of radioactive ma rials.
—For fissile mat ials, calculational procedures fo criticality and identification of Criticality Safety Index (CSI) c documents and packages
—Revise ship ng names and UN Identificati n Numbers
—Specific re uirements for uranium hexafluor e, both fissile and non-fissile

It should be noted that during the time since anuary when the current draft was epared, several technical meetings ave been held resulting in changes some of the provisions of the draft re lations. Some of these changes concern content and performance criteria or Type C packages. grandf hering for package designs and speci form, and requirements for uran m hexafluoride. Comments recei ed on the January 1995 draft will be r iewed and considered by RSPA to the tent possible during meetings at th AEA.

ued in Washington, DC on April 5, 1995 u r the authority delegated in 49 CFR Part 1 , Appendix A

in I. Roberts,

sociate Administrator for Hazardous aterials Safety

R Doc. 95–8839 Filed 4–10–95; 8:45 am]

ILLING CODE 4910–60–M

DEPARTMENT OF THE TREASURY

Departmental Offices, Debt Management Advisory Committee; Meeting

Notice is hereby given, pursuant to 5 U.S.C. App. 10(a)(2), that a meeting will be held at the U.S. Treasury Department, 15th and Pennsylvania Avenue, NW., Washington, DC, on May 2 and May 3, 1995, of the following debt management advisory committee:

Public Securities Association, Treasury Borrowing Advisory Committee

The agenda for the meeting provides for a technical background briefing by Treasury staff on May 2, followed by a charge by the Secretary of the Treasury or his designate that the committee discuss particular issues, and a working session. On May 3, the committee will present a written report of its recommendations.

The background briefing by Treasury staff will be held at 11:30 a.m. Eastern time on May 2 and will be open to the public. The remaining sessions on May 2 and the committee's reporting session on May 3 will be closed to the public, pursuant to 5 U.S.C. App. 10(d).

This notice shall constitute my determination, pursuant to the authority placed in heads of departments by 5 U.S.C. App. 10(d) and vested in me by Treasury Department Order No. 101–05, that the closed portions of the meeting are concerned with information that is exempt from disclosure under 5 U.S.C. 552b(c)(9)(A). The public interest requires that such meetings be closed to the public because the Treasury Department requires frank and full advice from representatives of the financial community prior to making its final decision on major financing operations. Historically, this advice has been offered by debt management advisory committees established by the several major segments of the financial community. When so utilized, such a committee is recognized to be an advisory committee under 5 U.S.C. App. 3.

Although the Treasury's final announcement of financing plans may not reflect the recommendations provided in reports of the advisory committee, premature disclosure of the committee's deliberations and reports would be likely to lead to significant financial speculation in the securities market. Thus, these meetings fall within the exemption covered by 5 U.S.C. 552b(c)(9)(A).

The Office of the Under Secretary for Domestic Finance is responsible for maintaining records of debt management advisory committee meetings and for providing annual reports setting forth a summary of committee activities and such other matters as may be informative to the public consistent with the policy of 5 U.S.C. 552b.

Dated: April 4, 1995.

Frank N. Newman,

Deputy Secretary of the Treasury.

[FR Doc. 95–8819 Filed 4–10–95; 8:45 am]

BILLING CODE 4810–25–M

[Treasury Order Number: 106–01]

Delegations of Authority to Act for e Secretary on Trust Fund Boards

Dated: March 22, 1995.

By virtue of the authority vest in the Secretary of the Treasury, in uding the authority vested by 31 U.S.C. 321(b) and delegated to the Deputy Se retary by Treasury Order (TO) 101–0 , I hereby delegate to the Fiscal Assista Secretary or, in the absence that official, the person designat d to act in that capacity, the authority o represent the Secretary of the Treas as a member of the:

1. National Archives T st Fund Board (see 44 U.S.C. 23) and to perform any act which e Secretary is authorized to perform that capacity; and

2. Library of Congr s Trust Fund Board (see 2 U.S.C. 1 1) and to perform any act which the S retary is authorized to perfo in that capacity.

3. CANCELLATI S

a. Treasury Ord (TO) 106–01, "Delegation of A hority to Act for the Secretary on the ational Archives Trust Fund Boa ," dated November 30, 1987.

b. TO 106– "The Library of Congress Tru Fund Board," dated June 22, 1978.

Frank N. New an,

Deputy Secre ry of the Treasury.

[FR Doc. 95 782 Filed 4–10–95; 8:45 am]

BILLING COD 810–25–P

Fiscal S rvice

[Dept. C c. 570, 1994 Rev., Supp. No. 20]

Suret Companies Acceptable on Fede al Bonds; Acadia Insurance Com any

A Certificate of Authority as an ac ptable surety on Federal Bonds is h eby issued to the following company u der Sections 9304 to 9308, Title 31, the United States Code. Federal bond-approving officers should annotate their reference copies of the Treasury Circular

Treasury Borrowing Advisory Committee
of the
Public Securities Association

Chairman

Stephen C. Francis
Managing Director
Fischer, Francis, Trees & Watts, Inc.
200 Park Avenue, 46th Fl.
New York, NY 10166

Vice Chairman

Richard Kelly
Chairman of the Board
Aubrey G. Lanston & Co., Inc.
One Chase Manhattan Plaza, 53rd Fl.
New York, NY 10005

Daniel S. Ahearn
President
Capital Markets Strategies Co.
50 Congress Street, Ste. 842
Boston, MA 02109

Thomas Bennett
Partner
Miller Anderson & Sherrerd
One Tow Bridge
West Conshohocken, PA 19428

James R. Capra
Principal
Moore Capital Management
350 Theodore Fremd Avenue
3rd Floor
Rye, NY 10580

Jon S. Corzine
Senior Partner & Chairman
Goldman, Sachs & Company
85 Broad Street
New York, NY 1004

Barbara Kenworthy
Managing Director
of Mutual Funds - Taxable
Prudential Insurance
McCarter Highway
2 Gateway Center, 7th Floor
Newark, NJ 07102-5029

Mark F. Kessenich, Jr.
President
Eastbridge Capital, Inc.
135 East 57th Street
New York, NY 10022

Bruce R. Lakefield
Managing Director
Lehman Brothers
200 Vesey Street, 9th Fl.
New York, NY 10285

Richard D. Lodge
President
Banc One Funds Management Co.
100 East Broad St., 17th Fl.
Columbus, OH 43271-0133

Robert D. McKnew
Executive Vice President
Bank of America
555 California Street,
10th Fl.
San Francisco, CA 94104

Joseph Rosenberg
President
Lawton General Corporation
667 Madison Avenue
New York, NY 10021-8087

Daniel T. Napoli
Senior Vice President
Merrill Lynch & Company
250 Vesey Street, North Tower
World Financial Ctr, 8th Fl.
New York, NY 10281

John C. Sites, Jr.
Executive Vice President
Bear Stearns & Company, Inc.
245 Park Avenue, 4th Fl.
New York, NY 10167

William H. Pike
Managing Director
Chemical Bank
270 Park Avenue
New York, NY 10017

Morgan B. Stark
Managing Director
Granite Capital International Group
375 Park Avenue, 18th Floor
New York, NY 10152

Marcy Recktenwald
Managing Director
Bankers Trust Company
1 Appold Street
Broadgate
London EC2A 2HE
England

Stephen Thieke
Chairman, Market Risk Committee
JP Morgan & Company, Inc.
60 Wall Street, 20th Floor
New York, NY 10260

Richard Roberts
Executive Vice President
Wachovia Bank & Trust Co., N.A.
P.O. Box 3099
Winston-Salem, NC 27150

Craig M. Wardlaw
Executive Vice President
Nations Bank Corporation
Nations Bank Corporate Center
Mail Code NCI 007-0606
Charlotte, NC 28255-0001

May 2, 1995

COMMITTEE CHARGE

The Treasury would like the Committee's specific advice on the following:

-- the composition of a financing to refund $32.1 billion of privately held notes and bonds maturing on May 15 and to raise $18 to $20 billion of cash in 3- and 10-year notes and a cash management bill;

-- reopening the 7-1/2% note of February 15, 2005;

-- the maturity of the cash management bill to be issued in the refunding;

-- the composition of Treasury marketable financing for the remainder of the April-June quarter and the July-September quarter; and

-- the levels of Treasury cash balances on June 30 and the end of September.

Other topics

We would like to have the Committee's views on the concept of regular offerings of Treasury inflation-indexed debt: the appropriate index for such securities; maturity; sale technique; potential demand for the securities from various types of investors; and any other considerations. To facilitate discussion, we are attaching hypothetical term sheets.

The Treasury would welcome any comments that the Committee might wish to make on related matters.

DRAFT FOR DISCUSSION PURPOSES

HYPOTHETICAL TERMS OF TREASURY INDEXED BOND

GENERAL INFORMATION

ISSUER	United States Treasury
ISSUE	Inflation-indexed bond
PAYMENT DATES	Principal on the indexed bond will be paid on the maturity date as specified in the offering announcement. Interest on the indexed bond is payable on a semi-annual basis on the interest payment dates specified in the offering announcement through the date the principal becomes payable. In the event any principal or interest payment date is a Saturday, Sunday or other day on which the Federal Reserve Banks are not open for business, the amount is payable (without additional interest) on the next business day.
MATURITY DATE	Two to thirty years maturity term.
INDEX RATIO	The face value of the indexed bond shall be indexed to the Consumer Price Index (CPI). The Reference Index will be the most recently released Consumer Price Index prior to the date of issuance of the indexed bond. The Current Reference Index will be the most recently released Consumer Price Index. The Index Ratio is determined by dividing the Current Reference Index level by the Reference Index.
PRINCIPAL VALUE	The Inflation-Adjusted Principal Value at any date is equal to the par value at issuance times the Index Ratio.
COUPON INTEREST	Coupon interest is paid semi-annually on the Inflation-Adjusted Principal Value of the indexed bond. The amount of interest paid each period would be determined by multiplying the Inflation-Adjusted Principal Value determined as of the coupon payment date by the stated interest rate divided by 2.
STRIPS	Eligible for the STRIPS program. For an indexed bond to be stripped into principal

and interest components at issuance, the par amount of the bond must be in an amount that, based on the coupon rate, will produce a semi-annual coupon payment, unadjusted for inflation, in a multiple of $1,000. For an inflation indexed bond to be stripped into principal and interest components at a later date, the current principal value of the bond must be an amount that would have been eligible for stripping at issuance at its original value. The minimum par amount required to strip an indexed bond will be provided in the press release announcing the auction results.

TAXATION

Coupon payments and appreciation of the principal will be taxed as ordinary income in the period earned or accrued.

AUCTION TECHNIQUE

Uniform price auction. Options:

(1) Bidders bid for coupon. The highest accepted yield becomes the coupon. Bond is issued at 100.

(2) Bidders bid real yield, coupons come in increments of 1/8, price is determined by pre-announced formula at the highest accepted yield.

(3) Before the auction Treasury announces a coupon, bonds are issued at lowest accepted price.

DRAFT FOR DISCUSSION PURPOSES

HYPOTHETICAL TERMS OF TREASURY ZERO-COUPON INDEXED BOND

GENERAL INFORMATION

ISSUER — United States Treasury

ISSUE — Zero-coupon Inflation-indexed bond

PAYMENT DATES — Principal and accrued interest on the indexed bond will be paid on the maturity date.

MATURITY DATE — Two to thirty years maturity term.

INDEX RATIO — The face value of the indexed bond shall be indexed to the Consumer Price Index (CPI). The Reference Index will be the most recently released Consumer Price Index prior to the date of issuance of the indexed bond. The Current Reference Index will be the most recently released Consumer Price Index. The Index Ratio is determined by dividing the Current Reference Index level by the Reference Index.

VALUE OF BOND AT MATURITY — The value of the bond at maturity is is determined by the following formula, where

P = original issue price
r = annual real rate (determined at issuance)
n = number of full semi-annual periods from issuance to maturity

$$\text{Value at maturity} = P * [1 + r/2]^{n} * [\text{Index Ratio}]$$

TAXATION — Appreciation of the principal will be taxed as ordinary income in the period accrued.

AUCTION TECHNIQUE — A uniform price auction. Bidders bid yield, bonds are issued at 100.

SUMMARY OF APRIL - JUNE 1995
ESTIMATED NET MARKETABLE BORROWING
(in billions of dollars)

Net new money raised or announced (as of May 1, 1995)

Regular weekly treasury bills	-16.3
52-week bills (includes $273 million foreign add-ons)	2.25
Cash management bills #	-9.1
2-year notes (includes $533 million foreign add-ons)	2.2
5-year notes (includes $550 million foreign add-ons)	12.05
7-year notes redemption	-7.0
	-15.9
Net new money to be raised:	
Regular weekly treasury bills	2.1
52-week bills	1.8
Cash management bills ##	10.0
2 and 5-year notes *	28.4
Refunding *	-0.6
	41.7
Total net marketable borrowing in quarter:	**25.8**

Note: Assumes an end of quarter cash balance of $45 billion.

SUMMARY OF JULY - SEPTEMBER 1995
ESTIMATED NET MARKETABLE BORROWING
(in billions of dollars)

Regular weekly treasury bills	15.8
52-week bills	4.15
Cash management bills +	-10.0
2 and 5-year notes **	30.0
Refunding **	14.0
7-year notes redemption	-6.8
Bonds called for redemption on August 15, 1995	-2.3
Total net marketable borrowing in quarter:	**44.85**

Note: Assumes an end of quarter cash balance of $30 billion.

The $25 billion cash mgmt bill issued on April 3 matured on April 20.

The $15 billion cash mgmt bill to be issued in mid May and $13 billion cash mgmt bill to be issued in early June are expected to mature within the quarter. A $10 billion cash mgmt bill to be issued in early June will mature in September.

* Includes anticipated foreign add-ons totaling approximately $4.5 billion.

+ The cash mgmt bills to be issued in the July - September quarter are expected to mature within the quarter.

** Includes anticipated foreign add-ons totaling approximately $4.5 billion.

ESTIMATED TREASURY MARKETABLE BORROWING
(in billions of dollars)

APRIL - JUNE 1995

Total estimated marketable borrowing	**25.8**
Total net marketable borrowing issued or announced through May 1, 1995	**-15.9**
Total remaining net marketable borrowing	**41.7**
Cash balance at end of quarter	**45.0**

	Amount maturing	Amount offered	Foreign add-ons	Cash raised	Cumulative Cash raised
3 &6 month bills					
Apr 6	26.8	24.2	-	-2.6	
Apr 13	26.9	23.3	-	-3.6	
Apr 20	26.7	23.2	-	-3.5	
Apr 27	27.1	23.4	-	-3.7	
May 4	27.6	24.7	-	-2.9	
May 11	27.6	25.6	-	-2.0	
May 18	28.3	26.8	-	-1.5	
May 25	27.3	27.6	-	0.3	
Jun 1	27.4	27.6	-	0.2	
Jun 8	27.2	27.6	-	0.4	
Jun 15	26.8	27.6	-	0.8	
Jun 22	25.7	27.6	-	1.9	
Jun 29	25.6	27.6	-	2.0	**-14.2**
52 week bills					
Apr 6	16.6	17.25	0.3	0.95	
May 4	16.6	17.9	0.05	1.35	
Jun 1	16.9	17.75	-	0.85	
Jun 29	16.8	17.75	-	0.95	**4.1**
Cash mgmt bills Settlement date					
Apr 3		25.1		25.1	
Apr 20	34.2			-34.2	
May 15 (Jun 22 mat)		~~15.0~~ 10.0		15.0	
Jun 1 (Jun 22 mat)		13.0		13.0	
7/15 ~~Jun1~~ (Sept 21 mat)		10.0		10.0	
Jun 22	28.0			-28.0	**0.9**
Coupons					
Apr 7-year	7.0			-7.0	
Apr 2-year	16.1	17.75	0.5	2.15	
Apr 5-year		11.5	0.55	12.05	
May 3-year		17.5	0.9		
May 10-year		12.5	0.6		
Refunding	32.1	30.0	1.5	-0.6	
May 2-year	16.3	17.75	0.9	2.35	
May 5-year		11.5	0.6	12.1	
Jun 2-year	16.8	17.75	0.9	1.85	
Jun 5-year		11.5	0.6	12.1	**35.0**
Grand Total	568.4	588.3	5.9	25.8	**25.8**

ESTIMATED TREASURY MARKETABLE BORROWING
(in billions of dollars)

JULY - SEPTEMBER 1995

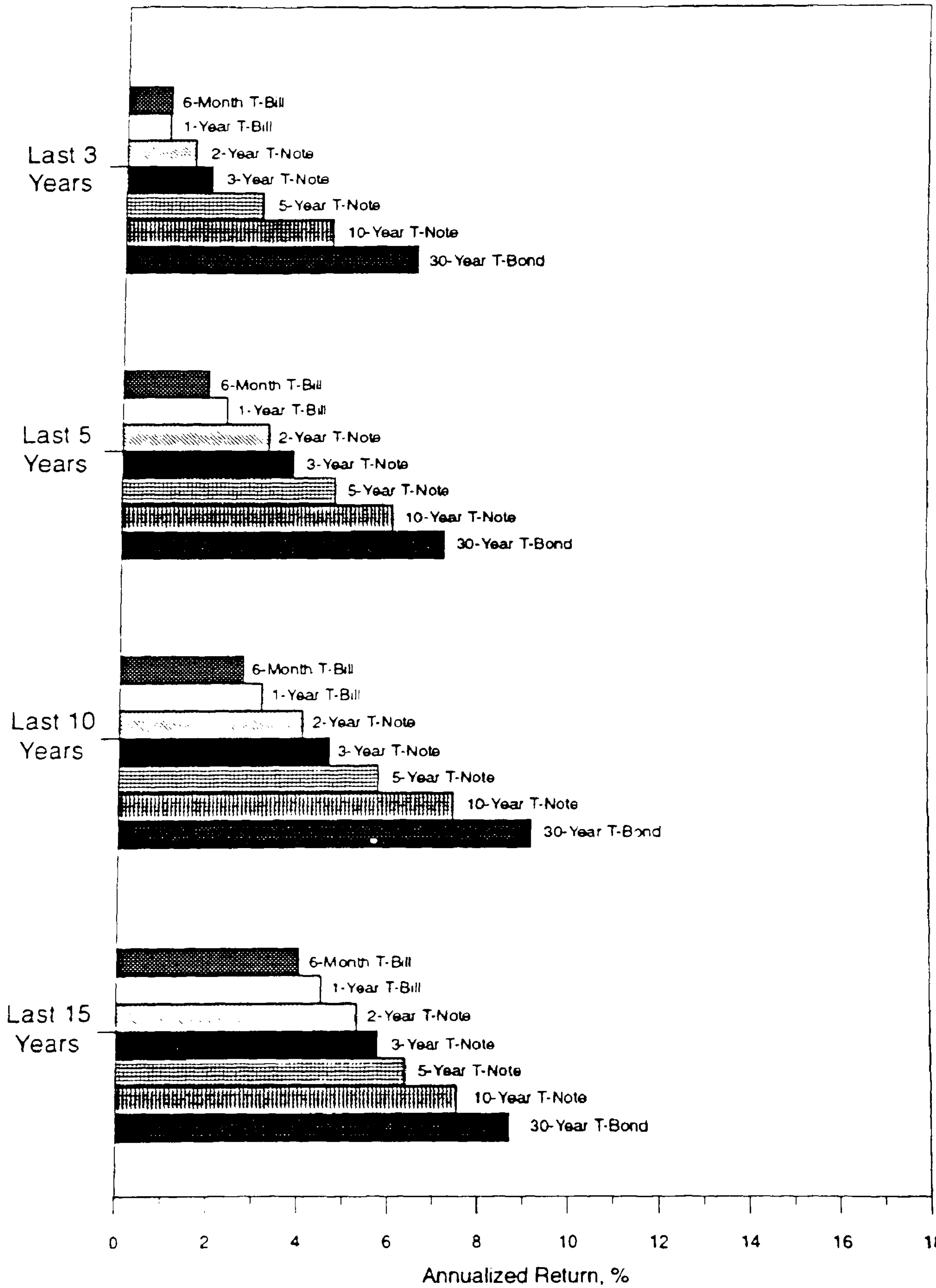
Total estimated marketable borrowing	44.85
Total net marketable borrowing issued or announced through May 1, 1995	0.0
Total remaining net marketable borrowing	44.85
Cash balance at end of quarter	30.0

	Amount maturing	Amount offered	Foreign add-ons	Cash raised	Cumulative Cash raised
3 &6 month bills					
Jul 6	26.3	27.6	-	1.3	
Jul 13	25.5	27.6	-	2.1	
Jul 20	25.2	27.6	-	2.4	
Jul 27	25.2	27.6	-	2.4	
Aug 3	26.0	27.6	-	1.6	
Aug 10	26.8	27.6	-	0.8	
Aug 17	27.8	27.6	-	-0.2	
Aug 24	27.4	27.6	-	0.2	
Aug 31	27.3	27.6	-	0.3	
Sep 7	26.9	27.6	-	0.7	
Sep 14	26.3	27.6	-	1.3	
Sep 21	26.4	27.6	-	1.2	
Sep 28	25.9	27.6	-	1.7	15.8
52 week bills					
Jul 27	17.0	18.25	-	1.25	
Aug 24	16.8	18.25		1.45	
Sep 21	16.8	18.25	-	1.45	4.15
			-		
Cash mgmt bills Settlement date					
Aug 15		10.0		10.0	
Sep 1		15.0		15.0	
Sep 21	35.0			-35.0	-10.0
Coupons					
Jul 7-year	6.8	.		-6.8	
Jul 2-year	16.6	18.25	0.9	2.55	
Jul 5-year		12.0	0.6	12.6	
Aug 3-year		~~18.0~~ 18.5	0.9		
Aug 10-year		~~13.0~~ 15.5	0.6		
Aug 30-year		~~11.5~~ 12.0			
Refunding	32.3 *	42.5	1.5	11.7	
Aug 2-year	16.9	18.25	0.9	2.25	
Aug 5-year		12.0	0.6	12.6	34.9
Grand Total	501.2	541.55	4.5	44.85	44.85

* includes $2.3 billion bonds called for redemption.

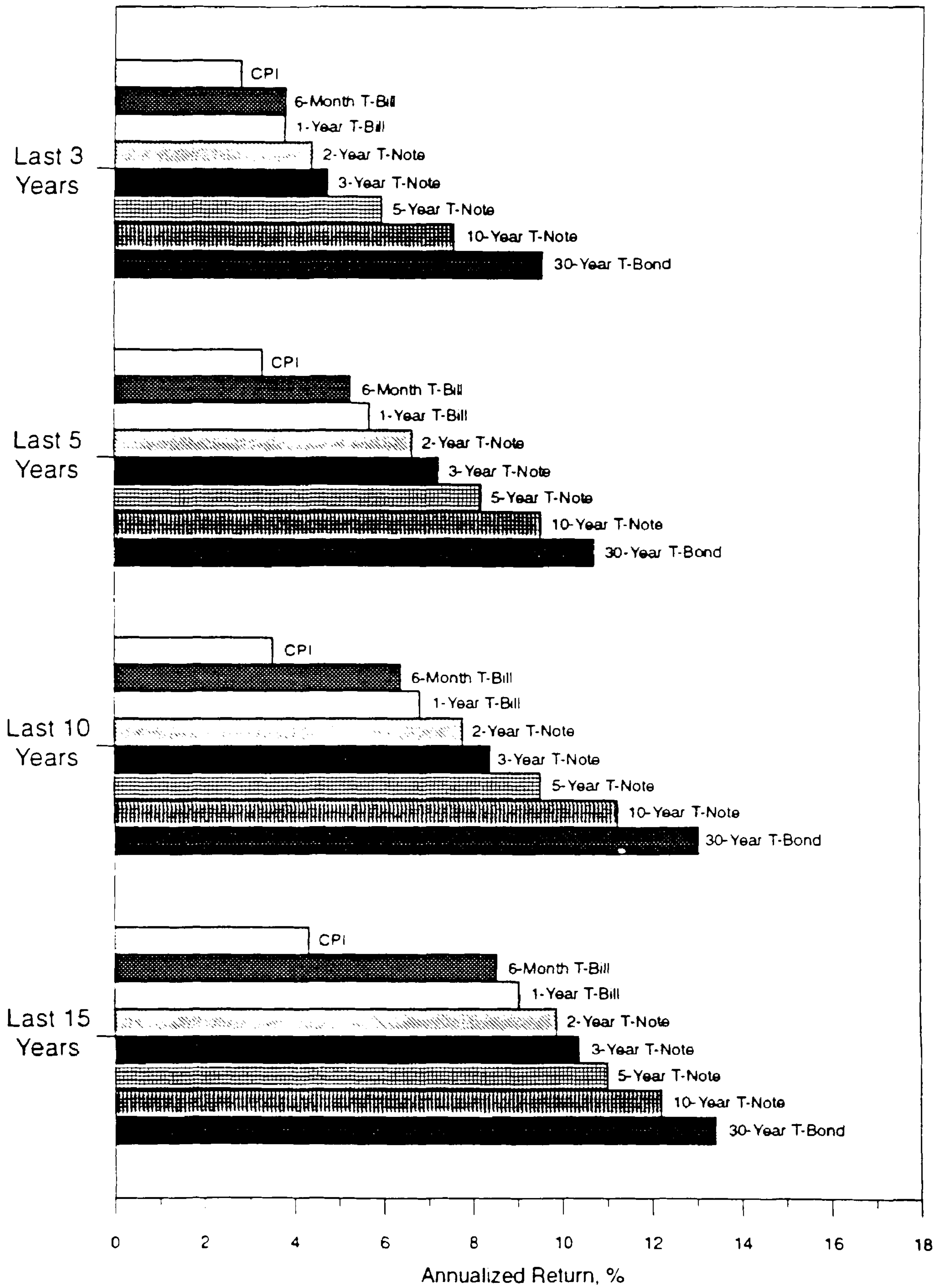
Real Rates of Return

Returns on Constant-Maturity Treasuries Minus the CPI
Periods Ending March 31, 1995



Nominal Rates of Return

Constant-Maturity Treasuries and the CPI
Periods Ending March 31, 1995



Nominal Rates of Return

Constant-Maturity Treasuries and the CPI
Periods Ending March 31, 1995

	CPI	6-Month T-Bill	1-Year T-Bill	2-Year T-Note	3-Year T-Note	5-Year T-Note	10-Year T-Note	30-Year T-Bond
Last 3 Years	2.82%	3.82%	3.80%	4.40%	4.77%	5.98%	7.60%	9.58%
Last 5 Years	3.30	5.29	5.72	6.68	7.27	8.23	9.57	10.77
Last 10 Years	3.55	6.42	6.84	7.79	8.41	9.54	11.26	13.06
Last 15 Years	4.34	8.54	9.05	9.88	10.38	11.01	12.20	13.42

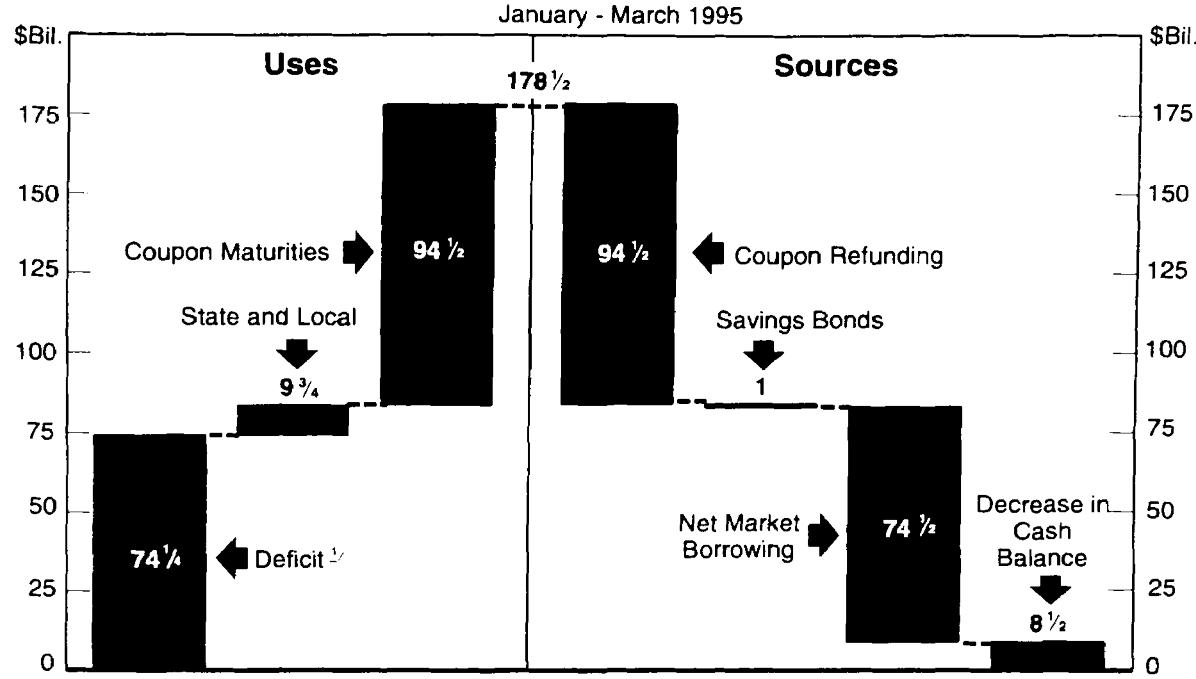
Real Rates of Return

Returns on Constant Maturity Treasuries Minus the CPI
Periods Ending March 31, 1995

	6-Month T-Bill	1-Year T-Bill	2-Year T-Note	3-Year T-Note	5-Year T-Note	10-Year T-Note	30-Year T-Bond
Last 3 Years	0.98%	0.96%	1.54%	1.91%	3.08%	4.66%	6.59%
Last 5 Years	1.93	2.34	3.28	3.85	4.78	6.08	7.24
Last 10 Years	2.77	3.18	4.10	4.70	5.79	7.45	9.18
Last 15 Years	4.04	4.53	5.32	5.80	6.40	7.54	8.71

TREASURY FINANCING REQUIREMENTS

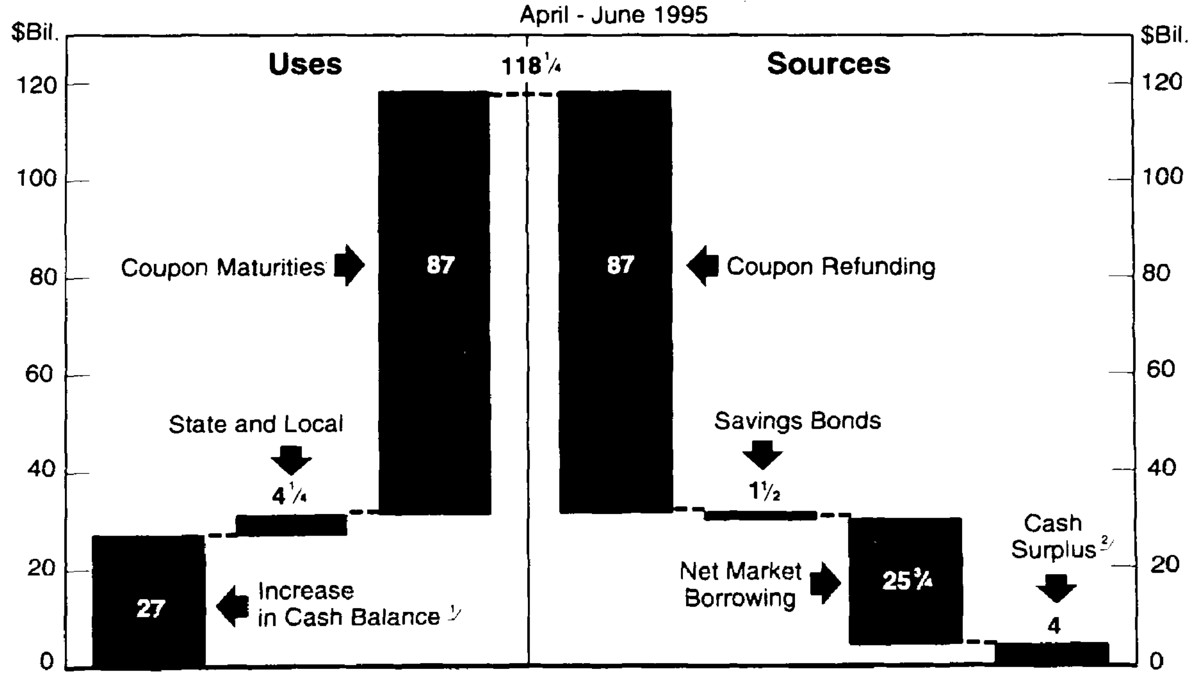
January - March 1995



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

TREASURY FINANCING REQUIREMENTS

April - June 1995



1/ Assumes a $45 billion cash balance June 30, 1995.

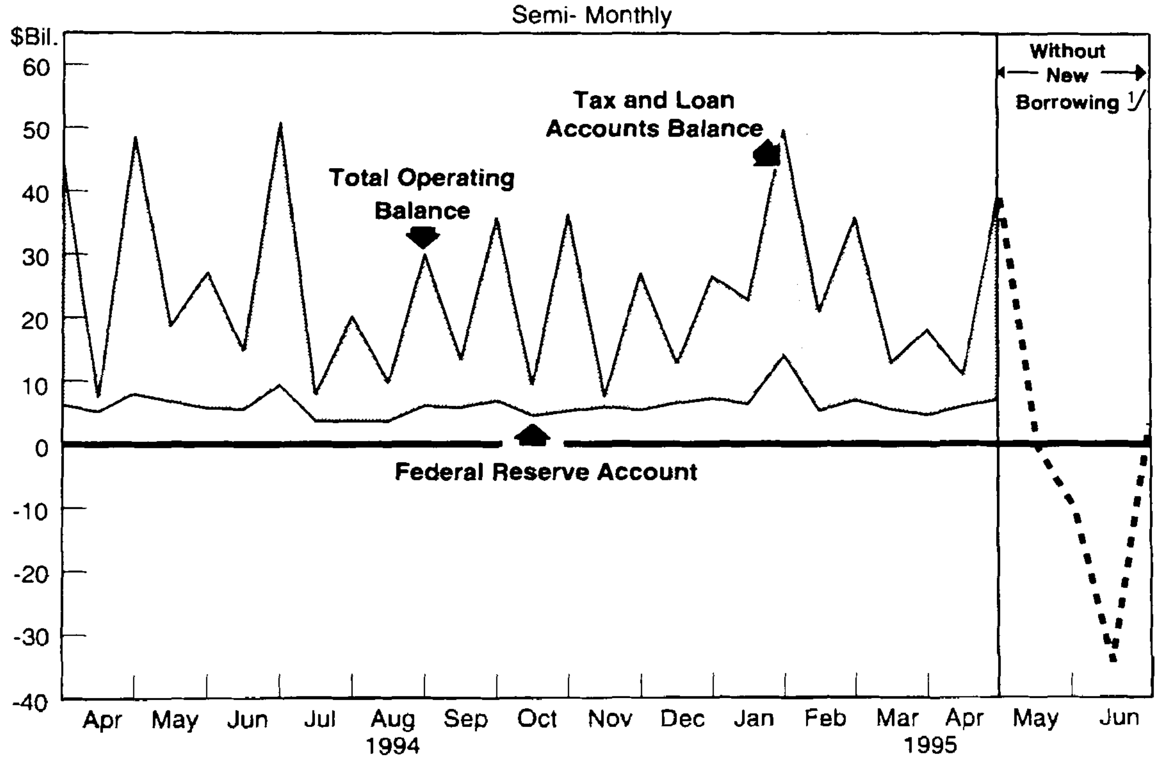
2/ Includes budget surplus, changes in accrued interest and checks outstanding and miscellaneous debt transactions.

NET MARKET BORROWING
April – June 1995
(Billions of Dollars)

Total		**25.8**
Done [1]		**-15.9**
Bills		
Regular weekly	-16.3	
52 week	2.3	
Cash management	-9.1	
Notes		
7 year note	-7.0	
2 year note	2.2	
5 year note	12.0	
To Be Done		**41.7**

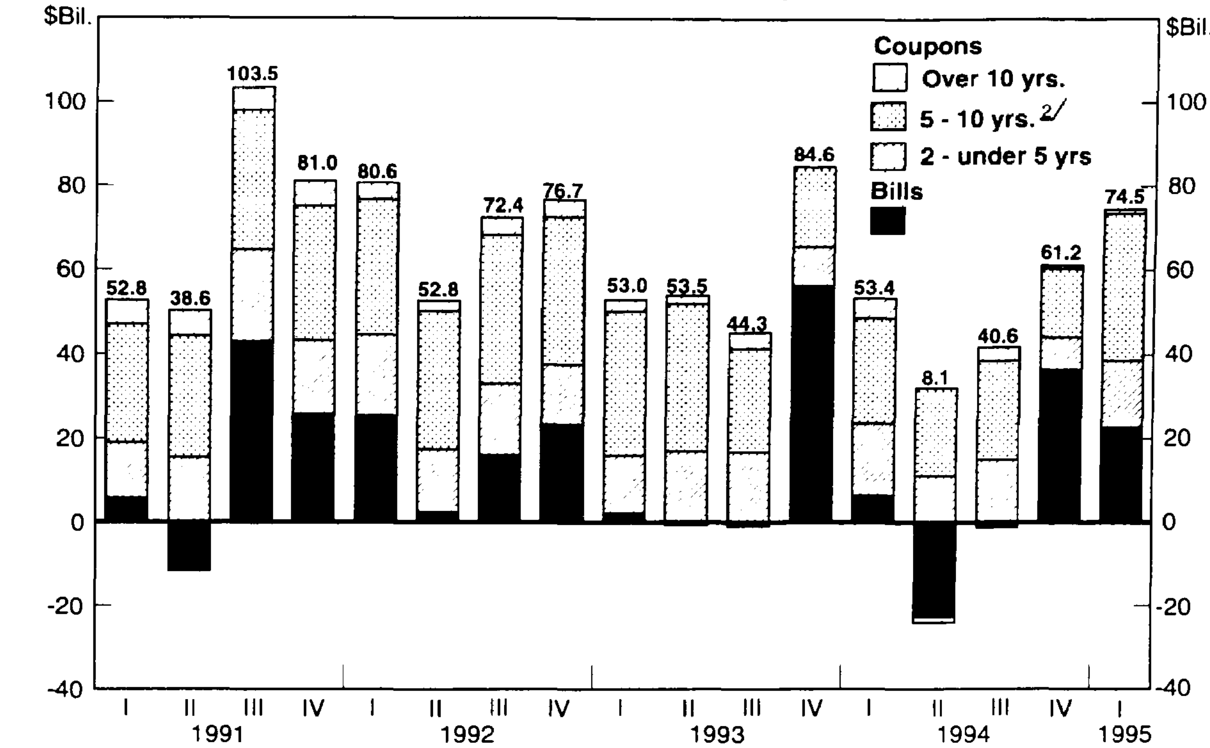
[1] Issued or announced through April 28, 1995.

TREASURY OPERATING CASH BALANCE
Semi- Monthly



[1] Assumes refunding of maturing issues.

TREASURY NET MARKET BORROWING [1/]



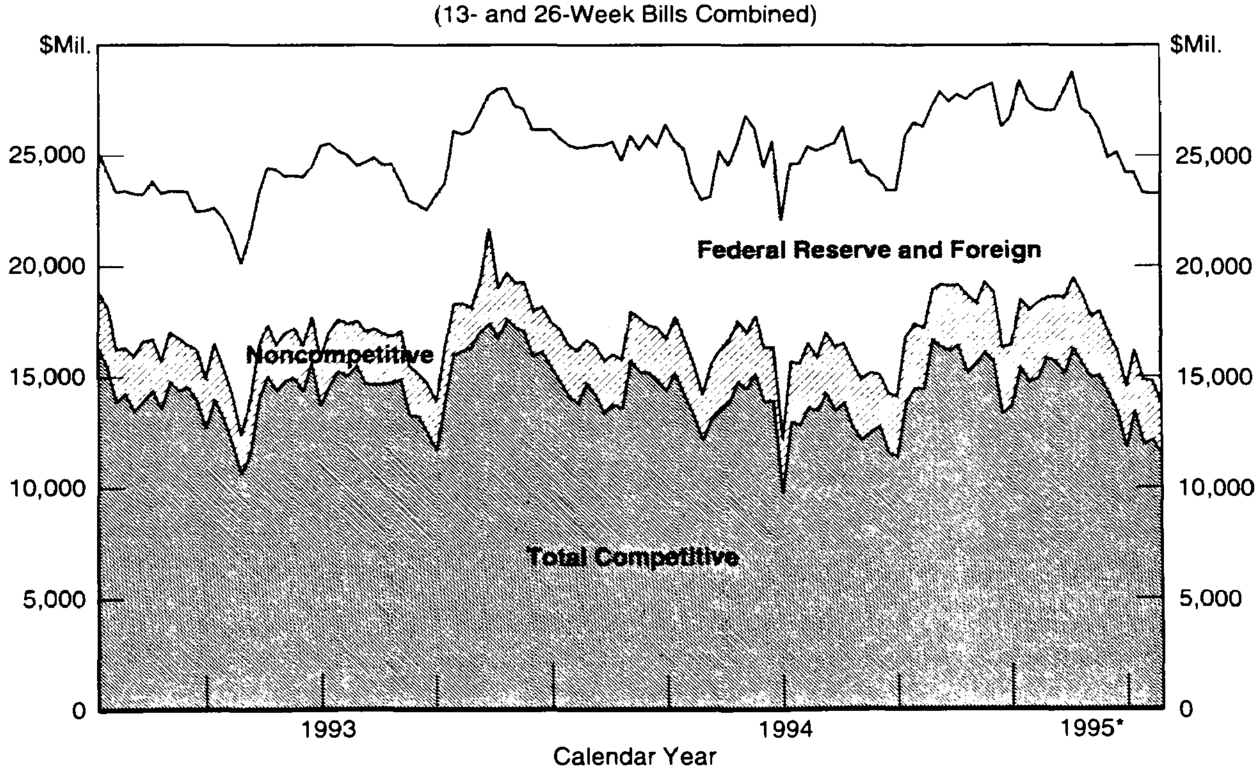
1/ Excludes Federal Reserve and Government Account Transactions.
2/ 7 year note discontinued after April 1993.

Department of the Treasury
Office of Market Finance

May 1, 1995-5

AWARDS IN WEEKLY BILL AUCTIONS

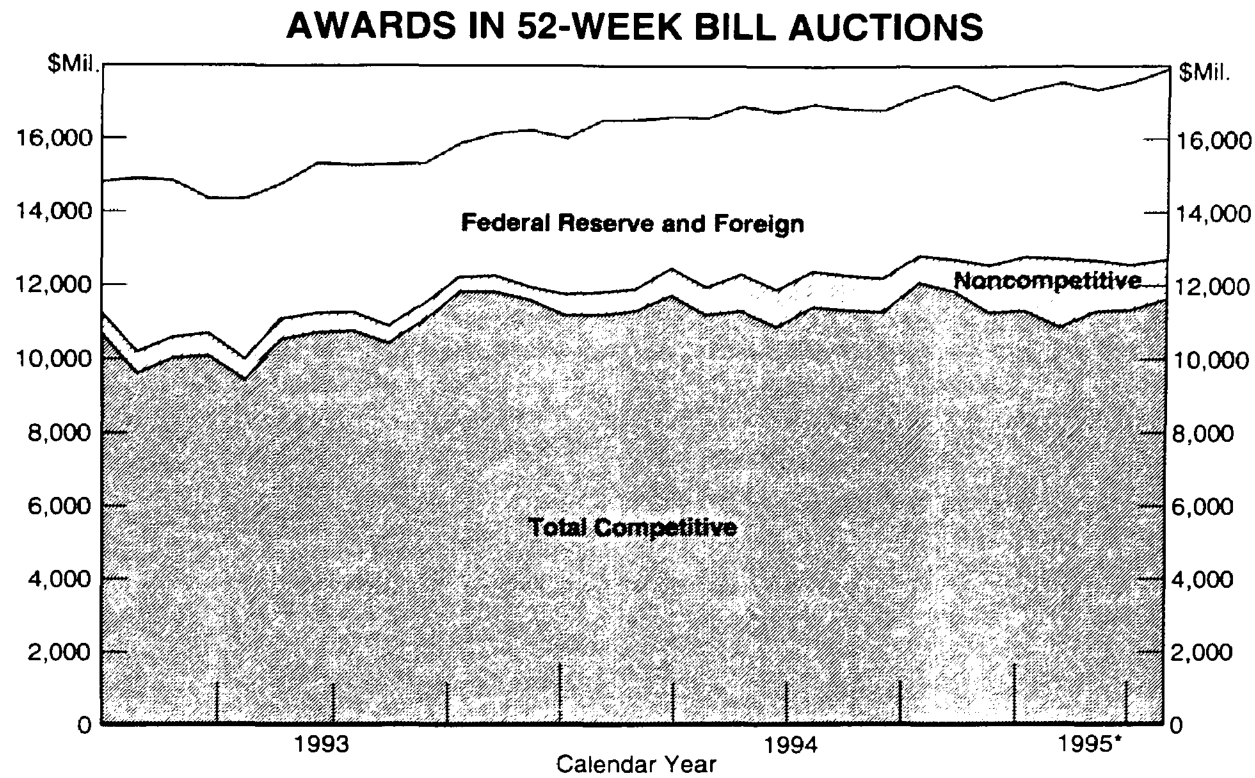
(13- and 26-Week Bills Combined)



*Data through April 24, 1995 Auction.

Department of the Treasury
Office of Market Finance

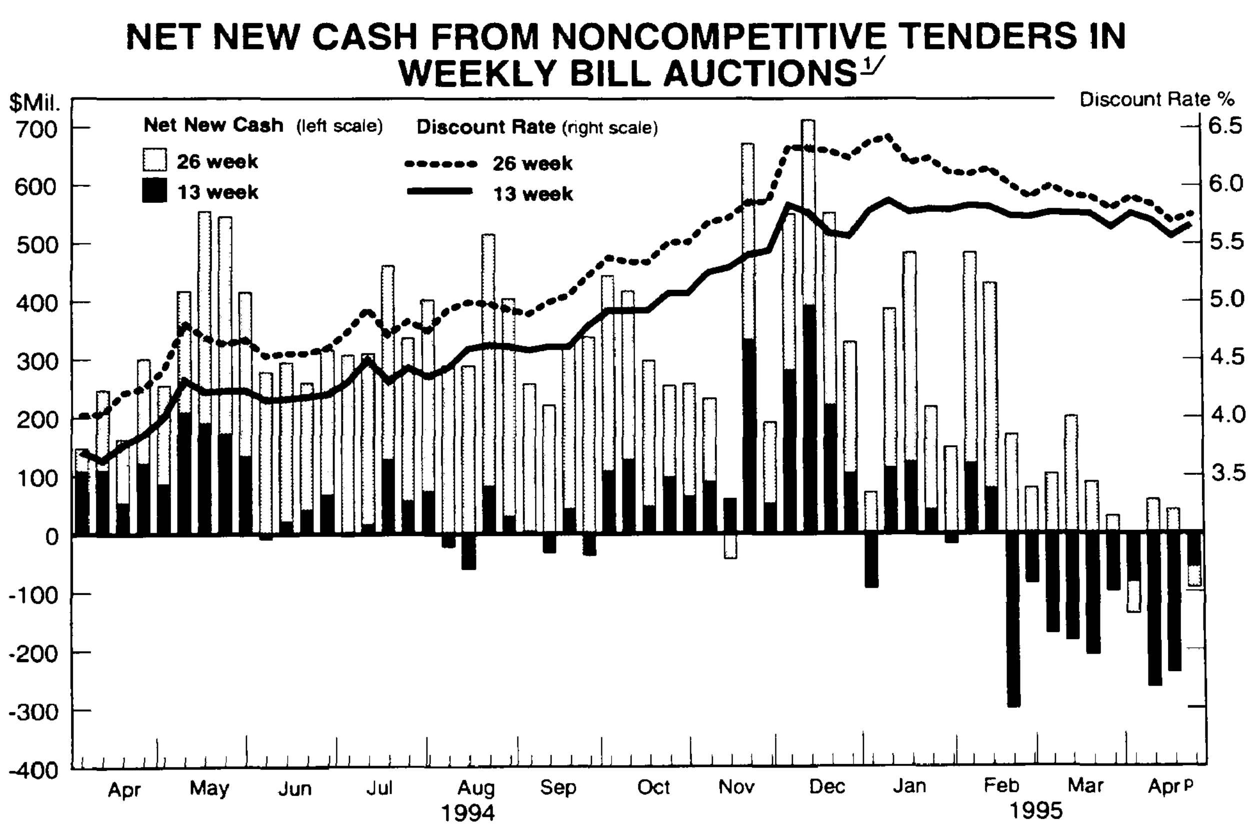
May 1, 1995-6



*Data through April 27, 1995 auction.

Department of the Treasury
Office of Market Finance

May 1, 1995-7

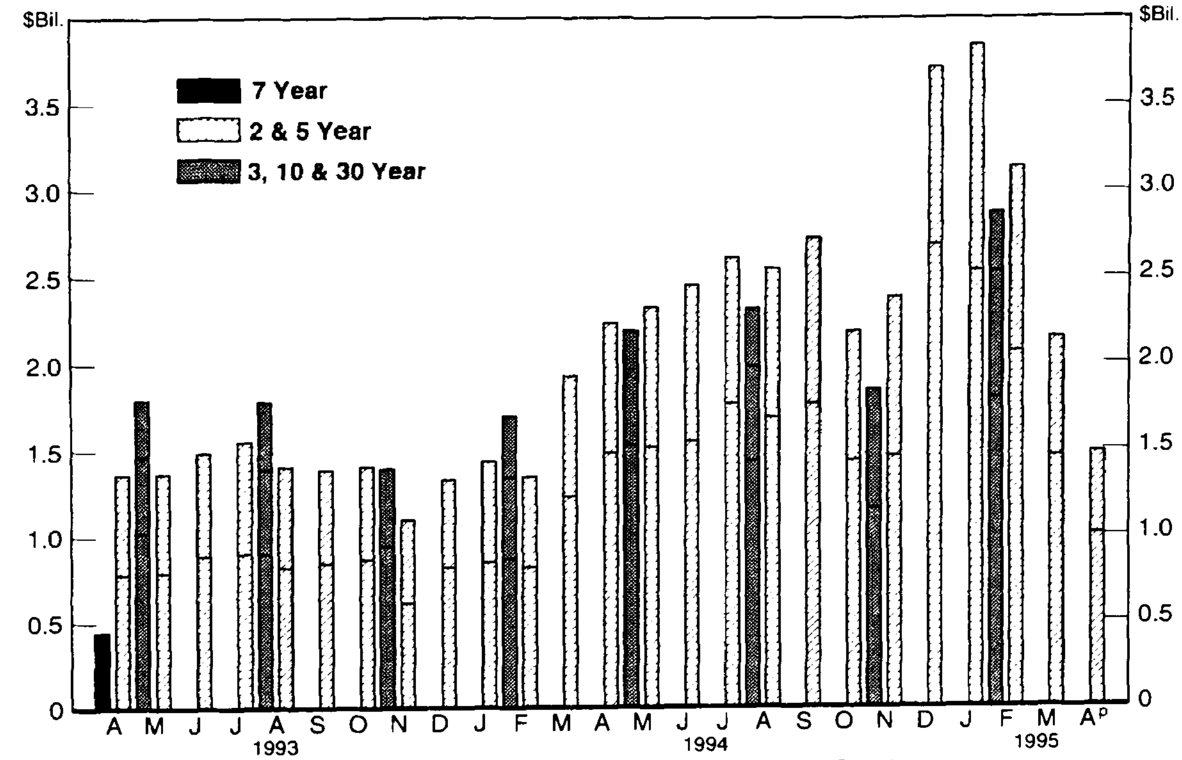


1/ Excludes noncompetitive tenders from foreign official accounts and the Federal Reserve account.
p Preliminary

Department of the Treasury
Office of Market Finance

May 1, 1995-8

NONCOMPETITIVE TENDERS IN TREASURY NOTES AND BONDS 1/



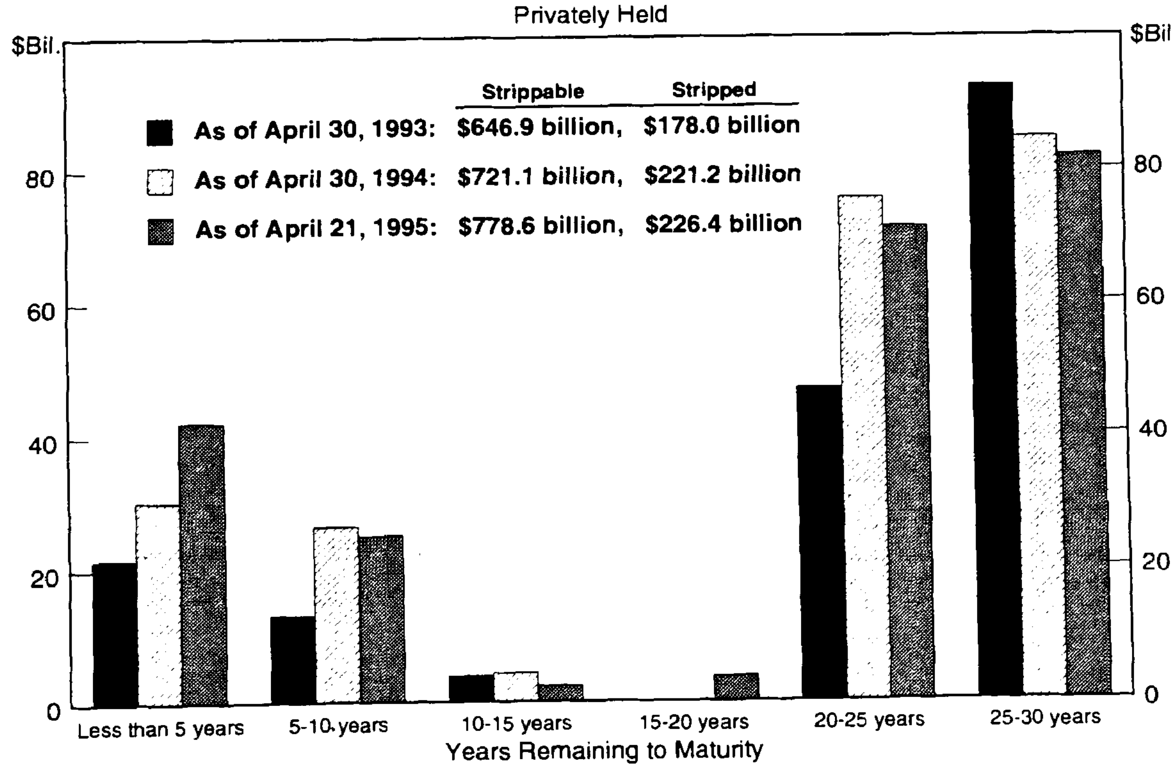
1/ Excludes foreign add-ons from noncompetitive tenders   p Preliminary

Treasury increased the maximum noncompetitive award to any noncompetitive bidder to $5 million effective November 5, 1991.

Effective February 11, 1992, a noncompetitive bidder may not hold a position in WI trading, futures, or forward contracts, nor submit both competitive and noncompetitive bids for its own account.

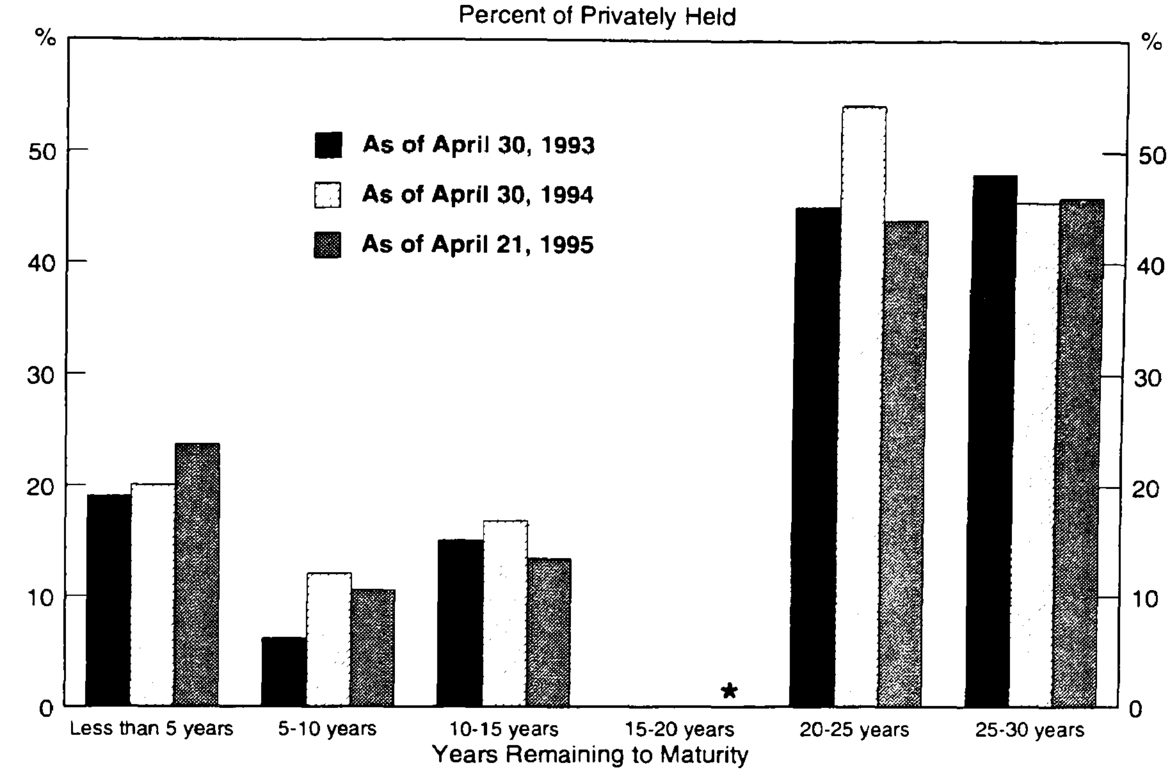
SECURITIES HELD IN STRIPS FORM 1993-1995

Privately Held



Note: The STRIPS program was established in February 1985. The 11 5/8% note of November 15, 1994, issued on November 15, 1984, was the first STRIPS-eligible security to mature.

SECURITIES HELD IN STRIPS FORM 1993-1995



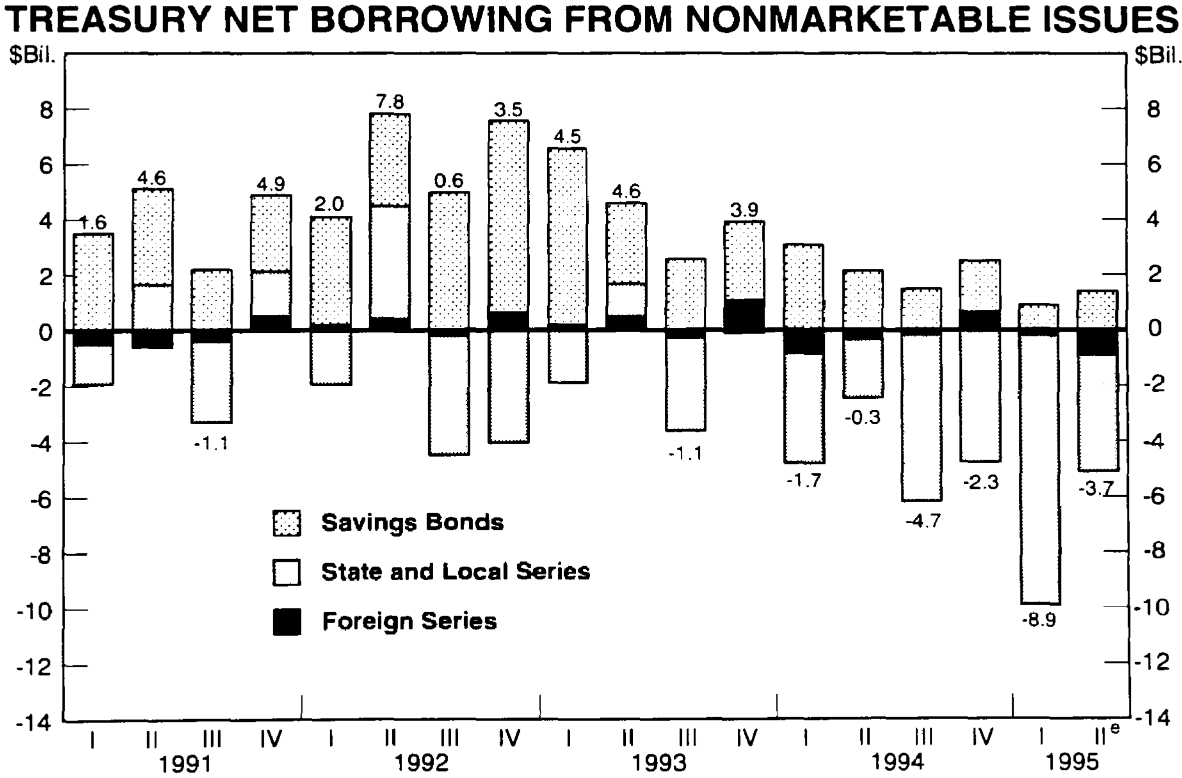
* The 11 3/4% bond of 11/15/09-14 had $4.9 billion (privately-held) available for stripping, of which 76% was held in stripped form.

Note: The STRIPS program was established in February 1985. The 11 5/8% note of November 15, 1994, issued on November 15, 1984, was the first STRIPS-eligible security to mature.

Department of the Treasury
Office of Market Finance

May 1, 1995-11

TREASURY NET BORROWING FROM NONMARKETABLE ISSUES



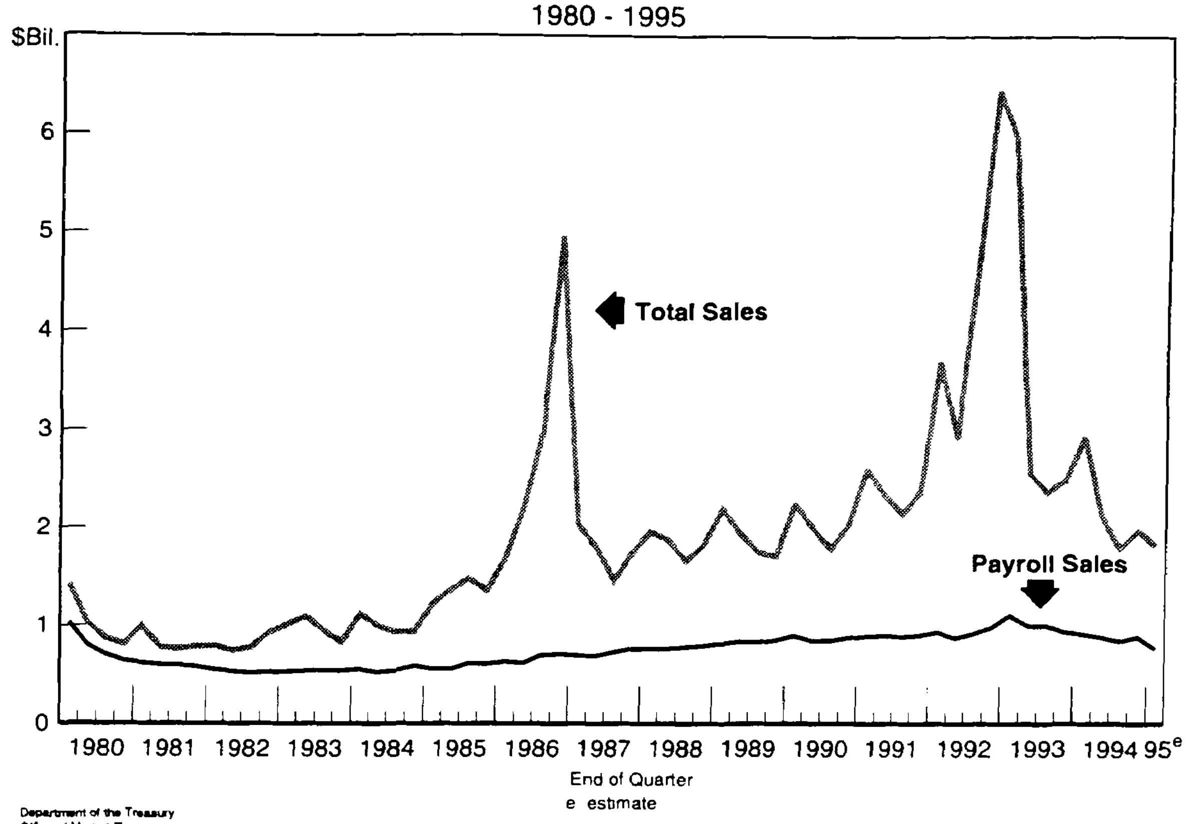
e estimate

Department of the Treasury
Office of Market Finance

May 1, 1995-12

SALES OF UNITED STATES SAVINGS BONDS

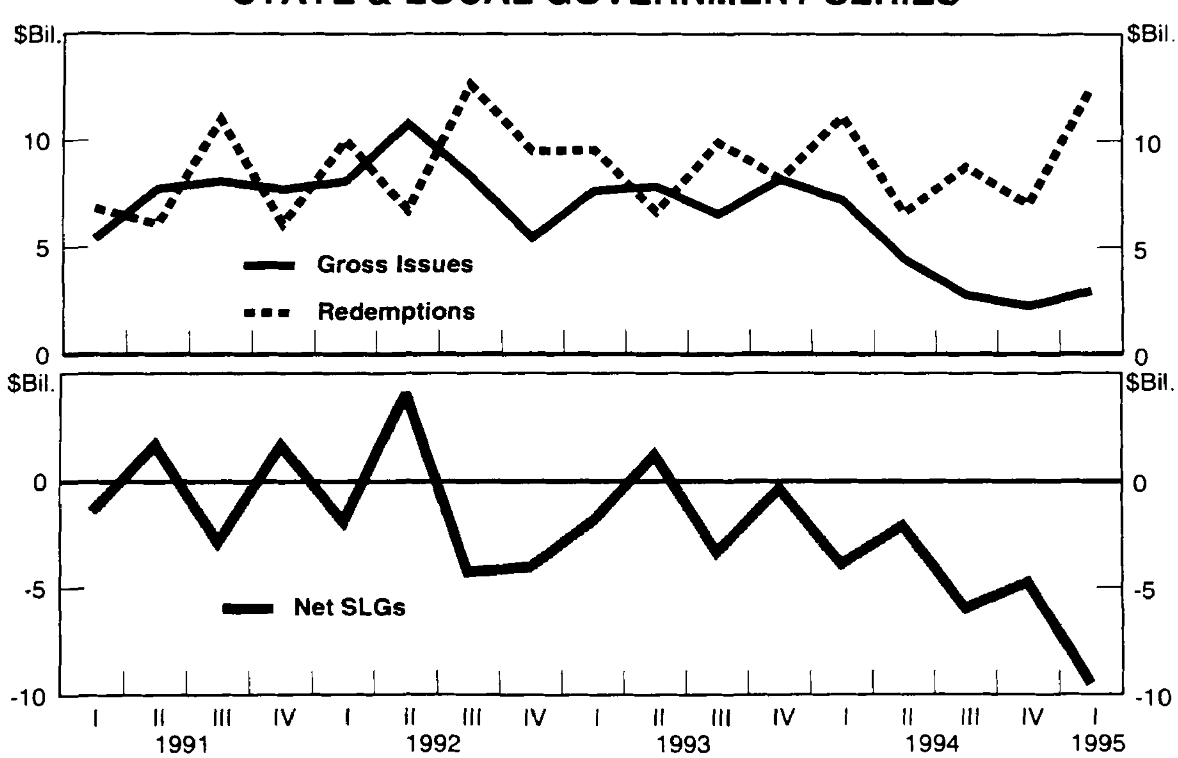
1980 - 1995



Department of the Treasury
Office of Market Finance

May 1, 1995-13

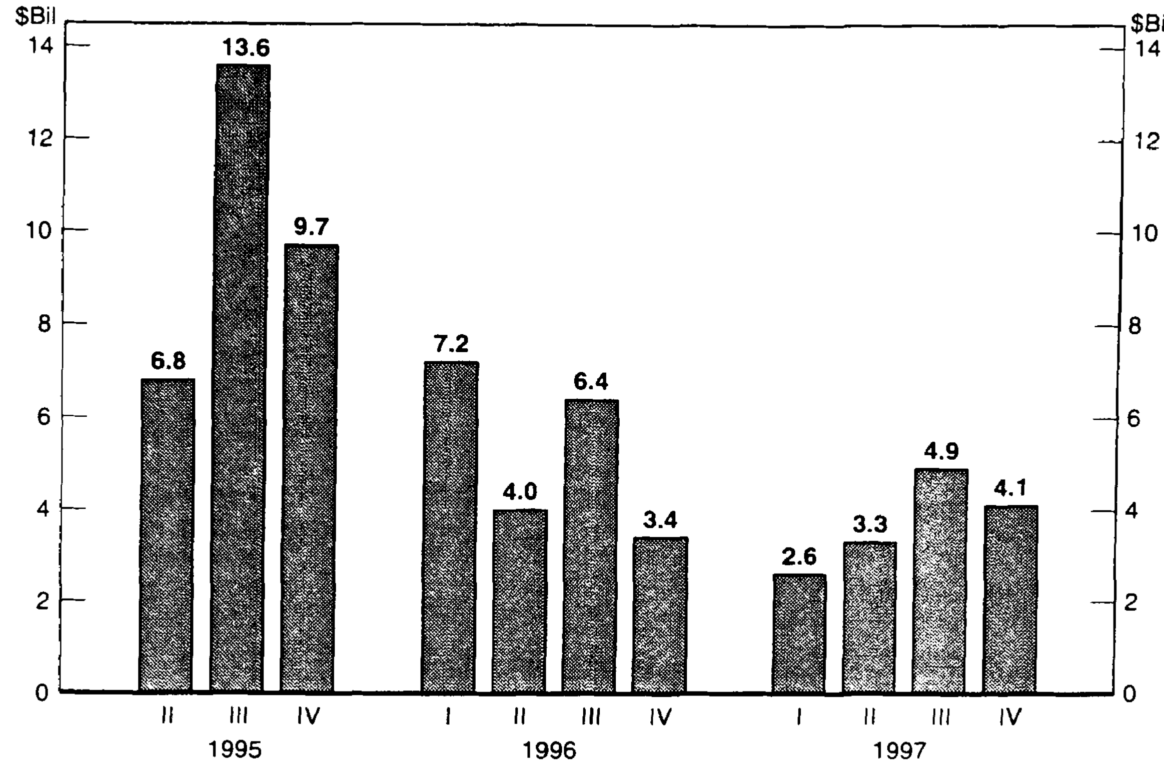
STATE & LOCAL GOVERNMENT SERIES



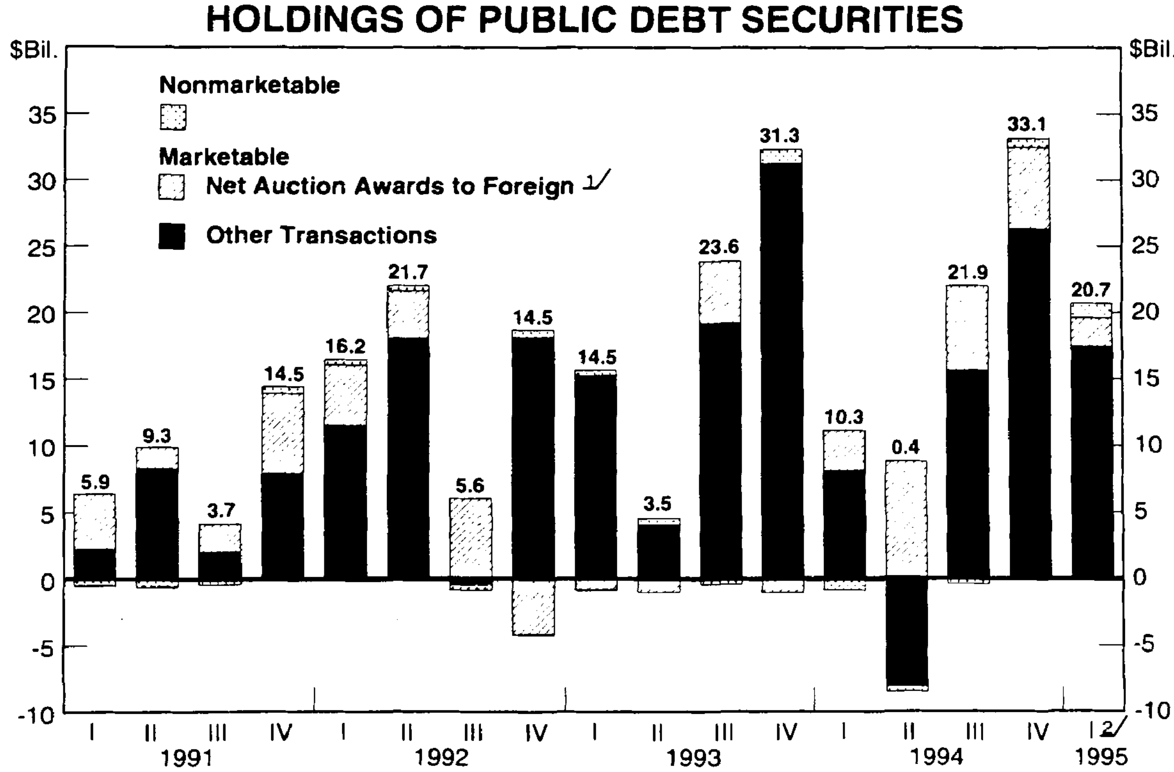
Department of the Treasury
Office of Market Finance

May 1, 1995-14

STATE AND LOCAL MATURITIES 1995-1997



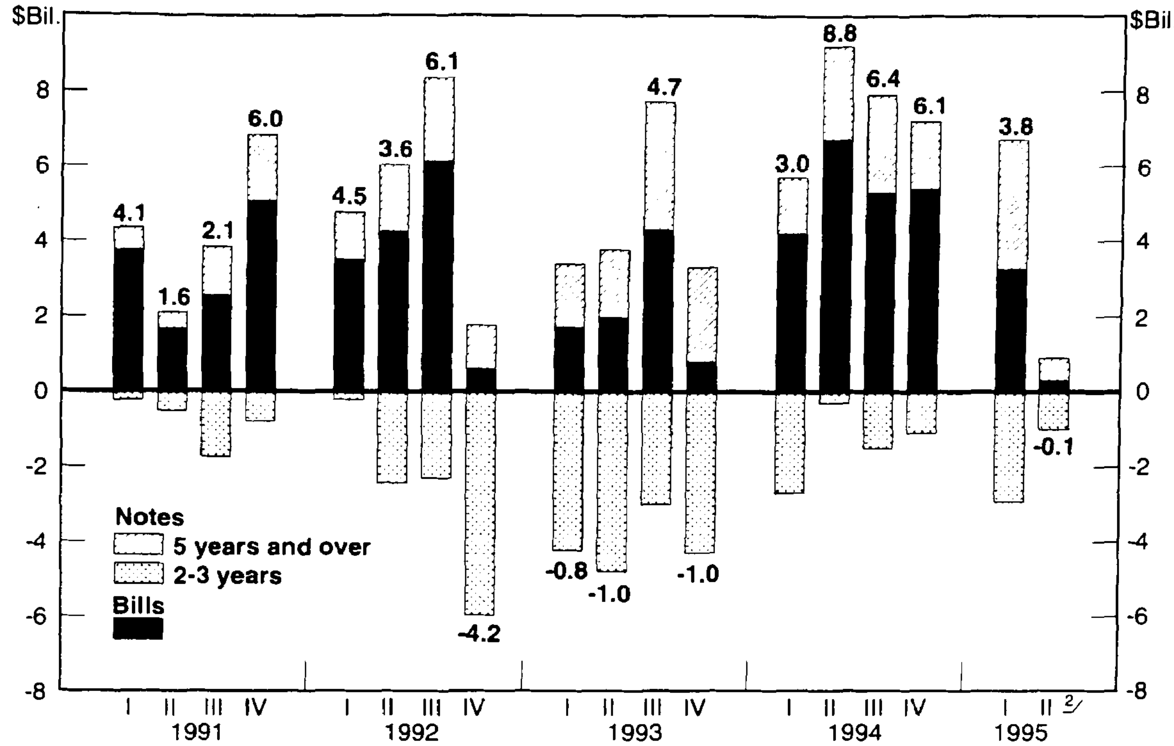
QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES



1/ Auction awards to foreign official purchasers netted against holdings of maturing securities.

2/ Data through February 28, 1995.

NET AWARDS TO FOREIGN OFFICIAL ACCOUNTS 1/



1/ Noncompetitive awards to foreign official accounts held in custody at the Federal Reserve in excess of foreign custody account holdings of maturing securities.

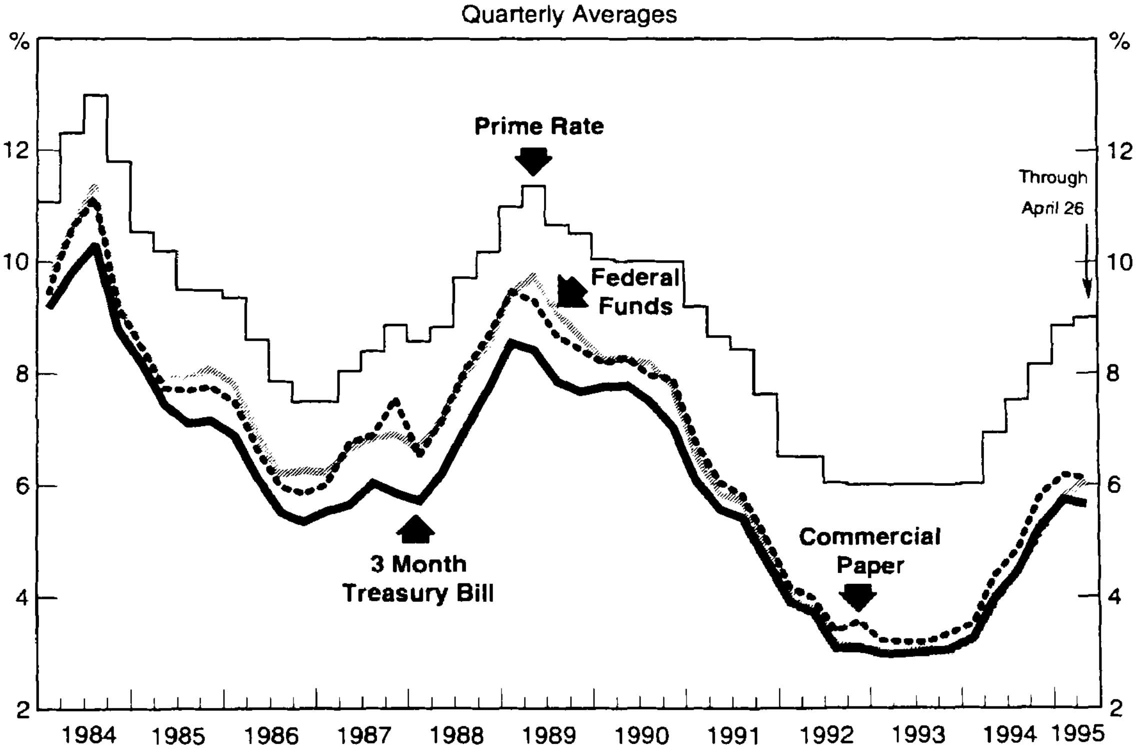
2/ Through April 28, 1995.

Department of the Treasury
Office of Market Finance

May 1, 1995-17

SHORT TERM INTEREST RATES

Quarterly Averages

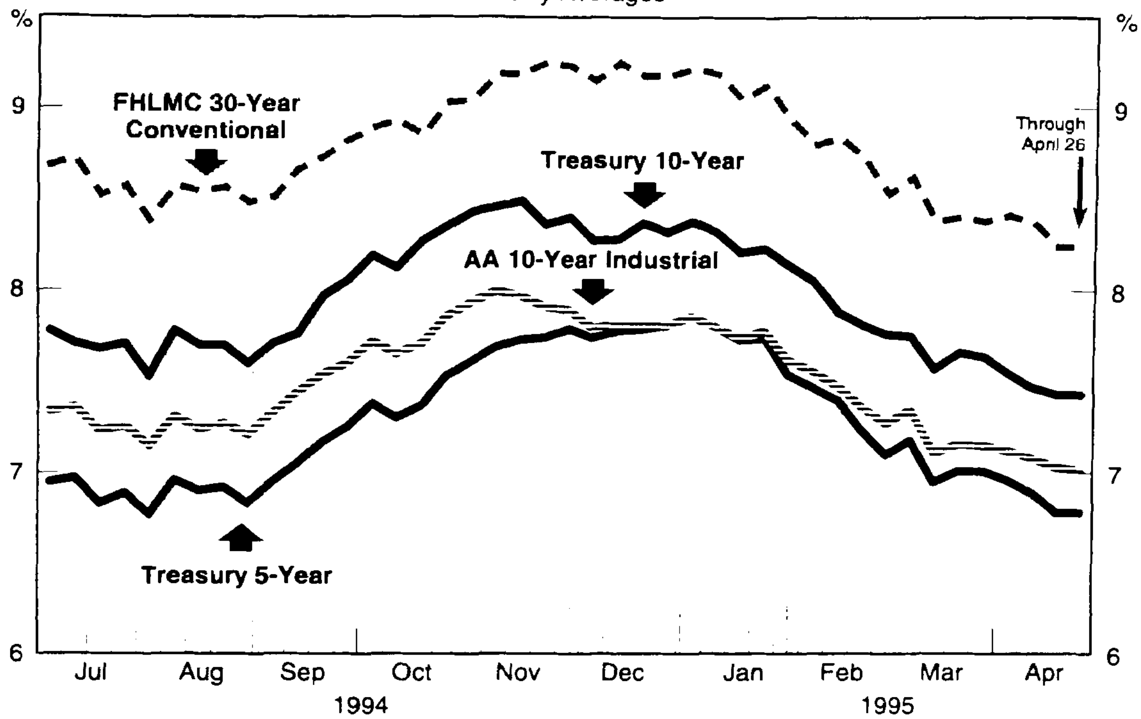


Department of the Treasury
Office of Market Finance

May 1, 1995-18

INTERMEDIATE TERM INTEREST RATES

Weekly Averages*

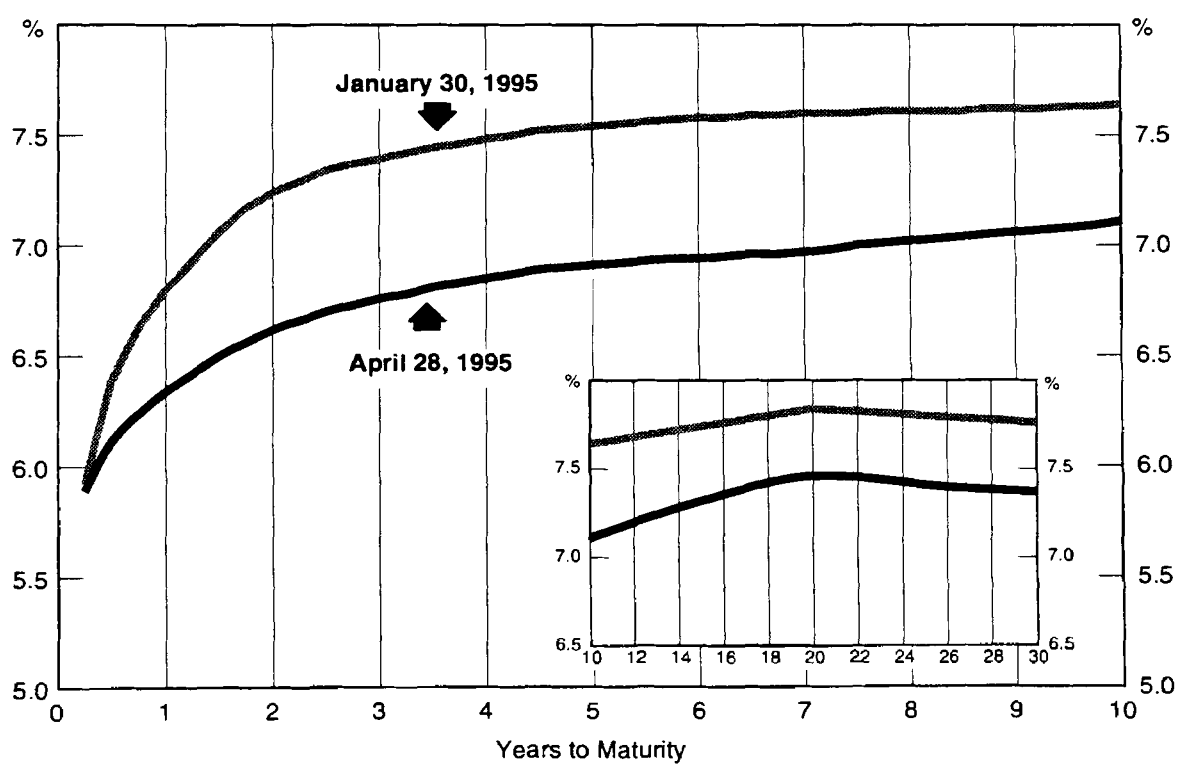


* Salomon 10-yr. AA Industrial is a Thursday rate.

Department of the Treasury
Office of Market Finance

May 1, 1995-21

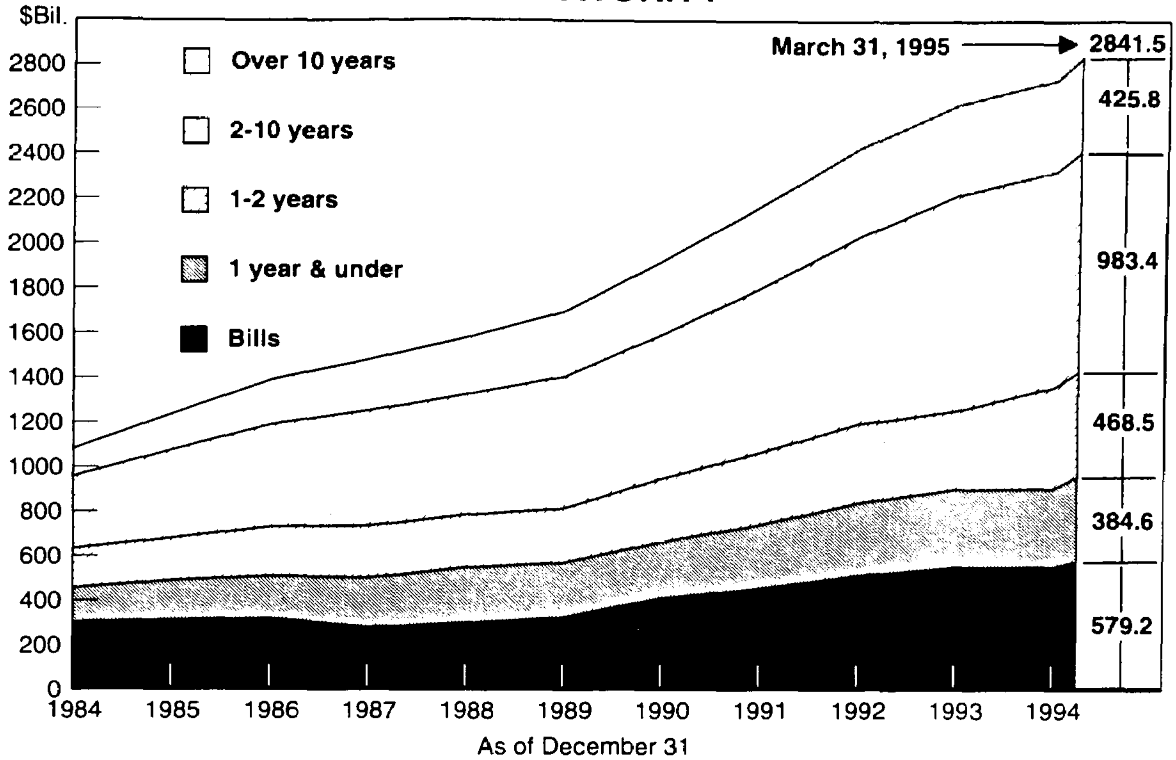
MARKET YIELDS ON GOVERNMENTS



Department of the Treasury
Office of Market Finance

May 1, 1995-22

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY

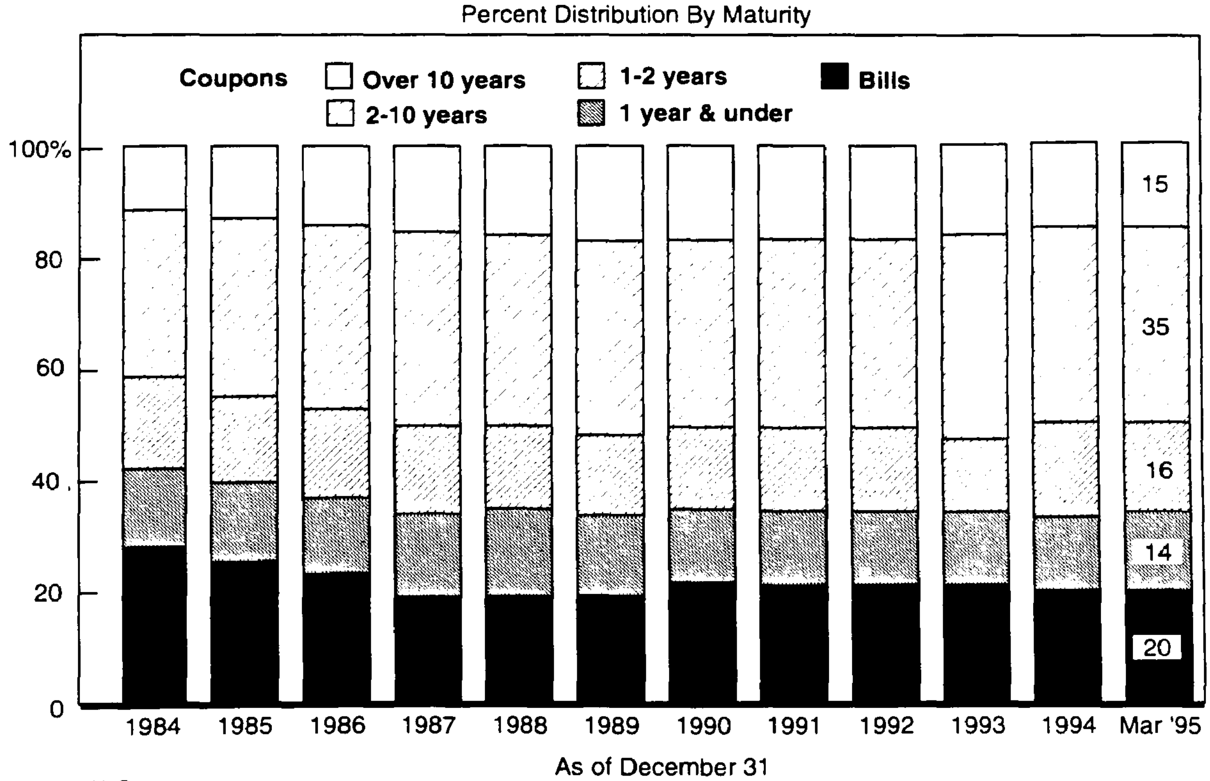


Department of the Treasury
Office of Market Finance

May 1, 1995-23

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT

Percent Distribution By Maturity

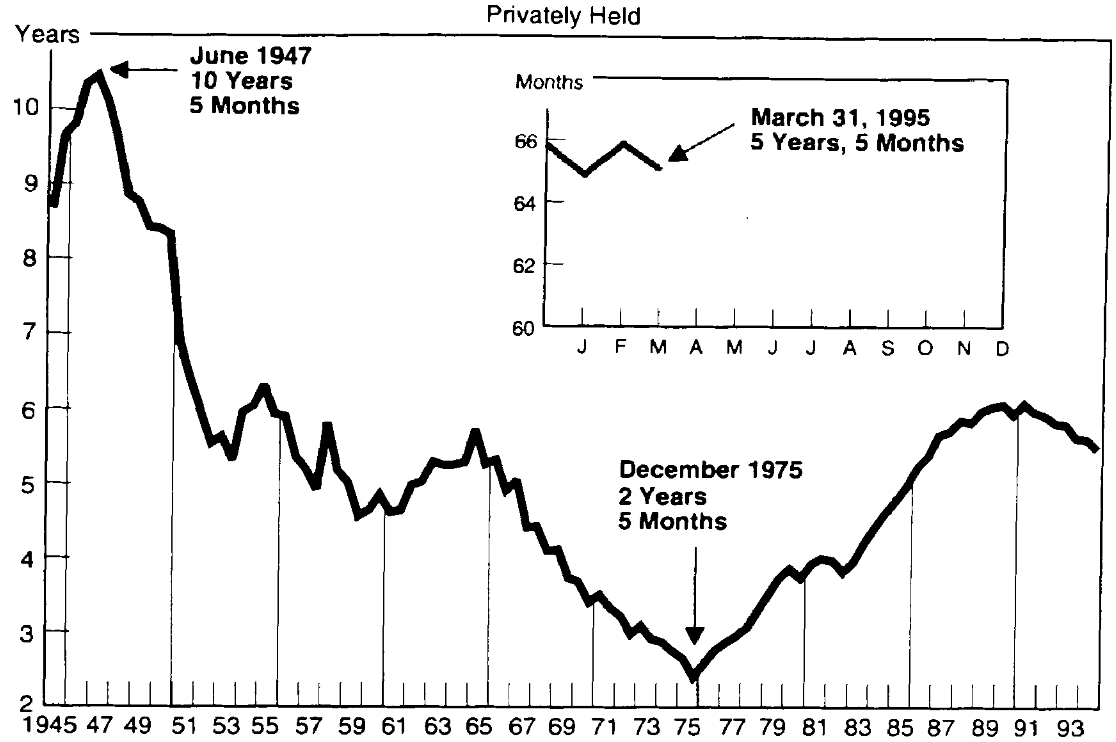


Department of the Treasury
Office of Market Finance

May 1, 1995-24

AVERAGE LENGTH OF THE MARKETABLE DEBT

Privately Held



MATURING COUPON ISSUES

May - September 1995

(in millions of dollars)

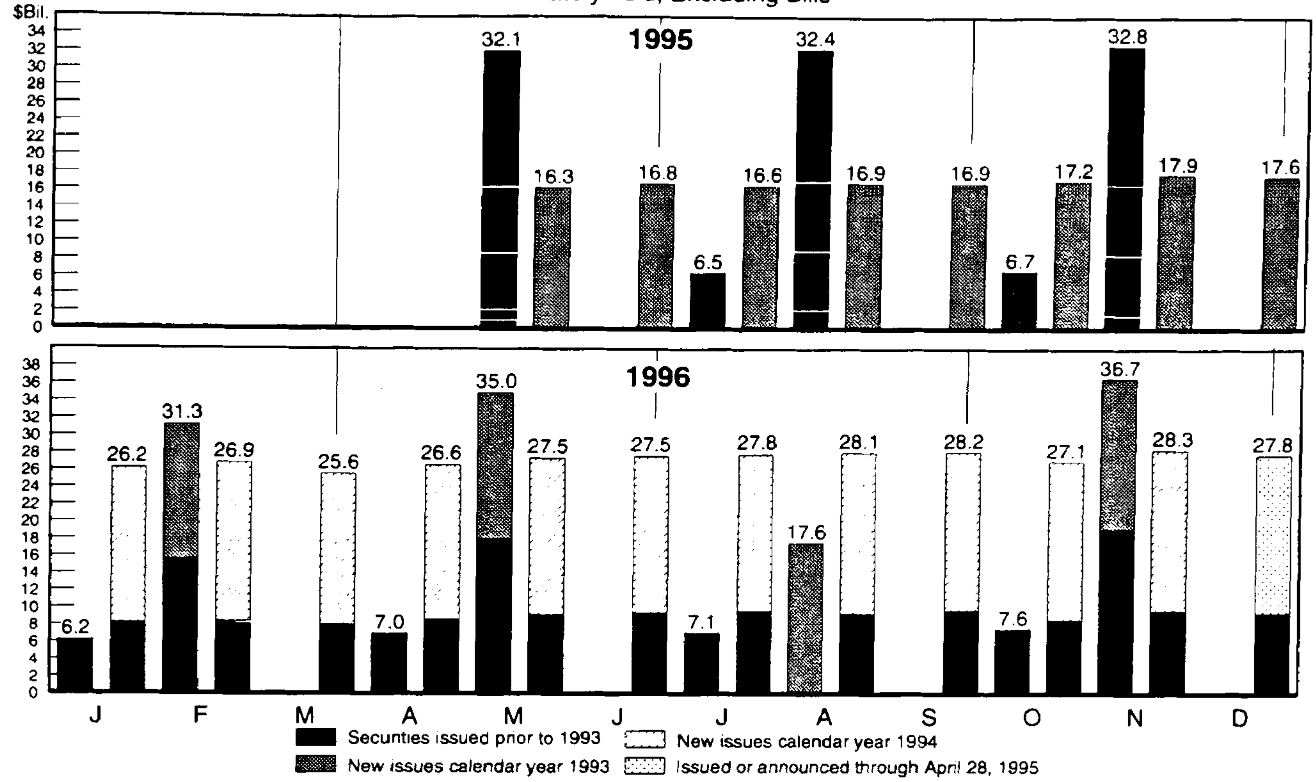
Maturing Coupons			March 31, 1995			
			Total	Held by		
				Federal Reserve & Government Accounts	Private Investors	Foreign 1/ Investors
5 7/8%	Note	5/15/95	19,152	3,829	15,323	999
8 1/2%	Note	5/15/95	8,293	273	8,020	286
11 1/4%	Note	5/15/95	7,127	798	6,329	55
12 5/8%	Bond	5/15/95	1,503	417	1,086	4
10 3/8%	Bond	5/15/95	1,504	126	1,378	201
4 1/8%	Note	5/31/95	17,527	1,227	16,300	2,275
4 1/8%	Note	6/30/95	18,164	1,392	16,772	1,934
8 7/8%	Note	7/15/95	6,805	300	6,505	415
4 1/4%	Note	7/31/95	17,183	562	16,621	1,650
8 3/8%	Bond	8/15/95 2/	4,612	2,219	2,393	46
10 1/2%	Note	8/15/95	7,956	1,097	6,859	437
8 1/2%	Note	8/15/95	8,877	866	8,011	953
4 5/8%	Note	8/15/95	18,038	2,911	15,127	922
3 7/8%	Note	8/31/95	17,577	725	16,852	2,592
3 7/8%	Note	9/30/95	17,904	961	16,943	2,206
Totals			172,222	17,703	154,519	14,975

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

2/ On April 11, Treasury called for redemption at par the 8 3/8% Bonds 1995-00, issued August 15, 1975.

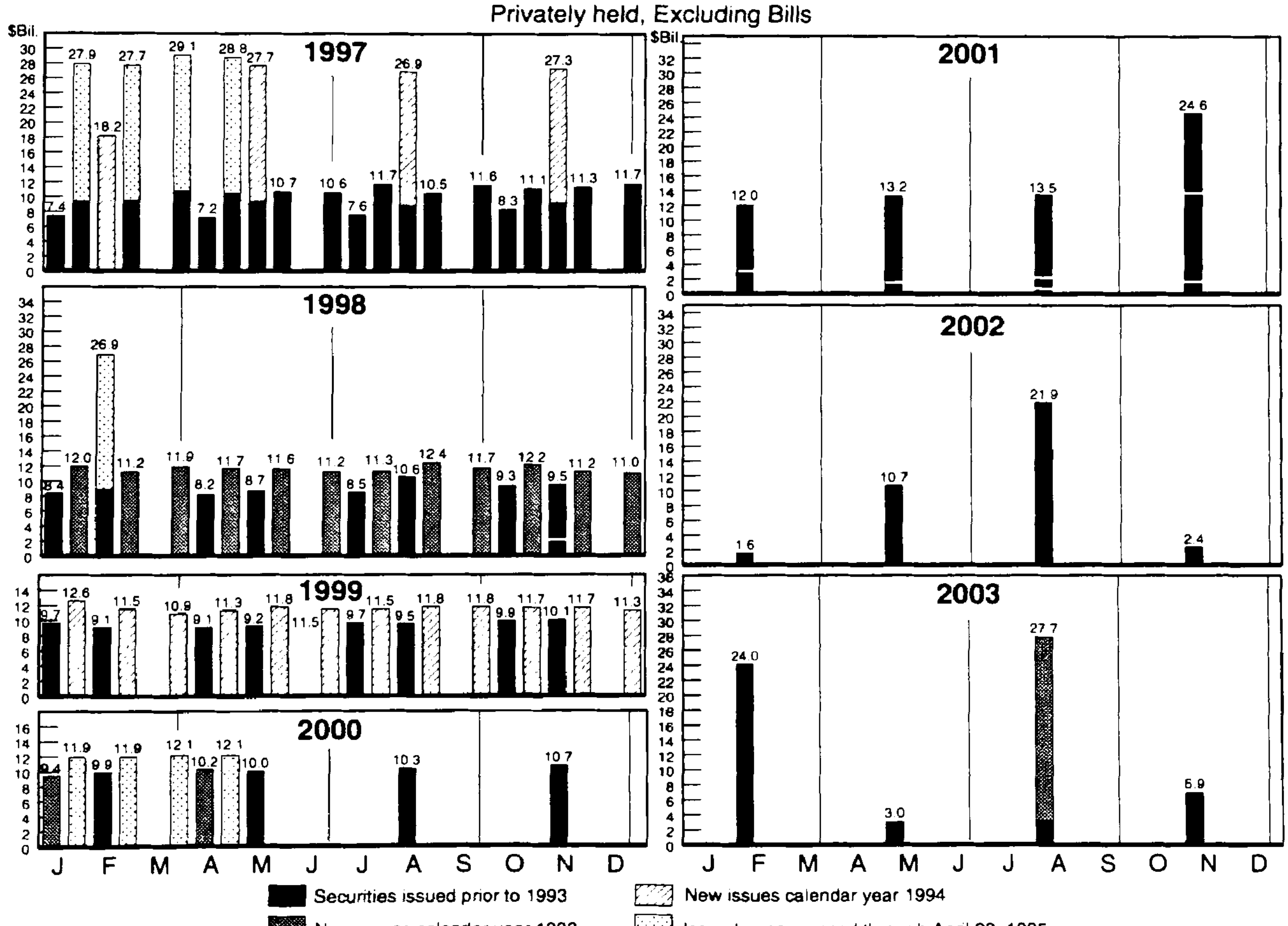
TREASURY MARKETABLE MATURITIES

Privately held, Excluding Bills

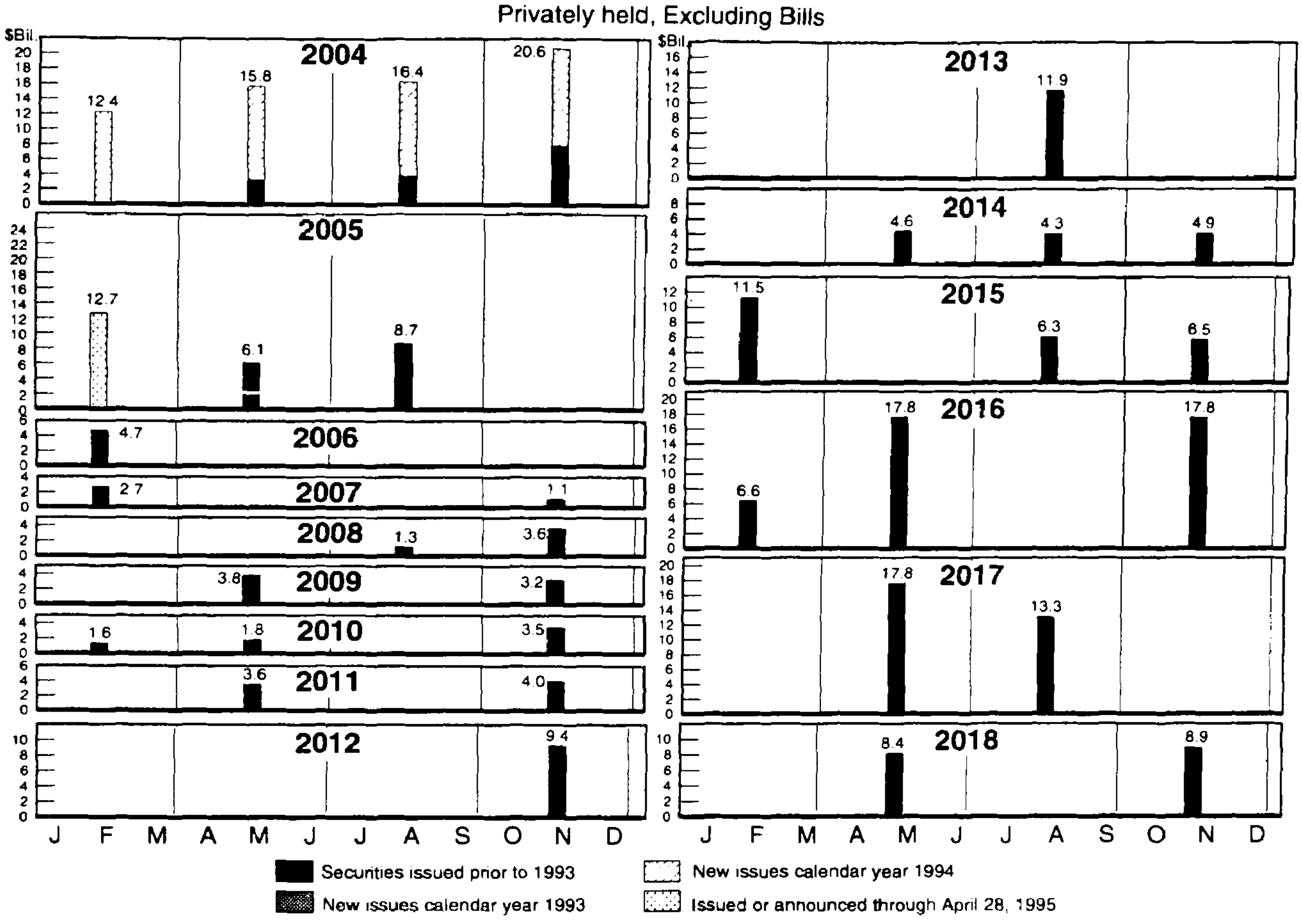


TREASURY MARKETABLE MATURITIES

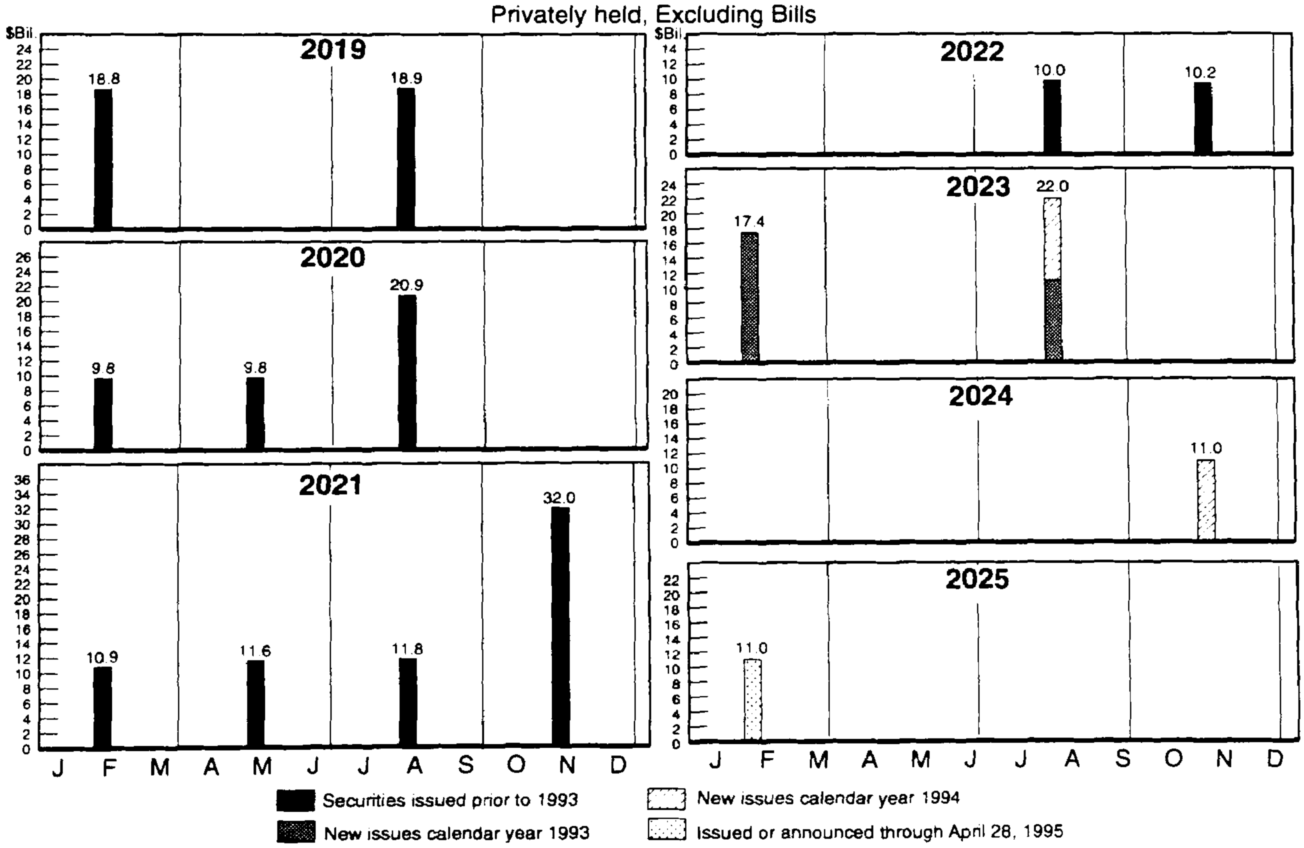
Privately held, Excluding Bills



TREASURY MARKETABLE MATURITIES
Privately held, Excluding Bills



TREASURY MARKETABLE MATURITIES
Privately held, Excluding Bills



SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN MAY 1995 1/

Monday	Tuesday	Wednesday	Thursday	Friday
1	2	3	4	5
8	9 Auction 3 year 2/	10 Auction 10 year 2/	11	12
15	16	17 Announce 2 year 5 year	18	19 Announce 52 week
22	23 Auction 2 year 3/	24 Auction 5 year 3/	25 Auction 52 week 4/	26
29 Holiday	30	31		

1/ Does not include weekly bills
2/ For settlement May 15
3/ For settlement May 31
4/ For settlement June 1

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN JUNE 1995 1/

Monday	Tuesday	Wednesday	Thursday	Friday
			1	2
5	6	7	8	9
12	13	14	15	16 Announce 52 week
19	20	21 Announce 2 year 5 year	22 Auction 52 week 2/	23
26	27 Auction 2 year 3/	28 Auction 5 year 3/	29	30

1/ Does not include weekly bills
2/ For settlement June 29
3/ For settlement June 30

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN JULY 1995 1/

Monday	Tuesday	Wednesday	Thursday	Friday
3	4 Holiday	5	6	7
10	11	12	13	14 Announce 52 week
17	18	19 Announce 2 year 5 year	20 Auction 52 week 2/	21
24	25 Auction 2 year 3/	26 Auction 5 year 3/	27	28
31				

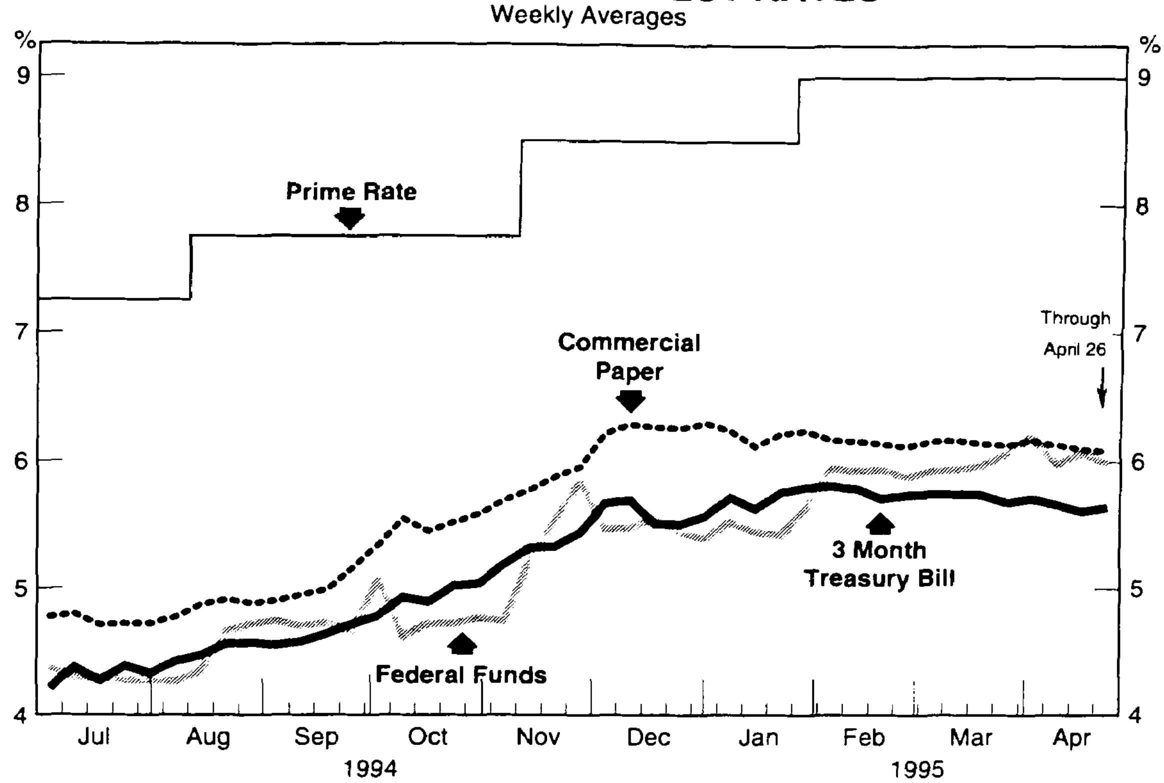
1/ Does not include weekly bills
2/ For settlement July 27
3/ For settlement July 31

Department of the Treasury
Office of Market Finance

May 3, 1995-33

SHORT TERM INTEREST RATES

Weekly Averages

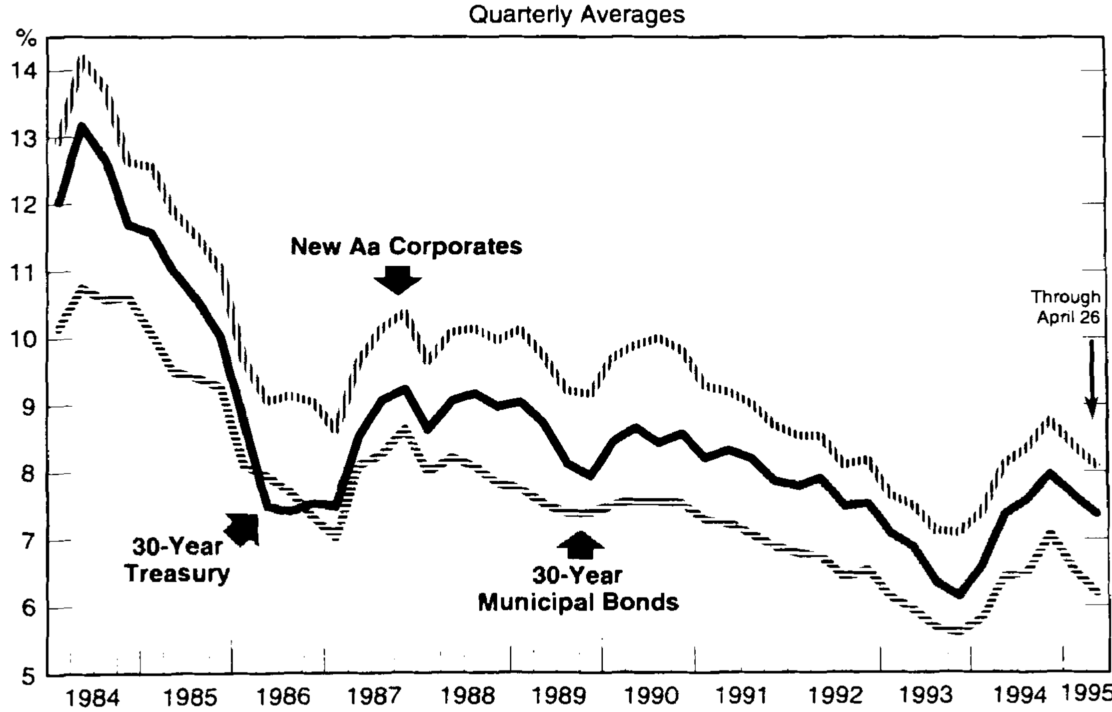


Department of the Treasury
Office of Market Finance

May 1, 1995-19

LONG TERM MARKET RATES

Quarterly Averages



Department of the Treasury
Office of Market Finance

May 2, 1995-20

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

FOR RELEASE AT 2:30 P.M.
May 2, 1995

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Treasury will auction two series of Treasury bills totaling approximately $25,600 million, to be issued May 11, 1995. This offering will result in a paydown for the Treasury of about $2,025 million, as the maturing weekly bills are outstanding in the amount of $27,637 million.

Federal Reserve Banks hold $7,088 million of the maturing bills for their own accounts, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders.

Federal Reserve Banks hold $2,891 million as agents for foreign and international monetary authorities, which may be refunded within the offering amount at the weighted average discount rate of accepted competitive tenders. Additional amounts may be issued for such accounts if the aggregate amount of new bids exceeds the aggregate amount of maturing bills.

Tenders for the bills will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. This offering of Treasury securities is governed by the terms and conditions set forth in the Uniform Offering Circular (31 CFR Part 356) for the sale and issue by the Treasury to the public of marketable Treasury bills, notes, and bonds.

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

oOo

Attachment

RR-266

HIGHLIGHTS OF TREASURY OFFERINGS OF WEEKLY BILLS TO BE ISSUED MAY 11, 1995

May 2, 1995

Offering Amount	$12,800 million	$12,800 million
Description of Offering:		
Term and type of security	91-day bill	182-day bill
CUSIP number	912794 U4 4	912794 V6 8
Auction date	May 8, 1995	May 8, 1995
Issue date	May 11, 1995	May 11, 1995
Maturity date	August 10, 1995	November 9, 1995
Original issue date	February 9, 1995	May 11, 1995
Currently outstanding	$13,996 million	- - -
Minimum bid amount	$10,000	$10,000
Multiples	$ 1,000	$ 1,000

The following rules apply to all securities mentioned above:

Submission of Bids:

Noncompetitive bids . . . . Accepted in full up to $1,000,000 at the average discount rate of accepted competitive bids

Competitive bids . . . .
(1) Must be expressed as a discount rate with two decimals, e.g., 7.10%.
(2) Net long position for each bidder must be reported when the sum of the total bid amount, at all discount rates, and the net long position is $2 billion or greater.
(3) Net long position must be determined as of one half-hour prior to the closing time for receipt of competitive tenders.

Maximum Recognized Bid at a Single Yield . . . . 35% of public offering

Maximum Award . . . . 35% of public offering

Receipt of Tenders:

Noncompetitive tenders . . . . Prior to 12:00 noon Eastern Daylight Saving time on auction day

Competitive tenders . . . . Prior to 1:00 p.m. Eastern Daylight Saving time on auction day

Payment Terms . . . . Full payment with tender or by charge to a funds account at a Federal Reserve Bank on issue date

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

For Release Upon Delivery
Expected at 9:30 A.M.
May 3, 1995

STATEMENT OF
LESLIE B. SAMUELS
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Committee:

I welcome the opportunity this morning to discuss the Administration's views regarding the importance of the individual and corporate alternative minimum tax (AMT), as well as the changes to the AMT proposed by H.R. 1215.

Since the introduction in 1969 of the individual and corporate minimum tax, its primary goal has been to strengthen taxpayers' confidence in the fairness of our income tax system. This was also one of the objectives of the sweeping changes made by the Tax Reform Act of 1986 (TRA 86). Strengthening the individual and corporate minimum taxes was one of the ways that TRA 86 sought to increase both the actual and perceived fairness of the income tax by inhibiting tax shelter activities and ensuring that taxpayers with substantial economic income pay tax on that income.

The AMT is not a perfect mechanism, although some improvements have been made in recent years. The complexity of the AMT, especially the corporate AMT, has been eased repeatedly since 1986, most recently in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93), which repealed the depreciation component of adjusted current earnings (ACE) for assets placed in service after 1993.

We are committed to simplifying the AMT where possible through administrative measures, as we had done in November, 1994, through the promulgation of a regulation allowing regular tax AGI to be used for AMT purposes where AGI acts as a constraint in limiting deductions or exclusions. Moreover, the Administration welcomes the opportunity to work with the Congress to identify areas where further simplification is possible on a revenue-neutral basis, either within the AMT or by identifying other acceptable revenue offsets.

In reviewing the AMT, it is important to note that although theoretically more attractive approaches can be imagined, the flaws of an AMT fade when measured against the potential damage to our tax system that might result if wealthy individuals and profitable corporations were able to pay little or no tax by investing in tax-favored activities or assets. This would be particularly true if the tax cuts in H.R. 1215, which reflects the House Republicans' Contract with America, were to be enacted. Moreover, in the event H.R. 1215 were enacted, we estimate that approximately 76,000 corporations that would otherwise have paid income tax in 2005 would avoid paying any tax. These companies account for approximately $1.1 trillion in sales, or 16 percent of total sales ($7.1 trillion), and $2.7 trillion in assets, or 18 percent of total assets ($15.4 trillion) of corporations currently subject to tax.

In the remainder of my testimony, I will briefly review the history of the individual and corporate AMT, summarize how the AMT is calculated, and examine the record of AMT liabilities and credits, and the reasons why taxpayers are subject to the AMT. My testimony will briefly comment on economic issues related to the AMT. I will then turn to the provisions of H.R. 1215, which would significantly weaken the AMT system over the next five years and totally repeal the corporate AMT in 2001.

I. Legislative History of the Minimum Tax

Responding to Treasury studies that found some high-income individuals paid little or no tax, in 1969 Treasury proposed a minimum tax for individuals. The Tax Reform Act of 1969 included a minimum tax for individual and corporate taxpayers on certain tax preferences and excluded capital gains for individuals. A 10-percent tax was levied on the taxpayer's minimum tax base, which was the sum of the tax preferences less an exemption amount and the taxpayer's regular tax liability. This was an add-on rather than an alternative tax; taxpayers paid both the regular tax and the minimum tax. The Tax Reform Act of 1976 added more preferences to the base of the individual minimum tax, including one for "excess itemized deductions," and, for both the individual and corporate minimum tax, reduced the exemption amount and increased the minimum tax rate to 15 percent.

The Revenue Act of 1978 removed the excluded capital gains and excess itemized deductions preferences from the individual minimum tax, and included them as part of the base of an alternative tax with graduated rates ranging up to 25 percent, which would generate a supplemental AMT liability that applied only when the alternative tax was greater than the regular tax liability. From 1978 to 1982, individuals were subject to both the AMT and the add-on minimum tax. The Economic Recovery Tax Act of 1981 (ERTA) lowered the top AMT rate to 20 percent, so that the maximum rate on excluded capital gains would be no higher than on capital gains under the regular tax.

In the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the add-on tax for individuals was repealed, and the base of the AMT was broadened to include nearly all of the tax preferences that had been included in the add-on minimum tax. To address increasing concerns about the equity of the corporate tax system, TEFRA also contained a direct 15 percent cutback in certain corporate tax preferences.[1] Although these cutbacks operated independently of the corporate minimum tax, adjustments were made to the minimum tax to prevent the combination of that tax and the cutback provisions from unduly reducing the benefits from a preference.

The Deficit Reduction Act of 1984 increased the direct cutback of certain corporate tax preferences from 15 percent to 20 percent and again made corresponding adjustments to the corporate add-on minimum tax. Except for the cutbacks in preferences enacted in 1982 and 1984, the corporate add-on tax was essentially unchanged between 1978 and 1986. Just prior to the Tax Reform Act of 1986 (TRA 86), corporations paid an add-on minimum tax equal to 15 percent of certain tax preferences to the extent that the preferences exceeded the greater of regular tax paid or $10,000. The tax preferences in the corporate minimum tax base included the excess of accelerated depreciation over straight line, excess bad debt deductions for financial institutions, percentage depletion in excess of basis, and a portion of net capital gains.

While the corporate add-on minimum tax reduced benefits from tax preferences, it failed to ensure that corporations with book income paid tax in the year they received that income, and that all corporations with substantial economic income paid tax on that income. Groups outside the government brought attention to corporations reporting substantial earnings, while not paying corporate tax. Also, calculations of effective tax rates on economic income generally showed low or even negative effective tax rates on some forms of corporate investment. These results, in combination with publicity about tax shelters and high-income individuals without income tax liability, raised concerns about whether the high level of voluntary taxpayer compliance that had characterized our tax system could be maintained.

In response to these concerns about corporate tax avoidance, President Reagan's 1985 tax reform proposals included a provision

[1] Section 291, as amended by TRA 86, remains in current law.

to replace the add-on minimum tax with a 20 percent alternative minimum tax (AMT) that included various tax preferences. The President's message noted that "the prospect of high-income corporations paying little or no tax threatens public confidence in the tax system"[2] and asserted that "an alternative minimum tax limited to the tax preferences applicable to corporations under [pre-TRA 86] law would be insufficient to prevent many corporations from eliminating their regular tax on economic income."[3]

In enacting TRA 86, Congress reduced tax rates and broadened the tax bases of the individual and corporate income taxes to ensure that taxpayers with substantial economic income would not escape income tax by using tax preferences. TRA 86 repealed the investment tax credit, the partial exemption of capital gains income and certain other incentives, and imposed limits on deductibility of passive losses. To ensure that remaining incentives in the tax law did not allow taxpayers to escape tax completely, TRA 86 also replaced the corporate add-on minimum tax with a new AMT similar in structure to the alternative minimum tax that had applied to individuals before 1986. TRA 86 also changed the individual AMT by increasing the AMT tax rate, effectively eliminating the AMT exemption for joint returns with AMT income over $310,000 ($232,500 for single filers), and adding new preference items.[4]

For both corporations and individuals, TRA 86 introduced credits for previously paid AMT, allowing taxpayers to use part of AMT liability incurred in one year as a credit to offset regular tax liability in future years. These AMT credits, however, could only be generated from AMT liability resulting from "timing" preferences that turned around in future years. Allowing credits for timing preferences was necessary to enable taxpayers to recover fully the amount of capital invested. Without the credits, a taxpayer could be forced, for example, to use the relatively back-loaded AMT depreciation schedule in the

---

[2]"The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity," May, 1985, p. 335.

[3]Ibid., p. 334.

[4]An important effect of TRA 86 on the AMT came from the elimination of the capital gains exclusion in the regular tax. Before TRA 86, the capital gains exclusion was by far the largest difference between taxable income under the regular tax and under the AMT for individuals. TRA 86 also phased out the personal interest deduction, another major AMT preference item for individuals.

early years of an asset's life and the relatively accelerated regular tax schedule in the later years.

The Senate Finance Committee's Report discussed the rationale for these changes in the AMT:

> The Committee believes that the minimum tax should serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits. Although these provisions may provide incentives for worthy goals, they become counterproductive when taxpayers are allowed to use them to avoid virtually all tax liability. The ability of high-income individuals and highly profitable corporations to pay little or no tax undermines respect for the entire tax system and, thus, for the incentive provisions themselves. In addition, even aside from public perceptions, the committee believes that it is inherently unfair for high-income individuals and profitable corporations to pay little or no tax due to their ability to utilize various tax preferences.
>
> In particular, both the perception and the reality of fairness have been harmed by instances in which major corporations have paid little or no tax in years when they reported substantial earnings, and may even have paid substantial dividends, to shareholders. Even to the extent that these instances reflect deferral, rather than permanent avoidance, of corporate tax liability, the committee believes that they demonstrate a need for change.[5]

To ensure that corporations reporting book income paid some tax, TRA 86 included for years 1987 through 1989 an AMT adjustment for 50 percent of any excess of book income over minimum taxable income after other adjustments and preferences. Negative adjustments were not allowed. Beginning in 1990, TRA 86 replaced the book income adjustment with an adjustment based on tax definitions of earnings and profits, the adjusted current earnings (ACE) adjustment. Seventy-five percent of the amount by which ACE exceeds alternative minimum taxable income (AMTI) must be added to AMTI. Unlike the book-income adjustment, these adjustments could be either positive or negative.

The Omnibus Budget Reconciliation Act of 1989 extended the corporate AMT credit to all items generating an AMT liability, even "exclusion items." Exclusion items are preferences that cause a permanent difference in taxable income, rather than a

---

[5] U.S. Senate, Committee on Finance, "Tax Reform Act of 1986", Report 99-313, pp. 518-9, May 1986.

difference in the timing of income (for example, tax-exempt interest income). It also repealed a limitation on ACE writeoffs for depreciation, intangible drilling costs, depletion, and mining costs.

The Omnibus Budget and Reconciliation Act of 1990 (OBRA 90) permitted a special energy deduction against alternative minimum taxable income for oil and gas interests, which was in effect for tax years 1991 and 1992. In addition, OBRA 90 raised the individual AMT tax rate and removed as a preference item the capital gain from appreciated tangible personal property donated to charity. (Subsequent legislation applied this change to property donated through June 30, 1992, and then OBRA 93 made this change permanent.)

For years beginning in 1993, the Energy Policy Act of 1992 repealed the energy deduction enacted in OBRA 90 and eliminated excess intangible drilling costs and percentage depletion deductions as AMT and ACE preference items for independent producers, subject to certain limitations.

In its February 1993 Budget, this Administration proposed AMT tax relief. OBRA 93 incorporated one of the proposed AMT changes. The depreciation component of the ACE adjustment, which was measured by the difference between AMT depreciation (150 percent declining balance method) and depreciation based on use of the straight line method over the class life of the asset, was repealed for property placed in service after 1993. OBRA 93 also lengthened the depreciable life for non-residential structures under the regular tax, thereby reducing the AMT preference for those assets.

In addition, for individuals, OBRA 93 created a two-tier tax rate structure (26 percent on the first $175,000 of a taxpayer's AMT income subject to tax[6], and 28 percent on amounts in excess of $175,000), increased the AMT exemption to $45,000 for married individuals filing joint returns[7], and permanently removed the capital gain from charitable contributions of appreciated property as a preference item.

[6] $87,500 for married individuals filing separately.

[7] The exemption amount for single filers was raised to $33,750, and to $22,500 for married individuals filing separately.

II. Description of the AMT under Current Law

Corporate AMT

The computation of the corporate AMT is generally a two-step process. The starting point is the corporation's regular taxable income before any net operating loss deduction. This amount is increased by tax preferences for the year and increased (or decreased) by adjustments that modify certain items of income or deductions used in the computation of regular taxable income, and reduced by the net operating loss deduction for AMT purposes. In a second step, alternative minimum taxable income ("AMTI") is adjusted further to reflect the ACE adjustments. The resulting amount of AMTI, reduced by an exemption amount of $40,000 less 25 percent of the amount by which AMTI exceeds $150,000 (which effectively eliminates the AMT exemption for AMT income over $310,000), is taxed at a 20 percent rate to compute the tentative minimum tax before credits.

The tentative minimum tax before credits may be partially offset by the AMT foreign tax credit. If the resulting tentative minimum tax exceeds the corporation's regular tax, the excess is defined as the AMT; the corporation pays its regular tax plus the AMT. The AMT paid becomes a credit that may be used to offset regular tax in any later year, but may not be used to reduce regular tax below the tentative minimum tax for the year in which the credit is claimed.

Adjustments and Preferences

The adjustments and preferences applicable in computing unadjusted AMTI are:

Adjustments--all taxpayers:

(1) Depreciation (post-1986 property)--computed using generally longer class lives prescribed by the alternative depreciation system under the Code and either the straight-line method for property subject to this method for the regular tax, or the 150-percent declining balance method for other property.

(2) Amortization of pollution control facilities (post-1986 property)--computed using the alternative depreciation system under the Code.

(3) Mining exploration and development costs--capitalized and amortized over a 10-year period.

(4) Long-term contract taxable income (other than home construction)--computed using the percentage-of-completion method of accounting.

(5) Installment sales (property other than timeshares and residential lots)--installment method of accounting not available for dealers in property.

(6) Tax shelter farm or passive activities--losses denied.

Adjustments--corporate taxpayers only:

(1) Adjusted current earnings (ACE) adjustment--described below.

(2) Merchant Marine capital construction funds--special rules apply.

(3) Blue Cross and Blue Shield organizations--special deduction not allowable.

Preferences:

(1) Percentage depletion--excess over the adjusted basis of the property at the end of the taxable year. (Post-1992, the preference is not applicable to percentage depletion allowed for oil and gas properties.)

(2) Tax-exempt interest income--interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

(3) Intangible drilling and development costs--excess costs (over 10-year amortization) in the taxable year that exceed 65 percent of the net income from oil, gas, and geothermal properties. (Post-1992, this preference is not applicable to independent producers to the extent the producer's AMTI is reduced by 40 percent or less without the preference.)

(4) Bad debt reserves--excess deductions determined under the Code over the financial institution's actual experience.

(5) Real estate depreciation (pre-1987 property)--excess of accelerated depreciation over the straight-line method.

(6) Amortization of pollution control facilities (pre-1987 property)--excess over other methods under the Code.

(7) Gains on sale of certain small business stock--one-half of the amount excluded from income under the Code.

Operation of the Accumulated Current Earnings (ACE) Adjustment

A corporation must increase its AMTI by 75 percent of the amount by which ACE exceeds AMTI determined without regard to the

ACE adjustment and alternative tax NOLs. If unadjusted AMTI exceeds ACE, AMTI is reduced by 75 percent of the difference. This reduction, however, is limited to the aggregate amount by which AMTI has been increased by the ACE adjustment in prior years.

To calculate ACE, the following items are added to AMTI: (1) income items that are included in determining earnings and profits (E&P) but are not otherwise included in AMTI, such as tax-exempt interest (other than interest on specified private activity bonds); (2) items deductible in computing AMTI but not deductible for determining E&P, such as the dividends received deduction; and (3) certain specific adjustments, such as depreciation (other than for personal property placed in service after 1993). In addition, certain adjustments to the computation of unadjusted AMTI are required in computing ACE.

AMT NOLs

Net operating loss deductions under the AMT are determined by using a separate computation of AMT net operating losses and loss carryovers. This computation takes into account differences between the regular tax base and the AMT base. The amount of the AMT net operating loss for any taxable year is in general equal to the amount by which the deductions allowed in computing AMTI for the taxable year (other than the deduction for carryovers to the taxable year of AMT net operating losses) exceed the gross income includible in AMTI for the taxable year. In light of the parallel nature of the regular tax and AMT systems, any limitations applying for regular tax purposes to the use by a consolidated group of net operating losses or current-year losses apply for AMT purposes as well. Moreover, alternative tax NOLs cannot reduce current-year AMTI by more than 90 percent.

Foreign tax credits for AMT

The foreign tax credit (FTC) is allowed for minimum tax purposes, but the credit is calculated specially for the minimum tax. In essence, the minimum tax FTC is figured in the same manner as for the regular tax, except it includes only AMT items of income and deduction, uses AMT taxable income instead of regular taxable income, and uses AMT in place of regular tax. Foreign tax credits, in combination with NOLs, can offset no more than 90 percent of the tentative minimum tax. Excess AMT foreign tax credits can be carried forward 5 years or back 2 years.

AMT Credit

AMT paid by a corporation in one year is available as a credit against its regular tax liability in future years. This AMT credit generally compensates the corporation for the loss of a regular-tax benefit when the corporation is in an AMT position by reducing the corporation's regular tax in subsequent years.

The AMT credit cannot reduce regular tax after other credits below the tentative minimum tax. Unused AMT credits may be carried over indefinitely to subsequent tax years.

Individual AMT

The structure of the individual AMT is generally similar to that for corporations. Alternative minimum taxable income (AMTI) for individuals is taxable income (before limitations on personal exemptions) for the regular tax, and various preferences and adjustments, including an adjustment for the net operating losses allowed under the AMT. AMTI in excess of an exemption amount (described below), phased out at higher levels of AMTI, is then subjected to a two-tier tax rate structure (for married individuals filing a joint return, 26 percent for the first $175,000 of AMTI and 28 percent of AMTI in excess of $175,000). After allowance for the foreign tax credit for AMT purposes, the resulting tentative minimum tax is compared to the individual's regular tax liability, with the taxpayer owing the regular tax plus the individual AMT equal to the excess (if any) of the tentative minimum tax over the regular tax liability.

AMT NOLs

The net operating loss deduction allowed for individual minimum tax purposes is similar to that for the corporate AMT. It is calculated using AMT items of income and deduction, and cannot reduce AMT by more than 90 percent.

Preferences and Adjustments

Other than the previously listed adjustments and preferences applicable for all taxpayers, additional adjustments for individuals include the following:

(1) State, local, and foreign taxes.

(2) Miscellaneous itemized deductions (in excess of 2 percent of taxpayer's AGI).

(3) Special rules relating to incentive stock options.

(4) Standard deductions and personal exemptions.

(5) Medical deductions (between 7.5 percent and 10 percent of a taxpayer's AGI).

(6) Circulation expenditures--capitalized and amortized over a three-year period.

(7) Research and experimental expenditures--capitalized and amortized over a 10-year period (unless material participation by taxpayer).

Exemption amount for AMT

An exemption is allowed for AMTI of $45,000 for joint returns, and $33,700 for single returns. These amounts are phased out at a rate of $1 for every $4 of AMTI in excess of $150,000 for joint returns and $112,500 for single returns. This eliminates the exemption at AMTI of $310,000 for joint returns, and $232,500 for single returns.

Foreign tax credits for AMT

A foreign tax credit is allowed for minimum tax purposes, but it is calculated specially for the minimum tax (as discussed above).

AMT credits

AMT liability in one year may be credited against regular tax liability in future years. These AMT credits, however, cannot lower a taxpayer's regular tax liability for a given year below the taxpayer's tentative minimum tax for that year, and, for individuals, they can only be generated from AMT liability resulting from timing preferences. For example, AMT liability generated by accelerated depreciation can result in AMT credits, but not AMT liability resulting from state and local tax deductions. Excess credits can be carried forward indefinitely.

Pattern of Corporate AMT Liabilities and Credits

Table 1 summarizes the historical revenue pattern from corporate income taxes. Until TRA 86, the corporate minimum tax generally accounted for less than one percent of total corporate tax liabilities. TRA 86, however, substantially increased the importance of the corporate AMT as a source of revenue. From gross corporate AMT revenues averaging about $3 billion per year in 1987 though 1989, corporate AMT revenues jumped to $8.1 billion in 1990, with the replacement of the 50 percent book income adjustment by the 75 percent ACE adjustment that year. In 1991 and 1992, gross corporate AMT revenue declined to about $5 billion. At the same time, the use of AMT credits grew. From an average of less than $700 million in 1988 through 1990, corporate AMT credit use increased to $1.5 billion in 1991 and $2.4 billion in 1992, the last year for which corporate tax data are available. Thus, in 1992, the corporate AMT produced net revenue of $2.7 billion compared with net revenue of $7.4 billion in the peak year of 1990. The decline in net AMT revenue is expected to continue after 1992, with $1.4 billion estimated for 1993.

Table 1

HISTORIC PATTERN OF CORPORATE TAX REVENUE

Year	Total Corporate Income Tax (after credits)	Minimum Tax before Credits	AMT credits	Net Minimum Tax	Net Minimum Tax as % Total Tax	Unused AMT Credits
	(Dollar amounts in billions)					
1970	27.5	0.3		0.3	1.0%	
1971	30.2	0.3		0.3	0.9%	
1972	33.5	0.3		0.3	0.9%	
1973	39.1	0.3		0.3	0.9%	
1974	40.6	0.3		0.3	0.9%	
1975	39.7	0.2		0.2	0.4%	
1976	49.8	0.2		0.2	0.4%	
1977	56.7	0.3		0.3	0.5%	
1978	64.4	0.3		0.3	0.5%	
1979	65.9	0.4		0.4	0.7%	
1980	63.0	0.4		0.4	0.7%	
1981	58.4	0.5		0.5	0.9%	
1982	47.1	0.5		0.5	1.0%	
1983	51.9	0.6		0.6	1.1%	
1984	64.0	0.5		0.5	0.9%	
1985	62.4	0.7		0.7	1.2%	
1986	73.2	1.0		1.0	1.4%	
1987	87.0	2.2		2.2	2.5%	2.2
1988	95.9	3.4	0.5	2.9	3.0%	5.1
1989	96.1	3.5	0.8	2.7	2.8%	7.8
1990	96.4	8.1	0.7	7.4	7.7%	15.2
1991	92.6	5.3	1.5	3.8	4.1%	19.0
1992	104.6	5.1	2.4	2.7	2.6%	21.7
1993-est.	123.8	4.9	2.9	1.4	1.1%	23.1

Source: IRS, Corporation Income Tax Returns, relevant issues, and unpublished IRS data

Note: 1993 data are estimated.

This downward trend in AMT net revenues is expected to continue for several reasons. First, depreciation adjustments, by far the largest source of AMT revenue, only affect the timing, rather than the total amount, of depreciation deductions. Most AMT revenues are initially generated from the less-accelerated depreciation allowed for AMT purposes. Subsequently, these depreciation allowances reverse and AMT revenues from depreciation adjustments decline. We have now reached the period where this reversal is occurring for post-TRA 86 investment.[8]

Second, the removal of depreciation from the ACE adjustment under OBRA 93 and the lengthening of the regular-tax depreciation lives of non-residential real property are expected to reduce future AMT liabilities (and increase the utilization of AMT credits). Third, as the number of corporations subject to the AMT and tentative minimum tax liabilities decline, corporations are able to use an increasing amount of AMT credits to reduce their regular tax liability. The economic recovery will likely contribute to this trend. For these reasons, the downward trend in net corporate AMT revenues since 1990 (when the one-time spike in revenues occurred) is expected to continue.

The relative importance of adjustments and preferences in corporate AMTI is presented in Table 2, which is derived from data presented in a recent GAO report on experience with the corporate AMT.[9] Since the depreciation adjustment was the largest adjustment and played a dominant role in the ACE adjustment, the difference between regular tax and AMT depreciation has been the most significant reason most corporations were subject to the AMT.[10]

---

[8]However, net depreciation adjustments remain positive because corporate investment continues to grow.

[9]General Accounting Office, "The Experience with the Corporate Alternative Minimum Tax," GAO/GGD-95-88, April, 1995, Table II.20, p. 47 (hereinafter cited as "GAO").

[10]See also GAO (1995), Table II.21, p. 48.

Table 2.
Corporate AMT Adjustments and Preferences for 1992

Item	Amount ($ millions)	Percent of total
Adjustments		
ACE	18,890	44.6
Depreciation (post-1986)	22,030	54.0
Pollution facilities	21	0.0
Mining development	108	0.3
Basis adjustment on sale	-3,368	-8.0
Long-term contracts	95	0.2
Installment sales	-14	-0.0
Merchant marine construction	31	0.1
Section 833 deduction	1,478	3.5
Farm losses	0	0.0
Passive losses	34	0.1
Preferences		
Percentage depletion	1,620	3.8
Tax-exempt bonds	128	0.3
Charitable contribution of appreciated property	82	0.2
Intangible drilling costs	176	0.4
Reserves for bad debts	86	0.2
Accelerated depreciation of real property	108	0.3
Accelerated depreciation of personal property	4	0.0

Large firms pay most of the corporate AMT. Table 3 shows that corporations (other than pass-through entities) with assets over $500 million pay 75 percent of the corporate AMT and 69 percent of total corporate tax. Smaller corporations are largely eliminated from the corporate AMT by the $40,000 exclusion.

Table 3.
Corporate AMT Liabilities, AMT Credits, and Total Corporate Tax by Asset Size in 1992
($ millions)

Asset size class	AMT	AMT Credit	Total Tax Including AMT
less than 1	58	26	3,131
> 1 less than 10	222	100	5,710
> 10 less than 100	473	166	10,698
> 100 less than 500	567	238	13,356
> 500	3,738	1,846	71,698
Total	5,058	2,376	104,593

Although large corporations pay most of the AMT, and many large corporations have been subject to the AMT at least once, Table 4 shows that the duration of their AMT status has been relatively short. Based upon an analysis of a panel of approximately 9,000 large corporations with assets over $50 million, we found that approximately 55 percent were subject to the AMT in at least one year between 1987 and 1992. Of those that paid the AMT at least once, 64 percent paid it for only one or two years. Only 90 firms, or 1 percent of these large firms, were subject to the AMT in all 6 years (1987 - 1992).

Table 4.
Percentage of Corporations With Assets over $50 Million Paying AMT by the Number of Years Paying AMT (1987 - 1992)

Years in AMT Status

	Never Paid AMT	1	2	3	4	5	6
Corporations (Percent)	44.7	20.5	15.0	10.3	5.7	2.8	1.0

Pattern of Individual AMT Liabilities and Credits

The tax liability generated by the individual minimum tax has fluctuated substantially since it began, generally as a result of changes in tax law. Table 5 reports the individual minimum tax liabilities and the number of returns paying minimum tax from 1970 through 1993. It also indicates the years in which significant tax changes became effective.

From producing average revenue of $160 million on about 25,000 tax returns per year in the early 1970s, the individual minimum tax jumped to $1 billion paid by nearly 250,000 taxpayers in 1976 with the Tax Reform Act of 1976. The revisions in the Revenue Act of 1978 lowered total individual minimum tax revenues and taxpayers in 1979. Changes to the regular tax in the Economic Recovery Tax Act in 1981 boosted individual minimum tax liabilities, and the expansion of the individual minimum tax in the Tax Equity and Fiscal Responsibility Act of 1982 substantially increased individual minimum tax revenues in 1983 and later years.

The Tax Reform Act of 1986 had major effects on individual AMT collections, first raising them in 1986 before the capital gains exclusion ended, and then lowering them in 1987 when the exclusion had expired. TRA 86 also instituted the credit for previously paid AMT on timing preferences. These have averaged about 20 percent of the previous year's minimum tax, consistent with the share of total preferences and adjustments made up of timing preferences. OBRA 90 and OBRA 93 both expanded the impact of the individual AMT.

Economic conditions, as well as tax laws, affect minimum tax liability. Relatively modest decreases in minimum tax liability can be attributed to recessions in 1974 and 1982.

The preferences and adjustments to income that give rise to individual minimum tax liability have also varied over time. When excluded capital gains were a preference for the individual minimum tax, they accounted for around 70 to 80 percent of total preferences and adjustments in the mid-1980s, with state and local taxes the next largest preference at about 10 percent. About equally important were accelerated depreciation, miscellaneous itemized deductions, personal interest deductions, and personal exemptions, each accounting (on average) for about 2 percent of total preferences and adjustments.

As shown in Table 6, in 1992 deductions for state and local taxes contributed nearly 40 percent of total individual AMT preferences and adjustments, followed by miscellaneous deductions in excess of the 2 percent floor at about 25 percent, and depreciation at about 10 percent. Capital gains on certain charitable contributions added about 8 percent, certain allowed

TABLE 5

HISTORIC INDIVIDUAL MINIMUM TAX DATA
AND TAX LEGISLATION 1/

Liability Year	Total Income Tax Liability After Credits	Minimum Tax Liability: Net of Credits 2/	Minimum Tax Liability: Gross of Credits	Minimum Tax Liability: Credits	Number of Returns with: Minimum tax Liability 2/	Number of Returns with: AMT Credits
		(in millions)			(in thousands)	
1970	$83,905	$122			19	
1971	85,400	168			24	
1972	93,600	216			27	
1973	108,100	182			26	
1974	123,600	143			19	
1975	124,526	144			20	
		Tax Reform Act of 1976				
1976	141,800	1,000			247	
1977	159,800	1,323			399	
1978	188,200	1,514			495	
		Revenue Act of 1978				
1979	214,500	1,175			222	
1980	250,341	1,263			211	
		Economic Recovery Tax Act of 1981				
1981	284,100	1,827			251	
1982	277,600	1,520			225	
		Tax Equity and Fiscal Responsibility Act of 1982				
1983	274,200	2,521			265	
1984	301,900	4,490			370	
1985	325,710	3,792			428	
1986	367,300	6,713			609	
		Tax Reform Act of 1986				
1987	369,200	1,675			140	
1988	412,900	825	1,028	203	114	26
1989	432,900	578	831	253	117	40
1990	447,126	616	830	214	132	34
		Omnibus Budget Reconciliation Act of 1990				
1991	448,430	1,036	1,205	169	244	32
1992	476,239	1,073	1,357	274	287	63
		Omnibus Budget Reconciliation Act of 1993				
1993–prel. 3/	509,700	1,534	1,751	217	323	56

Source: Various issues of "Individual Income Tax Returns," IRS, Statistics of Income Division; and unpublished IRS data.

1/ Legislation is listed before the year in which it became effective.

2/ For 1979 – 1982, minimum tax liability includes both add–on and alternative minimum tax. Number of returns include those paying either AMT or add–on minimum tax.

3/ 1993 minimum tax data are preliminary.

TABLE 6

ADJUSTMENTS AND PREFERENCES FOR INDIVIDUAL TAX RETURNS REPORTING AMT LIABILITY, 1992

			Reported Amounts		Number of Returns
			In millions	Percent	(in 1000s)
Adjustments and Preferences from Form 6251					
1		State and local tax deductions	$5,644	39.7%	245
2		Miscellaneous deductions above the 2-percent floor	3,613	25.4%	169
3	3/	Post-1986 depreciation	1,441	10.1%	66
4		Charitable donations	1,073	7.5%	16
5	3/	Passive activity loss	824	5.8%	70
6		Depletion	576	4.0%	19
7	3/	Incentive stock options	450	3.2%	4
8	3/	Beneficiaries of estates	235	1.7%	21
9	3/	Intangible drilling costs	169	1.2%	5
10	3/	Long-term contracts	126	0.9%	1
11		Standard deduction	119	0.8%	38
12		Private activity bonds interest	116	0.8%	15
13	3/	Loss limitations	76	0.5%	3
14		Medical deductions	62	0.4%	30
15		Investment interest	50	0.4%	5
16		Home-mortgage interest	47	0.3%	6
17	3/	Mining costs	28	0.2%	1
18	3/	Circulation expenses and R&E expenses	27	0.2%	2
19	3/	Pre-1987 accelerated depreciation	19	0.1%	7
20	3/	Tax shelter farm loss	13	0.1%	1
21	3/	Pollution control facilities	1/	0.0%	2/
22	3/	Installment sales	(2)	-0.0%	2/
23	3/	Adjusted gain or loss	(99)	-0.7%	20
24		State and local tax refunds	(379)	-2.7%	112
		Total, Adjustments and Preferences	$14,228	100.0%	287

Source: Unpublished data from IRS Statistics of Income, Individual Income Tax Returns, 1992

Notes: 1/ Less than $500,000.
2/ Less than 500.
3/ Item is generally considered a "timing" item for purposes of calculating AMT credits.

passive losses contributed about 6 percent, and depletion allowance 4 percent. The remaining 20 preferences and adjustments each added little to total individual AMT revenues.

Like corporations, individuals tend to pay AMT only temporarily, not permanently. In recent years, on average 35 percent of individuals with AMT liability in one year have AMT liability in the following year. Of a panel of taxpayers with any AMT liability over 1989-91, only 6 percent had AMT liabilities in all years, and 80 percent had AMT liabilities in only one year.

With OBRA 93, total revenues from the individual AMT are expected to grow, as are the number of returns subject to the AMT. The relative importance of various individual preferences should not significantly differ from that reported in 1992. Incentive stock options appear to be an individual preference that is growing in importance, though for only relatively few taxpayers, while capital gains on charitable contributions has been removed as an individual AMT preference.

Has the AMT Accomplished its Goals?

As the legislative history for the TRA 86 suggests, the primary objective of the AMT is to ensure that taxpayers with significant economic income pay some income tax. Evidence indicates that the individual and corporate AMT, together with the TRA 86 changes to the regular income tax, have largely accomplished this objective. Over the 1990-92 period, the individual AMT imposed tax on about 19,000 taxpayers per year who paid no regular U.S. individual income tax. Of these, over 1,000 on average had AGI in excess of $200,000. At the same time, approximately 1,200 individuals with AGI over $200,000 paid neither AMT nor regular federal income tax.[11] This is not entirely indicative of success or failure, however, because the definition of income used in the analysis, adjusted gross income, is not the same as economic income. The possibility that some taxpayers with high economic income have been able to utilize tax-exempt bonds, and business and investment tax preferences to reduce their AGI below $200,000 is thus not reflected in this analysis. The AMT can only be as successful as the AMT definition of income is in capturing economic income.[12]

[11]Allen Lerman, "High Income Tax Returns for 1991," IRS, SOI Bulletin, Winter 1994-95.

[12]The individual AMT does not, for example, capture tax-exempt interest on public purpose municipal bonds or "inside-buildup" on life insurance. Consequently, this possibility is significant.

The 1995 GAO report points out that in every year examined (1987 - 1992) at least 6,000 corporations with positive book income that paid no regular tax paid some corporate AMT.[13] However, it also notes that in each of those years at least 290,000 corporations with positive book income paid no income tax. Although at first glance this might suggest that the corporate AMT, unlike the individual AMT, is not very successful, the GAO report also notes that about 98 percent of the non-taxpaying corporations were relatively small, having less than $10 million in assets. About 85 percent had less than $40,000 in net income and probably qualified for the AMT exemption. The few large non-taxpaying corporations with $1 billion or more in assets were predominantly mutual funds and investment companies, which generally pass all income to shareholders, and are exempt from the book income and ACE adjustments.[14]

More important, the objective of ensuring that profitable taxpayers pay some tax is too narrow a characterization of the goal of the AMT. A large fraction of taxpayers subject to the individual and corporate AMT ("AMT payers") pay both the regular and AMT tax (about 75 percent of corporate AMT payers and 92 percent of individual AMT payers in 1992). If the AMT were to be judged only by its impact on those taxpayers who pay no regular tax (i.e., who "zero out" their regular tax liability), it would thus be measured by its effect on only a fraction of the affected taxpayers.

A more appropriate standard for the success of the AMT is whether it helps ensure that taxpayers with significant economic income pay a tax relatively commensurate with that income. By examining the average tax rate (defined as the ratio of tax liability to regular taxable income) in each of eight major industries over the 1987-1992 period, the GAO report shows that the corporate AMT helped bring the average tax rate closer to the maximum statutory rate.[15] As in the case of the individual AMT, a more compelling demonstration that the corporate AMT has

---

[13]GAO (1995), Table III.7, p. 64.

[14]GAO (1995), Table III.14, p. 68. The measure of book income used in the GAO analysis (that shown on schedule M-1 of Form 1120) is reported inconsistently, because it does not affect the corporation's tax liability and is provided for informational purposes only. It is intended to reflect the income shown on the parent corporation's consolidated financial statement, which may not include the same members of the affiliated group that are included in the consolidated tax return.

[15]GAO (1995), Table II.12, p. 41.

achieved its goal would require measuring the tax paid against economic income, which is not generally possible to infer from the tax return information of non-AMT payers.

Criticisms of the AMT

The corporate AMT has been criticized for having adverse effects on economic growth. It has been argued that, by delaying the receipt of tax benefits, the AMT raises the cost of capital for many corporations, and thus reduces their incentive to invest. It has been suggested that it also creates different incentives for different corporations making identical investments, depending upon whether they are likely to be subject to the AMT, and if so, for how long. Furthermore, it has been suggested that the corporate AMT may encourage mergers and acquisitions and uneconomic leasing transactions in order to allow corporations to avoid the AMT or better utilize AMT credits.

While there is some validity to these concerns, they may easily be overstated. The lower AMT tax rate can increase the incentive to invest if the corporation were to remain subject to the AMT over the life of the asset, or if a firm not currently subject to the AMT anticipates that it will be subject to the AMT after a few years and can thus claim regular-tax depreciation allowances now, while a portion of the returns will be taxed at the lower 20 percent AMT rate in later years. Moreover, by design, the AMT reduces the incentive to invest in tax-favored assets. Thus, the overall efficiency of investment may be enhanced by the AMT's propensity to create a more neutral tax system.

Any potential adverse macroeconomic effect of the AMT on investment is also mitigated by the fact that few corporations are subject to the corporate AMT. Approximately 28,000 corporations, or about 1.3 percent of the 2.1 million non-subchapter S corporations, were subject to the AMT in 1992. Moreover, smaller corporations are less likely to be subject to the AMT. As noted in the GAO report, less than one-half of one percent of corporations with assets under $1 million, and only 7 percent of corporations with assets under $10 million, were subject to the AMT in 1992. In contrast, approximately 20 percent of corporations with assets over $1 billion were subject to the AMT in that year.[16] As noted above, however, most large corporations that paid AMT between 1987 and 1992 were AMT payers for one or two years.

---

[16]GAO (1995), Table II.4, p. 36.

In general, firms subject to the AMT do not permanently lose their tax benefits (except for the benefits of timing), because AMT liability generates credits that can be used against regular tax in later years. Although the relatively slow use of AMT credits has been a source of concern, the repeal of the ACE depreciation adjustment under OBRA 93 is expected to reduce future AMT liabilities and increase the use of AMT credits.

Concern also has been voiced about the compliance costs of the AMT. This concern has been addressed in part by the OBRA 93 repeal of the ACE depreciation adjustment for investment after 1993. Prior to the repeal of the ACE depreciation adjustment, taxpayers were required to make three separate depreciation computations to determine taxable income and alternative minimum taxable income. The depreciation adjustment was also the most important component of ACE. The repeal of the ACE depreciation adjustment eases the compliance costs for those likely to be subject to the AMT and will significantly reduce the application of the AMT to taxpayers. Moreover, as stated above, the Administration welcomes the opportunity to work with the Congress to identify areas where further simplification is possible on a revenue neutral basis, either within the AMT or by identifying other acceptable revenue offsets.[17]

While supporting revenue-neutral legislative changes to make the AMT more simple and rational, the Administration is also committed to simplifying the AMT through administrative measures, where possible. For instance, last November the Treasury Department issued final regulations that will eliminate substantial complexity and recordkeeping burden for all individual AMT taxpayers. The regulations allow taxpayers to use regular-tax AGI in determining items of income, exclusion, or deduction that are computed with reference to AGI (for instance, medical expenses) in computing AMTI, instead of having to make separate calculations of minimum-tax AGI for such purposes.

H.R. 1215 AMT Proposal

The tax provisions in House bill H.R. 1215, which incorporates the tax provisions in the House Republicans' Contract with America, provide significant tax benefits to individual and corporate taxpayers. The Administration is very concerned about the potential effects of H.R. 1215 on the Federal deficit, and in particular about the estimated $178 billion

---

[17]The concerns with complexity and compliance costs are particularly noteworthy for the individual AMT, with fewer than 0.3 percent of individual returns owing AMT liability, but ten times as many filing AMT forms.

revenue cost of the tax provisions over the FY 1995-2000 period, and the approximately $99 billion annual revenue cost by the year 2005. Several of these provisions, such as the Neutral Cost Recovery System (NCRS) and the capital gain exemption and indexing provisions, will further complicate an already complicated tax system and provide disproportionate benefits to high-income individuals and highly profitable corporations.

H.R. 1215 weakens the regular income tax as a measure of income. While the Administration opposes NCRS and the capital gains provisions of H.R. 1215, the fact that they are not subject to AMT compounds this problem. As I have noted, the primary objective of the individual and corporate AMT system is to ensure that taxpayers earning substantial economic income pay a tax relatively commensurate with that income. The greatly expanded tax benefits in the bill significantly increase the importance of an AMT system in serving that function, particularly for corporations. Whereas for individual taxpayers, the limits on passive losses may restrict tax avoidance activity, for corporations the AMT is the principal backstop. Yet the bill includes provisions that would seriously impair the AMT system:

1. For individuals, all AMT preferences (depletion, excess intangible drilling costs, tax shelter farm activities, passive losses) are repealed after 1995;

2 Those adjustments that are business-related (depreciation, mining exploration and development costs, long-term contracts, pollution control facilities, installment sales, circulation expenditures, research and experimentation expenditures) are repealed for transactions after 1995;

3. For corporations, AMT preferences and adjustments applying generally to transactions after 1995 are repealed;

4. The 90 percent limitations on the AMT use of net operating losses (NOLs) and foreign tax credits (FTCs) are repealed for taxable years after 1995;

5. The corporate AMT is repealed for taxable years beginning after December 31, 2000; and

6. AMT credits could be used to offset up to 90 percent of the regular tax liability for tax years (after application of other credits) after 1995, but not below the tentative alternative minimum tax.

These provisions leave only preferences and adjustments attributable to investments made prior to 1996 (many of which will reverse in future years) subject to the corporate AMT before its total repeal in 2001. Even if the other tax provisions of H.R. 1215 were not enacted, we estimate that the repeal of the corporate AMT alone when fully phased in in 2001, would allow over 12,000 corporations each year to avoid paying any income tax. Those corporations account for almost $840 billion in sales, or 12 percent of total sales, and approximately $2.1 trillion in assets, or 14 percent of total assets of all corporations currently subject to tax.

If NCRS is enacted and the corporate AMT repealed, we estimate that about 76,000 corporations that would otherwise have paid an income tax in 2005 would avoid paying any tax. These corporations account for approximately 16 percent of total sales ($7.1 trillion) and 18 percent of total assets ($15.4 trillion) of all non-subchapter S corporations currently subject to tax.

More important, NCRS is estimated to cost over $32 billion in 2005. Even if NCRS allows only a limited number of corporations to "zero out," it nevertheless results in a significant reduction in corporate tax liabilities. Because these tax benefits are not subject to AMT, corporations would no longer pay a tax that is relatively commensurate with their economic income. Likewise, none of the $12 billion cost of the individual capital gains tax cuts in 2005 would be reflected in the individual AMT.

While H.R. 1215 does not repeal the individual AMT, the only adjustments that remain subject to the tax are: miscellaneous itemized deductions; state, local, and foreign taxes; medical expenses between 7.5 and ten percent of adjusted gross income; tax-exempt interest on private activity bonds; standard deductions and personal exemptions; and incentive stock options. Unlike the corporate AMT, which is essentially vitiated by the bill even prior to its total repeal in 2001, the individual AMT is weakened in comparison to current law.

The revenue losses anticipated for the proposed changes to the individual and corporate AMT under H.R. 1215 are about $19 billion over the FY 1995-2000 period and $36 billion over the FY 1995-2005 period. These losses are much greater than simply the loss of AMT liabilities which would otherwise have been generated. The tentative alternative minimum tax, which currently acts as a limit on the extent to which AMT credits can be used to reduce the regular tax, would no longer be a meaningful constraint. The bill's 10 percent floor on the residual regular tax would instead allow a greatly accelerated use of the outstanding stock of unused AMT credits ($22 billion in 1992). This speed-up in credit usage accounts for the additional revenue cost of these provisions.

These estimated revenue losses, which make the commitment to fiscal responsibility more difficult, reflect only one dimension of the impact of H.R. 1215 on the AMT. Our tax system largely relies on voluntary compliance with the tax laws. Stories about large profitable corporations or wealthy individuals who manage to avoid paying any income tax reduce the willingness of other taxpayers to comply with our tax laws.

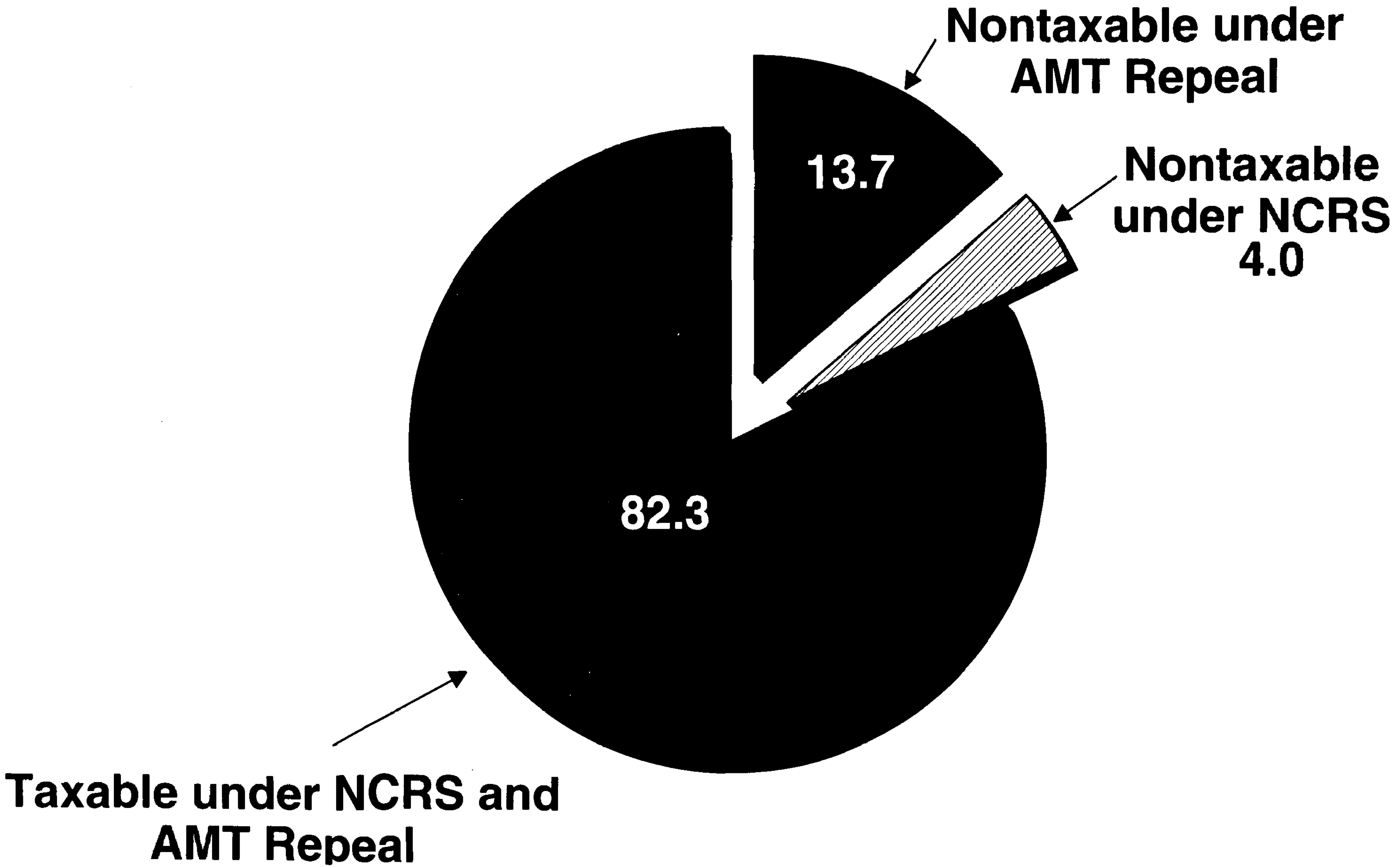
Conclusions

The AMT system has served a very useful purpose by helping ensure that individuals and corporations earning substantial economic income pay income tax relatively commensurate with that income. Since the last major reform of the minimum tax in TRA 86, Congress has simplified the system and provided targeted relief that has been, and will continue to be, reflected in a decline in net AMT revenues. Nevertheless, despite the lower revenues, the importance of the AMT system has not diminished. Thus, a visible AMT system should continue into the future.

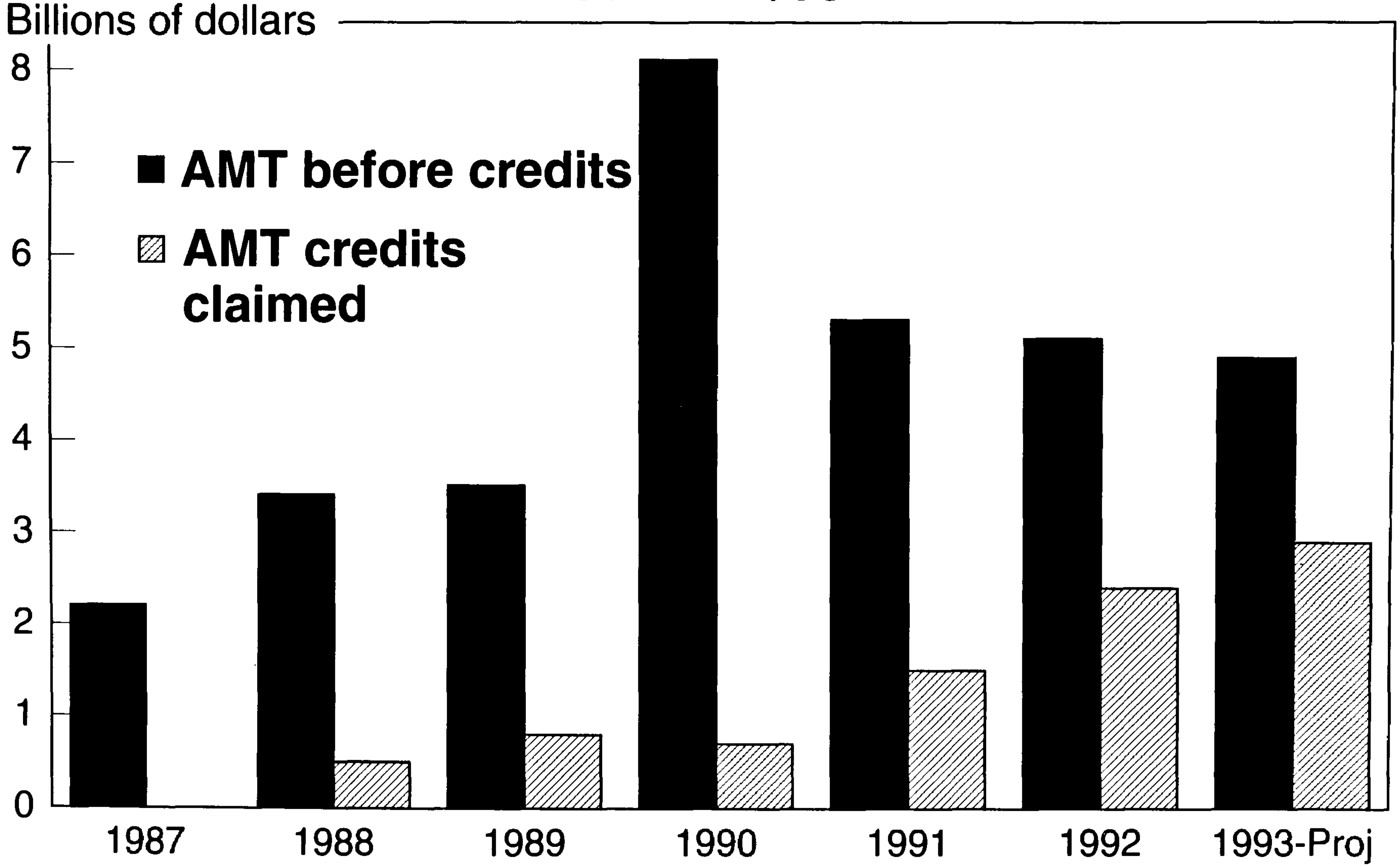
Indeed, if the tax cuts in H.R. 1215 (other than the AMT proposals) are enacted, an enhanced AMT system will eventually be required to prevent a reemergence of the tax reduction-type activity that characterized the years prior to enactment of TRA 86. Moreover, the provisions of H.R. 1215 that weaken the individual AMT, and weaken and then repeal the corporate AMT will, instead, facilitate tax avoidance and reduce the perceived and actual fairness of the income tax. Thus, the Administration opposes proposals in H.R. 1215 that seriously weaken the objectives of the AMT. However, the Administration would welcome the opportunity to work with the Congress to develop measures that would simplify the AMT on a revenue-neutral basis, either within the AMT or by identifying other acceptable revenue offsets.

Impact of Neutral Cost Recovery System and Repeal of Corporate Alternative Minimum Tax

Share of Assets of Currently Taxable Corporations

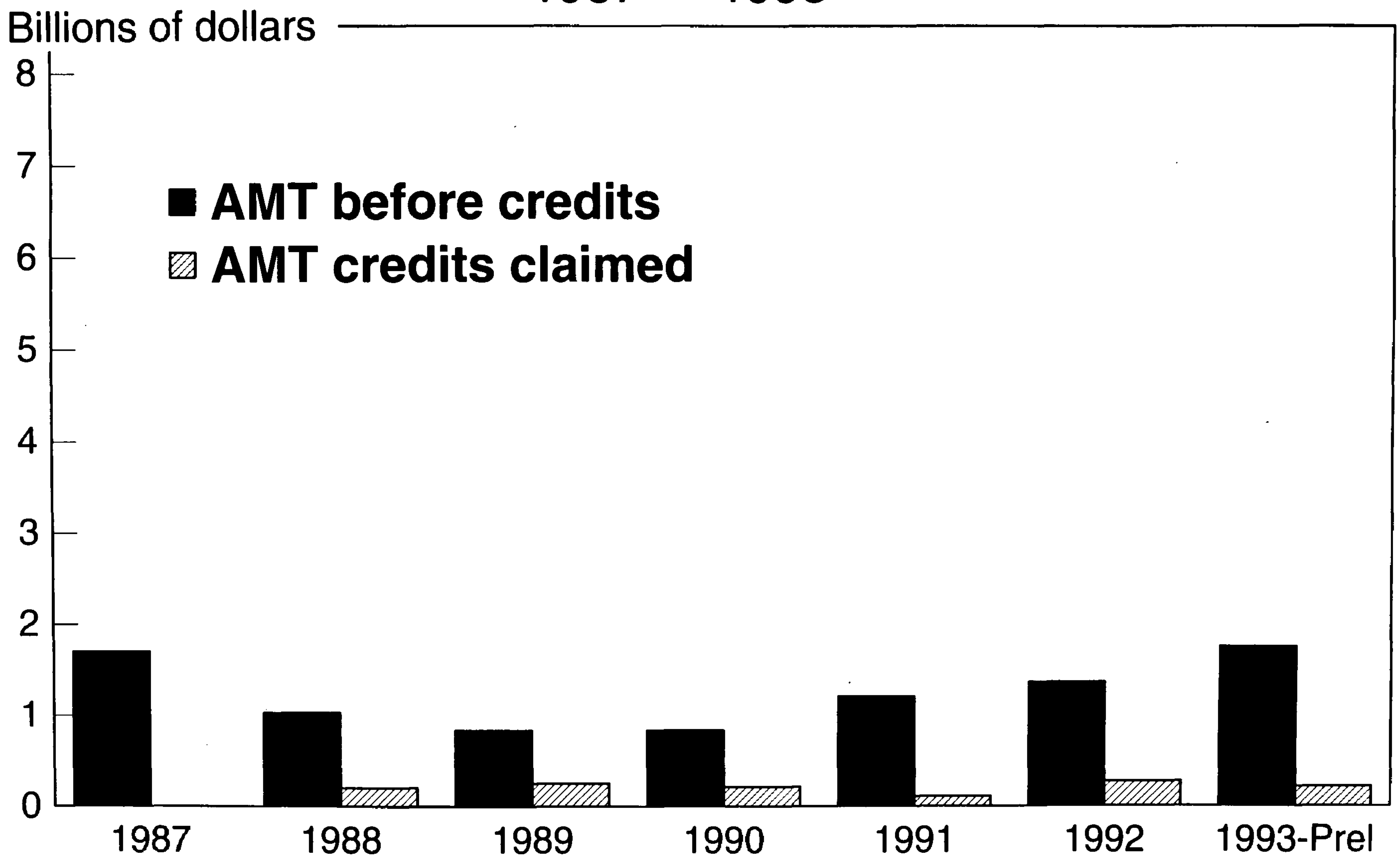


Corporate
Alternative Minimum Tax and Credits
1987 — 1993



1993 data are projections.

Individual
Alternative Minimum Tax and Credits
1987 — 1993



1993 data are preliminary.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

STATEMENT OF DARCY BRADBURY
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR FEDERAL FINANCE BEFORE THE
SUBCOMMITTEE ON POSTSECONDARY EDUCATION, TRAINING
AND LIFELONG LEARNING OF THE COMMITTEE ON ECONOMIC AND
EDUCATIONAL OPPORTUNITIES AND THE
SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH,
NATURAL RESOURCES AND REGULATORY AFFAIRS OF THE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES
MAY 3, 1995

Chairman McKeon, Chairman McIntosh, members, on behalf of Secretary Rubin, I welcome the opportunity to appear before you today to discuss the Administration's proposals to cut the ties to the Federal Government of two Government-sponsored enterprises ("GSE's") -- the Student Loan Marketing Association (Sallie Mae) and the College Construction Loan Insurance Association (Connie Lee). The Treasury has for a number of years, in Democratic and Republican Administrations, believed that it is appropriate to wean a GSE from Federal sponsorship once the GSE becomes economically viable and successfully fulfills the purpose for which it was created with Federal sponsorship, or when the purpose for which it was created ceases to exist.

The GSEs expose the Government to the market perception of implicit risk that legislation would be enacted to prevent a GSE

RR 268

from defaulting on its obligations. As the Treasury said in its 1990 Report on GSEs[1]:

> The market perception of Federal backing for GSEs weakens the normal relationship between the availability and cost of funds to the GSEs and the risks that these enterprises assume . . . The prospect that Congress would use taxpayer funds to prevent the failure of a GSE is perceived in the securities markets as protecting investors in GSE debt securities or GSE-guaranteed securities from loss . . .

In April 1991, as required by FIRREA and the Omnibus Budget Reconciliation Act of 1990[2], the Treasury followed up with a further report on the GSEs in 1991.[3] The 1991 Report reiterated statements of concern about the Government's risk exposure to the GSEs. At the Treasury's request, as part of the 1991 Report, Standard and Poors (S&P) assessed the likelihood that a GSE would be able to meet its future obligations from its own resources and expressed that likelihood as a traditional credit rating. S&P gave a triple-A credit rating to Sallie Mae. Connie Lee had obtained a triple-A credit rating from S&P previously, and in March 1990, S&P indicated to the Treasury that Connie Lee's status as a GSE was not a factor in granting the triple-A rating to Connie Lee as a bond reinsurer.

---

[1] Report of the Secretary of the Treasury on Government-sponsored Enterprises, May 1990, page 1. This 1990 Report was required under section 1404 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)(P.L. 101-73).

[2] Public Law 101-508, section 13501.

[3] Report of the Secretary of the Treasury on Government-sponsored Enterprises, April 1991, or the 1991 Report.

In 1992, legislation was enacted to provide for Federal financial safety and soundness oversight of the housing-related GSEs -- the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation -- and Sallie Mae to mitigate the perception of implicit risks to the Government. Federal oversight of the Farm Credit System had been tightened earlier as a result of problems that arose and required Federal assistance in the mid-1980s.

As a general principle, we believe that the Government and the GSEs would benefit from removal of the Government ties because privatizing the GSEs would:

- -- Reduce the amount of GSE debt, over time, that carries some perception of U.S. Government support;
- -- Demonstrate our commitment to moving from creating effective public-private partnerships to then enabling complete privatizing when Government support for an activity is no longer needed;
- -- Show the financial markets that the Government respects the interests of private bond- and shareholders; and
- -- Support Federal efforts to create new GSEs in the future, when appropriate, by demonstrating that the Federal relationship can be severed when the time is right. A business operation that starts as a GSE with a limited charter can be freed to operate in other markets once it has fulfilled the purpose for which it was created.

Sallie Mae

Under legislation enacted in 1992,[4] the Treasury has a special relationship with Sallie Mae as its financial safety and soundness regulator. We have reviewed Sallie Mae's financial condition and can see their successes to date and challenges for the future. Sallie Mae benefitted from large increases in leverage and relatively low cost GSE funding through the early 1990s. Sallie Mae's balance sheet grew rapidly in the 1980s, when it expanded market share in response to opportunities arising from amendments to its charter. The company's earnings record was especially strong in 1992, 1993, and early 1994, when market interest rates were low and Sallie Mae was able to capture windfall profits as a result of a floor on the interest rate on most of its student loan assets. Since then, however, return on assets and net interest margin have been negatively impacted by a rise in market rates of interest and shifts towards lower yielding assets.

The financial environment for Sallie Mae has changed since enactment of the Student Loan Reform Act of 1993[5], which reduced the returns on guaranteed student loans and imposed a 30 basis

---

[4] P.L. 102-325, enacted on July 23, 1992, added subsection 439(r) to the Sallie Mae charter in the Higher Education Act of 1965 (20 U.S.C. 1087-2(r)), providing a capital standard for Sallie Mae and for Treasury financial safety and soundness oversight.

[5] P.L. 103-66. Subtitle A of the Omnibus Budget Reconciliation Act of 1993.

point fee on all guaranteed student loans purchased by Sallie Mae after August 10, 1993. Even more significantly, the Act also established the Federal Direct Student Loan Program (now the William D. Ford Direct Loan Program), under which loan capital is provided directly to student and parent borrowers by the Federal Government rather than through private lenders.

The Student Loan Reform Act authorizes the Department of Education to replace up to 60 percent of (new loan volume in) the Federal guaranteed student loan programs with direct lending by the Department of Education by the 1998 academic year, and further provides that the proportion of direct loans may rise above 60 percent, if the Secretary of Education "determines that a higher percentage is warranted by the number of institutions of higher education that desire to and are eligible to participate in the program . . ."[6]

The Direct Student Loan Program is one of the President's top priorities. The Administration, in the Budget for FY 1996, proposed implementation of 100-percent direct lending (new loan volume) in 1997. Consistent with the implementation of direct lending under current law, the Administration has been studying options for the future of Sallie Mae, including in particular, restructuring the company into a fully private company. As noted above, privatizing Sallie Mae would significantly benefit the

[6] Subsection 453(a) of the HEA of 1965, as amended (20 U.S.C. 1087c(a)).

U.S. Government. In addition, removing Federal ties would mean that the restrictions on Sallie Mae's business operations under its current charter would cease to exist and that Sallie Mae could engage in profit-making activities that it cannot enter as a GSE.

In any restructuring, currently outstanding Sallie Mae debt would retain the characteristics of GSE debt, and customers with pre-existing commitments with the GSE would not be affected. Any new debt issued by a private company successor to Sallie Mae would not possess the characteristics of GSE debt.

The Administration believes that the benefits to be gained by the Government and Sallie Mae from privatization, in the context of continued expansion of the Direct Student Loan Program, are such that Congress should favorably consider legislation to authorize Sallie Mae's management to form a fully private company and to wind down the GSE during a transition period.

In this connection, we have been working with the Department of Education, the Office of Management and Budget, the Domestic Policy Council, and the National Economic Council to develop legislation to privatize Sallie Mae. We look forward to sharing an Administration legislative proposal with Congress in the near future. Key elements of the proposal are:

-- The Sallie Mae Board of Directors would be authorized to carry out a reorganization, after which Sallie Mae would be a wholly-owned subsidiary of an ordinary state-chartered holding company;

-- The reorganization plan would be subject to certain reviews by the Departments of Education and Treasury followed by approval by holders of a majority of Sallie Mae common stock;

-- After the reorganization, Sallie Mae would enter a transition period during which new business activities of the GSE would be restricted and new debt issued by the GSE would be restricted;

-- During the transition, excess capital of the GSE could be transferred to the new private holding company subject to specific limitations and approval of the Secretaries of Education and Treasury, and continued compliance with the GSE's statutory capital requirements;

-- During the transition, the GSE would be protected from the financial failure of the holding company or its other subsidiaries;

-- As a form of "exit fee", to recognize the benefits Sallie Mae has received because of its GSE status, the legislation would enable the United States to participate in the success of the holding company, for example through the issuance of stock warrants, and in addition, the rest of the legislation must be revenue neutral.

Connie Lee

The Administration proposed in the Budget for FY 1996 to convert Connie Lee to a fully private enterprise. Congress structured Connie Lee as a private, for-profit corporation, but provided for a limited infusion of Federal capital in the form of stock purchases by the Secretary of Education in order to get the corporation started. Congress clearly intended the Federal Government's direct interest in Connie Lee to diminish and eventually terminate,[7] as evidenced by the statutory limitations on purchases of stock by the Secretary of Education and the authorization of the sale of such stock.

The Administration will soon propose legislation that will sever all Federal ties with Connie Lee, largely by requiring that the Connie Lee stock that is held by the Department of Education be sold by a date to be specified in the bill[8]. The legislation would also delete Federal approval of directors and eliminate all business restrictions. In marketing securities, Connie Lee would have to notify potential investors of these changes. The Treasury is prepared to act on behalf of the Department of Education to sell the Government's stake in Connie Lee. Thus,

---

[7] U.S. Congress, House, Committee on Education and Labor, Higher Education Amendments of 1985, 99th Congress, 1st sess., 1985, H. Rept. 99-383 to accompany H.R. 3700, page 74.

[8] In the 1990 Report, the Treasury proposed that the Federal Government sell its Connie Lee stock when it had authority to do so (February 1992).

Connie Lee would be permitted to pursue business opportunities and the Federal Government would be free of any perception of implied risk that it would be called upon to provide assistance in the unlikely event that Connie Lee gets into financial difficulty.

Conclusion

We appreciate the opportunity to testify on these two proposals. Privatization, if implemented in a careful and deliberate manner, can benefit the U.S. Government and taxpayers, as well as Sallie Mae's and Connie Lee's stockholders, and the students and schools we are all trying to serve.

I will be glad to answer any questions that you may have.

DEPARTMENT OF THE TREASURY

TREASURY NEWS

OFFICE OF PUBLIC AFFAIRS • 1500 PENNSYLVANIA AVENUE, N.W. • WASHINGTON, D.C. • 20220 • (202) 622-2960

Remarks by
Lawrence H. Summers
Under Secretary of the Treasury
Symposium on Capital Flows
Jerusalem, Israel
April 3, 1995

Introduction

Thank you very much. I am delighted to have the chance to participate in this symposium on this very important topic.

The problem of how to approach capital flows provokes a range of differing opinions. Nonetheless, it is encouraging to recognize that the entire discussion of developing economies takes place within an area of consensus that is far larger than would have been the case even a decade ago. No one who discusses emerging markets today can doubt the fundamental importance of stabilization. No one can doubt the fundamental importance of openness in promoting economic growth, or the role played by the private sector as a critical engine of economic growth. It is a sign of progress that our discussion today is much narrower than the discussion we would have had 10 or 15 years ago. The IMF and the multilateral development banks have had a great deal to do with that development.

I would like to propose some answers -- very tentative answers to be sure -- to three questions which I think must be addressed in any discussion of how countries should treat capital flows. First, when are capital inflows a problem? Second, what can countries facing strong capital inflows, or excessive volatility, do in response? And third, how can the international system respond?

When Are Capital Flows a Problem?

First, when are capital inflows a problem? Nigel Lawson attempted to provide an answer to that question. He proposed that large flows are not a cause for concern if they can be attributed largely to private sector requirements, and are not caused by a public sector deficit.

I agree with his formulation to the extent that the absence of a public deficit is a necessary condition for confidence that capital inflows will not create difficulties. But I do not believe that the lack of a public deficit alone is a sufficient condition for confidence.

I would suggest three critical tests to determine when a potential problem exists.

First, policymakers and analysts must look at how capital flows are being used. Presumptively, for nations as well as people, borrowing to finance investment is healthy; borrowing to finance consumption is much more problematic. When the lion's share of inflows are being used for investment, there is the presumption that the economy is generating the capacity to repay these obligations. That presumption is much safer when investment is taking place largely in the export sector, rather than in the non-tradeable goods sector.

Similarly, the national savings rate can offer some evidence as to whether capital inflows are being used to finance unsustainable consumption or investment. The national savings rate also provides an indicator of a nation's ability to weather a sudden diminution or reversal of capital flows. It is a basic truth that Latin America's lower savings rate, in relation to Asia's, explains this continent's poorer economic record, and weaker resistance to capital flow volatility.

Second, analysts must examine the terms under which capital is being lent or invested. When the money is entering on terms that are steadily more favorable and more secure for the borrower, there is much less need for concern. When flows are proceeding on steadily less secure terms for the borrower and more secure terms for the lender, greater concern is in order.

How can one determine whether terms are improving or deteriorating for the borrower? The maturity of outstanding debt is one indicator. There is less need for worry when maturities are lengthening. The opposite is true if they are shortening. Similarly, when debt is increasingly denominated in local currency, there is much less of a problem than when debt is increasingly denominated in foreign currency. Last, when flows are going increasingly into direct investments or into portfolio or equity investments rather than debt investments, there is much less of a problem. On the other hand, when the pattern is one of increasingly short-term, increasingly foreign-currency-denominated debt, that would suggest that a serious problem is arising.

The third criteria for determining when a problem exists centers on the size of capital flows. It is very unlikely that any country can, over a very long period of time, borrow more than 5% of its GNP unless it is growing at a very rapid rate. The adjustment required when simply the rate of growth of debt suddenly has to be reduced can be very dangerous. That is the case even when the total stock of debt or investment need not fall, and people are holding the stock that they wish. For that reason, an excessive rate of growth of outstanding debt, or, equivalently, an excessive current account deficit, is dangerous.

I think that analysts and policymakers seeking to determine when countries must adjust to potential capital flow problems can be usefully guided if they respond to these three criteria: investment versus consumption, the terms under which capital inflows are coming, and the quantity of those flows.

The Appropriate Response

The second question policymakers must answer is, how should countries respond when they judge that capital flows are a problem? I think the one point on which almost all would agree is that policymakers should respond conservatively.

That suggests a number of specific approaches.

First, there is a natural human tendency to suppose that periods of substantial inflows represent a permanent change, whereas periods of capital outflows represent a transitory disturbance. I think that experience suggests the opposite is true. As a rule, inflows should be treated as temporary, and outflow pressures as permanent. The policy responses are likely to be much healthier if that view is internalized.

The second general rule must be that responses are less painful if implemented sooner and quicker. The same policy response taken preemptively will generate a much greater response, and a much greater corrective effect, than if taken under duress.

I think that calls forth three further rules.

First, countries must respond through fiscal policy. For most countries, an improved budgetary position is the right response to pressure both from capital inflows and from capital outflows. For the vast majority of nations, a larger budget surplus or a smaller budget deficit would represent an important contribution to economic health. If economics and accounting have one thing to teach politicians, it is that budget deficits are not an alternative to tax increases or reductions in expenditures. They are merely a way of postponing them, and way of postponing them with very substantial risks.

Second, countries should be very cautious about sterilizing changes in reserves, particularly when they are associated with capital outflows. That conclusion results from the principle that I suggested a few moments ago, that one should treat outflows as likely to be permanent, and inflows as likely to be temporary.

The final point regarding how countries should respond to changing or volatile financial circumstances is that they should respond aggressively, with changes in the tools and methods of financial supervision and regulation. In my judgment, it is clear that we would all rather live in countries which capital is trying to get into, rather than countries from which capital is trying to get out. That suggests that countries should be very cautious about imposing capital controls with the objective of discouraging capital inflows. At the same time, new techniques of financial innovation present challenges to stability. It is appropriate for supervisory authorities to think about reserve requirements and new regulations, and to be prepared to respond aggressively to changes in the pattern of capital inflows, through regulatory and supervisory improvements.

The International Response

Let me turn to the final question which policymakers must address. How can the international community respond to this new environment, of vastly greater and more volatile capital flows to emerging and other markets?

First, I think it is important to recognize that despite the enormous changes we have seen in international capital markets, the basic tenets still hold. Money borrowed, if used wisely, serves nations well. But money borrowed, if used poorly, throws nations into difficulty.

In evaluating the international financial system and how it must adapt, I would highlight four issues. The first is the overwhelming importance of transparency. The need for financial transparency is something of a cliche, so I don't think it is treated with the importance that it deserves. Timely and frequent publication of comprehensive data on national accounts, on monetary conditions, and on central bank balance sheets makes an important contribution to international confidence, in those countries who practice it. It serves to signal, at an early stage, that potential problems may arise. It therefore calls market and policy responses into play at an early stage, when responses are most effective. Transparency therefore exercises important discipline on policymakers, so that they cannot slip and slide through a difficult situation.

I believe that it is very important that the world move quickly to raise very substantially the international norms and standards for the publication of financial information. This is a task in which the international financial institutions have a role to play.

Second, I believe that we have to improve our tools and our means of surveillance. Policymakers and analysts must systematically examine the criteria I have just suggested for judging capital inflows. In part, this is a task for the international financial institutions. But in a very large part, it is also a task for the markets. Increased emphasis on transparency is something the markets should insist upon.

Third, the official sector needs to be able to respond in extraordinary circumstances when problems of confidence arise. The dictum that there is a need for lending of last resort in situations where there are liquidity problems but not solvency problems has a role in the international arena.

Fourth, there may be a need for enhanced coordination of debt restructuring involving both private and public creditors, when nations do run into difficulties. Just as in the corporate setting, it is sometimes in all creditors' interest to coordinate their response to debtor difficulties, while insisting on conditions needed to ensure a return to economic stability. The fact that sovereign debt is today widely traded means that the old methods of coordinating bank-debt restructuring may no longer be applicable.

It is right to worry about moral hazard. Moral hazard is a very serious problem. But I do not side with those who believe that the fire department should not exist because it will encourage people to smoke in bed. In just the same way, it is appropriate for the international community to respond at times of crisis, particularly when the crisis is of a systemic nature, as it is in the case of Mexico. The G-7 leaders will give careful consideration at Halifax to how we can begin to consider modifications to the international financial architecture. We will have to give careful thought to how to maintain the capacity to respond at moments of extraordinary duress. But any solutions must ultimately rely on what is most important to international financial stability: market incentives, and strong policy decisions by particular countries. These are the ultimate guarantors of stability and confidence.